TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Fiscal Year 2022 Improper Payment Reporting Requirements Were Largely Met; However, Improper Payment Estimates Are Less Precise

May 12, 2023

Report Number: 2023-40-032

TIGTACommunications@tigta.treas.gov | www.tigta.gov

HIGHLIGHTS: Fiscal Year 2022 Improper Payment Reporting Requirements Were Largely Met; However, Improper Payment Estimates Are Less Precise

Final Audit Report issued on May 12, 2023 **Report Number 2023-40-032**

Why TIGTA Did This Audit

This audit was initiated because TIGTA is required to annually assess and report on the IRS's compliance with the reporting requirements contained in the Payment Integrity Information Act of 2019. The objective of this review was to determine whether the IRS complied with the annual improper payment reporting requirements for Fiscal Year (FY) 2022.

Impact on Tax Administration

The Office of Management and Budget (OMB) defines an improper payment as any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient. The IRS currently has identified four programs that meet the OMB's definition of a high-priority program susceptible to improper payments. The OMB defines high-priority programs as programs with improper payments resulting in monetary losses that exceed $100 million annually.

The IRS estimated the following improper payment rates:

- American Opportunity Tax Credit (AOTC): 36 percent.
- Earned Income Tax Credit (EITC): 32 percent.
- Net Premium Tax Credit: 27 percent.
- Additional Child Tax Credit (ACTC): 16 percent.

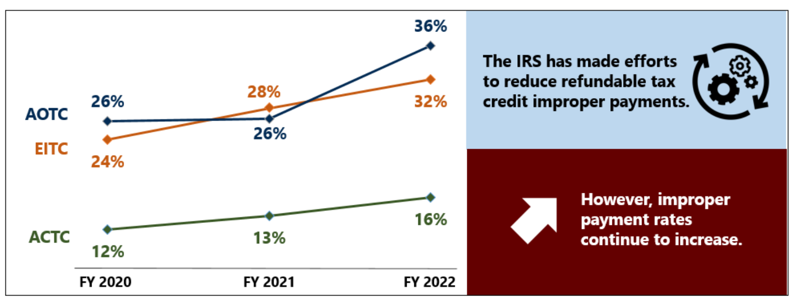
This is the first year the IRS has estimated an improper payment rate for the Net Premium Tax Credit.

What TIGTA Found

For FY 2022, the IRS was largely compliant with the reporting requirements contained in the Payment Integrity Information Act of 2019. However, the IRS still has not satisfied the Payment Integrity Act goal to reduce improper payment rates to less than 10 percent.

The IRS uses its National Research Program to measure reporting compliance for different types of taxes, including calculating estimated improper payment rates. For FY 2022, the IRS reduced the National Research Program sample size due to limited resources. The smaller sample size resulted in a wider confidence interval and a less precise estimated improper payment rate. Furthermore, to estimate the amount of improper payments, the IRS applied the estimated improper payment rate to returns on a tax year basis rather than a fiscal year basis as it has done in the past, which is more consistent with the filing and processing of tax returns.

Estimates of improper payment rates have risen since Fiscal Year 2020. However, refundable credit improper payments are not primarily the result of internal control weaknesses that the IRS can address. Eligibility rules differ for each credit and are often complex because they address complicated family relationships and residency arrangements to determine eligibility.



IRS management also advised TIGTA recently that there is a growing expectation for the IRS to notify individuals who are potentially eligible for but are not claiming refundable credits to encourage them to file a tax return and claim the credits. The same limitations that prevent the IRS from verifying refundable credit claims may also limit its ability to proactively identify eligible individuals who are not claiming these credits. This type of outreach could result in additional improper payments and increased taxpayer burden.

What TIGTA Recommended

TIGTA did not make any recommendations in this report.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20024

May 12, 2023

MEMORANDUM FOR: COMMISSIONER, INTERNAL REVENUE

Heather Hill

FROM: Heather M. Hill
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Fiscal Year 2022 Improper Payment Reporting Requirements Were Largely Met; However, Improper Payment Estimates Are Less Precise (Audit # 202340001)

This report presents the results of our review of the Internal Revenue Service's compliance with annual improper payment reporting requirements for Fiscal Year 2022. This review is part of our Fiscal Year 2023 Annual Audit Plan and addresses the major management and performance challenge of *Reducing Tax Fraud and Improper Payments*.

Management's complete response to the draft report is included as Appendix V. If you have any questions, please contact me or Diana Tengesdal, Acting Assistant Inspector General for Audit (Returns Processing and Account Services).

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Background

The Office of Management and Budget (OMB) defines an improper payment as any payment that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient.[1] Agency Inspectors General are responsible for evaluating agency information related to improper payments.

