The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season

September 26, 2012

Reference Number: 2012-40-119

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

Redaction Legend:
2(f) = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

THE MAJORITY OF INDIVIDUAL TAX RETURNS WERE PROCESSED TIMELY, BUT NOT ALL TAX CREDITS WERE PROCESSED CORRECTLY DURING THE 2012 FILING SEASON

Highlights

Final Report issued on September 26, 2012

Highlights of Reference Number: 2012-40-119 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

The filing season, defined as the period from January 1 through mid-April, is critical for the IRS because it is during this time that most individuals file their income tax returns and contact the IRS if they have questions about specific tax laws or filing procedures. As of April 28, 2012, the IRS received more than 133.4 million individual income tax returns and issued slightly more than 99.1 million tax refunds totaling approximately $269 billion.

WHY TIGTA DID THE AUDIT

One of the challenges the IRS confronts each year in processing tax returns is the implementation of new tax law changes. Before the filing season begins, the IRS must identify new tax law and administrative changes and, when possible, revise the various tax forms, instructions, and publications. The objective of this review was to evaluate whether the IRS timely and accurately processed individual paper and electronically filed tax returns during the 2012 Filing Season.

WHAT TIGTA FOUND

The IRS timely processed the majority of individual income tax returns during the 2012 Filing Season. However, some taxpayers who electronically filed early in the 2012 Filing Season experienced delays in receiving their tax refunds. The IRS indicated that it had experienced problems with its filters established to identify fraud and with the program used by the Modernized E-File system to create output files using the accepted electronically filed tax return data format that other IRS systems need to continue processing the tax returns.

As of April 28, 2012, the IRS had identified tax returns with $6.4 billion in fraudulent tax refunds and prevented the issuance of $6.1 billion of the fraudulent tax refunds. The IRS also identified 210,473 tax returns filed by prisoners for fraud screening, a 5.3 percent increase compared to last year.

The IRS assisted approximately 2.3 million individuals at its Taxpayer Assistance Centers and received approximately 90.4 million attempts from taxpayers calling the various Customer Account Services function toll-free telephone assistance lines.

The processing of Homebuyer Credit repayments has improved. However, some taxpayer repayments continue to be inaccurately processed resulting in almost $2.6 million in erroneous refunds and more than $290,000 in incorrect assessments to taxpayers' accounts. In addition, more than $14.6 million was not properly assessed and more than $650,000 was incorrectly over-assessed to taxpayers' accounts when taxpayers reported a disposition of the property.

In addition, 125,684 taxpayers also claimed more than $29.7 million in erroneous Nonbusiness Energy Property Credits, and 109,618 taxpayers claimed more than $159 million for the American Opportunity Tax Credit for students who, based on age, are unlikely to be pursuing an undergraduate degree or vocational certification.

WHAT TIGTA RECOMMENDED

TIGTA made a number of recommendations including recommendations to initiate recovery programs for erroneously paid claims and to ensure that Homebuyer Credit claims are processed correctly.

IRS management agreed and implemented corrective actions for all recommendations that included changing computer programming, updating processing procedures, and initiating recovery procedures for credits that were erroneously refunded.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 26, 2012

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

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

SUBJECT: Final Audit Report – The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season (Audit # 201240010)

This report presents the results of our review to evaluate whether the Internal Revenue Service timely and accurately processed individual paper and electronically filed tax returns during the 2012 Filing Season. This review is included in our Fiscal Year 2012 Annual Audit Plan and addresses the major management challenge of Implementing Major Tax Law Changes.

Management's complete response to the draft report is included in Appendix VII.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Augusta R. Cook, Acting Assistant Inspector General for Audit (Returns Processing and Account Services), at (770) 617-6434.

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Abbreviations

AOTC	American Opportunity Tax Credit
AQC	Automated Questionable Credit
e-file(d); e-filing	Electronically file(d); electronic filing
EITC	Earned Income Tax Credit
IRS	Internal Revenue Service
MeF	Modernized E-File
TIGTA	Treasury Inspector General for Tax Administration

Background

The filing season[1] is critical for the Internal Revenue Service (IRS) because it is during this time that most individuals file their income tax returns and contact the IRS if they have questions about specific tax laws or filing procedures. As of April 28, 2012, the IRS received more than 133.4 million individual income tax returns.

The IRS received more than 133.4 million individual income tax returns as of April 28, 2012.

One of the challenges the IRS confronts each year in processing tax returns is the implementation of new tax law changes. Before the filing season begins, the IRS must identify new tax law and administrative changes and, when possible, revise the various tax forms, instructions, and publications. It must also reprogram its computer systems to ensure tax returns are accurately processed. Problems with tax return processing could delay tax refunds, affect the accuracy of tax accounts, and result in the generation of incorrect notices.

Tax law provisions affecting the 2012 Filing Season

- ***The Worker, Homeownership, and Business Assistance Act of 2009***[2] – Enacted on November 6, 2009, this Act modified the First-Time Homebuyer Credit[3] to allow the credit for homes purchased through May 1, 2011, and for closings through July 1, 2011, *only* to members of the uniformed services, the Foreign Service, and the intelligence community.
- ***The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010***[4] – Enacted on December 22, 2010, this Act extended the Nonbusiness Energy Property Credit[5] one year through December 31, 2011, and also reduced the aggregate credit for purchases after December 31, 2005, down to $500 from $1,500. The Nonbusiness Energy Property Credit allows a credit to individuals who purchase certain exterior windows (including skylights), exterior doors, and metal or asphalt roofs for their personal residence. The Joint Committee on Taxation estimates that the extension of this provision will cost $477 million in Fiscal Year 2012.

[1] See Appendix VI for a glossary of terms.
[2] Pub. L. No. 111-92, 123 Stat. 2984 (2009).
[3] Internal Revenue Code § 36(h)(3).
[4] Pub. L. No. 111-312, 124 Stat. 3296 (2010).
[5] Internal Revenue Code § 25C.

