

# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



## **Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing**

September 22, 2021

Report Number: 2021-40-057

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.

[TIGTACommunications@tigta.treas.gov](mailto:TIGTACommunications@tigta.treas.gov) | [www.treasury.gov/tigta](http://www.treasury.gov/tigta)

# HIGHLIGHTS: Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing

Final Audit Report issued on September 22, 2021

Report Number 2021-40-057

## Why TIGTA Did This Audit

This audit was initiated to evaluate IRS processes to identify and prevent potentially fraudulent individual international tax returns.

Nonresident aliens (hereafter referred to as nonresidents) are generally required to file a tax return to report their U.S. source income and pay any tax due. In contrast, residents of a U.S. territory generally report their U.S. source income on their territory tax return (*i.e.*, do not have a U.S. tax return filing requirement), unless these individuals have self-employment income of \$400 or more, or are eligible to claim certain tax credits.

### Impact on Taxpayers

Individual taxpayers filed 873,009 international tax returns for Tax Year 2018.

Nonresidents generally file using Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, or Form 1040NR-EZ, *U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents*. Residents of a U.S. territory who have self-employment income or who are eligible for a tax credit file Form 1040-SS, *U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)*, or Form 1040 PR, *Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)*, which is the Spanish version of Form 1040-SS.

## What TIGTA Found

The IRS does not have sufficient processes in place to identify potentially fraudulent individual international tax returns at the time these returns are filed. TIGTA's review of Tax Year 2018 tax returns identified 8,332 international tax returns with potentially erroneous or fraudulent refunds totaling nearly \$20.6 million that were not identified by the IRS.

These returns include [REDACTED] discrepancies, potentially erroneous Additional Child Tax Credit claims, potentially fraudulent refunds [REDACTED] and potential prisoner fraud. The reporting of [REDACTED] is an IRS confirmed fraud scheme. The IRS has also confirmed that tax returns that are [REDACTED] are often returns that were filed by fraudsters who have stolen a legitimate taxpayer's identity.

In addition, the IRS currently has no processes and procedures in place to ensure the legitimacy of [REDACTED] at the time returns are filed. [REDACTED] are taxed at a reduced rate or are exempt from U.S. taxes on certain U.S. source income. TIGTA identified 130,448 international tax returns with a [REDACTED] for which the IRS [REDACTED].

These individuals reduced or eliminated the Federal income tax paid on nearly \$2 billion in income.

The IRS also has not implemented processes to verify that international taxpayers [REDACTED] at the time the return is filed. TIGTA identified 50,297 [REDACTED], that were incorrectly filed by residents of a U.S. territory and nonresidents. As a result of incorrectly filing [REDACTED], these individuals received erroneous Earned Income Tax Credits, Additional Child Tax Credits, and American Opportunity Tax Credits totaling more than \$83.7 million.

## What TIGTA Recommended

TIGTA made 15 recommendations. TIGTA recommended that the IRS improve the identification and prevention of potentially fraudulent individual international tax returns, require individuals who report a [REDACTED] to provide documentation [REDACTED], and develop processes to address claims for which the documentation is not provided. TIGTA also recommended that the IRS develop processes to systemically identify and address international taxpayers who are potentially filing [REDACTED] to receive refundable tax credits.

The IRS agreed with 12 of the 15 recommendations. The IRS did not agree to require [REDACTED] documents for [REDACTED] or to work with the Department of Education to obtain and perfect eligible educational institution Employer Identification Number data.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

## U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 22, 2021

### MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing (Audit # 202040001)

This report presents the results of our review to evaluate Internal Revenue Service processes to identify and prevent potentially fraudulent individual international tax returns. This review was part of our Fiscal Year 2020 Annual Audit Plan and addresses the major management and performance challenge of *Compliance and Enforcement*.

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

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

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## Background

Each year, thousands of nonresident aliens<sup>1</sup> (hereafter referred to as nonresidents) are gainfully employed in the United States. These international taxpayers are generally required to file a tax return to report their U.S. source income and pay any tax due. U.S. source income may be reported to the nonresident on a Form W-2, *Wage and Tax Statement*, Form 1099 series,<sup>2</sup> or Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*. U.S. source income includes wages, commissions, interest, dividends, pensions, gambling winnings, *etc.* This income is subject to income tax withholding requirements. These individuals generally file using Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, or Form 1040NR-EZ, *U.S. Income Tax Return for Certain Nonresident Aliens With No Dependents*.<sup>3</sup>

Unlike nonresidents, bona fide residents<sup>4</sup> of the Commonwealth of the Northern Mariana Islands (CNMI), Guam, and the U.S. Virgin Islands (USVI) generally report their U.S. source income on their territory tax return. U.S. citizens and resident aliens who are bona fide residents of American Samoa and Puerto Rico are required to file a U.S. income tax return if they have income from U.S. sources, foreign sources, or income sourced in any other U.S. territory. Territory residents who do not have a U.S. income tax filing requirement but who do have a self-employment tax filing requirement file Form 1040-SS, *U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)*, or Form 1040-PR, *Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)*, which is the Spanish version of Form 1040-SS.

Form 1040-SS is filed by taxpayers residing in American Samoa, the CNMI, Guam, and the USVI. Residents of Puerto Rico can file either Form 1040-PR or Form 1040-SS. The Forms 1040-SS and 1040-PR are filed to pay self-employment taxes, household employment taxes, and additional Medicare tax. Figure 1 provides the types of individual income tax returns used by international filers, filing requirements, and filing exclusions/limitations associated with the specific income tax return types for Tax Year 2018.

**Figure 1: Tax Year 2018 International Tax Return Filing Requirements and Limitations<sup>5</sup>**

Income Tax Form Type	Filing Requirements	Filing Exclusions/Limitations
<b>Form 1040NR</b>	<ul style="list-style-type: none"><li>Nonresident engaged in a trade or business in the United States or received income from U.S. sources that is reportable on Form 1040NR, Schedule NEC, <i>Tax on Income Not</i></li></ul>	None.

<sup>1</sup> A nonresident alien is an individual who is not a U.S. citizen or U.S. national and is not a lawful permanent U.S. resident (*e.g.*, has a green card).

<sup>2</sup> Various types of U.S. information returns.

<sup>3</sup> Form 1040NR-EZ could only be filed through Tax Year 2019. This form is now obsolete.

<sup>4</sup> An individual is considered bona fide resident of a U.S. territory if they meet the physical presence test, do not have a tax home outside the territory, and do not have a closer connection to the U.S. or a foreign country than to the territory.

<sup>5</sup> The IRS considers Form 1040NR, Form 1040NR-EZ, Form 1040-PR, and Form 1040-SS as international tax returns.

**Improvements Are Needed to Identify Potentially Fraudulent  
Individual International Tax Returns During Processing**

Income Tax Form Type	Filing Requirements	Filing Exclusions/Limitations
	<p><i>Effectively Connected With a U.S. Trade or Business</i>, and not all U.S. tax was withheld or owe any other tax.</p> <ul style="list-style-type: none"> <li>Received a Health Savings Account or Medical Savings Account distribution.</li> <li>Had net self-employment income of \$400 or more and are a resident of a country with whom the United States has a Social Security agreement.</li> <li>Received advanced payments of the Premium Tax Credit or Health Coverage Tax Credit (HCTC).</li> <li>Representative for a deceased person, estate, or trust.</li> </ul>	
<b>Form 1040NR-EZ</b>	Nonresidents whose only U.S. source income is from wages, salaries, tips, refunds of State and local income taxes, scholarship or fellowship grants, and nontaxable interest or dividends and the total of this income is less than \$100,000.	<ul style="list-style-type: none"> <li>Cannot claim any dependents or be claimed as a dependent on another person's U.S. tax return.</li> <li>Only exclusion allowed is for scholarship and fellowship grants.</li> <li>Cannot claim tax credits.</li> <li>Only taxes owed are income tax or unreported Social Security and Medicare tax.</li> <li>Cannot claim a credit for excess Social Security tax and tier 1 Railroad Retirement tax withheld.</li> <li>Only deductions allowed are student loan interest and itemized deduction for State and local taxes (or standard deduction for India students or business apprentices).</li> </ul>
<b>Form 1040-SS <u>and</u> Form 1040-PR</b>	U.S. citizens and bona fide residents of American Samoa, the CNMI, Guam, Puerto Rico, and the USVI who are not required to file a U.S. income tax return but who have self-employment income or are eligible to claim certain credits. Residents of Puerto Rico may file Form 1040-PR in place of Form 1040-SS.	<p>Only bona fide residents of Puerto Rico may be able to claim the Additional Child Tax Credit (ACTC) if all of the following apply:</p> <ul style="list-style-type: none"> <li>Social Security and Medicare taxes were withheld from wages or self-employment taxes were paid.</li> <li>Cannot be claimed as a dependent on someone else's U.S. income tax return.</li> <li>Must have three or more qualifying children.</li> </ul>

Source: Treasury Inspector General for Tax Administration's (TIGTA) review of IRS.gov and Tax Year 2018 forms and publications.

## Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing

Figure 2 provides the number of Tax Year 2018 international tax returns filed as of December 12, 2019, by type of tax return.

**Figure 2: Tax Year 2018 Individual International Income Tax Returns Received**

	Form 1040NR/EZ	Form 1040-PR	Form 1040-SS	Total
<b>Electronic</b>	<b>261,558</b>	<b>8,018</b>	<b>30,347</b>	<b>299,923</b>
Paid Preparer	256,325	4,055	23,933	284,313
Self-Prepared	5,233	3,963	6,414	15,610
<b>Paper</b>	<b>456,000</b>	<b>92,376</b>	<b>24,710</b>	<b>573,086</b>
Paid Preparer	164,592	34,269	14,077	212,938
Self-Prepared	291,408	58,107	10,633	360,148
<b>Total Returns Filed</b>	<b>717,558</b>	<b>100,394</b>	<b>55,057</b>	<b>873,009</b>

Source: TIGTA's analysis of the Individual Return Transaction File (IRTF)<sup>6</sup> as of December 12, 2019.

### International taxpayers' eligibility for refundable tax credits

Individuals who meet the qualifications to file Form 1040NR can claim refundable tax credits including the Excess Social Security Tax Credit, the ACTC, the HCTC, and Premium Tax Credit. Residents of Puerto Rico who file Forms 1040-PR or 1040-SS can claim refundable credits including the ACTC (filer must report three or more qualifying children), the Excess Social Security Tax Credit, and the HCTC. Figure 3 shows the amount of refundable credits claimed for Tax Year 2018 by individual international tax return type.

**Figure 3: Refundable Credits Claimed on Tax Year 2018 International Returns**

Form Types	Credit Claimed	Number of Returns	Amount Claimed
<b>1040NR, 1040-PR, and 1040-SS<sup>7</sup></b>	ACTC	40,767	\$104,165,164
<b>1040NR, 1040-PR, and 1040-SS</b>	Excess Social Security Tax Credit	1,102	\$2,634,543
<b>1040NR, 1040-PR, and 1040-SS</b>	HCTC	18	\$41,431
<b>1040NR</b>	Premium Tax Credit	392	\$147,844

Source: TIGTA's analysis of the IRTF as of December 12, 2019.

### Identification of potentially fraudulent tax returns

The Internal Revenue Service (IRS) uses two programs in an effort to identify potentially fraudulent tax return filings:

**Return Review Program (RRP)** – An application that uses a series of filters to identify suspicious returns for additional [REDACTED] for Processing Year 2020. In addition, the IRS [REDACTED] that are identified [REDACTED] for potential review, including returns identified as part of the RRP [REDACTED].

<sup>6</sup> A database maintained by the IRS that contains information on the individual tax returns it receives.

<sup>7</sup> Only residents of Puerto Rico can file Form 1040-PR and Form 1040-SS to claim the ACTC.

**Dependent Database** – A rules-based selection application that is designed to identify potential identity theft filings as well as potentially ineligible refundable credit claims (*e.g.*, Earned Income Tax Credit (EITC), the ACTC, American Opportunity Tax Credit (AOTC)). The IRS generally excludes [REDACTED] and returns with a [REDACTED] from selection for identity theft review.<sup>8</sup> For Processing Year 2020, the IRS has one Dependent Database rule specific for international tax returns. This rule is specific to [REDACTED] ACTC claims [REDACTED] and identifies returns that claim the ACTC with [REDACTED]. Returns identified by this filter are sent to the IRS's Automated Questionable Credit<sup>9</sup> program for treatment. During Processing Year 2019, the IRS identified for review 275 [REDACTED] as having a questionable refundable credit claim. Of these, [REDACTED] were selected for review and the [REDACTED].

