



*Prisoner Tax Refund Fraud:
Delays Continue in Completing
Agreements to Share Information
With Prisons, and Reports to Congress
Are Not Timely or Complete*

September 25, 2014

Reference Number: 2014-40-091

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

Redaction Legend:

2 = Risk Circumvention of Agency Regulation or Statute



HIGHLIGHTS

PRISONER TAX REFUND FRAUD: DELAYS CONTINUE IN COMPLETING AGREEMENTS TO SHARE INFORMATION WITH PRISONS, AND REPORTS TO CONGRESS ARE NOT TIMELY OR COMPLETE

Highlights

**Final Report issued on
September 25, 2014**

Highlights of Reference Number: 2014-40-091 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Refund fraud associated with prisoner Social Security Numbers remains a significant problem for tax administration. The number of fraudulent tax returns filed using a prisoner's Social Security Number that were identified by the IRS increased from more than 37,000 tax returns in Calendar Year 2007 to more than 137,000 tax returns in Calendar Year 2012. The refunds claimed on these tax returns increased from \$166 million to \$1 billion.

WHY TIGTA DID THE AUDIT

This audit was initiated because prior TIGTA reports identified concerns with the IRS's efforts to identify and prevent prisoner tax fraud. The overall objective was to evaluate the effectiveness of the IRS's corrective actions to identify and reduce prisoner fraud.

WHAT TIGTA FOUND

TIGTA found that the IRS has not yet shared fraudulent prisoner tax return information with Federal or State prison officials. TIGTA also found that the required annual prisoner fraud reports to Congress are not timely and that the reports do not address the extent to which prisoners may be filing fraudulent tax returns using a different individual's SSN. TIGTA also followed up on a condition identified in a past review and found that IRS processes still do not ensure that all tax returns filed using a prisoner

Social Security Number are assigned a prisoner indicator.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, ensure that Memorandums of Understanding are timely established with the Federal Bureau of Prisons and all State Departments of Corrections. The IRS should also ensure that the required annual report on prisoner fraud is issued to Congress timely and that processes are developed to identify tax returns filed that have the same characteristics of confirmed fraudulent prisoner tax returns and determine whether these tax returns should be included in the annual report to Congress. The IRS should also ensure that all tax returns that are filed using a prisoner Social Security Number are assigned a prisoner indicator.

The IRS agreed with four of the six recommendations. The IRS did not agree to develop a process to identify other tax returns that have the same characteristics as confirmed fraudulent prisoner returns. Without such processes the IRS annual report will not include, as required, information related to the filing of all false and fraudulent tax returns by prisoners.

In addition, the IRS did not agree to correct a computer programming error that resulted in its not assigning a prisoner indicator to 3,139 tax returns TIGTA identified. Without the proper assignment of a prisoner indicator, the tax returns are not sent through those fraud detection filters specific to a prisoner-filed tax return.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 25, 2014

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM:

Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Prisoner Tax Refund Fraud: Delays Continue in Completing Agreements to Share Information With Prisons, and Reports to Congress Are Not Timely or Complete (Audit # 201340016)

This report presents the results of our review to evaluate the effectiveness of the Internal Revenue Service's (IRS) corrective actions to identify and reduce prisoner fraud. We conducted follow-up testing to evaluate the effectiveness of the IRS's actions to address recommendations made in a previous Treasury Inspector General for Tax Administration report. In addition, we evaluated the IRS's compliance with the continuing provisions of the Inmate Tax Fraud Prevention Act of 2008¹ and the American Taxpayer Relief Act of 2012.² This audit is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Fraudulent Claims and Improper Payments.

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

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

¹ Pub. L. No. 110-428, 122 Stat. 4839.

² Pub. L. No. 112-240, 126 Stat. 2313.



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Abbreviations

EFDS	Electronic Fraud Detection System
IRS	Internal Revenue Service
MOU	Memorandum of Understanding
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration



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Background

Tax refund fraud associated with prisoners remains a significant problem for tax administration. Figure 1 shows that the number of fraudulent tax returns filed using prisoner Social Security Numbers (SSN) that were identified by the Internal Revenue Service (IRS) increased from more than 37,000 tax returns in Calendar Year 2007 to more than 137,000 tax returns in Calendar Year 2012. The refunds claimed on these tax returns increased from \$166 million to \$1 billion.

**Figure 1: Fraudulent Tax Returns Filed Using
a Prisoner SSN for Calendar Years 2007 Through 2012**

Calendar Year	Fraudulent Tax Returns	Refunds Claimed (Millions)	Refunds Prevented (Millions)	Refunds Issued (Millions)
2007	37,447	\$166	\$137	\$29
2008	47,898	\$190	\$162	\$28
2009	44,944	\$295	\$256	\$39
2010	91,434	\$758	\$722	\$35 ¹
2011	186,483	\$3,725 ²	\$3,569	\$156
2012	137,883	\$1,005	\$936	\$70

Source: IRS Criminal Investigation and IRS Wage and Investment Division.

Legislation enacted in an effort to address fraud perpetrated by prisoners

- **The Inmate Tax Fraud Prevention Act of 2008**,³ signed October 15, 2008, gave the Secretary of the Treasury temporary authority to disclose to the head of the Federal Bureau of Prisons tax return information for individuals incarcerated in Federal prisons who the Secretary has determined may have filed or facilitated the filing of a fraudulent return. The act stated that no disclosure may be made after December 31, 2011.

The act also requires the Secretary of the Treasury to provide an annual report to Congress on the filing of false or fraudulent tax returns by Federal and State prisoners.

¹ Calendar Years 2010 and 2012 refund amounts do not add up due to rounding.

² The IRS indicated that this figure includes 468 returns filed by prisoners requesting refunds of more than \$100,000 and totaling \$2.9 billion. This is what caused the marked increase in refunds claimed in Calendar Year 2011.

³ Pub. L. No. 110-428, 122 Stat. 4839.



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The first report completed by the IRS reporting on returns filed using a prisoner SSN was issued for Calendar Year 2009.

- **The Homebuyer Assistance and Improvement Act of 2010**,⁴ enacted in July 2010, expanded the authority of the Secretary of the Treasury to also include disclosing prisoner tax return information to the State Departments of Corrections.⁵ However, the expanded authority to disclose prisoner tax return information to the State Departments of Corrections as well as the Federal Bureau of Prisons still expired on December 31, 2011.
- **The United States–Korea Free Trade Agreement Implementation Act**,⁶ signed October 21, 2011, requires the Federal Bureau of Prisons and State Departments of Corrections to provide the IRS with an electronic list of all the prisoners incarcerated within their prison system for any part of the prior two calendar years or the current calendar year through August 31. The Federal Bureau of Prisons and States were required to provide the first list of prisoners to the IRS not later than September 15, 2012, and are to provide updated information annually thereafter.
- **The American Taxpayer Relief Act of 2012**,⁷ enacted in January 2013, expanded the Secretary of the Treasury’s authority to share false prisoner tax return information with Federal and State prisons and gave the IRS permanent authority to share such information.

