

# TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



## **Assessment of Processes to Verify Tentative Carryback Refund Eligibility**

June 2, 2021

Report Number: 2021-46-035

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.

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**Why TIGTA Did This Audit**

This audit was initiated to assess the IRS's efforts to ensure the validity and accuracy of tentative refund applications reporting a carryback loss.

This is a part of a series of audits to evaluate the IRS's implementation of specific business provisions incorporated into the pandemic relief legislation. TIGTA is conducting separate reviews of the IRS's processing of employer tax credits, including the repayment of deferred payroll taxes.

**Impact on Taxpayers**

Provisions 2303 and 2304 of the *Coronavirus Aid, Relief, and Economic Security (CARES) Act*, signed into law on March 27, 2020, made several modifications that temporarily repeal certain restrictions imposed by the *Tax Cuts and Jobs Act* affecting net operating losses. Additionally, the CARES Act requires a taxpayer with a net operating loss arising in a taxable year beginning in 2018, 2019, or 2020 to carry that loss back to each of the five preceding years unless the taxpayer elects to waive or reduce the carryback.

**What TIGTA Found**

TIGTA's review of 25,403 tentative refund applications, received by the IRS from March 27, 2020, through September 30, 2020, identified a total of 1,061 late-filed applications belonging to 1,026 taxpayers. Further analysis of these applications found that the IRS may have erroneously processed 150 of these applications resulting in the issuance of more than \$186 million in tentative refunds. This occurred because the customer service representatives were not always properly adhering to filing deadline procedures and the Accounts Management function was not providing adequate oversight to ensure that the customer service representatives did not process these late-filed applications.

Further, TIGTA's review of the 25,403 tentative refund applications identified 132 applications whereby the taxpayers' tax accounts had either a confirmed or unresolved identity theft indicator. These applications had approximately \$186 million in tentative refunds paid without appropriate reviews to ensure the validity of the application, as required. This occurred because IRS employees did not always follow their internal guidance to refer cases to a specialized identity theft liaison.

Finally, TIGTA identified 1,404 taxpayers (296 individuals and 1,108 businesses) that had [REDACTED] on their accounts prior to submitting a tentative refund. [REDACTED]

[REDACTED] Business taxpayers making employment tax payments should have been separately sent notification that there was a change to their address on their IRS tax account. The Consolidated Appropriations Act of 2014, enacted January 17, 2014, requires the IRS to issue a notice as confirmation of [REDACTED] relating to an employer making employment tax payments.

**What TIGTA Recommended**

TIGTA made five recommendations to the Commissioner, Wage and Investment Division, that included determining if the late-filed applications were processed in error and taking appropriate corrective action, and ensuring that tentative refund applications associated with taxpayers whose tax accounts have an identity theft indicator or [REDACTED] are sent for required review.

IRS management agreed with all five recommendations.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

## U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

June 2, 2021

### MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

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

**SUBJECT:** Final Audit Report – Assessment of Processes to Verify Tentative  
Carryback Refund Eligibility (Audit # 202040636)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) efforts to ensure the validity and accuracy of tentative refund applications reporting a carryback loss. This review is part of our ongoing expedited Coronavirus Aid, Relief, and Economic Security Act<sup>1</sup> audits and addresses the major management and performance challenge of *Implementing Tax Law Changes*.

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

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

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<sup>1</sup> Pub. L. No. 116-136, 134 Stat. 281 (2020).

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## Background

Sections 2303 and 2304 of the *Coronavirus Aid, Relief, and Economic Security (CARES) Act*,<sup>1</sup> signed into law on March 27, 2020, made several modifications that temporarily repeal certain restrictions imposed by the *Tax Cuts and Jobs Act*<sup>2</sup> affecting net operating losses (NOL).<sup>3</sup> In particular, the CARES Act temporarily repeals:

- The 80 percent taxable income limitation of NOLs arising in tax years beginning after December 31, 2017.<sup>4</sup>
- The disallowance of NOL carrybacks for taxpayers whose NOLs are not farming losses and taxpayers that are not non-life insurance companies.
- The requirement for non-corporate taxpayers not to deduct excess business losses and to carry them as NOLs (excess business losses are reportable on Form 461, *Limitation on Business Losses*).
- The two-year carryback requirements for business losses incurred in the trade or business of farming<sup>5</sup> and losses incurred by non-life insurance companies.

These temporary repeals provide taxpayers with the opportunity to carryback losses. Additionally, the CARES Act requires a taxpayer with a NOL arising in a taxable year beginning in 2018, 2019, or 2020 to carry that loss back to each of the five preceding years unless the taxpayer elects to waive or reduce the carryback.