## **Results of Review**

Our review found that the IRS does not have sufficient processes in place to identify potentially fraudulent individual international tax returns at the time these returns are filed. Our review of Tax Year 2018 tax returns identified 8,332 international tax returns with potentially erroneous or fraudulent refunds totaling nearly \$20.6 million that were not identified by the IRS. These returns include [REDACTED], potentially erroneous ACTC claims, potentially fraudulent refunds of [REDACTED], and potential prisoner fraud. The 8,332 returns we identified include:

- 8,099 returns with potentially fraudulent refunds totaling more than \$20 million in which the [REDACTED] reported on the return was not [REDACTED]. These returns were not identified because the IRS does not [REDACTED] as it does for domestic returns. The reporting of [REDACTED] is an IRS confirmed fraud scheme.
- 133 returns with potentially fraudulent refunds of [REDACTED] totaling \$239,717 that taxpayers [REDACTED]. The majority of these returns were not identified because IRS fraud processes do not identify international tax returns in which the taxpayer's refund is below a specified dollar limit. IRS processes also do not identify questionable refunds for review when [REDACTED]. The IRS has confirmed that tax returns that are [REDACTED] are often returns that were filed by fraudsters who have stolen a legitimate taxpayer's identity and would not know that the taxpayer [REDACTED].

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<sup>8</sup> The IRS usually excludes [REDACTED] and any returns with [REDACTED]. However, this exclusion rule can be bypassed, and there are instances of these returns being selected.

<sup>9</sup> A prerefund treatment process to address questionable refundable credit claims that do not meet the IRS's examination tolerance.

## Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing

- [REDACTED] returns with potentially erroneous ACTC totaling \$170,901 for which the taxpayer did not obtain their Taxpayer Identification Number (TIN)<sup>10</sup> before the due date of the tax return, or the taxpayer did not [REDACTED] ACTC, or meet the qualifying child requirements.
- [REDACTED]. Although we identified [REDACTED], there is a risk that prisoners could migrate to international tax return fraud as the IRS improves its detection of other confirmed prisoner tax fraud schemes.

Our review also identified 180,745 taxpayers who potentially avoided paying the proper amount of U.S. Federal income tax or filed the incorrect tax form allowing them to receive refundable tax credits to which they are not entitled. The IRS currently has no processes and procedures in place to ensure the legitimacy of [REDACTED] or verify that international taxpayers [REDACTED] at the time tax returns are filed. These returns include:

- 130,448 Forms 1040NR and 1040NR-EZ with a tax [REDACTED] for which the IRS has no indication that the taxpayer [REDACTED], residents (not necessarily citizens) of foreign countries are taxed at a reduced rate or are exempt from U.S. taxes on certain items of income they receive from sources within the United States. These taxpayers reduced or eliminated the Federal income tax paid on nearly \$2 billion in income.
- 50,297 [REDACTED], that were incorrectly filed by residents of a U.S. territory and nonresidents. The type of tax return an individual should file is dependent on the individual's residency status. Nonresidents who have U.S. source income are generally required to file a Form 1040NR. U.S. citizens and resident aliens who are bona fide residents of American Samoa and Puerto Rico are required to file a U.S. income tax return if they have income from U.S. sources, foreign sources, or income sourced in any other U.S. territory. Residents of a U.S. territory, who have U.S. source income such as wages, generally do not have a U.S. income tax filing requirement. Rather, these individuals generally report the income on their territory tax return. As a result of incorrectly filing [REDACTED], these individuals received erroneous EITC, ACTC, and AOTC totaling more than \$83.7 million.

As we have continually reported, new fraud patterns are constantly evolving. As such, the IRS needs to adjust its existing filters and continue to expand its detection processes. For example, we found that fraudsters began exploiting weaknesses in other business returns, as the IRS improved its detection of tax fraud on business returns.<sup>11</sup> We believe international tax returns also present a significant risk of fraud to the IRS. The questionable international tax returns we

<sup>10</sup> A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, it can be an Employer Identification Number, a Social Security Number, or an Individual Taxpayer Identification Number.

<sup>11</sup> TIGTA, Report No. 2021-40-004, *Refinement and Expansion of Filters to Include Additional Business Returns Will Continue to Improve Business Identity Theft Detection Efforts* (Oct. 2020).

identified indicate that fraudsters may already be testing IRS processes to identify new ways to obtain fraudulent tax refunds.

### **Processes Have Not Been Implemented to Identify Potentially Fraudulent Refund Claims Resulting From \*\*\*\*\*2\*\*\*\*\***

Our review of 364,628 Tax Year 2018 Forms 1040NR/NR-EZ that reported [REDACTED] and 39,824 Tax Year 2018 Forms 1040-PR and 1040-SS that reported [REDACTED] for purposes of claiming the ACTC identified 8,099 returns with [REDACTED] that were not identified by the IRS before refunds were paid. As such, these taxpayers received questionable refunds totaling more than \$20 million. The reporting of [REDACTED] is an IRS confirmed fraud scheme. However, the IRS does not verify [REDACTED] on individual international returns at the time the return is filed as it does for domestic returns. According to the IRS, it has [REDACTED] from its prerefund income verification process since Processing Year [REDACTED] and [REDACTED] since Processing Year [REDACTED]. Management noted that these filings were [REDACTED].

These 8,099 returns include:

- 6,731 Forms 1040NR<sup>12</sup> with questionable refunds totaling more than \$17.7 million in which the IRS had [REDACTED] reported on the tax return.
- 1,368 Forms 1040-PR and 1040-SS filed by residents of Puerto Rico with potentially erroneous ACTC totaling more than \$2.3 million in which the [REDACTED] used to claim the ACTC. For Puerto Rico residents, [REDACTED] qualifies for the ACTC.

### **Processes are needed to ensure that the \*\*\*\*\*2\*\*\*\*\* reported on international returns are supported by \*\*\*\*\*2\*\*\*\*\* before refunds are paid**

Our analysis of 364,628 Tax Year 2018 Forms 1040NR that reported [REDACTED] identified 31,993 returns (9 percent) with no [REDACTED]. Of the 31,993 returns without a [REDACTED], 6,731 returns (21 percent) received refunds totaling more than \$17.7 million. These 6,731 returns reported [REDACTED] on their return of more than \$218.3 million and [REDACTED] of more than \$32.6 million.

We alerted the IRS of our concerns on September 23, 2020, and recommended that the IRS expand RRP [REDACTED] processes to select individual international returns for prerefund review when the [REDACTED] on the tax return are [REDACTED]. IRS management agreed that there is potential for fraud with international refund returns with [REDACTED]. IRS management stated

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<sup>12</sup> Includes Forms 1040NR-EZ.

that they will study this population during Processing Year 2021 and make appropriate changes to the RRP program for Processing Year 2022.

### **Processes are needed to ensure that [REDACTED] by residents of Puerto Rico to qualify for the ACTC is supported**

Our analysis of 39,824 Tax Year 2018 Forms 1040-PR and 1040-SS that reported [REDACTED] for purposes of claiming the ACTC identified 1,368 tax returns (3 percent) filed by residents of Puerto Rico that [REDACTED]

[REDACTED] from sources within Puerto Rico but there was no [REDACTED].

These individuals potentially received more than \$2.3 million in erroneous ACTC. The IRS has no processes in place to ensure that international taxpayers have [REDACTED] before the ACTC claim is allowed and refunds are paid.

For residents of Puerto Rico, [REDACTED] qualifies for the ACTC. The ACTC is also limited for those with income greater than \$200,000 or \$400,000 for married filing joint filers. Additionally, the ACTC is limited to the amount of [REDACTED]

[REDACTED] are reported to taxpayers [REDACTED]

[REDACTED]. To qualify for the ACTC, bona fide residents of Puerto Rico [REDACTED] Form 1040-PR or Form 1040-SS. Figure 4 shows how bona fide residents of Puerto Rico [REDACTED] when claiming the ACTC.

**Figure 4: Reporting for Bona Fide Residents of Puerto Rico Claiming ACTC**

Form 1040-SS (2018)

Page 2

**Part II Bona Fide Residents of Puerto Rico Claiming Additional Child Tax Credit—See instructions.**

**Caution:** You must have three or more qualifying children to claim the additional child tax credit.

1	Income derived from sources within Puerto Rico . . . . .	1		
2	Withheld social security, Medicare, and Additional Medicare taxes from Puerto Rico Form(s) 499R-2/W-2PR (attach copy of form(s)). If married filing jointly, include your spouse's amounts with yours . . . . .	2		
3	<b>Additional child tax credit.</b> Use the worksheet in the instructions to figure the amount to enter here and in Part I, line 9 . . . . .	3		

Source: IRS.gov.

According to IRS management, a decision was made [REDACTED]. Specifically, management noted that [REDACTED], is not formatted like [REDACTED].

[REDACTED]. IRS management stated that because of the formatting differences, RRP filters were not comparing [REDACTED].

The [REDACTED]. As such, IRS management stated that it could not change the format to [REDACTED]. Figure 5 provides a comparison of the format of [REDACTED] along with [REDACTED] where the formatting is different.

**Improvements Are Needed to Identify Potentially Fraudulent  
Individual International Tax Returns During Processing**

**Figure 5: Comparison of \*\*\*\*\*2\*\*\*\*\***

\*\*\*\*\*2\*\*\*\*\*

Field		
	Line 1	Line 7
	Line 2	Line 13
	Line 3	Line 17
	Line 4	Line 18
	Line 5	Line 19
	Line 6	Line 20

Source: TIGTA's analysis of

We questioned why IRS management did not make adjustments to the programming to data for systemic verification processes. IRS management stated that they do not control the loading of and instead changed the selection criteria, which they do have control over. We agree that IRS management has no controls over the loading or layout of. However, they can create additional filters specifically for, as opposed to.

We alerted the IRS of our concerns on January 22, 2021, and recommended that the IRS develop processes to systemically identify and address reported on Forms 1040-PR or 1040-SS before refunds are paid. IRS management stated that the IRS does not have math error authority to adjust ACTC claims as a result of. As such, the claims we identified can be addressed only using statutory deficiency procedures (*i.e.*, an examination). We understand that the IRS must use statutory deficiency procedures to address the ACTC claims we identified. However, there is nothing that prevents the IRS from establishing processes to identify ACTC claims on Forms 1040-PR and 1040-SS for additional review in its Automated Questionable Credit program when reported on the tax, similar to how the IRS identifies and examines certain ACTC claims filed on a Form 1040.

The Commissioner, Wage and Investment Division, should:

**Recommendation 1:** Develop prerefund processes to identify and address Form 1040NR refund claims in which the reported on the return is not supported by.

**Management's Response:** The IRS agreed with this recommendation and plans to study this population during 2021. IRS management plans to make changes to the RRP Non-Identity Theft filters/rules as appropriate for potential Non-Identity Theft selections in 2022.

## Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing

**Recommendation 2:** Review the 6,731 Forms 1040NR refunds we identified in which the [REDACTED] on the tax return was not supported by [REDACTED] and take actions to recover erroneous refunds.

**Management's Response:** The IRS agreed with this recommendation and plans to review the 6,731 Forms 1040NR identified by the TIGTA. IRS management plans to take appropriate actions on a sample of these returns based on resource availability.

**Recommendation 3:** Develop at-filing processes to identify and address ACTC claims on Forms 1040-PR and 1040-SS in which [REDACTED] reported on the tax return is [REDACTED].

**Management's Response:** The IRS agreed with this recommendation and plans to study this population during 2021. IRS management plans to update the RRP Non-Identity Theft filters/rules, as appropriate, for potential selections in 2022.

**Recommendation 4:** Review the 1,368 Forms 1040-PR and 1040-SS we identified in which the [REDACTED] reported on the tax return for the purposes of claiming the ACTC is not supported [REDACTED] and take actions to recover erroneous credits.

**Management's Response:** The IRS agreed with this recommendation and plans to review the 1,368 Forms 1040-PR and 1040-SS identified by the TIGTA. IRS management plans to take appropriate actions on a sample of these returns based on resource availability.

## Programming Modifications Are Needed to Identify Additional Potentially Fraudulent Filings for Refunds of \*\*\*\*\*2\*\*\*\*\*

Our analysis of 873,009 Tax Year 2018 international tax returns identified 2,686 returns in which the taxpayer [REDACTED]. One of the confirmed characteristics of individual tax-related identity theft is the filing of a tax return with a refund claim [REDACTED]. We determined that 133 (5 percent) of these returns with [REDACTED] totaling \$239,717 were not identified by IRS error resolution processes or fraud filters for additional review.