The authority for the IRS to disclose fraudulent prisoner tax return information with Federal and State Prisons became permanent in January 2013.

Prisoner File and the Electronic Fraud Detection System (EFDS)

To combat the continuing problem of refund fraud associated with tax returns filed using prisoner SSNs, the IRS compiles a list of prisoners (the Prisoner File) received from the Federal Bureau of Prisons and State Departments of Corrections. Various IRS offices and functions use the Prisoner File in an effort to prevent and detect fraud. The Prisoner File is the cornerstone of the IRS’s efforts to prevent the issuance of fraudulent refunds to individuals filing false tax returns using a prisoner SSN.

The EFDS is the primary system used by the IRS to identify tax returns filed using prisoner SSNs. The EFDS consists of a series of filters the IRS has designed to evaluate tax returns for potential fraud. Tax returns are processed through the EFDS, whereby the primary and secondary SSNs listed on the tax return are matched to the Prisoner File to determine if the tax

⁴ Pub. L. No. 111-198, 124 Stat. 1356.

⁵ General term used to refer to the various State agencies that oversee State prisons.

⁶ Pub. L. No. 112-41, § 502

⁷ Pub. L. No. 112-240, 126 Stat. 2313.



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return is filed using a prisoner SSN. If the SSN on the tax return matches a prisoner on the Prisoner File, a prisoner indicator is assigned to the tax return.

Tax returns assigned a prisoner indicator and that meet specific criteria are evaluated to determine if the tax return is fraudulent. This evaluation includes screening and verifying the wage and withholding information reported on the tax return. For example, in the screening process, a tax examiner reviews the tax return for income and withholding information, **2**
*****2*****
*****2*****. If the tax examiner concludes that the tax return is potentially fraudulent, the tax return is then sent for verification. In the verification process, a tax examiner attempts to contact the employer(s) associated with the reported income and withholding to confirm the income and withholding. If the tax examiner is unable to verify the income and withholding with the employer, the refund is frozen to prevent issuance.

Prior Treasury Inspector General for Tax Administration (TIGTA) reports identified concerns with IRS efforts to identify and prevent prisoner tax fraud

TIGTA has issued two reports on the IRS's efforts to combat prisoner fraud since Congress enacted the Inmate Tax Fraud Prevention Act of 2008. In December 2010⁸ we reported that as of October 2010, the IRS had not completed required agreements to allow it to disclose prisoner tax return information to prison officials. As a result, no information had been disclosed to either the Federal Bureau of Prisons or State Departments of Corrections. In addition, we identified a lack of managerial oversight relating to the process used to compile the Prisoner File to ensure the accuracy and reliability of this file.

In December 2012⁹ we reported that despite increased efforts by the IRS to improve the accuracy of the Prisoner File, some prisoner information contained in the file is inaccurate. For example, the file contains incomplete records, and not all facilities that house prisoners reported prisoners. As such, controls used to ensure that the IRS identifies fraudulent refunds on tax returns prepared by prisoners are not fully effective. Further, the IRS's authority to disclose information to prisons expired on December 31, 2011,¹⁰ which limited the ability of prison officials to curtail prisoners' continued abuse of the tax system. IRS management indicated that even though the authority to disclose information to prisons expired on December 31, 2011, the Federal Bureau of Prisons and State Departments of Corrections have been taking advantage of other voluntary IRS prisoner fraud programs that do not require a contract and have minimal cost to the Federal Bureau of Prisons and State Departments of Corrections. However, these programs only alert the

⁸ TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Dec. 2010).

⁹ TIGTA, Ref. No. 2013-40-011, *Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete* (Dec. 2012).

¹⁰ As noted on page 2 of the report, the American Taxpayer Relief Act of 2012, enacted January 2013, has given the IRS permanent authority to disclose this information to the prisons.



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Federal Bureau of Prisons, State Departments of Corrections, and the IRS to potential wrongdoing, whereas prisoner tax fraud data represent known fraud for which the Federal Bureau of Prisons and State Departments of Corrections can take action to address. Figure 2 details the recommendations and corrective actions contained in these reports.

**Figure 2: Prior TIGTA Audit Recommendations and
Actions Taken by the IRS to Address Recommendations**

TIGTA Report	Recommendation	Actions Taken to Date
2011-40-009 Dec. 2010	Work with the Department of the Treasury to seek legislation to extend the period of time the IRS has to disclose prisoner tax return information to the Federal Bureau of Prisons and State prison officials.	The American Taxpayer Relief Act of 2012 gave the IRS permanent authority to share false prisoner tax return information with Federal and State prisons.
	Provide Congress with a complete assessment of potential prisoner fraud by revising the annual report to include the total number of tax returns filed by prisoners, the number selected for fraud screening, and the number verified false/fraudulent.	The Inmate Tax Fraud Prevention Act of 2008 requires the IRS to annually provide Congress a report that includes the number of false and fraudulent returns associated with prisoner filings. In addition, the IRS will respond to future congressional requests pertaining to prison-related tax fraud.
	Ensure that all tax returns filed using a prisoner SSN are processed through the EFDS and receive a prisoner indicator.	Improvements were made to identify those individuals who are incarcerated, but no changes were made to the process to assign the prisoner indicator.
	Revise prisoner filters to verify the validity of the wages and withholding associated with prisoners incarcerated for a year who filed tax returns claiming a refund.	Filters are in place to verify the validity of wages and withholding associated with tax returns filed using a prisoner SSN. In addition, the IRS improved its processes for identifying individuals incarcerated for a full tax year.
	Develop a process to assess the reliability of data received from Federal and State prisons and communicate with prison facilities that provide missing or inaccurate information in an attempt to obtain corrected information.	The IRS identified structural or formatting errors and duplicated records in the 2012 Prisoner File. The IRS worked with the correctional systems to resolve the errors when possible.



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TIGTA Report	Recommendation	Actions Taken to Date
2013-40-011 Dec. 2012	Ensure that the validation and verification of future IRS Prisoner Files include a check for a prisoner using a deceased individual's identity information and a comparison of the Institution and Prisoner Files to ensure that all facilities that house prisoners reported them.	The IRS implemented processes to identify prisoner SSNs with a Date of Death. If the prisoner information was verified with Social Security Administration data, it was loaded into the EFDS with the "Validated" indicator left unchecked for the deceased prisoners on the prisoner file. Processes were also implemented in Calendar Year 2014 to ensure that prisons were reporting required prisoner information to the IRS.
	Legislation is needed that would permanently authorize the IRS to share data with the Federal and State prisons when it determines that prisoners may be using other individuals' identities.	The American Taxpayer Relief Act of 2012 improved and made permanent the authority for the IRS to disclose false prisoner tax return information to Federal and State prisons.

Source: TIGTA analysis of actions taken in response to prior audit reports.