## Process to carryback losses

Taxpayers with a NOL have a choice of two methods to carryback their loss, each of which has separate rules.<sup>6</sup> A taxpayer may:

- **File an application for tentative refund.** The Form 1045, *Application for Tentative Refund*, (individuals) or Form 1139, *Corporation Application for Tentative Refund*, generally must be filed within one year after the end of the tax year with the NOL. A taxpayer can file one form to carryback their loss to all applicable preceding gain years. The primary advantage of filing a tentative refund application using Form 1045 or

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<sup>1</sup> Pub. L. No. 116-136, 134 Stat. 281 (2020).

<sup>2</sup> Pub. L. No. 115-97, 131 Stat. 2054 (2017).

<sup>3</sup> A NOL is created when certain deductions exceed income from all sources. These deductions must relate to a trade or business, work as an employee, or casualty or theft losses. A NOL deduction can be applied or “carried” to offset taxable income in either preceding or later taxable years. A NOL may allow a refund for taxes already paid when carried back to an earlier year.

<sup>4</sup> Under the Tax Cuts and Jobs Act, for NOLs arising in taxable years beginning after December 31, 2017, the NOL deduction generally is limited to 80 percent of taxable income determined without regard to the NOL deduction (the “80-percent taxable income limitation”). Excess losses generally may be carried forward indefinitely, but not back, and carryovers of such NOLs to other taxable years are adjusted to take account of the 80-percent taxable income limitation.

<sup>5</sup> Under the *COVID-Related Tax Relief Act of 2020*, Pub. L. No. 116-260, the modifications to carryback provisions of the CARES Act do not apply to qualifying taxpayers with a farming loss that make an applicable election.

<sup>6</sup> Individuals, Estates, Trusts, Corporations, and Charitable and Exempt Organizations are eligible to carryback their losses.

Form 1139 is that the return that generated the NOL does not have to be completely processed by the Internal Revenue Service (IRS) before the refund can be approved, thus making the refund “tentative.” This means the refund can be issued prior to verification of the posted tax return. Additionally, a tentative refund is processed prior to referral for examination.

- **File an amended return.** Unlike the tentative refund, an amended return has to be filed for each carryback year and must generally be filed within the statutory period of three years from the due date of the loss year return, including extensions. A carryback filed on an amended return is subject to examination criteria on the loss/gain years before allowing the claim.

While the IRS is required to process tentative refund applications within 90 days, interest must be paid on refunds if they are not issued within 45 days. The same rules apply for processing amended returns and computing and paying interest for refunds not processed within 45 days; however, the IRS is not statutorily required to process amended return carryback claims within 90 days.

When a taxpayer files an application for tentative refund, customer service representatives (CSR) working in the Wage and Investment Division’s Accounts Management function begin by conducting research to verify all necessary information (e.g., authorized signature, documentation) is completed and attached. If necessary information is missing, the CSR will attempt to contact the taxpayer by telephone to obtain the necessary missing information. Once all of the necessary information is confirmed or provided in response to a CSR contacting the taxpayer, the CSR will then review the taxpayer’s tax account on the IRS’s data systems to ensure that it matches the information provided on the application, determine if there have been [REDACTED] and determine if there are any identity theft indicators on the taxpayer’s account. If the CSRs are unable to resolve any of these issues, or an application should otherwise be rejected, the CSRs will issue Letter 216C, *Tentative Carryback Application Adjustment Request*, to reject a tentative carryback application and if applicable request additional information. Figure 1 summarizes the differences between the methods for claiming a carryback.

**Figure 1: Differences Between Tentative Refund and Amended Return Refunds**

Form	When to File	Forms Required for Each Year	Interest Payment Rules	Type of Refund
<b>Form 1045 or 1139</b>	Generally, within one year following the end of the loss tax year (e.g., Dec. 31, 2021, for a 2020 Calendar Year taxpayer).	One form can be used to carryback to multiple other tax years.	No interest is paid by the IRS if the refund is processed within 45 days of receipt.	Refunds are considered “tentative” and the IRS can assess and collect tax immediately if the refund is found to be in error.
<b>Amended Returns</b>	Generally within three years after the due date of the loss year tax return.	A separate amended return must be filed for each year the loss is carried back.	No interest is paid by the IRS if the refund is processed within 45 days of receipt.	The claim is considered “correct” when the refund is issued and erroneous refund procedures would be needed to recover any tax.

Source: Internal Revenue Manual 21.5.9.

This is a part of a series of audits to evaluate the IRS's implementation of specific business provisions incorporated into the pandemic relief legislation. The Treasury Inspector General for Tax Administration is conducting separate reviews of the IRS's processing of employer tax credits.<sup>7</sup>

## Results of Review

This report presents the continued results of our assessment of the IRS's response to the COVID-19 pandemic. The information is provided as of the date in which our audit testing was completed. If we were able to get more updated information prior to the issuance of our report, we noted this and added the most up-to-date information.