The IRS has implemented two processes to identify tax returns, including international returns, in which the taxpayer claims a refund and [REDACTED]. IRS error resolution processing identifies tax returns in which the refund claim is less than or equal to [REDACTED]. In addition, IRS fraud filters identify tax returns in which the [REDACTED] are more than [REDACTED]. These returns were not identified by the IRS because programming did not [REDACTED], returns below the IRS's dollar tolerance for selection, and returns with [REDACTED] on their tax account [REDACTED].

We shared the results of our analysis with the IRS on December 10, 2020. We recommended that the IRS adjust its fraud filters or error resolution processes to identify international tax returns when [REDACTED] and prevent them from

being refunded prior to review, even if there is [REDACTED] management agreed with our findings and modified its filters for Processing Year 2021.

**Recommendation 5:** The Commissioner, Wage and Investment Division, should review the 133 international returns we identified for which the IRS issued a potentially fraudulent refund of [REDACTED] and take actions to recover the fraudulent refunds and ensure that the fraudulently refunded [REDACTED] are properly credited to the true taxpayer's tax liability.

**Management's Response:** The IRS agreed with this recommendation, but disagreed with the related outcome measure. On January 4, 2021, IRS management reviewed the 133 international returns identified by TIGTA and determined none of the payments were lost, so there are no refunds to recover.

**Office of Audit Comment:** Given IRS management's determination that no payments were lost, we cannot yet quantify the potential outcome the IRS will realize because of modifying its fraud detection filters. We will continue to monitor the IRS's fraud detection processes and will quantify the outcome associated with our recommendation at that time.

## **Modifications Are Needed to Identify Additional Potentially Erroneous Additional Child Tax Credit Claims**

Our analysis of 80,280 Tax Year 2018 Forms 1040NR and 1040-PR/SS claiming the ACTC identified 99 returns that received potentially erroneous ACTC totaling \$170,901, which was not identified by the IRS prior to claims being paid. Specifically:

- 48 Form 1040NR tax returns that received the ACTC totaling \$61,855 for which [REDACTED] on the tax return [REDACTED] does not qualify for the ACTC. International taxpayers must be a U.S. national<sup>13</sup> or a [REDACTED] in order to claim the ACTC.<sup>14</sup> Our review of existing processes and procedures for verifying ACTC claims found that the IRS [REDACTED] the ACTC is paid only to international taxpayers who [REDACTED].

We alerted the IRS of our concerns on January 22, 2021, and recommended that the IRS develop systemic prerefund processes to identify for additional review international returns claiming the ACTC when [REDACTED] on the tax return [REDACTED]. IRS management stated that the IRS does not have the authority to systemically adjust an ACTC claim based on [REDACTED]. As we detailed previously in our report, the IRS does have its Automated Questionable Credit program in which it can address questionable credit claims.

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<sup>13</sup> A U.S. national is an individual who, although not a U.S. citizen, owes his or her allegiance to the United States. U.S. nationals include American Samoans and Northern Mariana Islanders who chose to become U.S. nationals instead of U.S. citizens.

<sup>14</sup> [REDACTED]

**Improvements Are Needed to Identify Potentially Fraudulent  
Individual International Tax Returns During Processing**

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- [REDACTED] Form 1040-PR and 1040-SS returns that received the ACTC totaling \$101,133 filed by residents of Puerto Rico in which the taxpayer did not report [REDACTED]. To be eligible to claim the ACTC, bona fide residents of Puerto Rico must [REDACTED].

We shared the results of our analysis with the IRS on January 22, 2021. IRS management stated that fraud filters were implemented to identify Forms 1040-PR and 1040-SS that are filed by residents of Puerto Rico and claim the ACTC with [REDACTED]. These filters identify returns when the refund claimed is above a certain dollar limit. Of the 44 Forms 1040-PR and 1040-SS we identified, 31 claimed a refund below the dollar limit. In addition, management stated that the remaining 13 Forms 1040-PR and 1040-SS were worked by the Error Resolution function. However, employees made errors when verifying the returns at processing.

According to IRS management, the *American Rescue Plan Act of 2021*,<sup>15</sup> enacted subsequent to our review on March 11, 2021, amended the requirement for Puerto Rican residents to [REDACTED] to qualify for the ACTC beginning in Tax Year 2021.

- [REDACTED] Form 1040NR tax returns with erroneous ACTC totaling \$6,464 that was paid to taxpayers in which the taxpayer's TIN or the spouse's TIN was issued after the due date of the return. Section 205 of the Protecting Americans from Tax Hikes Act<sup>16</sup> requires taxpayers and their spouse to have a valid TIN that was issued on or before the due date of the tax return to be eligible to claim the ACTC.

We alerted the IRS of our concerns on January 22, 2021. IRS management stated that the ACTC claims we identified are the result of errors made by Error Resolution employees when verifying the returns at processing.

- [REDACTED]. Individuals, other than those residing in Puerto Rico, are required to have [REDACTED] qualifying child to be eligible for the ACTC.

We shared the results of our analysis with the IRS on January 22, 2021. IRS management stated that [REDACTED].

The Commissioner, Wage and Investment Division, should:

**Recommendation 6:** Develop prerefund processes to systemically identify and address potentially erroneous ACTC claimed on international refund tax returns in which [REDACTED] on the return [REDACTED].

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<sup>15</sup> Pub. L. No. 117-2.

<sup>16</sup> Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242 (2015).

**Management's Response:** The IRS agreed with this recommendation and plans to study the feasibility of sampling this work. IRS management plans to take appropriate actions based on the result of the study and available resources.

**Recommendation 7:** Ensure that Error Resolution tax examiners are aware of the proper procedures for resolving ACTC claims on international tax returns in which the taxpayer's TIN or spouse's TIN was not issued prior to the due date of the tax return and in which the taxpayer does not meet the qualifying child requirements.

**Management's Response:** The IRS agreed with this recommendation and plans to provide training for returning and new tax examiners in the Error Resolution function to emphasize this aspect of processing the ACTC.

**Recommendation 8:** Review the 99 questionable returns that received the ACTC that TIGTA identified and take actions to recover any erroneous ACTC received.

**Management's Response:** The IRS agreed with this recommendation, but disagreed with the related outcome measure (see Appendix II for more detailed information on the reported outcome measure). IRS management acknowledges erroneous processing in seven returns and plans to take steps to have the improperly allowed ACTC corrected. Management is also currently reviewing the remaining returns in question to determine whether the ACTC was properly allowed and plans to take steps, when possible within the constraints of the assessment statute of limitations date, to have any improperly allowed ACTC corrected.

## **Processes and Procedures Are Needed to Identify International Tax Returns Filed Using a Prisoner's Social Security Number**

Our analysis of 873,009 Tax Year 2018 international income tax [REDACTED]

[REDACTED]

While the potential refund fraud by prisoners on international returns remains low at this time, we believe there is potential for fraudsters to exploit vulnerabilities in the filters. As such, we alerted the IRS of our concern [REDACTED]

[REDACTED]

When we questioned IRS management about this further, management stated the selection criteria identifies all prisoner returns, including international returns. However, management acknowledged [REDACTED]. IRS management updated the criteria for the 2021 Filing Season to ensure that all international returns filed by prisoners who are incarcerated for the entire tax year will be identified [REDACTED].

## Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing

**Recommendation 9:** The Commissioner, Wage and Investment Division, should review the [REDACTED]

**Management's Response:** The IRS agreed with this recommendation, but disagreed with the related outcome measure. [REDACTED]

**Office of Audit Comment:** [REDACTED]

[REDACTED], we cannot yet quantify the potential outcome the IRS will realize because of modifying its fraud detection filters. We will continue to monitor the IRS's fraud detection processes and will reevaluate the potential outcome of our recommendation in the future.

### Processes and Procedures to Ensure the Legitimacy of Billions of Dollars in

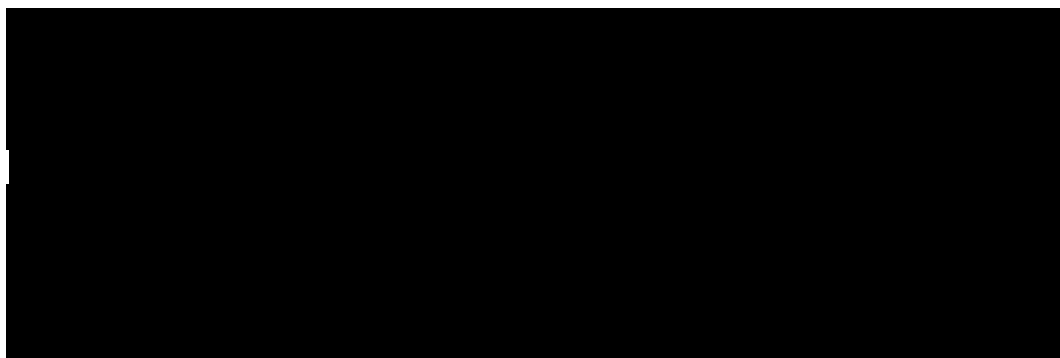
\*\*\*\*\*2\*\*\*\*\* Are Inconsistent With \*\*\*\*\*2\*\*\*\*\*

\*\*\*2\*\*\*

Our review identified 130,448 Forms 1040NR and 1040NR-EZ Tax Year 2018 returns claiming nearly \$2 billion in income [REDACTED]. The United States has [REDACTED] residents (not necessarily citizens) of foreign countries are taxed at a reduced rate, or are exempt from U.S. income tax on certain types of income they receive from sources within the United States. These reduced rates and exemptions vary among countries and with specific items of income.

However, the IRS has not developed any processes to ensure that these individuals [REDACTED] before Federal income tax exclusions are allowed, increasing the risk that taxpayers [REDACTED] to intentionally avoid paying U.S. income tax. Foreign individuals who [REDACTED] report the [REDACTED] on Form 1040NR, [REDACTED]. Figure 6 shows how taxpayers report [REDACTED].

**Figure 6:** \*\*\*\*\*2\*\*\*\*\*



Source: IRS.gov, Forms and Publications.

As Figure 6 shows, an individual claiming [REDACTED] provides [REDACTED] the amount of exempt income for the [REDACTED]

## Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing

tax year, *etc.* However, the individual is not required to provide [REDACTED] before the IRS allows the income exclusion. Once a return [REDACTED] is received by the IRS, the IRS will ensure that [REDACTED] is attached and necessary fields are completed (*i.e.*, [REDACTED] and the amount of exempt income during the tax year). If the [REDACTED] is not attached or does not contain the necessary information, the IRS will correspond with the taxpayer requesting the missing information. If the taxpayer reports [REDACTED], an amount that exceeds the limitation [REDACTED], or does not respond to the IRS with requested missing information, the IRS will adjust the tax return disallowing the income exclusion.

### The IRS is inconsistent with [REDACTED] as it relates to required documentation [REDACTED] to qualify for an income exclusion

Many [REDACTED] require U.S. residents to provide [REDACTED] in order to claim [REDACTED] foreign countries. The IRS provides this [REDACTED] for U.S. residents via [REDACTED] is a computer-generated letter printed on stationary bearing the U.S. Department of Treasury letterhead certifying that the individuals or entities listed [REDACTED].

We alerted the IRS of our concerns on September 23, 2020, recommending that the IRS update its processes to require taxpayers reporting [REDACTED] to provide supporting documentation, [REDACTED], with their tax return. We also recommended the IRS develop processes to use this information to verify that the taxpayer is eligible [REDACTED] before the exclusion is allowed. IRS management explained that they understood TIGTA's concerns but they do not have the statutory authority under Internal Revenue Code (IRC) § 6213(g)(2) to disallow a claim if the taxpayer did not provide the requested documentation. Additionally, the IRS stated that the process requested by TIGTA would delay the processing of these returns and require additional resources for front-end screening.

The IRC does not limit the IRS's ability to suspend the processing of tax returns and correspond for this documentation when it is not provided. Further, 36 percent of all Forms 1040NR are filed electronically, and the documentation could be required before accepting the tax return for processing. The IRS could then use its limited and more costly enforcement options to address the potentially fraudulent claims (*i.e.*, those that did not provide supporting documentation at filing).

The Commissioner, Wage and Investment Division, should:

**Recommendation 10:** Require international taxpayers reporting [REDACTED] to provide supporting documentation with their tax return, [REDACTED] that the taxpayer [REDACTED].

**Management's Response:** The IRS disagreed with this recommendation. IRS management stated that the documents are not necessary for satisfying the Beard test for a valid return, and the IRS does not have the statutory authority to require those

documents for inspection outside of deficiency procedures (an audit of the return), which is not a viable treatment for use during return processing. Further, [REDACTED] does not conclusively establish [REDACTED].

**Office of Audit Comment:** The process we recommended is consistent with existing IRS processes. For example, the IRS requires taxpayers to submit additional information when claiming a Foreign Tax Credit and suspends processing when the documentation is not provided.<sup>17</sup> At a minimum, the IRS, in conjunction with the Department of Treasury's Office of Tax Policy, should ensure that policies for certifying [REDACTED] of individuals [REDACTED] are consistent with [REDACTED].