This review is a follow-up of the IRS's efforts to address conditions identified in TIGTA's December 2010 report. Our review was performed with information obtained from the IRS Wage and Investment Division Headquarters Return Integrity and Correspondence Services function in Atlanta, Georgia, during the period July 2013 through June 2014. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Fraudulent Prisoner Tax Return Information Has Yet to Be Shared With Federal or State Prison Officials

As of June 2014, the IRS has yet to complete needed agreements to begin sharing information related to false prisoner tax return information with Federal and State prison officials. This is despite the fact that the IRS was initially given the authority to share information with Federal prison officials in October 2008. Since October 2008, subsequent legislation temporarily expanded the IRS's authority to share information with State prison officials,¹¹ and permanent authority to share information was granted in January 2013. This authority was granted because Congress believes the ability of the IRS to share information with prison officials will enable them to take action to punish prisoners for perpetrating fraud and will help stop the abuse of our tax system.

According to the IRS, prior to the enactment of the American Taxpayer Relief Act of 2012, the IRS worked with the Department of the Treasury to create a legislative proposal to reauthorize disclosure and to address the most significant concerns related to the sharing of this information identified by Federal and State prison officials in Calendar Year 2011. Addressing these concerns was intended to ensure the success of prison administrative proceedings upon restarting the disclosure program. The proposed language that addressed these concerns was included in the American Taxpayer Relief Act of 2012.

IRS management also indicated that Memorandums of Understanding (MOU) establishing an information sharing agreement must be negotiated with the Federal Bureau of Prisons and each of the State Departments of Corrections. These MOUs outline how tax return information will be received, secured, and used by the receiving prison. In addition to the MOUs, the Federal Bureau of Prisons and the States must implement required information security safeguards before tax return information can be received.

The IRS indicated that previously completed MOUs were no longer valid when authority to share information expired

The Inmate Tax Fraud Prevention Act of 2008 and the Homebuyer Assistance and Improvement Act of 2010 granted the IRS with the temporary authority to share false prisoner tax return information with the Federal Bureau of Prisons and State Departments of Corrections through

¹¹ The American Taxpayer Relief Act of 2012 expanded the scope of sharing to allow disclosure of false prisoner tax returns and tax return information to contractors of State and Federal prison facilities, during a judicial or administrative proceeding, and to the representatives of the prisoner involved in such proceedings.



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December 2011. As of December 31, 2011, the IRS had finalized MOUs with the Federal Bureau of Prisons and 22 State Departments of Corrections under this temporary authority. However, IRS management indicated that the 23 MOUs the IRS had finalized were no longer valid once the temporary authority to share prisoner tax return information expired on December 31, 2011. The IRS indicated that with the enactment of the new legislation, the previous MOUs could not be used because they did not reflect the expanded requirements included in the American Taxpayer Relief Act of 2012. Therefore, new agreements had to be executed with the Federal Bureau of Prisons and the State Departments of Corrections once the IRS was given permanent authority to share prisoner return information in January 2013.

The IRS has created an MOU template that reflects the requirements of the American Taxpayer Relief Act of 2012. The IRS finalized the MOU template in July 2013 but then subsequently revised the MOU template in February 2014 to reflect changes to the Safeguarding guidelines. IRS management stated that the significant delays in finalizing the MOU template resulted from the number of reviews, approval signatures, and overall routing process. The IRS is taking steps to document and improve these processes to minimize future delays.

Participation in the sharing of prisoner tax return information is voluntary on the part of the Federal Bureau of Prisons and State Departments of Corrections. As such, the IRS indicated that letters were sent to the Federal Bureau of Prisons, the State Departments of Corrections,¹² and each State Governor as well as the Mayor of Washington, D.C. These letters explain the law, solicit participation, and indicate that the IRS will be reaching out to request a point of contact. These letters were not sent until February 2014, more than one year after permanent authority was granted. IRS management stated that leadership changes and the review process contributed to the delay in sending the letters.

As of July 11, 2014, the IRS has received points of contact for the Federal Bureau of Prisons, Washington, D.C., and 44 State Departments of Corrections. The IRS has not received a point of contact from six States, but plans to continue to reach out to these States to establish a point of contact. The *****2***** is the only State that has signed an MOU. Three additional States are currently in the process of signing MOUs (*****2*****). Figure 3 illustrates the timeline of actions taken by the IRS subsequent to January 2013, when permanent authority to share information on false prisoner tax returns was granted.

¹² See Appendix IV for an example of the letter sent to the State Departments of Corrections.



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Figure 3: Timeline of IRS Efforts to Share Prisoner Tax Return Data

Date	Event
January 2013	Legislation enacted that provides the IRS with permanent authority to share false prisoner tax return information with Federal and State prisons. IRS management establishes a cross-functional team to lead the development and execution of the MOU renewal strategy.
July 2013	The IRS finalizes the MOU template.
February 2014	The MOU template is revised to reflect new Safeguarding guidelines. The IRS sends solicitation letters to the Federal Bureau of Prisons, the State Departments of Corrections, the State Governors, and the Mayor of Washington, D.C.
March 2014	Field government liaisons begin contacting all State Departments of Corrections to establish a point of contact that the IRS can work with to begin the MOU process.
April 2014	The IRS secures the first signed MOU with the *****2*****. The IRS also receives notification that the *****2*****declines to participate in the program due to the financial burden associated with carrying out the administrative actions and the limited Departments of Corrections benefits at this time.
July 2014	Three additional MOUs are in the approval process. The IRS is still working to secure a point of contact for six States.

Source: IRS Return Integrity and Correspondence Services function.

Once an MOU is signed, meetings to support the State Departments of Corrections in completing the Safeguard Security Report can begin. These reports are required to be completed before any data will be shared. The reports detail the specific processes, procedures, and security controls in place to protect Federal tax information. As of July 2014, no Safeguard Security Reports have been completed.

Recommendation

Recommendation 1: The Commissioner, Wage and Investment Division, should ensure that points of contact for the remaining six State Departments of Corrections are obtained and ensure that MOUs are timely established with the Federal Bureau of Prisons and all State Departments of Corrections that have indicated an interest in receiving false prisoner tax return information.



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Management's Response: The IRS agreed with this recommendation. As of August 1, 2014, the IRS has identified points of contact for all State Departments of Corrections. The IRS stated that it is committed to securing signed MOUs with the Federal Bureau of Prisons and the State Departments of Corrections indicating interest in receiving information on false tax return information submitted by prisoners. According to the IRS, it is in discussions with 47 State Departments of Corrections, with 17 expressing an interest in signing an MOU. Because execution of an MOU is contingent on actions of other agencies, and is beyond the control of the IRS, the IRS did not commit to an additional corrective action in this regard.

***Required Annual Prisoner Fraud Reports to Congress Are Not Timely
and Do Not Address the Extent of Fraudulent Tax Return Filings by
Prisoners***

The IRS is not timely providing annual reports on the filing of fraudulent tax returns by Federal and State prisoners to Congress. The Inmate Tax Fraud Prevention Act of 2008 requires the Secretary of the Treasury to annually submit to Congress and make publicly available a report on the filing of false and fraudulent returns by individuals incarcerated in Federal and State prisons. Such a report shall include statistics on the number of false and fraudulent returns associated with each Federal and State prison. The first report completed by the IRS reported on tax returns filed using prisoner SSNs in Calendar Year 2009.