- ***The United States-Korea Free Trade Agreement Implementation Act***[6] – Enacted on October 21, 2011, this Act amended Internal Revenue Code Section (§) 6695(g) to increase the penalty from $100 to $500 on paid tax return preparers who fail to comply with Earned Income Tax Credit (EITC) due diligence requirements.

- ***The Emergency Economic Stabilization Act of 2008***[7] – Enacted on October 3, 2008, this Act established cost basis-related reporting requirements for individual investors and brokers. Brokers and other intermediaries must report their clients' adjusted cost basis on Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions*. Investors must report the correct cost basis on the Schedule D, *Capital Gains and Losses*, and Form 8949, *Sales and Other Dispositions of Capital Assets*. There is a three-year phase-in (beginning January 1, 2011) for full implementation of the legislation.

IRS-initiated changes affecting the 2012 Filing Season

- The Department of the Treasury and the IRS issued final regulations[8] on December 20, 2011, in response to concerns over improper EITC payments on tax returns completed by paid tax return preparers. The regulations require tax return preparers to submit a Form 8867, *Paid Preparer's Earned Income Credit Checklist*, with each Tax Year 2011 tax return claiming the EITC.

- In response to several Treasury Inspector General for Tax Administration (TIGTA) reviews[9] of the IRS's process for identifying erroneous claims for Vehicle Credits, the IRS is now requesting that taxpayers supply the 17-digit Vehicle Identification Number on the following forms:
  - Form 8834, *Qualified Plug-in Electric and Electric Vehicle Credit*.
  - Form 8910, *Alternative Motor Vehicle Credit*.
  - Form 8936, *Qualified Plug-in Electric Drive Motor Vehicle Credit*.

- The IRS added a new line 59b, Homebuyer Credit Repayment, to the Form 1040, *U.S. Individual Income Tax Return*, to facilitate taxpayers reporting of any required Homebuyer Credit installment payments.[10] This alleviates the need for taxpayers to prepare a Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit*, to report their repayments.

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[6] Pub. L. No. 112-041, 125 Stat. 428 (2011).
[7] Pub. L. No. 110-343, 122 Stat. 3765 (2008).
[8] Treas. Reg. § 1.6695–2.
[9] See Appendix V, report Ref. No. 2011-41-011, report Ref. No. 2010-41-128, and report Ref. No. 2011-40-128.
[10] The Housing and Economic Recovery Act of 2008, enacted on July 30, 2008, requires individuals who purchased a home between April 9 and December 31, 2008, and claimed a Homebuyer Credit to begin repaying the credit on their Tax Year 2010 tax return. The credit is intended to be repaid over 15 years in equal annual installments each year.

The IRS processed individual income tax returns at five Wage and Investment Division Submission Processing sites during the 2012 Filing Season: Fresno, California; Andover, Massachusetts; Kansas City, Missouri; Philadelphia, Pennsylvania; and Austin, Texas.[11]

The 2012 Filing Season results are being presented as of April 21, April 28, or May 2, 2012, unless specified otherwise.[12] This review was performed at the Wage and Investment Division Headquarters in Atlanta, Georgia; the Submission Processing function offices in Cincinnati, Ohio; the Modernization and Information Technology Services organization Headquarters in Lanham, Maryland; and the Submission Processing Site in Austin, Texas, during the period January through June 2012. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

[11] Andover, Massachusetts, and Philadelphia, Pennsylvania, process electronically filed tax returns only.
[12] Results are provided as of April 21, April 28, or May 2, 2012, depending on the date the IRS reported the respective data.

Results of Review

The Majority of Individual Income Tax Returns Were Timely Processed

The IRS timely processed the majority of individual income tax returns during the 2012 Filing Season and issued associated tax refunds within 45 calendar days of the April 17, 2012, tax return due date. However, some taxpayers who filed their tax returns early in the 2012 Filing Season experienced delays in receiving their tax refunds.

The IRS indicated that it had experienced problems with its filters established to detect fraud and with the program used by the Modernized E-File (MeF) system to create output files using the accepted electronically filed (e-filed) tax return data format that other IRS systems need to continue to process tax returns. Fraud filters initially identified taxpayers as having indicators of possible fraud, which resulted in their tax returns being held for additional screening. However, the IRS determined that these filters were incorrectly identifying some taxpayers. Once the IRS made necessary adjustments to these filters, the problem was corrected.

MeF system programming problems resulted in tax return processing delays for 7.8 million tax returns early in the filing season.

The IRS explained that MeF system programming problems resulted in the creation of incomplete and/or duplicate output files using the accepted e-file data. This resulted in delays in sending the output files to downstream processing systems. According to the IRS, the programming problems delayed the processing of approximately 7.8 million tax returns. The majority of these tax returns were processed through the MeF system from February 2 through February 11, 2012. The IRS indicated that all of the delayed tax returns were sent to downstream systems for processing by February 18, 2012.

In addition, the MeF system programming problems have resulted in accepted tax return information not always being timely available for use in IRS customer service operations, including "Where's My Refund." The IRS stated that these problems were addressed and processes were established to account for all tax returns accepted via the MeF system during the time period the processing problem existed. The IRS noted that it was developing an end-to-end balancing process to track MeF system tax returns from acceptance to the posting of the tax return on the Master File.

As of April 28, 2012, the IRS received more than 133.4 million individual income tax returns. Of those, about 111.3 million (83.4 percent) were e-filed and about 22.1 million (16.6 percent) were filed on paper (a decrease of 14.1 percent from this time last year). In addition, the IRS issued slightly more than 99.1 million tax refunds totaling approximately $269 billion. Figure 1 presents a summary of tax return filing statistics as of April 28, 2012.