On March 2, 2020, the Payment Integrity Information Act of 2019 (PIIA) repealed several improper payment laws but set forth similar improper payment reporting requirements.[2] For example, agencies must conduct a program-specific risk assessment for each program or activity identified by the agency as exceeding $10 million in annual outlays at least once every three years, provide the methodology for identifying and measuring improper payments, and report on actions the agency intends to take to prevent future improper payments. In addition, the following remain in effect:

- Executive Order 13520, *Reducing Improper Payments*, signed by the President on November 20, 2009, increased Federal agencies' accountability for reducing improper payments while continuing to ensure that Federal programs serve and provide access to intended beneficiaries. It requires Federal agencies to provide agency Inspectors General with detailed information on efforts to identify and reduce the number of improper payments in Federal programs with the highest dollar value of improper payments.
- The *Consolidated Appropriations Act of 2021*, enacted on December 27, 2020.[3] This Act directed the Internal Revenue Service (IRS) to make the elimination of improper payments an utmost priority. In addition, the Act directed the IRS to implement, within 270 calendar days of enactment of the Act, all open and unimplemented recommendations from the Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office that address improper payments, or report on impediments to implementation of each open recommendation. We previously assessed the IRS's compliance with this requirement and found the IRS reported all unimplemented recommendations as required.[4]
- OMB revised Circular A-123 Appendix C, *Requirements for Payment Integrity Improvement*, issued March 5, 2021. Appendix C provides agencies and Inspectors General with guidance on improper payment determinations and reporting. According to the OMB, the goal of the revised Appendix C is to transform the payment integrity compliance framework and create a more comprehensive and meaningful set of requirements to allow agencies to spend less time complying with low-value activities and more time researching the underlying causes of improper payments, balancing payment integrity risks and controls, and building the capacity to help prevent future improper payments. Every year, each agency Inspector General must review its agency's

[1] See Appendix VI for a glossary of terms.

[2] Pub. L. No. 116-117, 134 Stat. 113. See Appendix III for a list of repealed improper payment laws.

[3] Pub. L. No. 116-260, 134 Stat. 1182.

[4] TIGTA, Report No. 2021-40-036, *Improper Payment Rates for Refundable Tax Credits Remain High* (May 2021) and TIGTA, Report No. 2022-40-037, *Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported* (May 2022).

improper payment reporting in the Agency Financial Report (AFR) and any accompanying material, such as that provided on www.paymentaccuracy.gov, to determine if the agency complies with improper payment legislation and OMB guidance.

Process to identify IRS programs for improper payment risk assessment

Agencies must conduct an improper payment risk assessment at least once every three years for each program with annual outlays over $10 million. The Department of the Treasury (Treasury Department) identifies the programs that the IRS must assess for the risk of improper payments each fiscal year. The IRS must complete a Treasury Certification for each program that was not identified as needing a risk assessment this year stating there were no material changes to the program since the last risk assessment was completed. For Fiscal Year (FY) 2022, the Treasury Department selected eight program fund groups that required certification and 11 IRS programs that required a risk assessment.[5]

The IRS can use one of two types of risk assessments:

- Qualitative Risk Assessment – used to assess the risk that a program's internal controls could lead to susceptible improper payments. The OMB requires agencies to conduct qualitative assessments after the first 12 months of the program and at least once every three fiscal years thereafter. Once the IRS determines that a program is susceptible to improper payments, it must produce a statistically valid estimate of the improper payments the following fiscal year.
- Quantitative Risk Assessment – used to review a sample of disbursements to formulate the overall estimated improper payment rate. In cases in which a quantitative risk assessment is conducted, it could take one of several forms, such as a statistical assessment similar to what is required for the regular improper payment estimate or a nonstatistical assessment in which its ratio of improper payments and unknown payments is projected to the annual outlays.

In addition, the IRS must provide the following information, as part of an improper payment estimate for any program identified as susceptible to significant improper payments as a result of a risk assessment for inclusion in the Treasury Department's next fiscal year AFR:

- The rate and amount of improper payments.
- The root causes of the improper payments.
- The actions taken to address the root causes.
- The annual improper payment reduction targets.
- A discussion of any limitations to the IRS's ability to reduce improper payments.

[5] Appendix II provides the list of the 11 IRS programs identified for improper payment risk assessments for FY 2022 and the type of risk assessment or estimate completed for each program.

The Treasury Department and the IRS continue to request relief from improper payment reporting requirements for refundable tax credit claims

As we reported in May 2022, the Treasury Department and the IRS informed the OMB in October 2020 that the tax system is primarily a collection system and not a payment program.[6] The Treasury Department and the IRS acknowledged that refundable tax credits currently fall under the scope of the PIIA but do not believe that the refundable tax credits meet the definition of payments in the traditional sense. Therefore, the Treasury Department believes the credits should be reported only under the Tax Gap framework that comprehensively assesses the tax collection system and no longer be reported under improper payment requirements.

In December 2020, officials at the Treasury Department and the IRS met with OMB officials to discuss the request. The OMB requested additional information from the IRS, which was provided to the OMB in February 2021. OMB officials advised that they would provide a response on next steps once the full OMB leadership team was in place.

IRS management stated that IRS and Treasury officials met with the OMB on March 1, 2022, to discuss their proposal for using only Tax Gap reporting to eliminate duplicative reporting on refundable tax credits under the PIIA, including *Appendix C* and www.paymentaccuracy.gov. Their proposal would:

- Eliminate a significant portion of Part 3, Section D of the Treasury Department's AFR on Payment Integrity, including the discussion of refundable tax credits and the reporting of improper payment rates for these credits.
- Eliminate reporting information on refundable tax credits on www.paymentaccuracy.gov, including improper payment rates, reduction targets, corrective action plans, *etc*.
- Continue reporting on refundable tax credits as part of the "Tax Gap framework," including the following specific information:
    - Total credits.
    - Amounts and rate of over and under claimed.
    - Root cause analysis, *i.e.*, sources of error, which enables corrective actions and mitigation strategies.
    - Compliance analysis.