The IRS issued the Calendar Year 2009 report on the filing of false or fraudulent prisoner tax returns in September 2010. If the IRS had followed this general time frame for subsequent reports, it would have issued the Calendar Year 2010 report in September 2011, the Calendar Year 2011 report in September 2012, *etc.* However, the IRS did not issue the Calendar Year 2010 annual report until July 2012. The Calendar Year 2011 report was not issued until December 2013. As of June 30, 2014, the IRS has yet to issue the Calendar Year 2012 or Calendar Year 2013 required annual prisoner fraud reports. Figure 4 shows the time between the end of the calendar year and issuance of the annual prisoner tax fraud reports for Calendar Years 2009 through 2013.



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Figure 4: Issuance of the Annual Prisoner Fraud Reports to Congress

Calendar Year Report	Date Issued to Congress	Months Elapsed Since the End of the Calendar Year
Calendar Year 2009	September 3, 2010	8
Calendar Year 2010	July 3, 2012	18
Calendar Year 2011	December 23, 2013	24
Calendar Year 2012	Not Issued as of June 2014	18
Calendar Year 2013	Not Issued as of June 2014	6

Source: TIGTA analysis of the IRS's Annual Reports to Congress.

In response to our concerns with the delays in issuing the annual prisoner fraud report, the IRS indicated that some delays were a result of the approval process and others were directly related to the data analysis process. The IRS also indicated that preparing the report to Congress is labor intensive and it has limited resources. IRS management stated that they are taking necessary steps to document the process in order to minimize these delays in the future.

To prepare the annual report, the IRS uses data contained in the EFDS. Most tax returns are screened and verified through the EFDS at the time the tax return is filed, which is generally between January and April each year. The IRS also tracks the number of potentially fraudulent prisoner tax returns it screens and/or verifies as well as those it confirms as fraudulent throughout the year. This information is reported weekly in internal IRS fraud reports, and we include it in our annual assessment of the individual tax return filing season.

Furthermore, the IRS has most of the information it needs to prepare the annual prisoner fraud report soon after the end of the calendar year. For example, IRS management indicated that each February (after the end of the previous calendar year) they obtain information from the EFDS that identifies tax returns filed using a prisoner SSN. The data are then manipulated in order to be able to report prisoner information by State and institution.

The annual prisoner fraud report does not address the extent of tax fraud committed by prisoners using ***2*******

The law requires the IRS to provide an annual report on the filing of false or fraudulent tax returns by Federal and State prisoners. *****2*****
*****2*****. The report does not address the extent to which prisoners may be filing fraudulent tax returns*****2*****. For example, in the following tax fraud schemes, the prisoner is filing fraudulent tax returns *****2*****and this type of fraud is not included in the annual report. The report will only include those tax returns filed*****2*****.



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*On August 23, 2012, in Harrisburg, Pa., Theodore Scott, an inmate at Camp Hill Correctional Institution, was sentenced to 33 months in prison, three years of supervised release and ordered to pay \$5,110 in restitution to the IRS for his role in a false claims tax scheme. Scott pleaded guilty to one count of conspiracy to defraud the United States by obtaining or aiding to obtain the payment of a false, fictitious or fraudulent claim. According to the indictment, Scott **obtained the social security numbers of other persons and used them to file false and fraudulent tax returns requesting refunds from the IRS.** Scott also filed false and fraudulent tax returns in his own name. These false tax returns declared fictitious income amounts and claimed fraudulent tax refunds. As part of the scheme, the refund checks were directed to the addresses of co-conspirators who would deposit them [into] bank accounts that Scott controlled.*

*On March 18, 2014, in Birmingham, Ala., Shermaine German was sentenced to 66 months in prison, three years of supervised release and ordered to pay \$788,280 in restitution to the government. German pleaded guilty in December 2013 to a tax conspiracy. German, now paroled from state prison, was an inmate at Donaldson Correctional Facility in Bessemer when he orchestrated the tax scheme. According to court documents, from January 2008 to May 2013, while an inmate at Donaldson, German **obtained the names, birth dates and Social Security numbers of other people,** often fellow inmates. He used their information to create false income tax returns that contained fabricated amounts of tax withholdings. German also created false power of attorney forms, which he mailed out of the prison along with the false income tax returns. Various other members of the conspiracy notarized the power of attorney forms and used them to cash or deposit income tax refund checks received as part of the scheme.*

To help determine the possible extent of the filing of false or fraudulent tax returns by Federal and State prisoners that is not included in the IRS's annual reports to Congress, we performed data analysis using the direct deposit number included on tax returns filed using a prisoner SSN. Our analysis of direct deposit information from the tax returns identified as fraudulent and filed using a prisoner SSN identified other individuals who used the same direct deposit number to receive a refund. For example, our analysis of the 579,592 tax returns that the IRS identified as being filed using a prisoner SSN found that 157,041 were determined to be fraudulent by the IRS. Of the 157,041 fraudulent prisoner tax returns, 157,025 claimed refunds. The IRS was not able to prevent the issuance of a refund for 16,449 fraudulent returns that used a direct deposit account. There were 16,342 unique direct deposit accounts used on these 16,449 tax returns.

Using the 16,342 direct deposit account numbers, we identified that 1,777 of the direct deposit account numbers were also used on another 47,321 tax returns. These 47,321 tax returns were filed*****2*****. The tax refunds claimed on these tax returns totaled more than \$102 million. For example, as Figure 5 shows, Bank Account A was used on a tax return filed with a prisoner SSN to receive a refund. The same bank account was also used on 7,645 additional tax returns. This type of analysis could assist the IRS in identifying characteristics of tax returns that may involve a prisoner refund scheme as well as the



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possible extent of the filing of false or fraudulent tax returns by Federal and State prisoners. Figure 5 shows the number of tax returns and amounts deposited into the top 10 direct deposit account numbers used in these situations.

**Figure 5: Top 10 Direct Deposit Account Numbers
Used on Both Prisoner and Nonprisoner Tax Returns**

Bank Account	Tax Returns Using the Same Direct Deposit Account As a Tax Return Filed by a Prisoner	Refunds Claimed
Bank Account A	7,645	\$30,481,992
Bank Account B	1,855	\$753,800
Bank Account C	1,840	\$6,875,604
Bank Account D	1,740	\$618,935
Bank Account E	1,174	\$345,053
Bank Account F	1,124	\$1,570,009
Bank Account G	1,065	\$1,949,558
Bank Account H	871	\$3,882,072
Bank Account I	797	\$1,936,025
Bank Account J	734	\$1,800,597

Source: TIGTA analysis of Processing Year¹³ 2013 files.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 2: Ensure that the required annual report on the filing of false or fraudulent tax returns by Federal and State prisoners is issued to Congress timely. Given the availability of the data needed to compile the report, the report should be issued within nine months of the end of the applicable calendar year.