**Recommendation 11:** Develop processes to suspend the processing of [REDACTED] for which the supporting documentation is not provided and correspond with the taxpayer for the missing documentation.

**Management's Response:** The IRS disagreed with this recommendation. IRS management stated that the documents are not necessary for satisfying the Beard test for a valid return, and the IRS does not have the statutory authority to require those documents for inspection outside of deficiency procedures (an audit of the return), which is not a viable treatment for use during return processing. Further, correspondence would not be an effective action as it would delay return processing and increase costs.

**Office of Audit Comment:** See our Office of Audit Comment for Recommendation 10.

## **Processes Do Not Identify and Address [REDACTED] Resulting in Erroneous Refundable Credit Claims**

As detailed in the Background section, an individual who is not a U.S. citizen is referred to as an alien for U.S. income tax purposes. Aliens can be classified as either a resident, nonresident, or dual-status alien.<sup>18</sup> Nonresidents are to file a Form 1040NR, 1040NR-EZ, 1040-PR or 1040-SS. Unlike a nonresident, residents of a U.S. territory generally report their U.S. source income on their territory tax return (*i.e.*, do not have a U.S. tax return filing requirement) unless they have self-employment income of \$400 or more, or are eligible to claim certain tax credits. However, U.S. citizens and resident aliens who are bona fide residents of American Samoa and Puerto Rico are required to file a U.S. income tax return if they have income from U.S. sources, foreign sources, or income sourced in any other U.S. territory. Residents of a U.S. territory report their self-employment income or claim allowable tax credits on Forms 1040-PR or 1040-SS. We found that the IRS has no processes to identify nonresidents who [REDACTED] and receive tax benefits to which they are not entitled. Our review of Tax Year 2018 [REDACTED] tax returns identified 50,297 returns filed by individuals with characteristics that suggest the filers are likely a nonresident filing an incorrect tax form. These individuals received more than \$83.7 million in refundable tax credits to which they may not have been entitled. These include:

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<sup>17</sup> The IRS requires taxpayers to attach Form 1116, *Foreign Tax Credit*, to their tax return. However, the IRC does not require such reporting.

<sup>18</sup> See Appendix V.

## Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing

- 36,373 [REDACTED] filed by individuals whose Social Security Number status and third-party income documents indicate that they are potentially a nonresident. These individuals received more than \$33.1 million in potentially erroneous refundable AOTC.
- 13,924 returns filed by taxpayers who had received wage income from a company in a U.S. territory that erroneously filed a [REDACTED] to receive more than \$50.6 million in refundable tax credits to which they may not have been entitled.<sup>19</sup>

The lack of adequate processes to identify nonresidents who [REDACTED] tax return became even more apparent with regard to the issuance of the Economic Impact Payments. In May 2021, we reported that our analysis of payments issued as of July 16, 2020, identified 324,864 payments totaling nearly \$444 million that were potentially issued to nonresidents who filed a [REDACTED].<sup>20</sup> Of the 324,864 payments, 30,175 of these payments totaling more than \$37 million were calculated by the IRS using a [REDACTED] that listed a foreign address.

### Nonresidents are potentially receiving erroneous AOTC because they are \*\*\*\*\*2\*\*\*\*\* \*\*\*\*\*2\*\*\*\*\*

The AOTC is a tax credit of up to \$2,500 of the cost of tuition and related expenses paid during the tax year. Forty percent of the AOTC is refundable. To be eligible to receive the AOTC, a taxpayer must be a U.S. citizen or resident alien for the entire tax year, among other things. Nonresidents, who are required to file Form 1040NR, Form 1040NR-EZ, Form 1040-PR, or Form 1040-SS are not eligible to claim the AOTC.

Our review of Tax Year 2018 [REDACTED] returns that received the AOTC identified 180,420 returns in which the information in the Social Security Administration database indicates the taxpayer is a legal alien authorized to work in the United States. However, further review found that 36,373 (20 percent) of these returns were filed by individuals who had no Federal Insurance Contributions Act tax withheld from their wages in Tax Year 2018, which indicates they are likely not considered a resident alien.<sup>21</sup> These individuals received more than \$33.1 million in potentially erroneous refundable AOTC.

Under IRC § 3121(b)(19), individuals who hold certain non-immigrant visa statuses<sup>22</sup> are not subject to the Federal Insurance Contributions Act tax. Individuals who hold these same non-immigrant visa statuses are instructed to exclude their time in the United States for the purpose of their visa when determining if they are a resident or nonresident for U.S. tax purposes.

### Nonresidents are also claiming the AOTC for ineligible institutions

In addition to being a U.S. citizen or resident alien, students must also attend an eligible institution to be eligible to receive the AOTC. Eligible institutions are institutions that are authorized to receive Title IV funding (*i.e.*, Federal student aid) from the U.S. Department of Education. Our review of the 36,373 identified [REDACTED] tax returns with the AOTC that were

<sup>19</sup> We identified returns with credits exceeding \$250.

<sup>20</sup> TIGTA, Report No. 2021-46-034, *Implementation of Economic Impact Payments* (May 2021).

<sup>21</sup> There are exceptions in which a valid foreign person would be considered a resident and not subject to the tax. However, we are unable to identify individuals with these exceptions with the available tax return data.

<sup>22</sup> Individuals in an F-1, J-1, M-1, Q-1, or Q-2 non-immigrant visa status.

potentially filed by nonresidents found that 6,967 (19 percent) returns reported an ineligible institution Employer Identification Number (EIN) on Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*. Many of the institution EINs were obviously not for a post-secondary educational institution (*e.g.*, banks, corporations, preschools). These 6,967 returns received refundable AOTC of more than \$6.4 million. Our review of Forms 1098-T, *Tuition Statement*, associated with these 6,967 returns found that 1,715 returns had a Form 1098-T.

We previously reported that billions of dollars in potentially erroneous education credits continued to be claimed for ineligible students and institutions.<sup>23</sup> Specifically, we found that more than 1.6 million taxpayers received education credits totaling approximately \$2.5 billion for which Department of Education data showed the educational institution listed on the Form 8863 was not an eligible institution. We recommended that the IRS work with the Department of Education to use its data to verify eligibility of educational institutions reported on returns claiming education credits. The IRS disagreed with our recommendation and stated that it could not use third-party data to correct a tax return during processing under its existing statutory authority.

On January 5, 2021, we alerted the IRS of our concerns that nonresidents may [REDACTED] [REDACTED] to receive the AOTC to which they are not entitled, including using an ineligible educational institution. IRS management again did not agree to develop processes to use Department of Education data to verify AOTC claims stating that they cannot use third-party information to correct a tax return during processing. In addition, IRS management indicated that they had evaluated the Department of Education data and determined the data are incomplete for IRS purposes. For example, management stated that the data do not contain specific EINs for an institution's satellite and sister campuses. Management also stated that they believe their current post-processing procedures to match a student claimed for the AOTC to a Form 1098-T filed by the educational institution are sufficient to identify AOTC claims for ineligible institutions.

However, we disagree that these processes are sufficient to identify potentially erroneous AOTC claims before the AOTC is paid. While the Department of Education data are not perfect for the IRS's needs, the data remain the only data source that the IRS can use to definitively verify that the EINs are in fact for eligible institutions. While eligible institutions are generally required to file a Form 1098-T, there are exceptions to this requirement. As discussed previously, we found that many of the institutions provided on Form 8863 are obviously not an eligible institution. In addition, Forms 1098-T are not required to be filed with the IRS until February 28 (March 31 if filing electronically) after many individual tax returns are filed.

We are not suggesting that the IRS bypass its authority and adjust tax returns without following deficiency procedures. As previously mentioned, the IRS can use its Automated Questionable Credit program to address questionable returns claiming refundable credits. In addition, we continue to believe that the IRS can and should do more to verify AOTC claims before refunds are paid. For example, the IRS can use Department of Education data to exclude AOTC claims from examination selection when the data show that the institution provided on Form 8863 is an eligible institution. The IRS may also be able to use its existing EIN data to identify AOTC claims

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<sup>23</sup> TIGTA, Report No. 2015-40-027, *Billions of Dollars in Potentially Erroneous Education Credits Continue to Be Claimed for Ineligible Students and Institutions* (Mar. 2015).

in which the EIN on the Form 8863 is obviously not an eligible institution. Finally, the IRS may be able to use this same EIN data to perfect Department of Education data by associating the EIN of a parent institution with the EINs issued by the IRS to the parent institutions related entities.

**Bona fide residents of U.S. territories are potentially receiving erroneous refundable tax credits because they** \*\*\*\*\*2\*\*\*\*\*

U.S. territories have their own separate and independent tax systems. An individual first must determine whether they are a U.S. resident or nonresident, as previously discussed, and whether they are a bona fide resident of the U.S. territory before determining which tax return(s) to file and the taxability of their income.<sup>24</sup> An individual is generally considered a bona fide resident of a U.S. territory if they:

- Are physically present in the territory for 183 days during the tax year.
- Do not have a tax home outside the territory during the tax year.
- Do not have a closer connection to the United States or a foreign country.

Bona fide residents of American Samoa, the CNMI, Guam, and the USVI are generally not eligible to receive refundable tax credits on a U.S. income tax return, regardless of whether the income was earned in the United States or the applicable territory. Similarly, bona fide residents of American Samoa and Puerto Rico are also generally not eligible for the EITC on a U.S. income tax return, regardless of where the income was earned. However, bona fide residents of Puerto Rico may be eligible for the ACTC if they have a U.S. income tax filing or self-employment tax filing requirement. These individuals may claim the ACTC only if they have three or more qualifying dependents and they must claim the ACTC on Form 1040-PR or Form 1040-SS.

It is difficult for the IRS to determine whether an individual is a bona fide resident of a U.S. territory without conducting an examination. However, we believe there are opportunities for the IRS to use available wage data to identify bona fide territory residents who may be [REDACTED]. For example, if individuals primarily earned income in a U.S. territory, it is a strong indicator that they likely spent more than one-half of the year in the territory and qualify as a bona fide resident of the territory. Our analysis of 71,382 Tax Year 2018 [REDACTED] returns that had at least one Form W-2 from a U.S. territory identified 13,924 returns that were filed by taxpayers who received all or the majority of their wages from a company located in a U.S. territory. These individuals received more than \$50.6 million in potentially erroneous refundable tax credits. Figure 7 shows the U.S. territories that these tax returns received wages from and which refundable credits these returns received.

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<sup>24</sup> See Appendix IV for the filing requirements for each U.S. territory based on an individual's alien classification and bona fide resident status.

**Figure 7: Summary of U.S. Territories and Refundable Credits Received**

U.S. TERRITORY	RETURNS	AOTC	ACTC	EITC	TOTALS
Puerto Rico	10,526	\$1,929,455	\$13,407,670	\$19,354,323	\$34,691,448
USVI	2,141	\$200,968	\$2,977,162	\$6,296,141	\$9,474,271
American Samoa	797	\$16,484	\$1,433,063	\$3,141,185	\$4,590,732
Guam	409	\$35,324	\$509,094	\$1,106,726	\$1,651,144
CNMI	51	\$7,000	\$52,958	\$133,299	\$193,257
<b>TOTALS</b>	<b>13,924</b>	<b>\$2,189,231</b>	<b>\$18,379,947</b>	<b>\$30,031,674</b>	<b>\$50,600,852</b>

Source: TIGTA's analysis of the IRTF and the Information Returns Master File (IRMF).<sup>25</sup>

On January 5, 2021, we alerted the IRS of our concerns and recommended that the IRS develop processes to identify and address these potentially erroneous returns before refunds are paid. IRS management stated that the IRS does not have the authority to adjust tax credit claims during processing that result from [REDACTED]. However, IRS management informed us that the IRS has a post-processing compliance initiative that is intended to address this noncompliance. IRS management stated that it closed 2,877 cases in Fiscal Years 2016 through 2018 as part of this compliance initiative, with a change rate of 92 percent. IRS management stated that they will review the cases TIGTA identified and explore the possibility of refining the compliance initiative criteria. However, IRS management noted that they are concerned that changes to the criteria could affect the initiative's change rate by increasing the percentage of cases resulting in no changes. In addition, IRS management informed us that many of the returns we identified would not meet its criteria for the compliance initiative, as the returns fell below the IRS's dollar tolerance for selecting returns for review.

We plan to conduct a separate review to evaluate the IRS's efforts to identify international taxpayers who [REDACTED], either intentionally or unintentionally.<sup>26</sup>

The Commissioner, Wage and Investment Division, should:

**Recommendation 12:** Review the 36,373 returns TIGTA identified that potentially received erroneous AOTC and take actions to recover any erroneous AOTC received.