On March 27, 2023, IRS officials confirmed that the OMB continues to review the business case.

Results of Review

The OMB defines high-priority programs as programs with improper payments resulting in monetary losses that exceed $100 million annually. For FY 2022, as shown in Figure 1, the IRS calculated and reported the dollar amount and percentage rate of improper payments associated with four of its high-priority programs susceptible to improper payments.

[6] TIGTA, Report No. 2022-40-037, *Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported* (May 2022).

Figure 1: IRS Estimated FY 2022 Improper Payments and Rates[7]

Program	Estimated Improper Payment Rate	Total Payments	Estimated Improper Payments
Earned Income Tax Credit (EITC)	32%	$57.5 billion	$18.2 billion
Additional Child Tax Credit (ACTC)	16%	$32.8 billion	$5.2 billion
American Opportunity Tax Credit (AOTC)	36%	$5.6 billion	$2.0 billion
Net Premium Tax Credit (Net PTC)[8]	27%	$2.1 billion	$0.6 billion

Source: FY 2022 Treasury Department's AFR.

Assessment of Fiscal Year 2022 Compliance With Improper Payment Reporting Requirements

The IRS was largely compliant with the reporting requirements contained in the PIIA for FY 2022. Figure 2 provides a summary of our evaluation of the IRS's compliance with the various improper payment reporting requirements.

Figure 2: Compliance With Improper Payment Requirements for FY 2022

Improper Payment Requirement	Source of Requirement	IRS Compliance
Published Payment Integrity information with the annual financial statement.	PIIA	✓
Posted the annual financial statement and accompanying materials to agency website.	PIIA/ Executive Order	✓
Conducted improper payment risk assessments for each program with annual outlays greater than $10 million at least once in the last three years.	PIIA	✓
Adequately concluded whether programs are likely to make Improper Payments and Unknown Payments above or below statutory threshold.[9]	PIIA	✓
Published improper payment and unknown payment estimates for programs susceptible to improper payments and unknown in accompanying materials to the annual financial statement.	PIIA	✓

[7] For presentation purposes, the improper payment rates, total payments, and estimated improper payments as presented may be impacted by rounding. Further detail is available within the datasets found on www.paymentaccuracy.gov.

[8] The Net PTC is the amount of the PTC minus the amount of the Advance PTC. This is the first year the IRS has reported an improper payment rate for the Net PTC.

[9] Unknown payments are payments made by a program in which it is still unknown whether the payment is proper or improper. Payments are reported as unknown so that a program does not unintentionally over or under report the payment type results.

Improper Payment Requirement	Source of Requirement	IRS Compliance
Published corrective action plans for each program for which an estimate above the statutory threshold was published in the accompanying materials to the annual financial statement.	PIIA	✓
Published an improper payment and unknown payment reduction target for each program for which an estimate above the statutory threshold was published in the accompany materials to the annual financial statement.	PIIA	✓
Demonstrated improvements to payment integrity or to reach a tolerable improper payment and unknown payment rate.	PIIA	✓
Developed a plan to meet the improper payment and unknown payment reduction target.	PIIA/ Executive Order	✓
Reported an improper payment and unknown payment estimate of less than 10% for each program for which an estimate was published in the accompanying materials to the annual financial statement.	PIIA	✗
Established targets to reduce and recover improper payments.	Executive Order	✓
Provided the methodology to identify and measure improper payments.	Executive Order	✓
Provided plans and supporting analysis to ensure that the initiatives undertaken do not unduly burden program access and participation by eligible beneficiaries.	Executive Order	✓

Source: TIGTA's review of the IRS's compliance with improper payment requirements for FY 2022 for the programs listed in Appendix II.

While largely compliant, the IRS still has not satisfied the PIIA goal of reducing the overall improper payment rate for the EITC, the ACTC, the AOTC, and the Net PTC to less than 10 percent. As we have reported previously, the OMB advised the IRS that as an alternative to reducing the improper payment rate to less than 10 percent, a reduction target may remain constant given the complexities of the programs, as long as the complexities are explained in the AFR, which the IRS did.[10]

In addition, the IRS properly reported all other required information to the Treasury Department for posting to www.paymentaccuracy.gov. However, the OMB erroneously transcribed the FYs 2019 and 2020 margins of error for the EITC, the ACTC, and the AOTC when posting the information to www.paymentaccuracy.gov. IRS officials notified the Treasury Department and the OMB and requested correction of the errors. As of March 2023, the information on www.paymentaccuracy.gov was corrected.

The OMB also posts quarterly scorecards associated with high-priority programs to www.paymentaccuracy.gov. It determines the scorecards to be posted based on the prior year's AFR. Because this is the first year that an improper payment rate and amount for the Net PTC were included in the Treasury Department's AFR, the OMB did not request quarterly scorecards

[10] TIGTA, Report No. 2021-40-036, *Improper Payment Rates for Refundable Tax Credits Remain High* (May 2021).

for the Net PTC program. Treasury Department officials expect quarterly scorecards to be requested and reported for the Net PTC for FY 2023.