Our review found that subsequent to enactment of the CARES Act, the IRS immediately took steps in an effort to readily provide assistance to taxpayers in obtaining refunds associated with CARES Act tentative refund applications. The IRS established temporary procedures to accept eligible carryback refunds through dedicated e-fax lines on April 17, 2020. Only carryback refunds on Forms 1045 and Forms 1139 could be submitted via this dedicated fax line. This process was put in place to enable the CSRs to review and process these applications while working remotely during the pandemic. In addition, the IRS also updated its carryback internal processing procedures and issued these updates to the CSRs in an effort to properly implement the new legislative changes. Finally, in order to meet taxpayer demand, the IRS increased the number of CSRs assigned to work these CARES Act-related tentative refund applications from 67 to 131 employees.

As of September 30, 2020, 21,832 taxpayers submitted 25,403 tentative refund applications.<sup>8</sup> During Fiscal Year 2020,<sup>9</sup> the IRS's average processing time for tentative refund applications was approximately 17 days, which is well below the 90-day processing requirement. The IRS approved tentative refunds for 11,031 of these taxpayers totaling nearly \$13.3 billion. The remaining 10,801 taxpayers had applications that were still in processing (5,692 taxpayers) or whose applications were closed without having a refund approved (5,109 taxpayers). Figure 2 summarizes the number of taxpayers that submitted a tentative refund application and those that had their refunds approved.

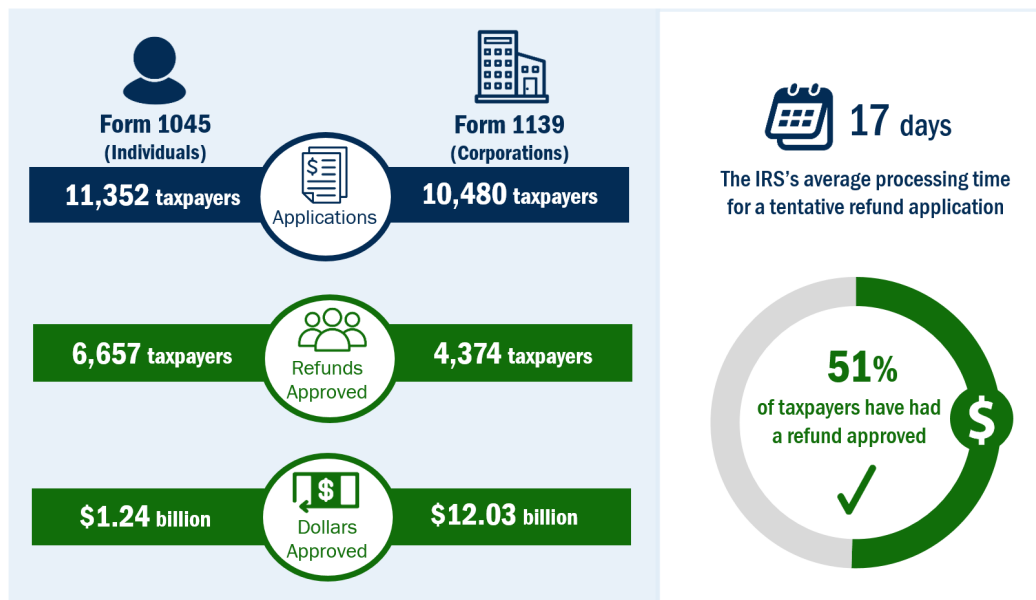
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<sup>7</sup> Audit No. 202040633, *Assessment of Actions Taken to Provide Relief to Businesses as a Result of the Coronavirus (COVID-19)*, and Audit No. 202140623, *Continued Review of COVID-19 Related Business Tax Relief Provisions*.

<sup>8</sup> Appendix I provides details pertaining to the scope of our review.

<sup>9</sup> A fiscal year is defined as a 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's Fiscal Year 2020 began on October 1, 2019, and ended on September 30, 2020.

**Figure 2: Breakdown of Submitted Tentative Refund Applications by Form Type**



Source: Treasury Inspector General for Tax Administration Analysis of Tentative Refund Applications received from March 27, 2020, through September 30, 2020, based on IRS Correspondence Imaging System (CIS)<sup>10</sup> data and Master File<sup>11</sup> information.

According to the IRS, as of February 12, 2021, it received 44,567 tentative refund applications for processing.

### **Some Tentative Refund Applications Were Erroneously Processed After the Filing Deadline**

Our review of 25,403 tentative refund applications received by the IRS as of September 30, 2020, identified that 1,061 Tax Year (TY) 2018 applications (4 percent) were submitted after the filing deadline of July 15, 2020. Further analysis of these applications found that the IRS may have erroneously processed 150 of these applications, resulting in the issuance of more than \$186 million in tentative refunds. This occurred because the CSRs were not always properly adhering to filing deadline procedures and Accounts Management was not providing adequate oversight to ensure that the CSRs did not process these late-filed applications. The IRS issued Notice 2020-23 providing payment and filing relief to taxpayers until July 15, 2020. This also extended the deadline for submitting tentative refund applications to carryback a NOL that arose in any taxable year that began during Calendar Year 2018 and that ended on or before June 30, 2019.