Figure 1: Comparative Filing Season Statistics as of April 28, 2012

Cumulative Filing Season Data	2011 Actual	2012 Actual	% Change
Individual Income Tax Returns			
Total Returns Received (in thousands)	130,706	133,460	***2.1%***
Paper Returns Received (in thousands)	25,756	22,135	***-14.1%***
E-Filed Returns Received (in thousands)	104,951	111,325	***6.1%***
Practitioner Prepared	67,082	69,846	***4.1%***
Home Computer	37,854	41,479	***9.6%***
Free File *(also included in Home Computer total)*	3,054	3,013	***-1.3%***
Fillable Forms *(also included in Home Computer total)*	410	454	***10.7%***
Individual Income Tax Refunds			
Total Number Issued (in thousands)	98,213	99,104	***0.9%***
Total $ (in millions)	$277,149	$269,141	***-2.9%***
Average $	$2,822	$2,716	***-3.8%***
Total Number of Direct Deposits (in thousands)	74,653	78,007	***4.5%***
Total Direct Deposit $ (in millions)	$227,211	$227,986	***0.34%***

Source: IRS 2012 Weekly Filing Season reports. Totals and percentages shown are rounded.

The e-filing rate is higher and use of home computers is increasing; however, use of the Free File Program is decreasing

Since the 1990 Filing Season, taxpayers have e-filed nearly 1 billion individual income tax returns. As of April 28, 2012, e-file volumes are 6.1 percent higher than the volumes for the same period in 2011. The IRS anticipates that e-filing of tax returns will continue to grow.

In addition, for the fourth year, the IRS and its partners are offering Free File Fillable Tax Forms, which opens up the Free File Program to nearly everyone, with no income limitations. More individuals are taking advantage of this filing option. Use of Fillable Forms has increased to approximately 454,000 tax returns, an increase of 10.7 percent from 2011. However, participation in the Free File Program has decreased by 1.3 percent when compared to the same period in 2011. The traditional IRS Free File Program is a free Federal online tax preparation and e-filing program for eligible taxpayers developed through a partnership between the IRS and the Free File Alliance, LLC (a group of private-sector tax preparation companies). The program enables eligible taxpayers to use commercial tax software for free, accessible only through the IRS's website, IRS.gov.

More erroneous tax refunds are being detected and stopped

Unscrupulous individuals continue to submit tax returns with false income documents to the IRS for the sole purpose of receiving a fraudulent tax refund. As of April 28, 2012, the IRS had identified tax returns with $6.4 billion claimed in fraudulent tax refunds and prevented the issuance of $6.1 billion (95.3 percent) of the fraudulent tax refunds. This represents a 39.1 percent increase in the number of fraudulent tax refund attempts identified as of the same period last processing year.

Figure 2 shows the number of fraudulent tax returns identified by the IRS for Processing Years 2009 through 2011, as well as the tax refund amounts that were claimed and stopped.

Figure 2: Fraudulent Tax Returns and Tax Refunds Identified and Stopped in Processing Years 2009 Through 2011

Processing Year	Number of Fraudulent Refund Returns Identified	Number of Fraudulent Refund Returns Stopped	Amount of Fraudulent Refunds Identified	Amount of Fraudulent Refunds Stopped
2009	457,369	369,257	$2,988,945,590	$2,517,094,116
2010	971,511	881,303	$7,300,996,194	$6,931,931,314
2011	2,176,657	1,756,242	$16,186,395,218	$14,353,795,007

Source: *IRS fraudulent return statistics for Processing Years 2009 through 2011.*

Individual tax returns are sent through the IRS's Electronic Fraud Detection System and receive a data-mining score based on the characteristics of the tax return and other data. For those tax returns meeting a certain score, the tax return is sent to an IRS tax examiner to screen the tax return for fraud potential. If a tax return is selected for further verification, the tax refund is held until employers or third parties are contacted to verify wage information on the tax return. If the verification process is not completed within a certain time period, the tax refund is automatically released. In general, if the employee concludes that a tax return contains false information, *e.g.*, false or inflated wages, the tax return is either resolved in the Accounts Management function or referred to one of the Examination functions[13] for resolution. Tax returns with refundable credits, such as the EITC, and tax returns for which the tax refunds were issued must

[13] According to the referral procedures, fraudulent refund returns are forwarded to either the Wage and Investment Division Examination function or the Small Business/Self-Employed Division Examination function. The majority of fraudulent refund returns are forwarded to the Examination function in the Wage and Investment Division. For purposes of this report, we use "Examination functions" unless we refer to a specific Division.

be sent to the Wage and Investment Division's Examination function because the law requires the IRS to follow deficiency procedures before making an assessment in these cases.

Beginning in the 2012 Filing Season, the IRS implemented new fraud filters specifically designed to detect identity theft

Tax returns identified via the new identity theft filters are being held during processing until the IRS can verify the taxpayer's identity. Once a taxpayer's identity has been confirmed, the tax return is released for processing and the tax refund is issued. The IRS removes those tax returns from processing for which the individual's identity could not be confirmed, thus preventing the issuance of a fraudulent tax refund. As of April 19, 2012, the IRS had stopped the issuance of approximately $1.3 billion in potentially fraudulent tax refunds as a result of the new identity theft filters.

The screening of prisoner tax returns also continues to increase

In a prior TIGTA review assessing the IRS fraudulent tax return screening process,[14] we reported that the majority of tax returns identified as being filed by prisoners are not sent to a tax examiner for screening to assess the potential that the tax return is fraudulent. As of April 28, 2012, the IRS had identified 210,473 tax returns filed by prisoners for screening. This represents a 5.3 percent increase in the number of prisoner tax returns identified as of the same period last processing year. Figure 3 shows a comparison of the number of tax returns filed by prisoners that were sent to a tax examiner for screening as of the last week in April for Processing Years 2010, 2011, and 2012.