The IRS is not reporting improper payments for all Coronavirus Disease 2019 (COVID-19)-related programs

The IRS has a number of COVID-19 related programs created by the American Rescue Plan Act of 2021; Coronavirus Aid, Relief, and Economic Security Act; and the Consolidated Appropriations Act, 2021.[11] These include the advance Recovery Rebate Credit (RRC) payments (also referred to as Economic Impact Payments) issued during Calendar Years (CY) 2020 and 2021 and the RRC claimed on Tax Years (TY) 2020 and 2021 tax returns.

Based on TIGTA's concerns with the IRS's initial evaluation of risk associated with these improper payments, the IRS subsequently performed qualitative risk assessments. As a result, the IRS rated the programs as susceptible to improper payments. However, it did not estimate the amount of improper payments for these programs.

According to the IRS, due to the short time frame over which the majority of disbursements will be made by these COVID-19-related programs, estimating the amount and rate of improper payments, assessing the root cause, and developing corrective action plans to reduce payment errors in the future would provide minimal value and be an ineffective use of resources. The IRS stated that it planned to only assess risk according to the requirements outlined in Appendix C of OMB Circular A – 123, rather than reporting an estimate of these programs in the AFR.

The Treasury Department notified the OMB of this decision on August 4, 2022. The OMB acknowledged the IRS's treatment of these payments, but it did not state whether this action was appropriate. The IRS's justification for not expending the resources to complete a qualitative assessment is reasonable. However, the IRS could have summarized information from external reviews and analysis, such as those completed by TIGTA, to provide perspective on the potential volume and cause of improper payments in these programs. For example, our reviews of the issuance of advance RRC payments and RRCs found that the IRS issued $8 billion in advance RRC payments and RRCs to potentially ineligible individuals since the enactment of the Coronavirus Aid, Relief, and Economic Security Act. Figure 3 shows the number of payments the IRS issued to potentially ineligible individuals.

[11] Pub. L. No. 117-2, 135 Stat. 4 (codified in scattered sections of 7, 12, 15, 19, 20, 26, 29, 42, and 45 U.S.C.); Pub. L. No. 116-136, 134 Stat. 281 (codified as amended in scattered sections of 2, 5, 12, 15, 20, 21, 29, 42, and 45 U.S.C.); and Pub. L. No 116-260, 134 Stat. 1182, respectively.

Figure 3: Payments Issued to Potentially Ineligible Individuals

TIGTA Report	Payments	Dollars
TIGTA, Report No. 2021-46-034, *Implementation of Economic Impact Payments* (May 2021)	4.5 million	$5.5 billion
TIGTA, Report No. 2022-47-030, American Rescue Plan Act: *Implementation of Advance Recovery Rebate Credit Payments* (Mar 2022)	1.2 million	$1.9 billion
TIGTA, Report No. 2022-46-032, *Processing of Recovery Rebate Credit Claims During the 2021 Filing Season* (May 2022)	355,015	$603 million
Total[12]	6.0 million	$8.0 billion

Source: TIGTA analysis of payments issued as of July 16, 2020, May 27, 2021, and September 16, 2021.

Changes in the Estimation of Improper Payments Make Year-to-Year Comparisons Difficult

The IRS uses its National Research Program (NRP) to measure reporting compliance for different types of taxes and various sets of taxpayers, including calculating an estimated improper payment rate for programs rated as "High-Priority" or susceptible to significant improper payments.

For FY 2022, the IRS relied on a smaller NRP sample size and changed the period for reporting on claims and improper payments. These changes resulted in less precise and lower improper payment estimates. The change in the reporting period resulted in lower estimates of the number and amount of improper payments than the original estimation method. These revisions make interpreting year-to-year changes in the IRS's reported improper payment estimates difficult.

The IRS relied on a smaller NRP sample size to estimate improper payment rates

NRP results are a statistically valid representation of the reporting compliance characteristics based on a representative sample of audited taxpayers. FY 2022 improper payment estimates are based on the TY 2018 NRP sample of returns filed predominately in CY 2019 because it takes approximately three years to complete all of the audits associated with those tax returns.