**Management's Response:** The IRS agreed with this recommendation, but disagreed with the related outcome measure (see Appendix II for more detailed information on the reported outcome measure). IRS management plans to review the 36,373 returns

<sup>25</sup> An IRS database that contains third-party information return documents for taxpayers.

<sup>26</sup> TIGTA, Audit No. 202140004, *Processes to Ensure That Aliens File the Correct Tax Form Based on Their Residency Status*.

identified by TIGTA and take appropriate actions on a sample of these returns based on available resources.

**Recommendation 13:** Coordinate with the Department of Education to obtain and perfect eligible educational institution EIN data and then develop at-filing processes to use these data to systemically identify and exclude tax returns claiming the AOTC from potential review, when the EIN reported on the Form 8863 is confirmed as an eligible education institution.

**Management's Response:** The IRS disagreed with this recommendation. In response to a previous TIGTA recommendation, the IRS coordinated with the Department of Education and tested its Postsecondary Education Participants System (PEPS) database. IRS management stated that the analysis demonstrated that the PEPS does not contain the EINs of all educational institutions that are reported on Form 1098-T and may not be a reliable source for the IRS to use in determining if a school is an eligible institution. In addition, IRS management stated that current IRS deficiency procedures cover any recommended stand-alone treatment to identify ineligible educational institutions claimed for the AOTC and is sufficient to identify inventory for additional review. Further, the IRS does not have the statutory authority to address the use of ineligible institutions when claiming education credits during return processing. IRS management indicated that without this authority, it would not be a good use of limited IRS resources to revisit discussions with the Department of Education about the use of its PEPS database.

**Office of Audit Comment:** As stated in our report, the due date for filing Forms 1098-T with the IRS is after many individual tax returns are filed, and there are exceptions to the filing requirement. As such, relying on the Form 1098-T alone to identify eligible institutions may also not be complete. In addition, we recommended that the IRS use PEPS data to *exclude* returns from further review when the institution EIN is confirmed by PEPS data. Claims in which the institution EIN does not match PEPS data would continue to be evaluated using the IRS's current procedures.

**Recommendation 14:** Review the 13,924 returns TIGTA identified that potentially received erroneous refundable credits and take actions to recover any erroneous refundable credits received.

**Management's Response:** The IRS agreed with this recommendation and plans to review the 13,924 returns identified by TIGTA. IRS management plans to take appropriate actions on a sample of these returns based on available resources.

**Recommendation 15:** Develop processes to systemically identify and address potentially erroneous tax returns filed by international taxpayers filing the incorrect tax forms to receive refundable credits, including returns filed by nonresidents claiming the AOTC, for which they are not eligible to receive.

**Management's Response:** The IRS agreed with this recommendation, but partially disagreed the related outcome measure (see Appendix II for more detailed information on the reported outcome measure). IRS management plans to study the feasibility of sampling this work and take appropriate actions based on the result of the study and available resources.

## **Appendix I**

### **Detailed Objective, Scope, and Methodology**

Our overall objective was to evaluate IRS processes to identify and prevent potentially fraudulent individual international tax returns. To accomplish our objective, we:

- Reviewed the IRS's policies and procedures for processing individual international tax returns and identifying potentially fraudulent returns, including review of the Internal Revenue Manual, code and edit rules, error resolution codes, and business rules.
- Identified the number of Tax Year 2018 international returns filed, including those filed on Form 1040NR, Form 1040-PR, and Form 1040-SS.
- Evaluated Forms 1040NR filed in Tax Year 2018 and compared them to IRMF data to determine if there were [REDACTED] on international returns not being identified by the IRS.
- Determined whether the IRS had effective processes in place to identify international returns that had refunds issued based upon potentially fraudulent [REDACTED] claims.
- Determined whether the IRS had effective processes in place to identify international returns claiming potentially fraudulent ACTC claims.
- Determined whether the IRS had effective processes in place to identify potentially fraudulent international returns filed by prisoners.
- Determined whether the IRS had effective policies and procedures to verify amounts of income excluded on international returns [REDACTED].
- Determined whether the IRS had effective processes in place to identify international taxpayers filing [REDACTED] to receive refundable credits for which they may not be entitled.

### **Performance of This Review**

This review was performed with information obtained from the IRS's Wage and Investment Division's Return Integrity and Compliance Service and Submission Processing offices located in Atlanta, Georgia; Kansas City, Missouri; and Austin, Texas, during the period January 2020 through February 2021. 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); Deann L. Baiza, Director; Jeffrey D. Cullum, Audit Manager; Linda M. Valentine, Lead Auditor; Jordan D. Bunte, Auditor; and Tracy L. Winfield, Auditor.

## **Validity and Reliability of Data From Computer-Based Systems**

We performed tests to assess the reliability of data from the IRS's IRTF, the IRMF, the Individual Master File (IMF),<sup>1</sup> the National Account Profile,<sup>2</sup> and the Modernized Tax Return Database<sup>3</sup> that were available on TIGTA's Data Center Warehouse.<sup>4</sup> We evaluated the data by performing electronic testing of required data elements and reviewing existing information about the data. In addition, we selected data from each extract and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System.<sup>5</sup> 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: the IRS's error codes and fraud filters to identify potentially fraudulent international tax returns. We evaluated these controls by the reviewing the Internal Revenue Manual, meeting with IRS management and subject matter experts, and reviewing relevant documentation provided by the IRS.

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<sup>1</sup> The IRS database that maintains transactions or records of individual tax accounts.

<sup>2</sup> IRS database that is a compilation of selected entity data from various IRS Master Files that also includes data from the Social Security Administration.

<sup>3</sup> The official repository of all electronic returns processed through the Modernized e-File system.

<sup>4</sup> A TIGTA repository of IRS data.

<sup>5</sup> IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

## Appendix II

### Outcome Measures

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

#### **Type and Value of Outcome Measure:**

- Revenue Protection – Potential; \$17,786,343 in refunds claimed on 6,731 tax returns without a [REDACTED] the IRS [REDACTED] on international returns (see Recommendations 1 and 2).

#### **Methodology Used to Measure the Reported Benefit:**

From the IRTF, we identified 873,009 Tax Year 2018 international tax returns (Forms 1040NR, 1040NR-EZ, 1040-PR, and 1040-SS) filed during Processing Year 2019, as of December 12, 2019. We matched these tax returns to the IRMF to obtain [REDACTED] for the primary taxpayer and spouse for Tax Year 2018. If a [REDACTED] was present, we excluded these returns from our analysis and did not ensure that the [REDACTED] fully supported the [REDACTED] reported by the taxpayer on their return. If a [REDACTED] was not present, we considered the tax return as an exception, as the IRS had [REDACTED] reported by the taxpayer on their return. We then limited our population to tax returns that [REDACTED], which effectively excluded Forms 1040-PR and 1040-SS, as these returns report [REDACTED]. We identified 31,993 Forms 1040NR/NR-EZ for which [REDACTED]. We limited our results to taxpayers who claimed a refund when they filed their tax return. Our analysis identified 6,731 tax returns [REDACTED] that claimed refunds totaling \$17,786,343.

#### **Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$2,366,596 paid in the ACTC on 1,368 tax returns because the IRS does not have processes in place to verify [REDACTED] on Forms 1040-PR or 1040-SS (see Recommendations 3 and 4).

#### **Methodology Used to Measure the Reported Benefit:**

From the IRTF for Processing Year 2019, we identified all Forms 1040-PR or 1040-SS that claimed the ACTC for Tax Year 2018. We matched these returns to the IMF, Tax Module Table, for Tax Year 2018, to identify the tax returns that posted, with a Transaction Code (TC)<sup>1</sup> 150. Using the IRMF, we obtained the [REDACTED] for the primary taxpayer and spouse for Tax Year 2018. We identified the taxpayers with one [REDACTED] and those with [REDACTED] present. For the taxpayers with more than [REDACTED], we determined if [REDACTED]. We kept the [REDACTED] in [REDACTED].

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<sup>1</sup> A three-digit code used to identify actions being taken on a taxpayer's account.

our population for the taxpayers with [REDACTED]. If we could not reasonably determine [REDACTED] to keep for the taxpayers, we allowed the taxpayer credit for the [REDACTED] with the largest [REDACTED] amounts. We computed the total [REDACTED] and then summed these amounts per return.

We matched these returns to the IMF Other Transaction Table for Tax Year 2018 to obtain the tax returns with a TC 766 or 767 with a Credit Reference Number<sup>2</sup> 336 for the returns that received the ACTC, including reversals. We calculated the difference between the total [REDACTED] to the total [REDACTED] Forms 1040-PR/SS [REDACTED] and identified those with a difference greater than \$100. We found 1,368 tax returns received \$2,366,596 in potentially erroneous ACTC, as the [REDACTED] reported on the tax return were not supported.

### **Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$6,464 in the ACTC paid on five tax returns because of IRS employee errors in verifying these returns during processing (see page 10).

### **Methodology Used to Measure the Reported Benefit:**

From the IRTF, we identified 873,009 Tax Year 2018 international tax returns (Forms 1040NR, 1040-PR, and 1040-SS) filed during Processing Year 2019, as of December 12, 2019. We matched these returns to the IMF Tax Module Table and identified 40,456 that posted. We limited our population to the 906 that filed a Form 1040NR. We matched the 906 returns to the IMF to obtain the population that had the ACTC, TC 766, and Credit Reference Number 336 posted to the tax account. We identified 753 Forms 1040NR that had the ACTC credit posted to the tax account. From this population, we identified one taxpayer had an Internal Revenue Service Number<sup>3</sup> and four taxpayers had a TIN that was issued after the due date of the return. These five taxpayers received \$6,464 in the ACTC.

### **Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$61,855 in the ACTC paid on 48 tax returns because the IRS does [REDACTED] to identify international returns claiming the ACTC by taxpayers who [REDACTED] that qualifies (see Recommendations 6 and 8).

### **Methodology Used to Measure the Reported Benefit:**

From the IRTF, we identified 873,009 Tax Year 2018 international tax returns (Forms 1040NR, 1040-PR, and 1040-SS) filed during Processing Year 2019, as of December 12, 2019. We matched these returns to the IMF Tax Module Table and identified 40,456 that posted to the Master File. We limited our population to the 906 returns that filed a Form 1040NR. We matched the 906 returns to the IMF to obtain the population that had the ACTC, TC 766, and Credit Reference Number 336 posted to the tax account. From this population, we identified

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<sup>2</sup> A three-digit code that refers to a specific credit on each tax return.

<sup>3</sup> A number assigned by the IRS that is used in place of a required TIN during processing.

48 taxpayers whose [REDACTED] the tax return [REDACTED]. These 48 taxpayers received \$61,855 in the ACTC.

### **Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$102,582 in the ACTC paid on [REDACTED] tax returns because the IRS does not have processes in place to ensure that tax examiners take appropriate actions when verifying the number of qualifying children (see Recommendations 7 and 8).

### **Methodology Used to Measure the Reported Benefit:**

From the IRTF, we identified 873,009 Tax Year 2018 international tax returns (Forms 1040NR, 1040-PR, and 1040-SS) filed during Processing Year 2019, as of December 12, 2019. We limited our population to 39,824 Forms 1040-PR or 1040-SS returns that claimed the ACTC. We matched these returns to the IMF Tax Module Table and identified 39,532 that posted. We identified 409 returns that [REDACTED] qualifying children. Qualifying children must have a valid Social Security Number that was issued before the due date of the return, including extensions. We matched these returns to the IMF Other Tax Module Transaction Table to identify tax accounts that had a TC 766 Action Code 336 on the tax account. We identified [REDACTED] tax returns that received \$101,133 in the ACTC.

In addition, from the population of 873,009, we identified 906 Forms 1040NR that posted to the IMF and claimed the ACTC. We matched these returns to the IMF Other Tax Module Transaction Table and identified 753 tax returns that had a TC 766 and Credit Reference Number 336, indicating they received the ACTC. From this population, we identified [REDACTED].

- [REDACTED].
- [REDACTED] in the ACTC received..

**Management's Response:** IRS management disagreed with the outcome measure, stating that in their review of [REDACTED] of the [REDACTED] returns, management found on [REDACTED] returns that the qualifying dependent was not visible in the file that TIGTA used for assuming an error in processing. Those [REDACTED] returns account for \$40,984 in properly allowed ACTC.