Figure 3: Prisoner Tax Returns Identified for Screening in Processing Years 2010 Through 2012 (as of the last week of April)

Processing Year	Number of Prisoner Tax Returns Identified for Screening	Increase From Prior Year
2010	56,101	
2011	199,854	256%
2012	210,473	5.3%

Source: IRS fraudulent return statistics for Processing Years 2010 through 2012 as of the last week in April.

[14] See Appendix V, report Ref. No. 2010-40-129, p. 9.

Individuals have increased the use of the savings bond and split tax refund options

Beginning with the 2010 Filing Season, individuals have the ability to use their tax refunds to purchase up to $5,000 in U.S. Series I Savings Bonds by requesting the bonds on their tax return. Individuals may request any portion of their tax refund that is an exact multiple of $50 be used to purchase up to three savings bonds for themselves or other persons by simply filling out the Form 8888, *Allocation of Refund (Including Savings Bond Purchases)*. Through May 2, 2012, a total of 42,212 individuals requested to convert tax refunds totaling more than $22 million into savings bonds. This represents almost a 40 percent increase over the same period last filing season.

In addition, individuals can still elect to have their Federal income tax refunds split and electronically deposited in up to three accounts, *e.g.*, checking, savings, or Individual Retirement Arrangement, and may have up to three different U.S. financial institutions, including banks, brokerage firms, or credit unions. Form 8888 must also be prepared for this option. As of May 2, 2012, a total of 868,333 individuals chose to split tax refunds totaling more than $3.7 billion between two or three different accounts. The number of individuals using the split tax refund option increased more than 15 percent compared to the same period last filing season.

The IRS continues to recover erroneous Qualified Motor Vehicle deductions

In April 2011, we reported that the IRS did not effectively identify 7,756 potentially erroneous Qualified Motor Vehicle deductions totaling more than $152 million.[15] IRS processes did not identify excessive claims, did not identify ineligible taxpayers, and did not ensure that tax refunds were stopped where the IRS identified the deduction as excessive. In response to our report, IRS management agreed to review erroneous Qualified Motor Vehicle deductions identified during our review. In our 2011 Filing Season review, we determined that the IRS had assessed $3 million in erroneous Qualified Motor Vehicle deductions.

As of April 19, 2012, the IRS had assessed an additional 1,563 taxpayers for erroneous Qualified Motor Vehicle deductions of almost $3.6 million. Figure 4 shows a breakdown of erroneous Qualified Motor Vehicle deductions assessed as of April 19, 2012.

[15] See Appendix V, report Ref. No. 2011-41-037.

Figure 4: Erroneous Qualified Motor Vehicle Deductions Assessed by the IRS

Time Period	Number of Taxpayers	Dollars Assessed
As of May 28, 2011	2,034	$3.0 million
Between May 29, 2011, and April 19, 2012	1,563	$3.6 million
Total	**3,597**	**$6.6 million**

Source: TIGTA analysis of IRS Master File as of April 19, 2012.

As of April 19, 2012, the IRS has assessed more than $6.6 million in erroneous Qualified Motor Vehicle deductions claimed on 3,597 (46 percent) of the 7,756 tax returns we identified in our April 2011 report.

Use of Customer Assistance Tools Continues to Increase

Taxpayers have several options from which to choose when they need assistance from the IRS, including telephone assistance through the toll-free telephone lines, face-to-face assistance at the Taxpayer Assistance Centers and Volunteer Program sites, and self-assistance through IRS.gov.

Face-to-face assistance at the Taxpayer Assistance Centers

The Taxpayer Assistance Centers are walk-in sites where taxpayers can obtain answers to both account and tax law questions, as well as receive assistance in preparing their tax returns. The IRS assisted approximately 2.3 million taxpayers during the 2012 Filing Season and plans to assist 6.1 million taxpayers in Fiscal Year 2012. During Fiscal Year 2011, the Taxpayer Assistance Centers served almost 6.4 million taxpayers, which included 2.8 million taxpayers served during the 2011 Filing Season. According to the IRS, as of April 21, 2012, 74 percent of the taxpayers who waited to speak to assistors at the 398 Taxpayer Assistance Centers that track wait time waited fewer than 30 minutes.[16]

Figure 5 shows the number of contacts by product line at the Taxpayer Assistance Centers for Fiscal Years 2009 through 2012.

[16] Tracking begins when the taxpayer is provided a ticket inside the Taxpayer Assistance Center and does not include the time a taxpayer may wait outside a Taxpayer Assistance Center.

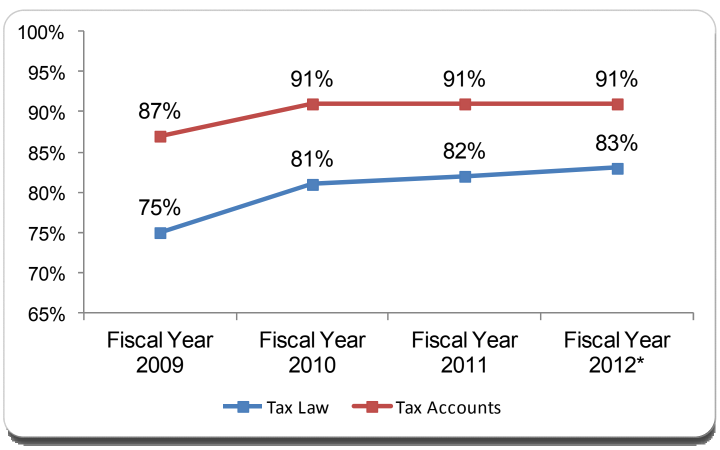
Figure 5: Contacts for Fiscal Years 2009 Through 2012 (in millions)

Contacts/Product Lines	Fiscal Year			
	2009	2010	2011	2012 Projections
Tax Accounts Contacts	3.2	3.5	3.7	3.6
Forms Contacts	0.8	0.7	0.6	0.6
Other Contacts[17]	1.5	1.5	1.5	1.7
Tax Law Contacts	0.3	0.3	0.3	0.2
Tax Returns Prepared[18]	0.4	0.4	0.3	
Totals	**6.2**	**6.4**	**6.4**	**6.1**

Source: IRS management information reports.