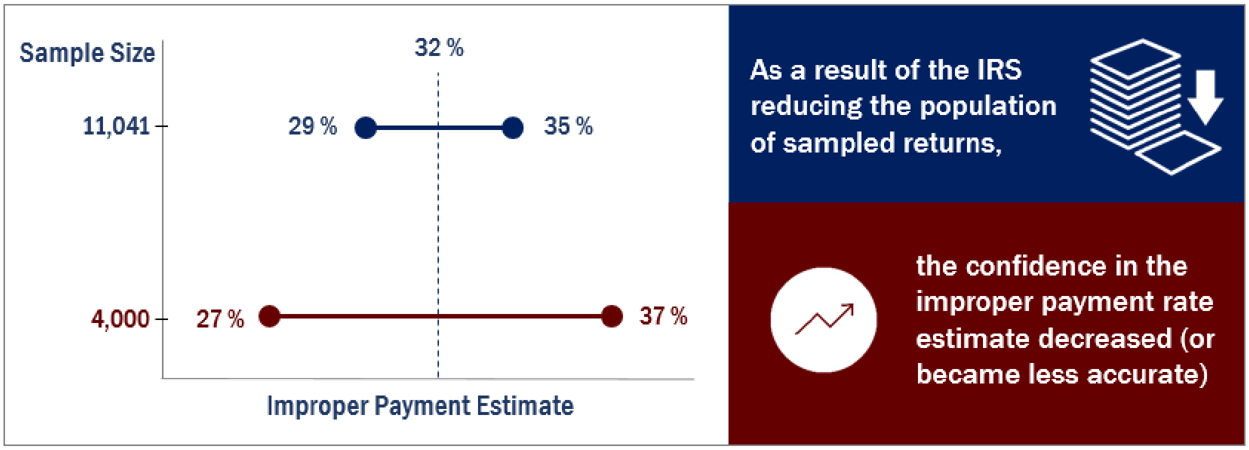
The IRS designed the TY 2018 NRP sample to include an original sample of 11,041 tax returns, which was a 20 percent decrease compared to prior years. However, the IRS reduced the overall sample to 4,000 returns due to limited resources.[13] Figure 4 shows how the change in NRP sample sizes affected the IRS's estimated EITC improper payment rate. The width of a confidence interval reflects the probability that the improper payment rate will fall between a set of values. As shown in Figure 4, the smaller sample of 4,000 returns resulted in the estimated EITC improper payment rate falling into a wider confidence interval (with less accuracy). As

[12] Totals may not reconcile due to rounding.

[13] The IRS reduced the original NRP sample size in TYs 2016, 2017, and 2018 due to resource constraints.

such, there is a larger range of values within which the improper payment rate falls, creating more uncertainty in the estimate.

Figure 4: Example of the Impact on the Margins of Error on the Estimated EITC Improper Payment Rate



Source: TIGTA analysis of the IRS's sampling and estimation methodology.

The IRS changed the way it calculated total claims and estimated the amount of improper payments

The IRS applied the estimated improper payment rate discussed previously to tax returns on a tax year basis rather than a fiscal year basis as it has done in the past. Specifically, the IRS applied the improper payment rate to TY 2020 returns filed in CY 2021 and CY 2022 instead of all tax returns filed between October 1, 2021, and September 30, 2022 (FY 2022).[14] To evaluate the potential impact of the change from a fiscal year to a tax year, we calculated the total EITC claims and improper payment estimates using TY 2020 tax returns filed in CY 2021 and CY 2022 and all tax returns filed in FY 2022. Figure 5 shows an example of the potential impact of this change on the estimated amount of EITC improper payments for FY 2022. However, this evaluation applies specifically to FY 2022 reporting, changes in various factors (such as changes in tax code or changes in taxpayer behavior) contribute to differences in volumes of claims each year.

[14] The improper payment rate was applied to TY 2020 tax returns, predominately filed in CY 2021, as that is the most recent full year of returns available from the IRS's Individual Returns Transaction File when the improper payment estimates were calculated in CY 2022.

Figure 5: Estimate of the Impact in Calculating Improper Payments for the EITC on a Tax/Calendar Year Basis Rather Than a Fiscal Year Basis

Program	Claims (in billions)	Improper Payments (in billions)	Improper Payment Rate
TIGTA Estimate of EITC Improper Payments Using FY 2022	$65.4	$20.7	32%
IRS EITC Estimate as Reported in the FY 2022 AFR Using Claims From TY 2020	$57.5	$18.2	32%
Difference	$7.9	$2.5	

Source: TIGTA analysis of data from the IRS's Individual Returns Transaction File for FY 2022 and the FY 2022 Treasury AFR.

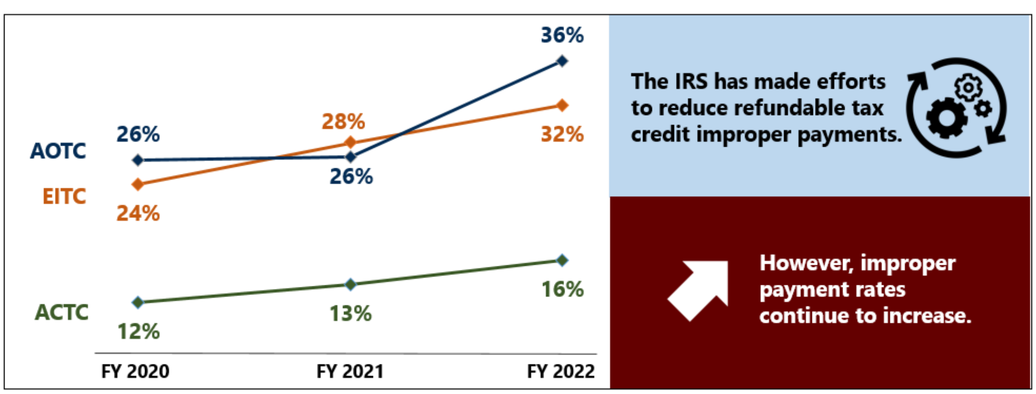
According to IRS officials, they changed the period of returns for estimation purposes to align Net PTC reporting by tax year with the same calendar year of Advance PTC improper payments being reported by the Department of Health and Human Services. IRS officials felt that also changing the estimate for the EITC, the AOTC, and the ACTC had the added benefit of moving the estimate of improper payments to a tax year basis, which is more consistent with the filing and processing of tax returns.