When we brought this to management's attention, management agreed that tentative refund applications received after their filing deadline should not be processed. They explained that the taxpayer has a legal right of claim when an amended return is filed to carryback a loss; however, the taxpayer does not have the same right when a tentative refund application is

<sup>10</sup> The CIS is a system used by Accounts Management that delivers an electronic workflow to the CSRs who can work cases in a paperless environment.

<sup>11</sup> The Master File is a record containing all information regarding the taxpayer's filing of returns and related documents.

submitted. In other words, when filing an amended return, the taxpayer is legally adjusting their tax filing and records. Moreover, the manner in which a taxpayer chooses to file for a NOL refund affects the statute of limitations on tax assessments that the IRS can impose on a taxpayer, which may allow for the IRS to examine returns that were otherwise closed.

**Figure 3: Example of Filing a Tentative Refund Application Versus an Amended Return**

<b>Filing a Tentative Refund</b>	In 2020, Taxpayer Z files Form 1139 to carryback an NOL from TY 2018 to TY 2013, claiming a refund of \$100,000. Taxpayer Z receives the refund claimed on Form 1139. Upon examination, the IRS identifies \$40,000 of adjustments for the TY 2013 return that is unrelated to the TY 2018 return. The general three-year assessment statute is closed for the carryback year. If the IRS allows the Form 1139 claim in full, under Internal Revenue Code Section 6501(k), it <u>can</u> assess the tax deficiency for the \$40,000 of adjustments unrelated to the NOL that were identified by the IRS on the TY 2013 return.
<b>Filing an Amended Return</b>	If Taxpayer Z had filed an amended return to carryback the TY 2018 NOL, the IRS would be barred from assessing the tax for TY 2013 because they were not related to the 2018 NOL carryback. If the IRS had not paid the refund prior to examining the claim, it could have instead offset the \$40,000 against the amount of the refund claim.

*Source: Hypothetical example was not drawn from any actual taxpayer case and was based on information presented in Tax Adviser article "NOL Carryback Claims Can Unlock Closed Statute of Limitation Years" (2010).*

In response to our discussions, management independently identified 315 late-filed tentative refund applications that were due by July 15, 2020. However, their review did not include 574 applications out of the 1,061<sup>12</sup> that we identified; therefore, the IRS still needs to take corrective action on these accounts to determine if the IRS should reverse the refund or reject the application. For the 315 tentative refund applications identified by the IRS, the IRS immediately took the following actions:

- Identified and reviewed closed late-filed applications. The IRS identified 258 closed late-filed tentative refund applications with approximately \$117 million tentative refunds approved. On October 19, 2020, Accounts Management instructed all processing sites to review each of these applications to determine if the tentative refund should be reversed. If the tentative refund was determined to be processed in error, the IRS instructed the CSRs to notify the taxpayer that an adjustment to their tentative refund was being made and instruct the taxpayer to file an amended return. Based on their review, as of November 12, 2020, the IRS incorrectly processed 12 of the 258 closed late-filed tentative refund applications. For the 12 taxpayers, we found that eight taxpayers were contacted and two of those taxpayers had their refunds reversed. The IRS indicated that the remaining 246 were correctly rejected or processed according to the case specifications (e.g., the taxpayer submitted multiple applications and one was timely submitted for processing).
- Identified open applications and proactively instructed employees. The IRS also identified 57 tentative refund applications still in process and instructed all processing sites on October 15, 2020, that these applications should be rejected from processing

<sup>12</sup> At the time of our review, we identified 446 out of 1,061 applications that were still in process that the IRS did not identify. We also identified 128 out of the 1,061 applications that were closed at the time of our review that the IRS did not identify.

and Letter 216C should be sent to the taxpayer. Accounts Management also proactively noted in its instructions that any newly assigned Calendar Year 2018 tentative carryback applications received after July 15, 2020, that were not previously provided, should be rejected.

The Commissioner, Wage and Investment Division, should:

**Recommendation 1:** Review the additional 574 late-filed tentative refund applications we identified and determine if the applications were processed in error. If so, take appropriate action to either reverse the erroneously approved refund or reject the application from processing.

**Management's Response:** The IRS agreed with this recommendation. IRS management plans to review the additional 574 tentative refund applications and will take appropriate action to reverse the erroneously approved refund or reject the application for those determined to be filed late.

**Recommendation 2:** Establish processes and procedures to identify late-filed tentative refund applications and ensure that these applications are rejected from processing.

**Management's Response:** The IRS agreed with this recommendation and advised that its internal guidelines contain procedures to identify late-filed CARES Act tentative applications for refund. However, IRS management plans to emphasize the importance of the timeliness procedures in recurring monthly communications and ensure that the applications are referred as required.