In Fiscal Year 2007, the IRS implemented a standardized quality measurement system to measure the quality of taxpayer service at its Taxpayer Assistance Centers. Fiscal Year 2007 was the baseline year. As shown in Figure 6, the accuracy rates are 75 percent or above.

Figure 6: Accuracy Rates for Fiscal Years 2009 Through 2012



*Source: IRS management information reports. *=Projected.*

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[17] Other Contacts includes Form 2063, *U.S. Departing Alien Income Tax Statement*; date-stamping tax returns brought in by taxpayers; screening taxpayers for eligibility of service; scheduling return preparation appointments; and helping taxpayers with general information such as addresses and directions to other IRS offices or other Federal Government agencies.

[18] In Fiscal Year 2012, Tax Returns Prepared is included in Other Contacts.

As a result of budget constraints, tax return preparation was provided only on a limited number of days per week and only on a first come, first served basis. Appointments were not available. The IRS hoped this would allow it to still provide tax return preparation to the many taxpayers who need it, but not to the detriment of other taxpayers with tax law and account issues. The IRS directed taxpayers and employees to alternative services for tax return preparation, such as Volunteer Income Tax Assistance, Free File, and Fillable Forms.

The IRS also did not provide extended hours for the Taxpayer Assistance Centers during the 2012 Filing Season. It had planned to extend hours of operation in approximately 47 Taxpayer Assistance Centers—before 8:30 a.m. and after 4:30 p.m. during the week and on some Saturdays. However, with budget cuts and continuing staffing shortages, Taxpayer Assistance Center hours were not extended.

Toll-free telephone assistance

Despite other options available to taxpayers, many taxpayers choose to use the telephone to contact the IRS. More taxpayers are calling the IRS's toll-free telephone lines every year. During the 2012 Filing Season, the IRS received approximately 90.4 million attempts from taxpayers calling the various Customer Account Services function toll-free telephone assistance lines[19] seeking help in understanding the tax law and meeting their tax obligations.[20] IRS assistors answered 13.3 million calls and achieved a 68.3 percent Level of Service and a 946 second (15.8 minutes) Average Speed of Answer. The IRS answered almost 41 million calls through automation.

A reduction in funding for toll-free telephone and correspondence services resulted in a Level of Service goal for Fiscal Year 2012 of 61 percent, compared to 70 percent the IRS achieved in Fiscal Year 2011. The last year the IRS provided a Level of Service more than 80 percent was Fiscal Year 2007. This decrease translates to longer customer wait times, increased customer abandons, and an increased number of customers redialing the IRS toll-free telephone lines for service.

In August 2011, the TIGTA reported that increased call demand and limited resources continue to adversely affect the toll-free telephone level of service.[21] In the 2011 Filing Season, the IRS received 48 percent more calls than during the 2007 Filing Season. Taxpayers waited on average 10 minutes to speak to an assistor, a 137 percent increase since the 2007 Filing Season. Nevertheless, the IRS reduced the operating hours for its main toll-free telephone help line, (800) 829-1040, from 7:00 a.m. to 10:00 p.m. local time to 7:00 a.m. to 7:00 p.m. local time.

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[19] The IRS refers to the suite of 28 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."
[20] Toll-free telephone assistance data presented in this report were taken from available IRS reports through the week ending April 21, 2012.
[21] See Appendix V, report Ref. No. 2011-40-087.

Over the same period (from the 2007 Filing Season to the 2011 Filing Season), the IRS's ability to process taxpayer correspondence in a timely manner also declined. Assistors who answer the toll-free telephone lines also handle taxpayer correspondence (including processing amended returns and identity theft cases). During the filing season, when call demand is usually at its highest, more resources are shifted to the telephones to answer calls, and correspondence and adjustment inventory processing is placed on hold until call demand subsides. As call volumes have increased and assistors have been moved to answer telephone calls, paper correspondence inventories have substantially increased. The correspondence inventory rose from approximately 480,000 at the end of Fiscal Year 2007 to more than 628,000 at the end of Fiscal Year 2010.[22] As of March 3, 2012, correspondence inventory was 816,905.

Tax preparation assistance at Volunteer Program sites

The Volunteer Program[23] plays an increasingly important role in the IRS's efforts to improve taxpayer service and facilitate participation in the tax system. It provides no-cost Federal tax return preparation and e-filing to underserved taxpayer segments, including low-income, elderly, disabled, and limited-English-proficient taxpayers. These taxpayers are frequently involved in complex family situations that make it difficult to correctly understand and apply tax law.

We visited 39 Volunteer Income Tax Assistance and Tax Counseling for the Elderly sites to determine if taxpayers receive quality service, including accurate preparation of their individual income tax returns. We developed scenarios designed to test quality controls and training the volunteers received in preparation for the 2012 Filing Season.

For the 2012 Filing Season, we had 39 tax returns prepared with a 49 percent accuracy rate, which is higher than the 39 percent accuracy rate we reported for the 2011 Filing Season. See our report on the quality of income tax preparation at Volunteer Program sites for the 2012 Filing Season.[24]

Figure 7 presents comparisons of Volunteer Program activities for the 2009 through 2012 Filing Seasons.

[22] Fiscal Year 2010 correspondence inventory is reported through the week ending September 25, 2010.
[23] The Volunteer Program is comprised of the Volunteer Income Tax Assistance Program, including the Volunteer Income Tax Assistance Grant Program, and the Tax Counseling for the Elderly Program.
[24] See Appendix V, report Ref. No. 2012-40-088.