**Office of Audit Comment:** Management's review indicated that data were not available to TIGTA because tax examiners did not take appropriate actions when verifying the number of qualifying children. While management states that [REDACTED] of the [REDACTED] returns they reviewed properly received \$40,984 in the ACTC, management did not provide TIGTA with any documentation to support this. In addition, the IRS subsequently reviewed the remaining [REDACTED] returns and agreed with the data TIGTA used but indicated it could not confirm whether the taxpayers were not eligible for the ACTC without reviewing the paper returns.

### **Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$33,151,406 paid in refundable AOTC on 36,373 tax returns because the IRS does not have filters in place to identify

nonresidents [REDACTED] claim the AOTC that they are not entitled to receive (see Recommendations 12 and 13).

### **Methodology Used to Measure the Reported Benefit:**

From the IRTF for Processing Year 2019, we identified [REDACTED] filed for Tax Year 2018 claiming refundable AOTC. From the IMF Other Transaction Table for Tax Year 2018, we obtained tax returns with a TC 766 and/or TC 767 with a Credit Reference Number 260, for those who received refundable AOTC, including reversals. We matched these returns to the National Account Profile to obtain citizenship codes. We filtered for those with a citizenship code of 'B,' which indicates a legal alien eligible to work in the United States. We matched these returns to the IRMF to obtain [REDACTED] for the taxpayers. We filtered for returns without [REDACTED], as this would indicate they were a nonresident. We limited our analysis to tax returns with [REDACTED] and a [REDACTED] because we could not determine if [REDACTED] if there was no [REDACTED]. We found 36,373 potential nonresidents who filed a Form 1040 and received \$33,151,406 in refundable AOTC to which they were not entitled.

**Management's Response:** IRS management disagreed with the outcome measure, stating that numerous factors contribute to whether an individual is considered a nonresident or resident alien for tax purposes. Additionally, there are several reasons that a resident alien [REDACTED]. Legal resident aliens from countries that entered into [REDACTED], with the United States for the purposes of avoiding double taxation of income with respect to [REDACTED], could avoid paying [REDACTED] by providing a [REDACTED] from their home country to their employer in the United States. A return with no [REDACTED] is not indicative of nonresident alien status, this criterion alone is not determinative to confirm that these taxpayers should be classified as nonresident aliens. Based on a review of a sample of these returns, some taxpayers appear to be students and all the taxpayers had a Social Security Number with a Citizenship Code associated with a Legal Alien – Authorized to Work. TIGTA's methodology uses the taxpayer's National Account Profile citizenship code and whether their [REDACTED].

**Office of Audit Comment:** As footnoted in our report, we acknowledge that there are exceptions in which a valid foreign person would be considered a resident and not subject to the tax. However, we are unable to identify individuals with these exceptions with the available tax return data, nor has the IRS provided us with such data.

### **Type and Value of Outcome Measure:**

- Cost Savings (Funds Put to Better Use) – Potential; \$50,600,852 in refundable credits paid on 13,924 tax returns because the IRS [REDACTED] identify international taxpayers [REDACTED] (see Recommendations 14 and 15).

### **Methodology Used to Measure the Reported Benefit:**

From the IRS's Compliance Data Warehouse, [REDACTED] data, we used the tax jurisdiction code and identified 1,381,143 Tax Year 2018 [REDACTED] located in a U.S. territory.

**Improvements Are Needed to Identify Potentially Fraudulent  
Individual International Tax Returns During Processing**

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There are five U.S. territories: American Samoa, the CNMI, Guam, Puerto Rico, and the USVI. We matched the employee TINs [REDACTED] the Processing Year 2019 IRTF and identified 71,943 tax returns filed by these employee TINs. We matched these returns to the IMF Tax Module Table and identified 71,382 posted tax returns. We removed 38,731 tax returns that did not claim any refundable credits. The remaining 32,651 tax returns claimed refundable credits. We matched these returns to the Tax Year 2018 IMF Other Tax Module Transaction and identified 32,303 tax returns that had at least one refundable transaction code: TC 766 Credit Reference Number 260, TC766 Credit Reference Number 336, or TC768, or any reversal transaction codes: TC 767 Credit Reference Number 260, TC767 Credit Reference Number 336, or TC 765. We limited our analysis to returns that had only territory [REDACTED] and no U.S. [REDACTED] and returns in which the [REDACTED] from territory [REDACTED]. We limited our results to returns with credits exceeding \$250. The net amount of refundable credits received for these 13,924 returns was \$50,600,852.

Improvements Are Needed to Identify Potentially Fraudulent  
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## Appendix III

### Tax Year 2018 Form W-2 and Form 499R-2/W-2PR

#### Tax Year 2018 Form W-2

22222		Void <input type="checkbox"/>		a Employee's social security number		For Official Use Only OMB No. 1545-0008	
b Employer identification number (EIN)				1 Wages, tips, other compensation		2 Federal income tax withheld	
c Employer's name, address, and ZIP code				3 Social security wages		4 Social security tax withheld	
				5 Medicare wages and tips		6 Medicare tax withheld	
				7 Social security tips		8 Allocated tips	
d Control number				9 Verification code		10 Dependent care benefits	
e Employee's first name and initial		Last name		Suff.		11 Nonqualified plans	
f Employee's address and ZIP code		15 State		Employer's state ID number		12a See instructions for box 12	
						12b	
						12c	
						12d	
16 State wages, tips, etc.		17 State income tax		18 Local wages, tips, etc.		19 Local income tax	
20 Locality name							

**Form W-2 Wage and Tax Statement 2018**

Department of the Treasury—Internal Revenue Service  
For Privacy Act and Paperwork Reduction Act Notice, see the separate Instructions.  
Cat. No. 10134D

**Do Not Cut, Fold, or Staple Forms on This Page**

Source: The IRS.

#### Tax Year 2018 Form 499R-2/W-2PR

GOBIERNO DE PUERTO RICO - GOVERNMENT OF PUERTO RICO DEPARTAMENTO DE HACIENDA - DEPARTMENT OF THE TREASURY		INFORMACIÓN PARA EL DEPARTAMENTO DE HACIENDA - DEPARTMENT OF THE TREASURY		INFORMACIÓN PARA EL SEGURO SOCIAL - SOCIAL SECURITY INFORMATION	
COMPROBANTE DE RETENCIÓN - WITHHOLDING STATEMENT		7. Sueldos - Wages		17. Total Sueldos Seguro Social - Social Security Wages	
1. Nombre - First Name		8. Comisiones - Commissions		18. Seguro Social Retenido - Social Security Tax Withheld	
Apellido(s) - Last Name(s)		9. Concesiones - Allowances		19. Total Sueldos y Pro. Medicare - Medicare Wages and Tips	
Dirección Postal del Empleado - Employee's Mailing Address		10. Propinas - Tips		20. Contrib. Medicare Retenido - Medicare Tax Withheld	
Fecha de Nacimiento: Día Mes Año Date of Birth: Day Month Year		11. Total = 7 + 8 + 9 + 10		21. Propinas Seguro Social - Social Security Tips	
2. Nombre y Dirección Postal del Patrono - Employer's Name and Mailing Address		12. Gastos Reemb. y Beneficios Marginales - Reimb. Expenses and Fringe Benefits		22. Seguro Social no Retenido en Propinas - Uncollected Social Security Tax on Tips	
Número de Teléfono del Patrono - Employer's Telephone Number		13. Cont. Retenida - Tax Withheld		23. Contrib. Medicare no Retenida en Propinas - Uncollected Medicare Tax on Tips	
Fecha Cese de Operaciones: Día Mes Año Cease of Operations Date: Day Month Year		14. Fondo de Retiro Gubernamental - Governmental Retirement Fund			
Número Confirmación de Radicación Electrónica - Electronic Filing Confirmation Number		15. Aportaciones a Planes Calificados - Contributions to Qualified Plans			
Número Control - Control Number		Salarios Exentos (Ver instrucciones) - Exempt Salaries (See instructions)			
Fecha de radicación: 31 de enero - Filing date: January 31		16. Código/Code			
		16A. Código/Code			
		16B. Código/Code			
		16C. Aportaciones al Programa Ahorra y Duplica tu Dinero - Contributions to the Save and Double your Money Program			

**PARA PROPOSITOS INFORMATIVOS SOLAMENTE. NO UTILICE PARA RENDIR.**

**Patrono: - Employer:**  
Indique si la remuneración incluye pagos al empleado por:  
Indicate if the remuneration includes payments to the employee for:  
A- ☐ Servicios prestados por un médico calificado bajo la Ley 14-2017  
Services rendered by a qualified physician under Act 14-2017  
B- ☐ Servicios domésticos - Domestic services  
C- ☐ Otros / Others:  
Año: 2018  
Year:

Source: Hacienda.Gobierno.pr.

## Appendix IV

### **U.S. Territories Filing Requirements**

<b>U.S. Territory</b>	<b>Bona Fide Territory Resident and U.S. Citizen or Resident Alien</b>	<b>Bona Fide Territory Resident and not a U.S. Citizen or Resident Alien</b>	<b>Not Bona Fide Territory Resident and U.S. Citizen or Resident Alien</b>	<b>Not Bona Fide Territory Resident and not a U.S. Citizen or Resident Alien</b>
<b>American Samoa</b>	An American Samoa tax return reporting your gross income from worldwide sources. If you report non-American Samoa source income on your American Samoa tax return, you can claim a credit against your American Samoa tax liability for income taxes paid on that income to the United States, a foreign country, or another possession.	An American Samoa tax return reporting worldwide income.	An American Samoa tax return reporting only your income from sources within American Samoa. Wages for services performed in American Samoa, whether for a private employer, the U.S. Government, or otherwise, is income from sources within American Samoa.	An American Samoa tax return reporting only your income from sources within American Samoa. In this situation, wages for services performed in American Samoa, whether for a private employer, the U.S. Government, or otherwise, is income from sources within American Samoa.
	A U.S. tax return reporting income from worldwide sources, but excluding income from sources within American Samoa by attaching Form 4563, <i>Exclusion of Income for Bona Fide Residents of American Samoa</i> . However, amounts received for services performed as an employee of the United States or any of its agencies cannot be excluded.	A U.S. tax return (Form 1040 or 1040-SR, <i>U.S. Tax Return for Seniors</i> ) reporting income from worldwide sources, but excluding American Samoa source income, by attaching Form 4563, other than amounts for services performed as an employee of the United States or any of its agencies.	A U.S. tax return reporting your income from worldwide sources. You can take a credit against your U.S. tax liability if you paid income taxes to American Samoa (or other possession or foreign country) and reported income from those sources on your U.S. tax return.	A U.S. tax return (Form 1040NR), reporting U.S. source income according to the rules for a nonresident.
<b>Commonwealth of Northern Mariana Islands (CNMI)</b>	File your income tax return with the CNMI. Include income from worldwide sources on your CNMI return. In determining your total tax payments, include all income tax withheld by either the CNMI or the United States, any credit for an overpayment of income tax to either the CNMI or the United States, and any payments of estimated tax to either the CNMI or the United States. Pay any balance of tax due with your tax return.		You are not liable for filing an income tax return with, or for paying tax to, the CNMI for the tax year.	A CNMI tax return reporting only your income from sources within the CNMI. In this situation, wages for services performed in the CNMI, whether for a private employer, the U.S. Government, or otherwise, is income from sources within the CNMI.

**Improvements Are Needed to Identify Potentially Fraudulent  
Individual International Tax Returns During Processing**

	Generally, if you properly file your return with, and fully pay your income tax to, the CNMI, then you are not liable for filing an income tax return with, or for paying tax to, the United States for the tax year.		File your income tax return with the United States. Include income from worldwide sources on your U.S. return. In determining your total tax payments, include all income tax withheld and paid to either the United States or the CNMI, any credit for an overpayment of income tax to either the United States or the CNMI, and any payments of estimated tax to either the United States or the CNMI.	A U.S. tax return (Form 1040NR) reporting U.S. source income according to the rules for a nonresident.
<b>Guam</b>	File your return with Guam. Include income from worldwide sources on your Guam return. In determining your total tax payments, include all income tax withheld and paid to either Guam or the United States, any credit for an overpayment of income tax to either Guam or the United States, and any payments of estimated tax to either Guam or the United States. Pay any balance of tax due with your tax return.		You are not liable for filing an income tax return with, or for paying tax to, Guam for the tax year.	A Guam tax return reporting only your income from sources within Guam. In this situation, wages for services performed in Guam, whether for a private employer, the U.S. Government, or otherwise, is income from sources within Guam.
	Generally, if you properly file your return with, and fully pay your income tax to, Guam, then you are not liable for filing an income tax return with, or for paying tax to, the United States.		File your income tax return with the United States. Include income from worldwide sources on your U.S. return. In determining your total tax payments, include all income tax withheld by either the United States or Guam, any credit for an overpayment of income tax to either the United States or Guam, and any payments of estimated tax to either the United States or Guam.	A U.S. tax return (Form 1040NR) reporting U.S. source income according to the rules for a nonresident.
<b>Puerto Rico</b>	A Puerto Rico tax return reporting income from worldwide sources. If you report U.S. source income on your Puerto Rico tax return, you can claim a credit against your Puerto Rico tax, up to the amount	A Puerto Rico tax return reporting income from worldwide sources. If you report U.S. source income on your Puerto Rico tax return, you can claim a credit against your Puerto Rico tax, up to the amount allowable, for income taxes paid to the United States.	A Puerto Rico tax return reporting only your income from Puerto Rico sources. Wages for services performed in Puerto Rico, whether for a private employer, the U.S. Government, or otherwise, is income	A Puerto Rico tax return reporting only your income from Puerto Rico sources. Wages for services performed in Puerto Rico, whether for a private employer, the U.S. Government, or otherwise, is income from Puerto Rico sources.