### Some Tentative Refund Applications Associated With Identity Theft Tax Accounts Were Not Sent for Required Fraud Review

Our review of 25,403 tentative refund applications received as of September 30, 2020, identified 132 applications with tentative refunds issued totaling more than \$186 million whereby the taxpayer's tax account had either a confirmed identity theft or pending/unresolved identity theft indicator. Reviews of these applications were not performed to ensure the validity of the application, as required. This occurred because the CSRs did not always follow their internal guidance to refer applications associated with tax accounts with identity theft indicators to an identity theft liaison. These 132 applications include:

- 17 business taxpayers with tentative refunds totaling approximately \$133.6 million. Internal guidelines state that if either the loss or gain year includes a tax period with a business identity theft indicator, the CSRs should refer the case to the IRS's Return Integrity and Compliance Services (RICS) function for review and a determination on how to proceed. We provided these cases to the IRS for review by the RICS function, which confirmed that 13 of the cases were not identity theft and four were still pending a response from the taxpayer. For the four cases that were still pending at the time of our review, the IRS issued tentative refunds in the amount of \$1,785,620.
- 32 individual taxpayer accounts with tentative refunds totaling approximately \$26.4 million. These accounts had unresolved identity theft markers (*i.e.*, the IRS was still reviewing the account to make a determination of identity theft) and were not referred

for review. Internal guidelines state that the CSRs review the taxpayer's account for identity theft indicators and refer the case to an Accounts Management identity theft liaison prior to processing. We provided these cases to the IRS for review. Management noted that they did not find any evidence of identity theft.

- 83 taxpayers with tentative refund applications totaling approximately \$26.2 million for which the taxpayer was a confirmed victim of identity theft. The IRS reviewed the 83 accounts and found there was no evidence of identity theft, despite the procedural error of not sending these cases to the identity theft liaison as required.

**Recommendation 3:** The Commissioner, Wage and Investment Division, should ensure that tentative refund applications associated with taxpayers whose tax accounts have an identity theft indicator are sent to an identity theft liaison for review as required.

**Management's Response:** The IRS agreed with this recommendation and advised that its internal guidelines contain procedures for forwarding tentative applications for refund, where identity theft indicators are present on the account, to the identity theft team for additional review. However, IRS management plans to place heightened emphasis on this requirement in recurring monthly communications to ensure that affected applications are referred as required.

### Some Tentative Refund Applications **\*\*\*\*\*2\*\*\*\*\*** **\*\*\*2\*\*\* Were Not Referred for Required Fraud Review**

Our review identified 1,404 (296 individuals<sup>13</sup> and 1,108 businesses) taxpayers that submitted tentative refund applications that had tax accounts showing there was [REDACTED] prior to the submission of the tentative refund application. Only one of these applications was sent to an identity theft liaison for the required review to ensure the validity of the claim. These taxpayers received approximately \$2.4 billion in tentative refunds.

The presence of [REDACTED] for a tentative refund, can be an indication of potential fraud or identity theft. Recognizing this risk, the IRS updated its internal guidelines instructing the CSRs to refer a tentative refund application to an identity theft liaison for review if there [REDACTED]. Once received, research must be performed to ensure the validity of the submission.

Although [REDACTED] business taxpayers making employment tax payments should have been separately sent notification of the fact that there was [REDACTED] on their IRS tax account. The *Consolidated Appropriations Act of 2014*,<sup>15</sup> enacted January 17, 2014, requires the IRS to issue a notice as [REDACTED] relating to an employer making employment tax payments. The IRS is required to send a notice to [REDACTED]. The notice

<sup>13</sup> The 296 individual taxpayers received a total of \$30.5 million in tentative refunds, as noted in Appendix II.

<sup>14</sup> The IRS defines a [REDACTED]

<sup>15</sup> Pub. L. No. 113-76, 128 Stat. 190 (2014).

instructs business taxpayers to contact the IRS if there should not be [REDACTED] on their account when they disagree with [REDACTED] and/or question the legitimacy of the source of the [REDACTED].

The Commissioner, Wage and Investment Division, should:

**Recommendation 4:** Review the 296 individual taxpayers we identified with [REDACTED] to ensure the validity of the tentative refund application.

**Management's Response:** The IRS agreed with this recommendation. IRS management plans to review the 296 individual taxpayers identified and will take appropriate actions to reject or reverse the adjustments taken on invalid tentative refund applications.

**Recommendation 5:** Ensure that tentative refund applications associated with taxpayers whose tax accounts showed that there was [REDACTED] are identified and sent to an identity theft liaison for review as required.

**Management's Response:** The IRS agreed with this recommendation and advised that its internal guidelines contain procedures for forwarding tentative applications for refund, where identity theft indicators are present on the account, to the identity theft team for additional review. However, IRS management plans to place heightened emphasis on this requirement in recurring monthly communications to ensure that affected applications are referred as required.