Figure 7: Year-to-Date Comparisons of Volunteer Program Activities for the 2009 Through 2012 Filing Seasons

	2009 Actual	2010 Actual	2011 Actual	2012 Actual
Volunteer Return Preparation	2,873,235	2,898,756	2,998,202	3,133,251
Volunteer E-Filing	95.4%	96.3%	97.0%	97.7%

Source: IRS 2009 through 2012 Filing Seasons Weekly Reports.

Self-assistance through IRS.gov and social media

The IRS is committed to helping taxpayers obtain the information they need to help them comply with the tax law. The IRS is offering more self-assistance options that taxpayers can access 24 hours a day, seven days a week.

Foremost is the IRS's public Internet site, IRS.gov. As of April 21, 2012, the IRS had reported a 20.4 percent increase in the number of visits to IRS.gov over the same period in the prior filing season. It had also reported a 71.4 percent increase in the number of taxpayers obtaining their refund information online via the "Where's My Refund" option found on IRS.gov. Figure 8 shows the year-to-date comparisons of various IRS.gov activity levels for the 2009 through 2012 Filing Seasons. The significant increase in the use of "Where's My Refund" in the 2012 Filing Season may be due to the problems with IRS filters and the MeF system that caused delays early in the filing season.

Figure 8: Year-to-Date Comparisons of IRS.gov Activity Levels for the 2009 Through 2012 Filing Seasons

	2009 Actual	2010 Actual	2011 Actual	2012 Actual
IRS.gov Visits	185,812,939	182,827,614	198,745,670	239,283,037
"Where's My Refund?"	45,319,260	52,837,745	63,545,026	108,896,851

Source: IRS 2009 through 2012 Filing Seasons Weekly reports.

The IRS also uses social media platforms and tools to share the latest information on tax changes, initiatives, products, and services. The IRS uses five different types of social media outlets and one mobile application, IRS2Go:

1. **IRS2Go.** "IRS2Go" is a smartphone application that allows taxpayers to check the status of their tax refund and obtain helpful tax information on certain mobile devices. The IRS first offered its "IRS2Go" app in January 2011 and in Calendar

Year 2011 had more than 350,000 downloads. This year, IRS2Go includes six tools.

- **Get Your Refund Status.** Taxpayers can check the status of their Federal income tax refund.
- **Get Tax Updates.** Taxpayers can use IRS2Go to subscribe to filing season tax updates by entering their e-mail address to automatically get daily tax tips issued daily during the tax filing season and periodically during the rest of the year.
- **Follow The IRS.** Taxpayers can use IRS2Go to sign up to follow the IRS Twitter news feed, @IRSnews.
- **Watch The IRS.** IRS2Go delivers video from the IRS YouTube channel to the mobile device.
- **Get The Latest News**. IRS news is available via IRS2Go as soon as it is released to the public.
- **Get My Tax Record.** Taxpayers can request their tax return or account transcript using their mobile device.

2. **YouTube.** The IRS publishes informational videos in English, multilingual, and American Sign Language on various tax administration topics beneficial to taxpayers.
3. **Twitter.** IRS tweets include tax-related announcements, news for tax professionals, and updates for job seekers.
4. **Podcasts.** The IRS creates audio files for use in podcasts. These short audio recordings provide useful information on one tax-related topic. These files are also available as podcasts on iTunes and through the Multimedia Center on IRS.gov as downloadable audio files (along with their transcripts).
5. **Widgets**. Widgets are tools that can be placed on websites, blogs, or social media networks to direct others to IRS.gov for information. The IRS has developed a variety of widgets that feature the latest tax initiatives and programs.
6. **Really Simple Syndication.** Really Simple Syndication is a way to get the news whenever it is updated through a family of web feed formats used to publish frequently updated works. Really Simple Syndication allows taxpayers and practitioners a way to gather a wide variety of content in one place on their computers, even if they are not on IRS.gov.

Not All Paid Tax Return Preparers Are Complying With the Recently Added Earned Income Tax Credit Due Diligence Requirement

The IRS implemented a new tax return preparer due diligence requirement for the 2012 Filing Season to improve the accuracy of EITC claims.[25] Beginning in January 2012, paid tax return preparers are required to attach Form 8867 to each tax return they prepare that claims an EITC. However, despite extensive efforts on the part of the IRS to communicate the new EITC due diligence requirement, not all paid tax return preparers are attaching the Form 8867 to their clients' EITC claims. The IRS reported that as of May 3, 2012, it processed 12.9 million tax returns with EITC claims totaling $38.7 billion that were prepared by paid tax return preparers. Almost 534,000 (4 percent) tax returns with EITC claims totaling more than $1.5 billion were filed without the required Form 8867.

Although as many as one in five eligible taxpayers fail to claim the EITC, some of those who claim it either compute it incorrectly or are ineligible. In Calendar Year 2011, more than 26 million people received nearly $59 billion in EITCs. Tax professionals prepared close to 66 percent of these claims. The Department of the Treasury estimates that between $14 and $17 billion were erroneous EITC claims. The due diligence requirements, enacted by Congress more than a decade ago, were designed to reduce errors on tax returns claiming the EITC.

The IRS created Form 8867 to help tax return preparers meet the requirement of obtaining eligibility information from their clients.

The IRS created Form 8867 to help tax return preparers meet the requirement of obtaining eligibility information from their clients. Prior to January 2012, tax return preparers were required to keep a Form 8867 in their records for each EITC claim they filed. The new requirement to attach the Form 8867 to the tax return is part of the IRS initiative to ensure that the credit is afforded to taxpayers who qualify. The regulations also reflect recent congressional action to increase the penalty for noncompliance with the due diligence requirements from $100 to $500 per occurrence.