Management's Response: The IRS agreed with this recommendation. The IRS stated that it recognizes the need for timely submission of the annual prisoner fraud report to Congress and strives to compile complete and accurate data for its preparation. The IRS indicated that the source data for the report are obtained from the Scheme Tracking and Retrieval System, which contains the results of actions the IRS took in reviewing returns and determining probable fraud. Because return reviews must be completed before results are entered into the Scheme Tracking and Retrieval System, needed processing year-end data are not available until the following February or later.

¹³ The calendar year in which the tax return or document is processed by the IRS.



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According to the IRS, compiling and analyzing the data is a labor intensive process that must be performed before the report is drafted. In addition, the report is subjected to a rigorous internal review as well as review by the Department of the Treasury, the Office of Management and Budget, and other affected agencies before submission to Congress. For the Calendar Year 2014 Prisoner Fraud Report, for which the data will become available in February 2015, the IRS will benchmark the report preparation and review process with the goal of a September 30, 2015, report date. The IRS will review and evaluate its performance after the report is released to establish a reasonable and realistic reporting time frame and expected delivery date for future reports.

Recommendation 3: Develop processes to identify tax returns filed that have the same characteristics as confirmed fraudulent prisoner tax returns, including those fraudulent tax returns identified as part of the IRS's other fraud detection programs, and determine whether these tax returns should be included in the annual report to Congress.

Management's Response: The IRS did not agree with this recommendation. The IRS stated that the methodology used in the annual report to Congress is consistent with the methodology used in reports of previous years. It reports all known false and fraudulent returns filed by prisoners as required by the statute. The IRS stated that the characteristics upon which our recommendation relies are not sufficiently reliable to conclude that all the returns identified are filed by inmates. According to the IRS, inmates are frequently also victims of identity theft, which can lead to an overstatement of fraudulent returns filed by prisoners. To ensure accuracy in reporting, the IRS accounts for returns when there is more than a circumstantial relationship to the identified prisoner.

Office of Audit Comment: The IRS's annual report only includes false and fraudulent tax returns filed using the SSN of a prisoner. The report does not include, as required, information related to the filing of false and fraudulent tax returns by prisoners. The characteristics we provided in our report were used to show information that could be used by the IRS to better determine the possible extent of the filing of false or fraudulent tax returns by Federal and State prisoners that is not included in the IRS's annual reports to Congress.

Processes Do Not Ensure That All Tax Returns Filed Using a Prisoner Social Security Number Are Assigned a Prisoner Indicator

Our analysis of tax returns filed during Calendar Year 2013 identified 43,030 tax returns that were filed using a prisoner SSN that were not assigned a prisoner indicator. Tax returns not assigned prisoner indicators include:

- 16,950 (39 percent) paper tax returns that did not meet the IRS's criteria for inclusion in the EFDS. Unlike all electronically filed tax returns being processed through the EFDS,



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the IRS has established certain criteria that will result in some paper tax returns not being processed through the EFDS.

- 26,080 (61 percent) tax returns that did meet the criteria for processing through the EFDS but were not assigned a prisoner indicator. We provided these tax returns to IRS management for review. On June 26, 2014, management agreed that an SSN that was on the Prisoner File was used to file the tax return. The IRS subsequently indicated that it did not agree that a prisoner indicator should have been assigned for the majority of these tax returns because the return reported a balance due or zero balance. Notwithstanding the IRS's response, we identified other balance due tax returns that were assigned a prisoner indicator. Analysis of the Calendar Year 2013 EFDS data identified 2,518 tax returns filed using a prisoner SSN with a balance due and the IRS assigned a prisoner indicator to the tax return.

In addition, we identified another 3,139 tax returns filed using the SSN of a prisoner for which the IRS did not assign a prisoner indicator because the name on the tax return was not the same name associated with the SSN on the Prisoner File. However, we were able to match the name on the tax return with the name on the Prisoner File and asked the IRS why it could not match the names on the two files. The IRS's review of these tax returns identified that the majority resulted from a two-character field (included on "preprinted" address labels provided to the taxpayer by the IRS) being loaded into the EFDS instead of the actual name control. A name control is the first four letters in an individual's last name, *e.g.*, the name control for Smith would be SMIT, but the two-character field NJ was loaded into the EFDS. The IRS is working to determine the cause of these programming issues.

A prior TIGTA review found that not all tax returns filed using the SSN of a prisoner were assigned an indicator

In December 2010, we reported that 54,410 tax returns filed during Calendar Year 2009 using a prisoner SSN did not receive a prisoner indicator. In that report, we recommended that the IRS ensure that all prisoner tax returns are processed through the EFDS and receive a prisoner indicator. In response to our recommendation, IRS management stated that the IRS has reviewed the process for identifying prisoner tax returns early in Calendar Year 2010, and changes were made that would improve the IRS's ability to identify those individuals who are incarcerated and assign a prisoner indicator to their account. When we questioned the IRS about the specific actions taken to improve the assignment of the prisoner indicator, it informed us that the process used to assign a prisoner indicator had not changed. As a result, the IRS still does not identify all tax returns filed using a prisoner SSN.

We are concerned that management has not taken action to address this issue which we have previously raised to their attention. The assignment of the indicator is an automated process within the EFDS whereby the primary and secondary name and the SSN on a filed tax return are compared to the names and SSNs listed in the Prisoner File. If a match is identified, a prisoner



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indicator is automatically set. All that is required is that the IRS processes all tax returns through the EFDS. As we have previously detailed, the IRS sets the specific criteria to be used to identify those tax returns with an indicator to be sent to screening and/or verification. For example, the IRS can exclude tax returns with a prisoner indicator that have a balance due from being sent to screening and/or verification.

When tax returns filed using a prisoner SSN are not assigned the required indicator, the tax return will not be subjected to the IRS's specialized prisoner fraud checks. All tax returns filed using a prisoner SSN should receive an indicator regardless of whether they appear fraudulent. The indicator should alert IRS employees who may be addressing other issues related to the tax return that the return was filed using a prisoner SSN.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 4: Ensure that all tax returns that are filed using a prisoner SSN are assigned a prisoner indicator.

Management's Response: The IRS agreed with this recommendation to the extent that it agrees that all accounts for which a tax return is filed using a prisoner SSN should be identified. The IRS stated that the Master File displays that information for all prisoner accounts to alert IRS employees addressing other issues related to the tax return or to that account. The IRS disagreed that an indicator should be assigned to returns for EFDS screening when a refund is not being claimed.

Office of Audit Comment: The IRS incorrectly noted that the Master File could be used by IRS employees to identify tax returns filed using a prisoner SSN. Our research of the specific returns we identified found that not all of them were identified on the Master File. As we previously reported, we believe the IRS should assign a prisoner indicator to all prisoner tax returns. The assignment of a prisoner indicator is an automated process requiring the IRS to expend no additional resources to ensure that tax returns with a prisoner SSN are consistently assigned.