## Appendix I

### Detailed Objective, Scope, and Methodology

Our overall objective was to assess the IRS's efforts to ensure the validity and accuracy of tentative refund applications reporting a carryback loss. To accomplish our objective, we:

- Determined the controls in place governing the processing of carrybacks and associated refunds.
- Reviewed tentative refund applications received from the enactment of the CARES Act from March 27, 2020, through September 30, 2020. We identified that 25,403 applications were received during this time period and these applications were associated with 21,832 taxpayers. The variance between the number of applications and number of taxpayers in our scope of review is due to the fact that a taxpayer can submit multiple tentative refund applications. The number of tentative refund applications and associated taxpayers was pulled from the CIS on October 28, 2020. To calculate the amount of refunds approved, we used Individual and Business Master File data current through October 21, 2020. We associated the net Transaction Code (TC)<sup>1</sup> 295 amounts for taxpayers included only in the population of 21,832 taxpayers.<sup>2</sup> The association of TCs 295 as tentative refunds approved is based on combining all TCs 295 on taxpayers' accounts that were posted on or after March 27, 2020, into one amount for all gain years (*e.g.*, TCs 295 for a taxpayer in 2013, 2014, and 2015). The total is net of any TCs 294 on taxpayers' accounts.<sup>3</sup>
- Assessed whether the IRS accurately processed CARES Act-related tentative refund applications according to existing controls.
- Assessed whether the IRS ensured the validity of CARES Act-related tentative refund applications.

### Performance of This Review

This review was performed with information provided by the Wage and Investment Division's Accounts Management and RICS functions during the period May 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); Diana M. Tengesdal, Director; Nina A. Hill, Audit

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<sup>1</sup> A transaction code is a three-digit code used to identify transactions being processed and to maintain a history of actions posted to a taxpayer's account.

<sup>2</sup> TC 295 indicates that a tentative refund has been approved on a taxpayer's account.

<sup>3</sup> TC 294 is used to adjust a previously posted tentative refund allowance.

Manager; Taylor C. McDonald, Lead Auditor; Gwendolyn S. Gilboy, Senior Auditor; Aranxa J. Delgado, Auditor; and Sandy Ramos, Auditor.

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

We performed tests to assess the reliability of data from the Business and Individual Master Files and the CIS. We evaluated the data by (1) performing electronic testing of required data elements, (2) reviewing existing information about the data and the system that produced them, and (3) coordinating with agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for purposes of this report.

### **Internal Controls Methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the processes in place for reviewing and approving tentative refund applications. We evaluated these controls by reviewing IRS procedures, conducting virtual walkthroughs of processing tentative refund applications, conducting various meetings with the IRS, and evaluating applications received in the CIS.

## 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; \$186.5 million in erroneously approved tentative refunds to 150 taxpayers that filed their applications late (see Recommendations 1 and 2).

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

During the COVID-19 pandemic, the IRS issued Notice 2020-23 providing payment and filing relief to taxpayers until July 15, 2020. This also extended the deadline for submitting tentative refund applications to carryback a NOL that arose in any taxable year that began during Calendar Year 2018 and that ended on or before June 30, 2019. We reviewed 25,403 tentative refund applications submitted by taxpayers from March 27, 2020, through September 30, 2020, and identified all those that filed a TY 2018 tentative refund application, excluding applications claiming only a carryback of a minimum tax credit, after the July 15, 2020, extension. We identified a total of 1,061 late-filed TY 2018 tentative refund applications under this criterion belonging to 1,026 taxpayers.

We determined that the IRS may have incorrectly processed \$186,462,114 in tentative refunds for 150 taxpayers that late-filed a tentative refund application for TY 2018. For calculating the amount of tentative refunds, we identified any TCs 295 posted on the 1,026 taxpayers' accounts from March 27, 2020, through October 21, 2020. To conservatively calculate the refund dollars, we limited the refund population to taxpayers that did not also have a TY 2019 tentative application listed in the CIS.

**Management's Response:** The IRS disagreed with the outcome measure stating that the impact of the error identified was procedural. IRS management believes that had the 150 tentative refund applications been rejected, those taxpayers would still be entitled to claim the \$186 million in associated refunds by filing amended tax returns for the carryback years.

**Office of Audit Comment:** We agree that the taxpayers can file an amended return to claim the tentative refunds associated with the 150 claims that the IRS may have processed in error. However, as explained in our report, tentative refunds claims are evaluated differently by the IRS than an amended return claims. Amended return claims are subject to examination criteria when processing, and if selected, the taxpayer's return could result in additional assessments or adjustments to their account. As such, there is no absolute as to whether these taxpayers would in fact be entitled to the full amount of associated refunds that was erroneously processed.

### Type and Value of Outcome Measure:

- Cost Savings – Funds Put to Better Use - Potential; \$1.8 million in potentially fraudulent tentative refunds approved for four taxpayers with identity theft indicators on their accounts (see Recommendation 3).