The IRS took immediate steps to communicate both the requirement to attach the Form 8867 to EITC claims as well as the increased penalty for noncompliance with the due diligence requirements. In addition, the IRS developed a process to identify tax return preparers who failed to attach the required Form 8867 to filed EITC claims.

During the 2012 Filing Season, the IRS assigned an indicator to taxpayers' accounts when the tax return preparer did not attach a Form 8867 to a Tax Year 2011 return claiming the EITC. However, the IRS did not assess the EITC due diligence penalty on noncompliant tax return preparers.

[25] Treas. Reg. § 1.6695–2.

IRS management indicated that the new requirement did not become effective until December 20, 2011, and although the IRS had taken immediate steps to communicate the requirement to the preparer community, it is possible the message was not fully disseminated before the filing season began. Management stated that they plan to send notices to those tax return preparers who did not comply with the requirement to attach the Form 8867 to remind them of the requirement. The notices will also address penalty consequences associated with noncompliance. The IRS plans to assess penalties for noncompliance for Tax Year 2012 returns.

Processing Homebuyer Credit Repayments Has Improved, but Some Taxpayer Repayments Continue to Be Inaccurately Processed

The IRS has developed adequate controls to prevent the Homebuyer Credit from being allowed for purchases with ineligible purchase dates.[26] In addition, the IRS continues to develop processes and procedures to assist individuals with the Homebuyer Credit repayment requirements. To assist these individuals, the IRS developed an online web tool that enables individuals to check the amount of their repayment obligation. However, the IRS is not accurately processing Homebuyer Credit repayments and dispositions. The IRS incorrectly processed:

- Homebuyer Credit installment payments processed through May 2, 2012, resulting in the issuance of almost $2.6 million in erroneous tax refunds and more than $290,000 in incorrect assessments to taxpayers' tax accounts for Tax Year 2011.
- Taxpayers' dispositions of property used to claim the Homebuyer Credit processed through December 31, 2011, resulting in more than $14.6 million not being properly assessed to taxpayers' tax accounts, and more than $650,000 incorrectly over-assessed to taxpayers' tax accounts.

Individuals who claimed the Homebuyer Credit for a home purchased between April 9 and December 31, 2008, are required to repay the credit in annual installments beginning with their Tax Year 2010 return. In addition, taxpayers who received the Homebuyer Credit must repay the credit, less any installment payments made, if they dispose of the home or if the home ceases to be their primary residence.[27]

Figure 9 shows the number of Homebuyer Credit claims, installments, and dispositions the IRS processed as of May 2, 2012.

[26] Only members of the uniformed services, the Foreign Service, or the intelligence community qualify to claim the Homebuyer Credit in Tax Year 2011. The credit is also limited to homes purchased prior to May 1, 2011, and for home purchases contracted prior to May 1, 2011, which are completed before July 1, 2011.
[27] For purposes of the credit, a home is disposed if the taxpayer sold the home or the home was foreclosed upon, converted the home for rental or business use, or the home was destroyed or condemned. A home is also considered to be disposed when ownership of the home is transferred as part of a divorce settlement.

Figure 9: Homebuyer Credits, Installments, and Dispositions as of May 2, 2012

Tax Year 2011 First-Time Homebuyer Credits Processed Through May 2, 2012			
Category	**Number of Tax Returns**	**Number of Individuals**	**Dollar Amount of Homebuyer Credit Reported by Taxpayers**
New Claims	9,993	N/A	$70,736,141
Installments	745,671	1,048,147	$316,309,424
Dispositions	37,244	46,708	$71,062,216

Source: TIGTA analysis of the IRS's Individual Return Transaction File as of May 2, 2012.

Processing Homebuyer Credit installment payments

As of May 2, 2012, the IRS had erroneously processed Homebuyer Credit installment payments made by 7,369 taxpayers. As a result, the IRS erroneously:

- Refunded almost $2.6 million in Homebuyer Credit installment payments to 6,288 taxpayers who correctly reported the required repayment amounts on their tax returns.
- Assessed additional Homebuyer Credit installment payments totaling more than $290,000 on 1,081 taxpayers' tax accounts who correctly reported the required repayment amounts on their tax returns.

In September 2011,[28] we reported that programming errors caused inaccurate processing of Homebuyer Credit repayments. As a result, the IRS developed a process to identify taxpayers who do not report the required Homebuyer Credit installment payment amount as an additional tax on their tax return. The IRS developed a program to compute the amount it expects the taxpayer to report on either line 59b of Form 1040 or on Form 5405. When tax returns are filed, the IRS matches the amount reported on the tax return to the amount it expected to receive. If a discrepancy exists, the tax return is sent to the IRS's Error Resolution System function for review. However, the IRS's Homebuyer Credit repayment computation program was not always correctly computing the amount that the taxpayer was required to repay.

We notified the IRS of this issue on February 21, 2012. According to IRS management, the following conditions were associated with the erroneous refunding of Homebuyer Credit installment payments.

[28] See Appendix V, report Ref. No. 2011-40-128, p. 11.

- Information regarding the amount of the Homebuyer Credit installment payment owed was not always correctly populating for MeF system tax returns. IRS management stated that they planned to extract data to identify taxpayers whose repayments were erroneously refunded and planned to contact these taxpayers to notify them that a repayment should be made to the IRS.
- Information included on the Homebuyer Credit Entity Section of taxpayers' tax accounts incorrectly showed some taxpayers as not having a repayment requirement. When a taxpayer sent in a repayment amount and IRS records showed no repayment obligation, the amount repaid was refunded to the taxpayer. The IRS changed procedures alerting tax examiners to fully research tax accounts for which a repayment is made but IRS records show no repayment is due.
- Tax examiners processed Homebuyer Credit installment payments in error if individuals repaid more than required. In those cases, the excess amount was erroneously refunded. The IRS updated guidance for how to handle installment payments in excess of the amount owed.