Recommendation 5: Identify and address the cause associated with the 26,080 tax returns filed using the SSN of a prisoner that were not identified with the prisoner indicator.

Management's Response: The IRS agreed with this recommendation. The IRS will review the refund returns included in the 26,080 exception cases to ascertain why they did not receive a prisoner indicator by the EFDS. The IRS indicated that the remainder were no-balance or balance due returns and will not be reviewed as they would not have been considered potential fraudulent refund returns.



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Recommendation 6: Correct computer programming errors that resulted in not assigning a prisoner indicator to 3,139 tax returns because the name in the EFDS did not match the name associated with the SSN on the Prisoner File.

Management's Response: The IRS did not agree with this recommendation. The IRS stated that the condition that caused the 3,139 returns not to receive prisoner indicators by the EFDS is a systemic limitation caused by unperfected entity data included in the return record that is delivered to the EFDS. According to the IRS, the condition affected approximately three percent of transcribed paper returns. Other processing systems validate and perfect the data before the return information posts to the Master File, and the returns are still processed through the EFDS to screen them and assign a data mining score to assess fraud potential.

Office of Audit Comment: We agree that these tax returns were evaluated using other EFDS filters. However, without the proper assignment of a prisoner indicator, these tax returns are not sent through those filters specific to a prisoner-filed tax return.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the effectiveness of the IRS's corrective actions to identify and reduce prisoner fraud. We conducted follow-up testing to evaluate the effectiveness of the IRS's actions to address recommendations made in a previous TIGTA report.¹ In addition, we evaluated the IRS's compliance with the continuing provisions of the Inmate Tax Fraud Prevention Act of 2008² and the American Taxpayer Relief Act of 2012.³ To accomplish our objective, we:

- I. Assessed the adequacy of the IRS's implementation of corrective actions in response to our prior audit.⁴
 - A. Determined the improvements the IRS has made to the process to identify individuals who are incarcerated and assign prisoner indicators to the tax returns filed using an SSN that is included on the Prisoner File.
 - B. Determined if these improvements corrected the previously reported conditions.
 1. Performed data analysis using TIGTA's Data Center Warehouse⁵ Individual Return Transaction File⁶ and the Prisoner File to identify tax returns filed using an SSN on the Prisoner File in Processing Year⁷ 2013.
 2. Requested a data extract of the EFDS⁸ for all tax returns filed that have the prisoner indicator for Processing Year 2013.
 3. Established the reliability of the computer-processed data from Steps I.B.1. and 2. In order to accomplish this, we compared the information from the various files

¹ TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Dec. 2010).

² Pub. L. No. 110-428, 122 Stat. 4839.

³ Pub. L. No. 112-240, 126 Stat. 2313.

⁴ We did not perform audit work to assess the adequacy of the IRS corrective action for TIGTA, Ref. No. 2013-40-011, *Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete* (Dec. 2012) because the implementation date for these actions was in April 2014.

⁵ The Data Center Warehouse provides data and data access services through the TIGTA intranet.

⁶ The Individual Return Transaction File contains data transcribed from initial input of the original individual tax returns during return processing.

⁷ The calendar year in which the tax return or document is processed by the IRS.

⁸ The EFDS consists of a series of filters the IRS has designed to evaluate tax returns for potential fraud. It is the primary system used by the IRS to identify tax returns filed using prisoner SSNs.



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and reviewed information from the IRS's Integrated Data Retrieval System⁹ and the Prisoner File. We determined that the data are sufficiently reliable for the purposes of this report.

4. Compared the files in Steps I.B.1. and 2. to determine if there are any returns in the EFDS data extract that were not identified in our data analysis. We determined why they were not in our data.
 5. Compared the files in Steps I.B.1. and 2. to determine if all prisoner tax returns we identified are included in the EFDS data extract and have the prisoner indicator. For any returns we identified as prisoner returns that are not included in the EFDS data extract, we determined if they met the criteria to be processed through the EFDS.
- II. Determined the status and effectiveness of the sharing of false or fraudulent tax returns filed by prisoners with the Federal and State prisons.
- A. Obtained copies of the completed MOUs and determined if MOUs have been set up with all State Departments of Corrections and the Federal Bureau of Prisons.
 - B. Determined what, if any, data have been shared with prisons.
- III. Assessed the IRS's compliance with the Inmate Tax Fraud Prevention Act of 2008 requirement to provide an annual report on prisoner fraud to Congress.
- A. Determined if the IRS timely provided a report for Calendar Years 2009 through 2013 to the Department of the Treasury for review and subsequently to Congress.
 - B. Performed data analysis using the EFDS data extract provided by the IRS and TIGTA's Data Center Warehouse Refund File¹⁰ to identify tax returns requesting direct deposits into the same accounts as fraudulent returns filed with prisoner SSNs in Processing Year 2013. We established the reliability of the Refund File by comparing the information in the file to the IRS's Integrated Data Retrieval System. We determined that the data are sufficiently reliable for the 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

⁹ The IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

¹⁰ The Refund File captures all refunds which are sent by the IRS to the Bureau of the Fiscal Service for processing. The refunds are sent by the Bureau of the Fiscal Service to the taxpayers in the form of bank account direct deposits or mailed paper checks.



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following internal controls were relevant to our audit objective: ensuring that the provisions of the Inmate Tax Fraud Prevention Act of 2008 and the American Taxpayer Relief Act of 2012 were implemented, identifying and evaluating the validity of the assignment of the prisoner indicator, and verifying that certain returns with prisoner SSNs are subject to compliance treatments. We evaluated these controls by obtaining information from IRS management about the status of data sharing with the Federal Bureau of Prisons and with the States and about the status of the annual prisoner fraud report to Congress. We analyzed data received from the IRS's EFDS as well as the Individual Return Transaction File and the Prisoner File from TIGTA's Data Center Warehouse to determine whether the prisoner indicators were being assigned correctly and whether certain returns were being reviewed.



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Appendix II

Major Contributors to This Report

Russell P. Martin, Acting Assistant Inspector General for Audit (Returns Processing and Account Services)
Deann L. Baiza, Director
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Chief, Criminal Investigation SE:CI
Deputy Chief, Criminal Investigation SE:CI
Deputy Commissioner, Wage and Investment Division SE:W
Director, Return Integrity and Correspondence Services SE:W:RICS
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Director, Return Integrity and Correspondence Services SE:W:RICS



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Appendix IV

*Example Letter Sent to
State Departments of Corrections*



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

FEB 03 2014

██████████
Secretary
██████████ Department of Corrections
██████████
██████████

Dear Secretary ██████████

We are committed to doing everything possible to stop inmate tax fraud, and we need your assistance again. One of the most important actions we take to fight this type of tax fraud is work with State corrections officials.