While our estimate does not necessarily reflect the amount of EITC improper payments the IRS would have reported had it continued to estimate using a fiscal year reporting period, it does provide some perspective of the potential impact the change in reporting period had on estimated improper payments.

Despite Internal Revenue Service Efforts, Improper Payment Rate Estimates Have Risen Since Fiscal Year 2020

The IRS has implemented a number of initiatives to help reduce refundable tax credit improper payment rates, yet rates remain persistently high. For example, the EITC improper payment rate increased from 24 percent in FY 2020 to 32 percent in FY 2022. Figure 6 shows the improper payment rates for the EITC, the ACTC, and the AOTC for the last three fiscal years.

Figure 6: FY 2020 Through FY 2022 Improper Payment Rates



Source: FY 2020 through FY 2022 AFRs.

Figure 7 lists the IRS initiatives implemented to reduce improper payments.

Figure 7: IRS Initiatives to Reduce Improper Payments

Initiative	Description
Nationwide Tax Forum	The annual tax forum offers three full days of seminars with the latest news from IRS leadership and experts. More than 8,300 tax return preparers attended the seminar entitled *Looking to Tax Year 2022: American Rescue Plan Tax Changes to the Earned Income Tax Credit and Other Child-Related Credits* at the 2022 virtual Nationwide Tax Forums.
Interactive Tax Return Preparer Due Diligence Training Module	The training module on IRS.gov covers the technical aspects of the tax return preparer due diligence requirements. In FY 2022, more than 10,400 preparers received a certificate of completion.
Tax Preparer Toolkit	The Tax Preparer Toolkit on IRS.gov has resources to assist tax return preparers with the EITC, the ACTC, the AOTC as well as other credits and tax benefits.
Software Developers Working Group	The IRS meets with members of tax preparation companies and software industry representatives to identify software enhancements that can help reduce errors made by taxpayers and paid preparers and to assist paid preparers in meeting their due diligence requirements.
Tax Return Preparer Due Diligence Webinars	The IRS hosts discussions and provides instructions and demonstrations over the Internet. In FY 2022, nearly 900 preparers attended the virtual webinar on due diligence requirements entitled *Keys to Mastering Due Diligence Requirements and What to Expect During a Due Diligence Audit*.
Tax Preparer Alerts	Alerts on IRS.gov provide return preparers with updated news and information on key refundable credit and return filing topics.
Refundable Credits Summit	In FY 2022, the IRS held its annual summit to provide a forum for interested internal and external stakeholders to discuss opportunities to reduce improper payments, ease taxpayer burden, and mitigate compliance risks. The IRS held an additional summit to discuss administering the Advanced Child Tax Credit provisions in the American Rescue Plan.

Source: FY 2022 AFR.

Refundable credit improper payments are not primarily the result of internal control weaknesses that the IRS can address. In addition to the lack of reliable, relevant, and timely third-party data for use in verifying refundable credit claims, the Treasury AFR reports that eligibility rules differ for each credit and are often complex because they address complicated family relationships and residency arrangements to determine eligibility. As we reported in September 2021, the requirements to claim certain refundable credits have increased in complexity over time. For example, when the EITC was created in 1975, the amount an individual was entitled to receive was based solely on the individual's earnings. Today, the EITC has four earnings limitations dependent on the taxpayer's filing status and the number of qualifying children. Since the credit's enactment, it has been modified to increase amounts and to differentiate between family size and structure.[15]

Outreach efforts to expand participation in refundable tax credit programs can increase improper payments

IRS management recently advised there is a growing expectation for the IRS to notify individuals who are potentially eligible for but not claiming refundable credits to encourage them to file a tax return and claim the credits. However, the same limitations that prevent the IRS from verifying refundable credit claims may also limit its ability to proactively identify eligible individuals who are not claiming these credits. This type of outreach could result in additional improper payments and increased taxpayer burden. The following hypothetical example illustrates how this might occur:

> *An individual has two children and earned income. The individual has a tax return filing requirement but does not file. The IRS sends the individual a letter informing them of their potential eligibility to claim the EITC and encouraging them to file and claim the credit on their tax return, which the individual does.*
>
> *The IRS processes the individual's return and issues the claimed refund. The IRS subsequently selects the individual's return for review. The IRS learns that the two children live with the individual's parents (the children's grandparents). As such, the individual is not eligible to claim the children for the EITC. The IRS denies the individual's claim and must now attempt to recover the improperly paid refund.*

Encouraging individuals to claim a refundable credit only to later deny the claim once filed may create confusion and be detrimental to the IRS's efforts to help taxpayers understand their tax responsibilities and meet their tax obligations. It could also negatively impact the public's perception of the IRS's ability to accurately administer the tax law with integrity and fairness.

[15] TIGTA, Report No. 2021-40-070, *Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation* (Sept. 2021).