### Methodology Used to Measure the Reported Benefit:

From a population of 25,403 tentative refund applications filed between March 27, 2020, and September 30, 2020, we identified 17 business taxpayers with tentative refunds totaling \$133.6 million for which the taxpayers had an unreversed identity theft indicator on one of the tax account years affected by the tentative carryback. According to the IRS's internal guidance, if either the loss or gain year includes a tax period with a business identity theft indicator, the CSRs should refer the case to the IRS's RICS function for review and a determination on how to proceed. These applications were not referred as required. We provided these cases to the IRS for review by the RICS function, which confirmed that 13 of the cases were not identity theft and four were still pending a response from the taxpayer. For the four cases that were still pending at the time of our review, the IRS issued tentative refunds in the amount of \$1,785,620.

**Management's Response:** The IRS disagreed with the outcome measure stating that two of the four taxpayers have responded confirming their identities. IRS management is still awaiting responses from the remaining two taxpayers, comprising of \$59,576 of the original \$1.8 million identified. Additionally, management has emphasized and communicated to employees their expectations that applications meeting potential fraud and identity theft criteria be appropriately routed for further review prior to being processed.

**Office of Audit Comment:** The outcome measure reflects the potential amount that the IRS may have erroneously paid prior to confirming the identities of these four taxpayers as required. We are pleased that as part of the IRS's corrective actions that steps have been taken subsequent to the completion of our testing to confirm these identities.

### Type and Value of Outcome Measure:

- Cost Savings – Funds Put to Better Use - Potential; \$30.5 million in potentially fraudulent tentative refunds approved for 296 individual taxpayers [REDACTED] (see Recommendations 4 and 5).

### Methodology Used to Measure the Reported Benefit:

In response to the passage of the CARES Act, the IRS updated its internal guidance, instructing the CSRs to refer a tentative refund application to an identity theft liaison if there has been a [REDACTED] on the taxpayer's account. From a population of 25,403 tentative refund applications filed between March 27, 2020, and September 30, 2020, we identified 296 individual taxpayers who filed a tentative refund application [REDACTED] prior to issuing a refund. These taxpayers received a total of \$30,510,142 in tentative refunds.

**Management's Response:** The IRS disagreed with the outcome measure stating that management's review of the accounts comprising the \$30.5 million in refunds is resulting in findings that identity theft had not occurred. Additionally, management has emphasized and communicated to employees their expectations that applications meeting potential fraud and identity theft criteria be appropriately routed for further review prior to being processed.

**Office of Audit Comment:** The outcome measure reflects the potential amount that the IRS may have erroneously paid prior to authenticating these filers as required. We are pleased that as part of the IRS's corrective actions that steps have been taken subsequent to the completion of our testing to authenticate these filers.

## Appendix III

### Management's Response to the Draft Report



COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

April 22, 2021

MEMORANDUM FOR MICHAEL E MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kenneth C. Corbin Digitally signed by David P. Alito  
Date: 2021.04.22  
12:09:22 -04'00'  
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Assessment of Processes to Verify  
Tentative Carryback Refund Eligibility (Audit # 202040636)

Thank you for the opportunity to review and comment on the subject draft audit report. On March 13, 2020, the United States declared the COVID-19 pandemic a national emergency. The IRS's efforts to help the nation weather the financial effects of COVID-19 began in March when Congress approved the Coronavirus Aid, Relief and Economic Security (CARES) Act<sup>1</sup> and other important tax-relief legislation. The IRS worked to make sure businesses knew about important tax relief available to them and provided guidance about business tax relief passed by Congress in response to the COVID-19 pandemic. The relief measures included provisions that allowed the carryback, over a five-year period, of Net Operating Losses sustained by businesses. We issued Notice 2020-26 and Revenue Procedures 2020-23 and 2020-24 to clarify this CARES Act provision and help businesses and partnerships take advantage of the relief it provided.

As a consequence of the COVID-19 pandemic, all IRS Submission Processing centers were closed for several months during 2020. To mitigate the impact of the closures, two separate e-Fax numbers were established for taxpayers to submit their CARES Act-related applications for tentative refunds on Forms 1045, *Application for Tentative Refund*, or 1139, *Corporate Application for Tentative Refund*. The e-Fax numbers were available for use on April 17, 2020 and allowed employees to access and process these applications while teleworking.

Taxpayers may carryback their losses by either filing an application for tentative refund or submitting either Form 1040-X, *Amended U.S. Individual Income Tax Return*, or Form 1120-X, *Amended U.S. Corporation Income Tax Return*. As a statutory requirement, the IRS must process tentative refund applications within 90 days. As

<sup>1</sup> Pub. L. No. 116-136

identified in the report, the average processing time for a tentative refund application was 17 days, and the Service continues to strive to meet this requirement.