The information prison officials provide annually allows us to identify false or fraudulent inmate returns. In 2011, we identified over 186,000 Federal tax returns filed by inmates that claimed over \$3.7 billion in false or fraudulent refunds. Inmates in your State prisons filed over ██████████ fraudulent Federal tax returns that claimed over ██████████ in refunds. Today, I'm asking you to take another step to reduce these claims and stop fraudulent tax refunds from entering our prison systems.

The previous temporary authority that allowed us to disclose information to you under a Memorandum of Understanding expired on December 31, 2011. On January 2, 2013, as part of the American Taxpayer Relief Act of 2012, the Congress made permanent our authority to disclose prisoner information to State and Federal prison officials when we determine a prisoner may have filed or helped file a false or fraudulent tax return. The Congress also added the following disclosure authorities for the purpose of taking administrative actions to prevent prisoners from filing false or fraudulent returns:

- The IRS can disclose information directly to employees and officers of a prison and to contractors responsible for operating a prison.
- The IRS can disclose copies of Federal tax returns to prison officials.
- A prison official can re-disclose an inmate's tax returns and return information to the prison's legal representative and the inmate's legal representative for administrative and judicial proceedings arising from the prison's administrative action

The law's enhancements and permanent status addresses a number of challenges prison officials told us they faced with implementing the previous authorization. The added disclosure authorities are a dramatic improvement to the Disclosure Program.



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For your convenience, we enclosed the history of the law authorizing disclosure of inmate tax fraud.

While I am counting on your support, I recognize the difficult fiscal situations facing the State governments. You have my commitment that we will work with you and your staff to identify practical, cost-effective ways to implement this program. In the coming days, the IRS governmental liaison for your state will contact your office to provide more information about this program. In addition, he or she will request a point of contact to set up a subsequent call to discuss this program with you or members of your staff.

Thank you for your continued partnership and support. If you have any questions, please contact me or a member of your staff may contact [REDACTED], Chief, Return Integrity and Correspondence Services Project and Technology Management and Agency Coordinator, at [REDACTED].

Thank you for your cooperation.

Sincerely,

Peggy Bogadi

Enclosure



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ENCLOSURE

History of the Law Authorizing Disclosure of Inmate Tax Fraud

In an effort to curb inmate tax refund fraud, Congress enacted the Inmate Tax Fraud Prevention Act of 2008 (Public Law 110-428) to authorize the IRS to disclose to the Federal Bureau of Prisons all tax return information for federal inmates who the IRS determines may have filed or helped someone file a fraudulent return. The Federal Bureau of Prisons could only use the information for inmate disciplinary proceedings to address possible violations of prison rules and regulations. This authority was codified in the Internal Revenue Code at 26 U.S.C. § 6103(k)(10).

The Congress didn't authorize similar disclosures to State prison agencies until the Homebuyer Assistance and Improvement Act of 2010 (Public Law 111-198). This Act amended 26 U.S.C. § 6103(k)(10) to authorize the IRS to disclose return information about fraudulent inmate returns to State agencies charged with the responsibility for administration of prisons. Just as with their Federal counterpart, the State agencies could only use the information in inmate disciplinary proceedings.

To initiate the Disclosure Program, the IRS, the Federal Bureau of Prisons, and various State departments of correction signed agreements in 2010 and 2011 on the disclosure process.

On December 31, 2011, our authorization to disclose return information expired.

On January 2, 2013, as part of the American Taxpayer Relief Act of 2012 (Public Law 112-240), the Congress authorized an enhanced disclosure authority in 26 U.S.C. § 6103(k)(10) that gives the IRS permanent authority to disclose return information about fraudulent inmate returns to State prison agencies and the Federal Bureau of Prisons.



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Appendix V

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

SEP 05 2014

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Prisoner Tax Refund Fraud: Delays
Continue in Completing Agreements to Share Information With
Prisons and Reports to Congress Are Not Timely or Complete
(Audit # 201340016)

We appreciate the opportunity to review the subject draft report and provide comments. The IRS has continued to build on processes to detect and stop potentially fraudulent refund claims made by prisoners. We have worked with the Federal Bureau of Prisons and State Departments of Correction to improve the quality and reliability of data used in compiling the annual file of incarcerated individuals. The file is used by our major processing systems to identify returns filed using prisoner Social Security Numbers (SSN), to identify potential fraud and other compliance issues affected by an individual's incarceration status. It is also used to alert IRS employees of that status when they are addressing other account issues beyond the processing of tax returns. We are working to establish Memoranda of Understanding (MOU) with the Federal Bureau of Prisons and the State Departments of Correction to strengthen our detection and prevention efforts by sharing fraudulent prisoner tax return information, as permitted by law. We have held conferences with the Federal Bureau of Prisons and 19 State Departments of Correction, and are scheduling meetings with the remainder. However, the execution of the MOUs is dependent upon their agreements.

The IRS had temporary authority to disclose prisoner tax return information to prison officials when fraud was suspected. Although that authority expired on December 31, 2011, and was not permanently reinstated until January 2013, the IRS continued to engage the Federal Bureau of Prisons and State Departments of Correction through other activities that allowed the IRS to receive information from the prisons on a voluntary basis. We held discussions with federal officials, the District of Columbia, and all states to explain the programs available to them that would reduce prisoner tax fraud. These programs included limiting access to tax forms, education on anti-tax fraud



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activities outside the scope of the MOUs, and the Blue Bag Program. Educational topics included information on preventing the most common inmate refund fraud schemes such as false or inflated wages or fictitious business income to receive false refunds and/or refundable credits. We provided guest speakers at several American Correctional Association conferences to address prevention of inmate tax fraud, and we provided subject matter experts for the Federal Bureau of Prison's investigator training on frivolous returns and inmate tax fraud. Posters advising prisoners of the ramifications of conviction for tax related offenses were provided to federal and state prisons for display. The Blue Bag program is a method for prisons to identify for review and/or treatment tax returns, correspondence and other tax-related documents associated with prisoners. With this program, states can send suspicious tax-related documents to the IRS for appropriate follow up actions.

The IRS participated in discussions with federal and state officials, and noted their concerns regarding administering a prisoner fraud prevention program. Based on these conversations, proposed legislation was drafted to address those concerns and was provided to Congress for consideration. The IRS proposals were included in the American Taxpayer Relief Act of 2012 (ATRA) enacted in January 2013. The ATRA provided permanent authority for the IRS to disclose tax returns and tax return information directly to officers and employees of the federal or state prison agencies. It also provided for disclosure to contractors operating prisons and re-disclosure by them to legal representatives of the prisons and/or contractors to defend against inmate appeals.

The Treasury Inspector General for Tax Administration (TIGTA) report does not accurately describe how the IRS uses prisoner information in identifying accounts and processing original and amended tax returns, or in responding to inquiries or other types of correspondence from taxpayers. The same source data file containing prisoner information is used by the Electronic Fraud Detection System (EFDS), Dependent Database, and Master File; however, each system has its own copy of the file and the data is used for different purposes. The prisoner data loaded into the EFDS is further refined to eliminate records where the name control associated with the SSN does not match the name control for that number in the Master File database. This is done to eliminate potentially erroneous records that could cause returns to be flagged as prisoner returns in error. Any return meeting the EFDS review criteria that does not get flagged for prisoner screening undergoes the normal data mining process for assessing fraud potential.