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective of this audit was to determine whether the IRS complied with the annual improper payment reporting requirements for FY 2022. To accomplish our objective, we:

- Determined whether the IRS complied with the improper payment reporting requirements for FY 2022.
- Evaluated the adequacy of the IRS's FY 2022 risk assessments for IRS revenue program funds identified by the Treasury Department.
- Reviewed the IRS's methodology to calculate EITC, ACTC, AOTC, and PTC improper payment rates for FY 2022.[1]
- Followed up on select prior audit findings to ensure that the IRS has taken the agreed-upon action to resolve the issues.

Performance of This Review

This review was performed with information obtained from the Office of the Chief Financial Officer and the Office of Research, Applied Analytics, and Statistics located at the IRS Headquarters in Washington, D.C., during the period December 2022 through April 2023. 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 Diana M. Tengesdal, Acting Assistant Inspector General for Audit (Returns Processing and Account Services); Deann L. Baiza, Director; Curtis J. Kirschner, Audit Manager; Linda M. Valentine, Lead Auditor; Jason J. Robertazzi, Auditor; Michael F. Shugrue, Auditor, and Johnathan D. Elder, Supervisory Information Technology Specialist (Data Analytics) – Applied Research and Technology Data.

Validity and Reliability of Data From Computer-Based Systems

During this review, we relied on data received from the IRS's Returns Transaction File databases for Processing Years 2021 and 2022 that were available on TIGTA's Data Center Warehouse. We determined 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

[1] TIGTA's contracted statistician assisted with reviewing the IRS's FY 2022 sample design and estimation plan.

following internal controls were relevant to our audit objective: the controls in place to ensure that the IRS met the annual improper payment reporting requirements established in the PIIA and Executive Order 13520. We tested these controls by reviewing and analyzing relevant documents and holding discussions with IRS management and the Treasury Department's Risk and Control Group.

Appendix II

Programs Identified for Improper Payment Risk Assessments

The following IRS programs were identified by the Treasury Department for improper payment risk assessments for FY 2022.

IRS Program	Type of Assessment	Total Non-Federal Disbursements
Earned Income Credit	IP Estimate	$60.8 billion
Additional Child Tax Credit	IP Estimate	$79 billion
American Opportunity Tax Credit	IP Estimate	$4 billion
Premium Tax Credit	IP Estimate	$68.3 billion
Refund Collection, Interest	Qualitative	$3 billion
Health Coverage Tax Credit	Qualitative	$22.9 million
Build America Bond Payments	Qualitative	$3 billion
Qualified Zone Academy Bonds	Qualitative	$54 million
Qualified School Construction Bonds	Qualitative	$796.9 million
New Clean Renewable Energy Bonds	Qualitative	$56.9 million
Qualified Energy Conservation Bonds	Qualitative	$43.2 million

Source: IRS Office of the Chief Financial Officer. IP = Improper Payment

Appendix III

Improper Payment Laws Repealed by the Payment Integrity Information Act of 2019

- Improper Payments Information Act of 2002, Pub. L No. 107-300, 116 Stat. 2350.
- Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111-204, 124 Stat. 2224.
- Improper Payments Elimination and Recovery Improvement Act of 2012, Pub. L. No. 112-248, 126 Stat. 2390.
- Fraud Reduction and Data Analytics Act of 2015, Pub. L. No. 114-186, 130 Stat. 546.

Appendix IV

Prior Improper Payment Reports by the Treasury Inspector General for Tax Administration

Issuance Date	Report Number	Report Title
May 2022	2022-40-037	Programs Susceptible to Improper Payments Are Not Adequately Assessed and Reported
May 2021	2021-40-036	Improper Payment Rates for Refundable Tax Credits Remain High
April 2020	2020-40-025	Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments
May 2019	2019-40-039	Some Refundable Credits Are Still Not Classified and Reported Correctly as a High Risk for Improper Payment by the Internal Revenue Service
April 2018	2018-40-032	The Internal Revenue Service Is Not in Compliance With Improper Payment Requirements
April 2017	2017-40-030	Revised Refundable Credit Risk Assessments Still Do Not Provide an Accurate Measure of the Risk of Improper Payments
April 2016	2016-40-036	Without Expanded Error Correction Authority, Billions of Dollars in Identified Potentially Erroneous Earned Income Credit Claims Will Continue to Go Unaddressed Each Year
April 2015	2015-40-044	Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014
March 2014	2014-40-027	The Internal Revenue Service Fiscal Year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act
February 2013	2013-40-024	The Internal Revenue Service Was Not in Compliance With All Requirements of the Improper Payments Elimination and Recovery Act for Fiscal Year 2012

Source: www.tigta.gov/reports/list.

Appendix V

Management's Response to the Draft Report

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

CHIEF FINANCIAL OFFICER

May 4, 2023

MEMORANDUM FOR HEATHER M. HILL
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Teresa R. Hunter
Chief Financial Officer

Teresa R. Hunter

Digitally signed by Teresa R. Hunter
Date: 2023.05.04 10:43:45 -04'00'

SUBJECT: Response to Draft Audit Report – Improper Payment Reporting Requirements Were Largely Met; However, Improper Payment Estimates Are Less Precise (Audit #202340001)

Thank you for the opportunity to review and comment on your draft audit report entitled *Improper Payment Reporting Requirements Were Largely Met; However, Improper Payment Estimates Are Less Precise*. The programs examined in this report are refundable tax credits (RTC) designed to achieve specific economic and social objectives, such as coronavirus pandemic relief, reducing poverty and increasing the affordability of higher education. Even before RTCs were key to the Federal government's response to the national emergency caused by the global worldwide pandemic, programs with RTC presented challenges of administering complex social benefit programs through the tax administration system. These, and other social programs, have been expanded and will continue to require education, oversight, and compliance activities going forward to ensure taxpayers receive the correct benefits.