Using e-Fax to receive Forms 1045 and 1139 from taxpayers yielded significant benefits by facilitating our ability to route them to teleworking Customer Service Representatives for expedited handling while the Submission Processing centers were closed; however, reviewing the applications and adjusting accounts remained a substantially manual process that was subject, at times, to human error. Up to 150 of the 25,403 applications received may have been erroneously processed after the July 15, 2020 deadline; however, it should be noted that had the tentative refund applications been rejected, those taxpayers would still be entitled to claim the \$186 million in associated refunds by filing amended tax returns for the carryback years. The impact is procedural, and we therefore disagree with the \$186 million claimed outcome measure for revenue protection.

We also are not in agreement with the outcome measures for cost savings of \$1.8 million and \$30.5 million associated with employee errors in not following identity theft procedures and potential identity theft associated with [REDACTED], respectively. We have received responses from two of the four taxpayers whose tentative applications for refund were approved while there were active identity theft indicators on their accounts. Both taxpayers confirmed their identities. We are waiting for responses on the remaining two, comprising \$59,576 of the original \$1.8 million identified. Our review of accounts comprising \$30.5 million in refunds associated with entities having [REDACTED] are also resulting in findings that identity theft had not occurred. We have emphasized and communicated to employees our expectations that applications meeting potential fraud and identity theft criteria be appropriately routed for further review prior to being processed.

Our responses to your specific recommendations are enclosed. If you have any questions, please contact me, or a member of your staff may contact Dietra Grant, Director, Customer Account Services, Wage and Investment Division, at 470-639-3504.

Attachment

Attachment

**Recommendations**

The Commissioner, Wage and Investment Division, should:

**RECOMMENDATION 1**

Review the additional 574 late-filed tentative refund applications we identified and determine if the applications were processed in error. If so, take appropriate action to either reverse the erroneously approved refund or reject the application from processing.

**CORRECTIVE ACTION**

We will review the additional 574 tentative refund applications and determine if they were late filed. If late filed, we will take appropriate action to reverse the erroneously approved refund or reject the application.

**IMPLEMENTATION DATE**

April 15, 2022

**RESPONSIBLE OFFICIAL**

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

**CORRECTIVE ACTION MONITORING PLAN**

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

**RECOMMENDATION 2**

Establish processes and procedures to identify late-filed tentative refund applications and ensure that these applications are rejected from processing.

**CORRECTIVE ACTION**

The Internal Revenue Manual (IRM) contains procedures to identify late-filed Coronavirus Aid, Relief and Economic Security (CARES) Act tentative applications for refund. In addition to the ongoing quality review efforts, we will focus additional efforts in recurring monthly communications to emphasize the importance of the timeliness procedures and to ensure these applications are referred as required.

**IMPLEMENTATION DATE**

April 15, 2022

**RESPONSIBLE OFFICIAL**

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

**CORRECTIVE ACTION MONITORING PLAN**

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

**RECOMMENDATION 3**

The Commissioner, Wage and Investment Division, should ensure that tentative refund applications associated with taxpayers whose tax accounts have an identity theft indicator are sent to an identity theft liaison for review as required.

**CORRECTIVE ACTION**

The IRM contains procedures for forwarding tentative applications for refund, where identity theft (IDT) indicators are present on the account, to the IDT team for additional review. We will place a heightened emphasis on this requirement in recurring monthly communications to ensure affected applications are referred as required.

**IMPLEMENTATION DATE**

April 15, 2022

**RESPONSIBLE OFFICIAL(S)**

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

**CORRECTIVE ACTION MONITORING PLAN**

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

**RECOMMENDATION 4**

The Commissioner, Wage and Investment Division, should:

Review the 296 individual taxpayers we identified [REDACTED]  
[REDACTED] to ensure the validity of the tentative refund application.

**CORRECTIVE ACTION**

We will review the 296 individual taxpayers identified and ensure validity of the tentative refund application. Tentative refund applications identified as invalid will be either rejected or, if previously processed, actions to reverse the adjustments will be taken.

**IMPLEMENTATION DATE**

September 15, 2021

**RESPONSIBLE OFFICIAL(S)**

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

**CORRECTIVE ACTION MONITORING PLAN**

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

**RECOMMENDATION 5**

Ensure that tentative refund applications associated with taxpayers whose tax accounts showed that there was a recent and significant address change are identified and sent to an identity theft liaison for review as required.

**CORRECTIVE ACTION**

The IRM contains procedures for forwarding tentative applications for refund where identity theft (IDT) indicators are present on the account, to the IDT team for additional review. We will place a heightened emphasis on this requirement in recurring monthly communications to ensure affected applications are referred as required.

**IMPLEMENTATION DATE**

April 15, 2022

**RESPONSIBLE OFFICIAL(S)**

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

**CORRECTIVE ACTION MONITORING PLAN**

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

## Appendix IV

### Abbreviations

CARES	Coronavirus Aid, Relief, and Economic Security
CIS	Correspondence Imaging System
CSR	Customer Service Representative
IRS	Internal Revenue Service
NOL	Net Operating Loss
RICS	Return Integrity and Compliance Services
TC	Transaction Code
TY	Tax Year



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Ben Franklin Station  
Washington, D.C. 20044-0589

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