**Improvements Are Needed to Identify Potentially Fraudulent  
Individual International Tax Returns During Processing**

	amount allowable, for income taxes paid to the United States.		from Puerto Rico sources.	
	A U.S. tax return reporting income from worldwide sources, but excluding Puerto Rico source income.	A U.S. tax return (Form 1040NR) reporting income from worldwide sources, but excluding Puerto Rico source income (other than amounts for services performed as an employee of the United States or any of its agencies). For tax purposes other than reporting income, however, you will be treated as a nonresident individual. For example, you are not allowed the standard deduction, you cannot file a joint return, and you are not allowed a deduction for a dependent unless that person is a citizen or national of the United States. There are also limitations on what deductions and credits are allowed.	A U.S. tax return reporting income from worldwide sources. Generally, you can claim a foreign tax credit for income taxes paid to Puerto Rico on the Puerto Rico income that is subject to Puerto Rico taxes and not exempt from U.S. taxes.	A U.S. tax return (Form 1040NR) according to the rules for a nonresident.
<b>U.S. Virgin Islands (USVI)</b>	File your tax return with the USVI. Include your worldwide income on your USVI return. In determining your total tax payments, take into account all income tax withheld and paid to either the USVI or the United States, any credit for an overpayment of income tax to either the USVI or the United States, and any payments of estimated tax to either the USVI or the United States. Pay any balance of tax due with your tax return.		File your original Form 1040 or 1040-SR with the United States and an identical copy of that return with the USVI if you have:  Income from sources in the USVI, or  Income effectively connected with the conduct of a trade or business in the USVI.	A USVI tax return reporting only your income from sources within the USVI. In this situation, wages for services performed in the USVI, whether for a private employer, the U.S. Government, or otherwise, is income from sources within the USVI.
	You generally do not have to file with the United States for any tax year in which you are a bona fide resident of the USVI during the tax year, provided you report and pay tax on your income from all sources to the USVI and identify the source(s) of the income on the return. However, if you have self-employment income, you may be required to file Form 1040-SS with the United States.			A U.S. tax return (Form 1040NR) reporting U.S. source income according to the rules for a nonresident.

Source: TIGTA's review of Publication 570, *Tax Guide for Individuals With Income From U.S. Possessions*.

## Appendix V

### Alien Classifications

For U.S. income tax purposes, an individual who is not a U.S. citizen is referred to as an alien. Aliens can be classified as either a resident, nonresident, or dual-status alien. Figure 1 shows how the classification of an alien determines how the alien is taxed, their eligibility for refundable credits, and what tax return the alien may be required to file.

**Figure 1: Alien Classifications**

Alien Classification and Description	Tax Return	Taxed On	Eligibility for Refundable Credits
<b>Resident –</b> Individuals are generally resident aliens if they are a lawful permanent resident of the United States at any time during the tax year, known as the “green card” test, <u>or</u> meets the substantial presence test.	Form 1040.	Worldwide income.	Resident aliens are allowed the EITC, the AOTC, and the ACTC, if they meet the same requirements for the credits as U.S. citizens.
<b>Nonresident –</b> Individuals who do not meet the definition of a resident alien are nonresidents. Married individuals may choose to treat a nonresident spouse as a resident alien for the entire tax year. Nonresidents who are bona fide residents of American Samoa or Puerto Rico for the entire tax year are generally taxed as resident aliens for income purposes and should file a Form 1040 but are allowed to exclude from gross income all income from sources in American Samoa and Puerto Rico. Individuals are not allowed the standard deduction, to file a joint return, or claim a dependent unless that person is a U.S. citizen or U.S. national.	Form 1040NR, Form 1040NR-EZ, Form 1040-PR, or Form 1040-SS.	Income from sources within the United States and on certain income connected with a trade or business in the United States.	Nonresidents are generally not allowed the EITC or the AOTC.  Only nonresidents who are U.S. nationals, <sup>1</sup> or residents of Canada, Mexico, South Korea, or India, in limited circumstances, qualify for the ACTC.
<b>Dual Status –</b> A dual-status alien usually occurs in the tax year the individual arrives or departs from the United States. Married individuals may choose to be treated as a resident alien if: they were a nonresident at the beginning of the tax year; they were a resident alien at the end of the tax year; they are married to a U.S. citizen or resident alien at the end of the tax year; and the individual’s spouse joins in making the choice. This choice is made by attaching a statement to the joint return in the year the choice is made.	Dependent on the residency status at the end of the tax year.	Dependent on residency status at the end of the tax year.	Dependent on residency status at the end of the tax year.

Source: TIGTA’s review of Publication 519, U.S. Tax Guide for Aliens.

<sup>1</sup> A U.S. national is an individual who, although not a U.S. citizen, owes his or her allegiance to the United States. U.S. nationals include American Samoans and Northern Mariana Islanders who chose to become U.S. nationals instead of U.S. citizens.

## **Green Card Test and Substantial Presence Test**

Individuals are considered to be a resident alien if they are approved, according to the immigration laws, to reside permanently in the United States as an immigrant. An individual generally has this status if the U.S. Citizenship and Immigration Services issued them an alien registration card, Form I-551, also known as a "green card."

Individuals who have not been issued a green card but who are physically present in the United States for a specified number of days are also generally considered to be a resident alien. Individuals who are physically present in the United States at least 31 days during the tax year and 183 days during the past three tax years<sup>2</sup> are generally considered to be a resident alien. However, there are some exceptions to this rule.

### **Exception for individuals with medical conditions or specific visas issued by the U.S. Citizenship and Immigration Services**

Individuals who are unable to leave the United States because of a medical condition or medical problem can exclude the days they had to remain in the United States when determining substantial presence. In addition, individuals in the following categories are considered an exempt individual for the purpose of determining substantial presence:

- An individual temporarily present in the United States as a foreign government-related individual under an "A" or "G" visa, other than individuals holding "A-3" or "G-5" class visas.
- A teacher or trainee temporarily present in the United States under a "J" or "Q" visa, who substantially complies with the requirements of the visa.
- A student temporarily present in the United States under an "F," "J," "M," or "Q" visa, who substantially complies with the requirements of the visa.
- A professional athlete temporarily in the United States to compete in a charitable sports event.

Exempt individuals and individuals with a medical condition are instructed to not count the days they were to exclude when determining the number of days they were physically present in the United States. Individuals who exclude days they were present in the United States for purposes of the substantial presence test must include Form 8843, *Statement for Exempt Individuals and Individuals With a Medical Condition*, with their income tax return. Individuals who do not have to file an income tax return are instructed to send Form 8843 to the address indicated in the Form 8843 instructions by the due date for filing an income tax return. Individuals who do not timely file Form 8843 cannot exclude the days they were present in the United States as a professional athlete or because of a medical reason.<sup>3</sup>

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<sup>2</sup> For Tax Year 2018, this would include Tax Years 2016, 2017, and 2018. The 183 days includes all days the individual was present in Tax Year 2018, one third of the days they were present in Tax Year 2017, and one sixth of the days they were present in Tax Year 2016.

<sup>3</sup> This does not apply if you can show, by clear and convincing evidence, that you took reasonable actions to become aware of the filing requirements and significant steps to comply with those requirements.

### **Closer connection exception**

Individuals who met the substantial presence test can still be treated as a nonresident if they are considered to have a closer connection to a foreign country. Individuals will be considered to have a closer connection to a foreign country than to the United States if they have maintained more significant contacts with the foreign country than with the United States. All foreign individuals who met the substantial presence test can still be treated as a nonresident if they meet all of the following:

- Were present in the United States less than 183 days during the year.
- Have a closer connection during the year to one foreign country in which they have a tax home than to the United States (unless they have a closer connection to two foreign countries).<sup>4</sup>
- Maintained a tax home in that foreign country during the entire year.
- Have not taken steps toward, and did not have an application pending for, lawful permanent resident status (green card).

There are additional exception criteria for foreign students who are unable to meet the prior criteria. A foreign student can be treated as a nonresident if the student meets all of the following:

- Does not intend to reside permanently in the United States.
- Has substantially complied with the immigration laws and requirements relating to their student non-immigrant status.
- Has not taken any steps to change their non-immigrant status in the United States toward becoming a permanent resident of the United States.
- Has a closer connection to a foreign country than to the United States.

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<sup>4</sup> Individuals who claim a closer connection to two foreign countries must meet additional requirements to be treated as a nonresident alien.

## Appendix VI

### Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

COMMISSIONER  
WAGE AND INVESTMENT DIVISION

July 29, 2021

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report - Improvements Are Needed to Identify  
Potentially Fraudulent Individual International Tax Returns During  
Processing (Audit # 202040001)

Thank you for the opportunity to review and comment on the subject draft audit report. We appreciate you calling attention to this potential area of identity theft in individual international tax returns. We recognize there is more work yet to be done in this area and are committed to protecting U.S. taxpayers by proactively detecting potentially fraudulent refund claims and preventing their payment. We will continue to evaluate and refine our processes, protect revenue and collaborate with partners and stakeholders proactively to improve prevention and detection of identity theft (IDT) tax refund fraud.

As referenced in the [REDACTED], the Return Review Program (RRP) previously identified and selected [REDACTED]

[REDACTED], as part of the [REDACTED] when the [REDACTED] reported on the return was [REDACTED] documents. However, based on an analysis performed in [REDACTED], we determined these selections were not productive due to [REDACTED] for these types of returns, [REDACTED], not being loaded into the Information Returns Masterfile (IRMF) with the correct fields. The [REDACTED] is formatted differently from the [REDACTED], which is the record layout used in the IRMF for this type of document.

The RRP identified and [REDACTED], but these filings were [REDACTED]. As a result, [REDACTED] process used with the RRP non-IDT filter selections [REDACTED] was selecting individual international returns [REDACTED]. Therefore, these [REDACTED] during the return integrity screening processes. We did make selections using the Dependent Database for Forms 1040-SS and 1040-PR with questionable Additional Child Tax Credit (ACTC), and they were treated through our non-compliance treatment stream in the Automated Questionable Credit (AQC) program.

We will re-examine the population of Forms 1040-PR and 1040-SS, filed by bona fide residents of Puerto Rico claiming the CTC, and Forms 1040-NR filed by non-residents claiming refunds based on [REDACTED]. Based on the results of the study, we will update Non-IDT filters/rules as appropriate for potential Non-IDT selections in 2022, within our resource capacity. Forms 1040-NR claiming [REDACTED], are verified by separate processes outside return integrity screening.

We will also study the feasibility of sampling individual international tax returns, where the ACTC is claimed and the taxpayer [REDACTED], or [REDACTED] to receive refundable credits. This will include returns filed by nonresident aliens claiming the American Opportunity Tax Credit. We will take appropriate actions based on the results of the study within our resource capacity. Additionally, we will also review the individual international returns the Treasury Inspector General for Tax Administration (TIGTA) identified as potentially receiving erroneous refunds and/or refundable credits to which they were not entitled, and will take appropriate actions within our resource capacity and assessment statute of limitations constraints.

Based on the TIGTA's findings where the IRS potentially issued refunds of [REDACTED] on fraudulent international returns, we [REDACTED] in 2021. This will ensure individual international returns with questionable [REDACTED] are selected for further review, protecting revenue. Additionally, for our Large Business and International Campaign 895, U.S. Territories Erroneous Refundable Credits, we improved our risk assessment model to include [REDACTED], and refined one Campaign 895 filter to eliminate the requirement of the [REDACTED]. We began testing these enhancements with tax year 2019 data and will include them in the examination process for tax year 2020 returns. These selections would be post refund. Any modifications to existing filter models in a campaign must be tested and approved by the campaign team and Risk Identification Control Board.

We appreciate the identification of opportunities for improving identity theft detection and prevention processes for individual international tax returns. We continue to improve our detection of individual identity theft and our abilities to prevent issuance of fraudulent refunds.