The IRS agrees with your assessment that refundable credit improper payments are not primarily the result of internal control weaknesses that the IRS can address. The complex eligibility requirements and IRS reliance on taxpayer self-certification of RTC claims do not fit well with the improper payment framework. We continue to believe that RTC overclaims are more effectively managed and reported holistically within the tax gap, where they can be prioritized relative to all other types of enterprise tax noncompliance mitigation strategies.

We appreciate your office's conscientious evaluation of these programs and the IRS's continuing efforts to reduce and eliminate erroneous claims within the structure of the tax administration system. Additional technical comments have been forwarded separately. If you have any questions, please contact me at 202-317-4147, or a member of your staff may contact Charles A. Messing, Associate Chief Financial Officer for Internal Controls, at 202-803-9762.

Appendix VI

Glossary of Terms

Term	Definition
Additional Child Tax Credit	A credit for individuals who receive less than the full amount of the nonrefundable Child Tax Credit. The ACTC may result in a refund even if no tax is owed.
Advance Premium Tax Credit	A tax credit that is paid in advance to a taxpayer's insurance company to help cover the cost of premiums.
Agency Financial Report	Presents the Treasury Department's financial and performance information for the fiscal year, with comparative prior year data where appropriate.
American Opportunity Tax Credit	A credit for qualified education expenses paid for an eligible student for the first four years of higher education. A partially refundable Federal tax credit used to help parents and college students offset the costs of college.
Data Center Warehouse	A TIGTA repository of IRS data.
Earned Income Tax Credit	A refundable tax credit for low-income to moderate-income workers.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
High-Priority Program	Program identified as susceptible to significant improper payments.
Improper Payment	Any payment that should not have been made or that was made in an incorrect amount under statutory, contractual, administrative, or other legally applicable requirements (including both overpayments and underpayments).
Improper Payment Rate	Amount in improper payments divided by the amount in program outlays.
Net Premium Tax Credit	When the PTC exceeds the Advance PTC (PTC minus Advance PTC = Net PTC). The Net PTC reduces a taxpayer's tax liability and, if it is more than the tax liability, results in a refundable tax credit.
Outlay	A payment to liquidate an obligation generally equal to cash disbursements (the measure of Government spending).
Overpayment	A payment in excess of what is due. When an overpayment occurs, the improper amount is the difference between the amount due and the amount that was actually paid. Overpayments are monetary loss IPs.
Payment	Any disbursement or transfer of Federal funds to any non-Federal person, non-Federal entity, or Federal employee that is made by a Federal agency, contractor, grantee, or a governmental or other organization administering a Federal program or activity.
Premium Tax Credit	Refundable tax credit that helps eligible individuals and families cover the premiums for their health insurance purchased through the Health Insurance Marketplace.

Term	Definition
Processing Year	The calendar year in which the tax return or document is processed by the IRS.
Program	Activities or sets of activities recognized as programs by the public, the OMB, or Congress as well as those that entail program management or policy direction.
Qualitative Risk Assessment	A technique used to quantify risk associated with IPs and Unknown Payments. For example, a qualitative IP risk assessment methodology prioritizes the identified IP and Unknown Payment risks using a predefined rating scale. Risks will be scored based on their probability or likelihood of occurring and the impact on IPs and Unknown Payments in the program should they occur.
Quantitative Risk Assessment	A risk assessment technique that focuses on measurable data such as improper or unknown payment amount. For example, a quantitative IP risk assessment will provide numerical IP amounts and assess the probability of their occurrence. The assessment may be similar to the regular IP estimate.
Returns Transaction File	An IRS database containing transcribed tax returns for individuals that includes most forms and schedules.
Significant Improper Payment	Annual IPs and Unknown Payments, *i.e.*, the sum of monetary loss IPs, non-monetary loss IPs, and Unknown Payments, in the program exceeding 1) both 1.5 percent of program outlays and $10,000,000 of all program or activity payments made during the fiscal year reported or 2) $100,000,000 (regardless of the IP percentage of total program outlays).
Tax Gap	The estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
Underpayment	A payment that is less than what is due. When an underpayment occurs, the improper amount is the difference between the amount due and the amount that was actually paid. An underpayment is a non-monetary loss IP.

Appendix VII

Abbreviations

ACTC	Additional Child Tax Credit
AFR	Agency Financial Report
AOTC	American Opportunity Tax Credit
COVID-19	Coronavirus Disease 2019
CY	Calendar Year
EITC	Earned Income Tax Credit
FY	Fiscal Year
IP	Improper Payment
IRS	Internal Revenue Service
NRP	National Research Program
OMB	Office of Management and Budget
PIIA	Payment Integrity Information Act of 2019
PTC	Premium Tax Credit
RRC	Recovery Rebate Credit
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year

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Treasury Inspector General for Tax Administration

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Washington, D.C. 20026

Information you provide is confidential, and you may remain anonymous.