The report also cites our response to your previous recommendation, where IRS management stated the process for identifying prisoner tax returns had been reviewed early in Calendar Year 2010, and changes were made to improve the IRS's ability to identify those individuals who were incarcerated and assign a prisoner indicator to their account. It is correct that the prisoner assignment indicator process has not changed since the prior report. However, we also stated in that response that the changes were



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made in the screening selection process. New rules and filters that focus on the identification of full year prisoners result in more efficient use of resources. Further, the assignment of a prisoner indicator in EFDS affects only the treatment of that return within EFDS, and is not information that is queried or used by other employees in working with taxpayer accounts.

It is also important to note that there are numerous ways a prisoner could earn income while incarcerated. Prisoners, like all other taxpayers, are responsible for paying federal income taxes on all taxable income. Also, some prisoners continue to have investments and businesses operating while they are in prison. They are receiving income from these investments/businesses in the form of distributions, dividends, interest, and other income. Depending on the amount of these earnings, these prisoners may be required to file a tax return and may be entitled to a tax refund. For those fulfilling their filing obligations and not claiming refunds, it is not a productive use of our resources to designate those returns as potentially fraudulent refund schemes.

We acknowledge the TIGTA's point that all tax returns filed using a prisoner SSN should receive an indicator regardless of whether they appear fraudulent. Although the EFDS applies more restrictive criteria in assigning prisoner indicators to the returns it evaluates, the prisoner status indicator attaches to all prisoner accounts in the Master File, regardless of the EFDS treatment of returns filed by those taxpayers. The prisoner designation is available to IRS employees addressing other account issues of these individuals.

Attached is our response to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Jodi L. Patterson, Return Integrity and Correspondence Services, Wage and Investment Division, at (404) 338-8961.

Attachment



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Attachment

Recommendation

RECOMMENDATION 1

The Commissioner, Wage and Investment Division, should ensure that points of contact for the remaining six State Departments of Corrections are obtained and ensure that MOUs are timely established with the Federal Bureau of Prisons and all State Departments of Corrections that have indicated an interest in receiving false prisoner tax return information.

CORRECTIVE ACTION

As of August 1, 2014, points of contact have been identified for all State Departments of Correction. The IRS is committed to securing signed Memoranda of Understanding (MOU) with the Federal Bureau of Prisons and the State Departments of Correction indicating interest in receiving information on false tax return information submitted by prisoners. We are in discussions with 47 State Departments of Correction, with 17 expressing an interest in signing an MOU. We will continue to work toward obtaining signed MOUs with the Federal Bureau of Prisons and all interested State Departments of Correction. Since execution of an MOU is contingent on actions of other agencies, and is beyond the control of the IRS, we do not commit to an additional corrective action in this regard.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

Director, Return Integrity and Correspondence Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

N/A

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 2

Ensure that the required annual report on the filing of false or fraudulent tax returns by Federal and State prisoners is issued to Congress timely. Given the availability of the data needed to compile the report, the report should be issued within nine months of the end of the applicable calendar year.

CORRECTIVE ACTION

The IRS recognizes the need for timely submission of the Annual Prisoner Fraud Reports to Congress and strives to compile complete and accurate data for its preparation. The source data for the report is obtained from the Scheme Tracking and



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Retrieval System (STARS), which contains the results of actions the IRS took in reviewing returns and determining probable fraud. Since return reviews must be completed before results are entered into STARS, needed processing year-end data is not available until the following February, or later. Compiling and analyzing the data is a labor intensive process that must be performed before the report is drafted. Recognizing the importance of the information being reported to Congress, a rigorous internal review process is performed. Additionally, the report is further reviewed by the Department of Treasury, the Office of Management and Budget, and other affected agencies before submission to Congress. For the Calendar Year 2014 Prisoner Fraud Report, for which the data will become available in February 2015, we will benchmark the report preparation and review process, with the goal of a September 30, 2015 report date. Performance will be reviewed and evaluated after the report is released to establish a reasonable and realistic reporting timeframe and expected delivery date for future reports.

IMPLEMENTATION DATE

February 15, 2016

RESPONSIBLE OFFICIAL

Director, Return Integrity and Correspondence Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 3

Develop processes to identify tax returns filed that have the same characteristics as confirmed fraudulent prisoner tax returns, including those fraudulent tax returns identified as part of the IRS's other fraud detection programs, and determine whether these tax returns should be included in the annual report to Congress.

CORRECTIVE ACTION

The methodology used in the annual report to Congress is consistent with the methodology used in reports of previous years. As required by the statute, the IRS reports all known false and fraudulent returns filed by prisoners. The characteristics upon which the recommendation relies are not sufficiently reliable to conclude that all the returns identified are inmate-filed. Frequently, inmates are also victims of identity theft, which can lead to an overstatement of fraudulent returns filed by prisoners. To ensure accuracy in reporting, the IRS accounts for returns when there is more than a circumstantial relationship to the identified prisoner. We disagree with the recommendation.

IMPLEMENTATION DATE

N/A



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RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 4

Ensure that all tax returns that are filed using a prisoner SSN are assigned a prisoner indicator.

CORRECTIVE ACTION

We agree with this recommendation to the extent that all accounts for which a tax return is filed using a prisoner Social Security Number should be identified. The Master File displays that information for all prisoner accounts, to alert IRS employees addressing other issues relating to the tax return or to that account. We disagree an indicator should be assigned to returns for Electronic Fraud Detection System (EFDS) screening when a refund is not being claimed.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 5

Identify and address the cause associated with the 26,080 tax returns filed using the SSN of a prisoner that were not identified with the prisoner indicator.

CORRECTIVE ACTION

We will review the refund returns included in the 26,080 exception cases to ascertain why they did not receive a prisoner indicator by the EFDS. The remainder were no-balance or balance due returns, which will not be reviewed as they would not have been considered potential fraudulent refund returns.

IMPLEMENTATION DATE

October 15, 2015



*Prisoner Tax Refund Fraud: Delays Continue in
Completing Agreements to Share Information With Prisons,
and Reports to Congress Are Not Timely or Complete*

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RESPONSIBLE OFFICIAL

Director, Return Integrity and Correspondence Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 6:

Correct computer programming errors that resulted in not assigning a prisoner indicator to 3,139 tax returns because the name in the EFDS did not match the name associated with the SSN on the Prisoner File.

CORRECTIVE ACTION

The condition that caused the 3,139 returns not to receive prisoner indicators by the EFDS is a systemic limitation caused by unperfected entity data included in the return record that is delivered to the EFDS. The condition affected approximately three percent of transcribed paper returns; however, other processing systems validate and perfect the data before the return information posts to the Master File, and the returns are still processed through the EFDS to screen them and assign a data mining score to assess fraud potential. Therefore, we do not agree with this recommendation.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A