We generally agree with the reported outcome measures, with the following exceptions:

- -Recommendation 5 – On January 4, 2021, we reviewed the 133 international returns identified by the TIGTA where the IRS potentially issued fraudulent refunds [REDACTED]. None of the payments were lost, so there are no refunds to recover.
- -Recommendation 8 – We accept the \$6,464 in erroneous payment of the ACTC in five returns and [REDACTED]. We do not agree with the assumption of improper payments totaling \$101,133 in ACTC. In our review of [REDACTED] of the [REDACTED] returns, we found on [REDACTED] returns that the qualifying dependent was not visible in the file the TIGTA used for assuming an error in processing. Those [REDACTED] returns account for \$40,984 in properly allowed ACTC.
- -Recommendation 9 – We disagree with this outcome measure. Review of the [REDACTED]
- -Recommendation 12 – We disagree with this outcome measure. Numerous factors contribute to whether an individual is considered a nonresident or resident alien for tax purposes. Additionally, there are several reasons that a resident alien [REDACTED]. Legal resident aliens from countries entered into [REDACTED], with the U.S. for the purpose of avoiding double taxation of income with respect to [REDACTED], could avoid paying U.S. [REDACTED] by providing a [REDACTED] from their home country to their employer in the U.S. A return with no [REDACTED] is not indicative of nonresident alien status, this criterion alone is not determinative to confirm that these taxpayers should be classified as nonresident aliens. Based on a review of a sample of these returns, some taxpayers appear to be students and all the taxpayers had an SSN with a Citizenship Code associated with a Legal Alien – Authorized to Work. The income reporting documents were also reviewed and showed that the taxpayers were paid by domestic companies with addresses in the U.S. For the returns reviewed, there were no indications that [REDACTED] had been filed. The complexity of this issue is beyond the scope of the AQC program. An examination of the taxpayer is required to

determine whether an international filer has [REDACTED].

- -Recommendation 15 – We partially disagree with this outcome measure. We agree with the measure when related to refundable credits excluding American Opportunity Tax Credit (AOTC) only claims. The proposed methodology is not reliable because, for example, both resident alien and nonresident alien students working part time for their college are [REDACTED]. For AOTC only claims, numerous factors contribute to whether an individual is considered a nonresident or resident alien for tax purposes. The TIGTA's methodology uses the taxpayer's National Account Profile citizenship code and whether [REDACTED]. A student working part time at their college institution [REDACTED]. An alien (not a U.S. citizen) is considered a nonresident alien unless they meet one of two tests, the Green Card test or Substantial Presence Test. Also, even if they do not meet either of these tests, they may be able to choose to be treated as a U.S. resident for part of the year. Without conducting an examination or studying this population, the IRS is unable to determine the alien classification. Lastly, this outcome measure does not consider resource constraints, workplan considerations, or fairness in case selection.

Attached is a detailed response with our planned corrective actions to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Michael Beebe, Director, Return Integrity and Compliance Services, Wage and Investment Division, at 470-639-3250.

Attachment

Attachment

### **Recommendations**

The Commissioner, Wage and Investment Division, should:

#### **RECOMMENDATION 1**

Develop pre-refund processes to identify and address Form 1040NR refund claims where the [REDACTED] reported on the return is not supported [REDACTED].

#### **CORRECTIVE ACTION**

We will study this population during 2021 and, based on the results of the study, will make appropriate changes to the Return Review Program (RRP) Non-Identity Theft (Non-IDT) filters/rules as appropriate for potential Non-IDT selections in 2022.

#### **IMPLEMENTATION DATE**

February 15, 2022

#### **RESPONSIBLE OFFICIAL**

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

#### **RECOMMENDATION 2**

Review the 6,731 Forms 1040NR refunds we identified in which [REDACTED] reported on the tax return was not supported [REDACTED] and take actions to recover erroneous refunds.

#### **CORRECTIVE ACTION**

We will review the 6,731 Forms 1040NR, *U.S. Nonresident Alien Income Tax Return*, identified by the Treasury Inspector General for Tax Administration (TIGTA), where the [REDACTED] reported on the return [REDACTED], and will take appropriate actions on a sample of these returns based on resource availability.

#### **IMPLEMENTATION DATE**

October 15, 2022

#### **RESPONSIBLE OFFICIAL**

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

#### **RECOMMENDATION 3**

Develop at-filing processes to identify and address ACTC claims on Forms 1040-PR and 1040-SS where the [REDACTED] reported on the tax return [REDACTED] Form [REDACTED].

**CORRECTIVE ACTION**

We will study this population during 2021 and update the RRP Non-IDT filters/rules, as appropriate, for potential selections in 2022.

**IMPLEMENTATION DATE**

February 15, 2022

**RESPONSIBLE OFFICIAL**

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

**RECOMMENDATION 4**

Review the 1,368 Forms 1040-PR and 1040-SS we identified where the [REDACTED] reported on the tax return for the purpose of claiming the ACTC is not [REDACTED] and take actions to recover erroneous credits.

**CORRECTIVE ACTION**

We will review the 1,368 [REDACTED]

[REDACTED], identified by the TIGTA, where the [REDACTED] reported on the tax return for the purpose of claiming the Additional Child Tax Credit (ACTC) was [REDACTED], and will take appropriate actions on a sample of these returns pursuant to resource availability.

**IMPLEMENTATION DATE**

October 15, 2022

**RESPONSIBLE OFFICIAL**

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

**Recommendation**

**RECOMMENDATION 5**

The Commissioner, Wage and Investment Division, should review the 133 international returns we identified for which the IRS issued a potentially fraudulent refund of [REDACTED] and take actions to recover the fraudulent refunds and ensure that the fraudulently refunded [REDACTED] are properly credited to the true taxpayer's tax liability.

**CORRECTIVE ACTION**

On January 4, 2021, we reviewed the 133 international returns identified by the TIGTA where the IRS potentially issued fraudulent refunds of [REDACTED]. None of the payments were lost, so there are no refunds to recover.

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

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

**Recommendations**

The Commissioner, Wage and Investment Division, should:

**RECOMMENDATION 6**

Develop pre-refund processes to systemically identify and address potentially erroneous ACTC claimed on international refund tax returns [REDACTED] on the return [REDACTED].

**CORRECTIVE ACTION**

We will study the feasibility of sampling this work and will take appropriate actions based on the result of the study and available resources.

**IMPLEMENTATION DATE**

February 15, 2022

**RESPONSIBLE OFFICIAL**

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

**RECOMMENDATION 7**

Ensure that Error Resolution tax examiners are aware of the proper procedures for resolving ACTC claims on international tax returns where the taxpayer's TIN or spouse's TIN was not issued prior to the due date of the tax return and where the taxpayer does not meet the qualifying child requirements.

**CORRECTIVE ACTION**

We will provide training for returning and new tax examiners in the Error Resolution function to emphasize this aspect of processing the ACTC.

**IMPLEMENTATION DATE**

April 15, 2022

**RESPONSIBLE OFFICIAL**

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

**RECOMMENDATION 8**

Review the 99 questionable returns that received ACTC that TIGTA identified and take actions to recover any erroneous ACTC received.

**CORRECTIVE ACTION**

We acknowledge erroneous processing in seven returns and will take steps to have the improperly allowed ACTC corrected. We are reviewing the returns in question to determine whether the ACTC was properly allowed and take steps, when possible within the constraints of the assessment statute of limitations date, to have any improperly allowed ACTC corrected.

**IMPLEMENTATION DATE**

October 15, 2022

**RESPONSIBLE OFFICIAL**

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

**Recommendation**

**RECOMMENDATION 9**

The Commissioner, Wage and Investment Division, should review the [REDACTED]

**CORRECTIVE ACTION**

**IMPLEMENTATION DATE**

Implemented

**RESPONSIBLE OFFICIAL**

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

## **Recommendations**

The Commissioner, Wage and Investment Division, should:

### **RECOMMENDATION 10**

Require international taxpayers reporting [REDACTED] to provide supporting documentation with their tax return, [REDACTED] that the taxpayer [REDACTED]

### **CORRECTIVE ACTION**

The documents are not necessary for satisfying the Beard test for a valid return, and the IRS does not have the statutory authority to require those documents for inspection outside of deficiency procedures (an audit of the return), which is not a viable treatment for use during return processing. Further, [REDACTED] does not conclusively establish [REDACTED]

### **IMPLEMENTATION DATE**

N/A

### **RESPONSIBLE OFFICIAL**

N/A

### **RECOMMENDATION 11**

Develop processes to suspend the processing of [REDACTED] where the supporting documentation is not provided and correspond with the taxpayer for the missing documentation.

### **CORRECTIVE ACTION**

The documents are not necessary for satisfying the Beard test for a valid return, and the IRS does not have the statutory authority to require those documents for inspection outside of deficiency procedures (an audit of the return), which is not a viable treatment for use during return processing. Correspondence would not be an effective action as it would delay return processing and increase costs.

### **IMPLEMENTATION DATE**

N/A

### **RESPONSIBLE OFFICIAL**

N/A

### **RECOMMENDATION 12**

Review the 36,373 returns TIGTA identified that potentially received erroneous AOTC and take actions to recover any erroneous AOTC received.

## **Improvements Are Needed to Identify Potentially Fraudulent Individual International Tax Returns During Processing**

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### **CORRECTIVE ACTION**

We will review the 36,373 returns identified by the TIGTA and take appropriate actions on a sample of these returns based on available resources.

### **IMPLEMENTATION DATE**

October 15, 2022

### **RESPONSIBLE OFFICIAL**

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

### **RECOMMENDATION 13**

Coordinate with the Department of Education to obtain and perfect eligible educational institution EIN data and then develop at-filing processes to use these data to systemically identify and exclude tax returns claiming AOTC from potential review, when the EIN reported on the Form 8863 is confirmed as an eligible education institution.

### **CORRECTIVE ACTION**

In response to a previous TIGTA recommendation, the IRS coordinated with the Department of Education and tested their Postsecondary Education Participants System (PEPS) database. We completed a thorough review of 405,000 students with an Employer Identification Number (EIN) shown on Form 8863, *Education Credits*, and a matching EIN on Form 1098-T, *Tuition Statement*. The result was that 60 percent had no match in the PEPS database. The analysis demonstrated that PEPS does not contain the EINs of all educational institutions that are reported on Form 1098-T and may not be a reliable source for the IRS to use in determining if a school is an eligible institution. Our current deficiency procedures include matching a student claimed for the American Opportunity Tax Credit (AOTC) to a corresponding Form 1098-T. The Form 1098-T contains the education institution's EIN, the student's Taxpayer Identification Number, the amount of tuition paid, scholarships, and student status (at least half-time/graduate). Since EINs are reported on Forms 1098-T, this procedure covers any recommended stand-alone treatment to identify ineligible educational institutions claimed for the AOTC and is sufficient for identifying inventory for additional review. Further, the IRS does not have the statutory authority to address the use of ineligible institutions when claiming education credits during return processing. Without this authority, it would not be a good use of our limited resources to revisit discussions with the Department of Education about the use of their PEPS database.

### **IMPLEMENTATION DATE**

N/A

### **RESPONSIBLE OFFICIAL**

N/A

**RECOMMENDATION 14**

Review the 13,924 returns TIGTA identified that potentially received erroneous refundable credits and take actions to recover any erroneous refundable credits received.

**CORRECTIVE ACTION**

We will review the 13,924 returns identified by the TIGTA as potentially receiving erroneous refundable credits and take appropriate actions on a sample of these returns based on available resources.

**IMPLEMENTATION DATE**

October 15, 2022

**RESPONSIBLE OFFICIAL**

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

**Recommendation 15**

Develop processes to systemically identify and address potentially erroneous tax returns filed by international taxpayers filing the incorrect tax forms to receive refundable credits, including returns filed by nonresidents claiming the AOTC, for which they are not eligible to receive.

**CORRECTIVE ACTION**

We will study the feasibility of sampling this work and take appropriate actions based on the result of the study and available resources.

**IMPLEMENTATION DATE**

February 15, 2022

**RESPONSIBLE OFFICIAL**

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

## Appendix VII

### Abbreviations

ACTC	Additional Child Tax Credit
AOTC	American Opportunity Tax Credit
CNMI	Commonwealth of the Northern Mariana Islands
EIN	Employer Identification Number
EITC	Earned Income Tax Credit
HCTC	Health Coverage Tax Credit
IMF	Individual Master File
IRMF	Information Returns Master File
IRS	Internal Revenue Service
IRTF	Individual Return Transaction File
PEPS	Postsecondary Education Participants System
RRP	Return Review Program
TC	Transaction Code
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number
USVI	United States Virgin Islands



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