Processing Homebuyer Credit dispositions

As of May 2, 2012, the IRS had inaccurately processed 66 percent (3,819 tax accounts) of the 5,756 taxpayer accounts it had processed as of December 31, 2011, where the taxpayer filed a joint tax return with his or her spouse when the Homebuyer Credit was claimed but the ownership of the property was later transferred as part of a divorce settlement. The IRS incorrectly:

- Overstated the net Homebuyer Credit repayment obligation for 136 tax accounts by more than $650,000. As a result, the IRS incorrectly assessed more than $650,000 in additional tax to these 136 tax accounts.
- Understated the net Homebuyer Credit repayment obligation for 3,683 tax accounts by more than $13.1 million. As a result, the amount the taxpayers were required to repay was erroneously reduced by more than $13.1 million in Homebuyer Credit repayments.

When ownership of a home used to claim the Homebuyer Credit is transferred in a divorce, the credit repayment obligation less any repayments that have been made is transferred to the spouse that receives full ownership of the home. This transfer is reported on Part III, Line 13, Box E of Form 5405. For example:

Taxpayers A and B file a joint tax return and claim a $7,500 Homebuyer Credit. Taxpayer A's tax account will show a credit repayment obligation of $3,750 and Taxpayer B's tax account will show a credit repayment obligation of $3,750. The couple makes a $500 Homebuyer credit repayment. The IRS credits one-half of the repayment to each taxpayer. As a result, Taxpayer A's tax account now shows a net repayment obligation of

$3,500 and Taxpayer B's tax account now shows a net repayment obligation of $3,500.

The couple gets divorced and Taxpayer A transfers ownership of the home to Taxpayer B. When ownership of the home is transferred, the net repayment obligation for Taxpayer A is transferred to Taxpayer B. As a result, Taxpayer A's tax account will now show a $0 repayment obligation and Taxpayer B's tax account will show a $7,000 net repayment obligation.

We notified the IRS of this issue on April 30, 2012. IRS management indicated that programming errors resulted in the incorrect computation of the Homebuyer Credit repayment amount when one ex-spouse reports the disposal of the home for which the couple took the credit and the other ex-spouse reports the transfer of the repayment obligation. IRS management stated that they will correct the computer programming and take action to correct the tax accounts processed incorrectly this year.

Processing of dispositions of property that was sold, converted to rental or business property, or no longer being used as the taxpayer's primary residence needs improvement

Taxpayers who sell a home for which the Homebuyer Credit was claimed, convert the home for rental or business use, or no longer use the home as a main home compute the amount of the Homebuyer Credit that has not yet been repaid in Part IV of Form 5405. Our analysis of a statistically valid sample of 189[29] Tax Year 2010 returns reporting these dispositions indicates the IRS did not identify taxpayers' errors in reporting the amount of Homebuyer Credit that was to be repaid.

- 49 (26 percent) tax returns reported a disposition of property on Form 5405 but made an installment payment instead of repaying $235,484 in outstanding Homebuyer Credits. We estimate that 96[30] taxpayers incorrectly reported installment payments instead of repaying Homebuyer Credits totaling approximately $459,754.[31] We notified the IRS of this issue on May 29, 2012. The IRS responded that the taxpayer's Homebuyer Credit amount does not affect the processing of a payment of the credit. However, incorrect information in taxpayers' Homebuyer Credit accounts led to erroneous processing of the payments. Subsequent to these payments being processed incorrectly, corrections were made to correct the Homebuyer Credit information in taxpayers' accounts to resolve this problem for future payments.

[29] Our sample size is based on a population of 369, a confidence level of 95 percent, an expected error rate of 50 percent, and a precision of ±5 percent.
[30] Our projection is based on a 95 percent confidence level, a point estimate of 96, and a range of 80 to 112 taxpayers.
[31] Our projection is based on a 95 percent confidence level, a point estimate of $459,754, and a range of $365,747 to $553,760.

- 89 (47 percent) tax returns where taxpayers understated their Homebuyer Credit claims by $511,933. We estimate that 174[32] taxpayers understated the amount of Homebuyer Credit claimed by almost $1 million[33] when reporting the disposition of the property. We notified the IRS of this issue on May 29, 2012. The IRS responded that the inaccuracy of the information in the taxpayers' Homebuyer Credit account and inconsistent retrieval of the correct information needed to process the taxpayers' payments by tax examiners led to incorrect processing of payments. These payments in our sample appeared to be processed in the first months of the filing season when the procedures for retrieving the correct information were new and tax examiners inconsistently followed the procedures. As the tax examiners became more familiar with the procedures and followed them more consistently, the number of incorrectly processed payments tapered off.

The IRS stated it plans to take actions to make assessments for the 138 accounts identified in our samples. Analysis of Homebuyer Credit dispositions reported on Tax Year 2011 returns processed as of May 2, 2012, indicates that the IRS has improved its processes for identifying taxpayer reporting errors on dispositions.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Ensure that the required Homebuyer Credit repayment field in taxpayers' tax accounts is accurately populated with the amount that must be repaid by each taxpayer.

> ***Management's Response:*** The IRS agreed with this recommendation. On February 28, 2012, programming changes were made to ensure the required Homebuyer Credit repayment field in taxpayers' tax accounts is accurately populated. There have been no further reports of problems since the program correction was implemented.

Recommendation 2: Ensure that tax examiners processing Homebuyer Credit repayments and installment payments process the payments accurately and make correct adjustments to the taxpayers' accounts.

> ***Management's Response:*** The IRS agreed with this recommendation. On May 4, 2012, Servicewide Electronic Research Program Alert #12A0329 was issued to advise Error Resolution System function tax examiners of the correct procedures as stated in Internal Revenue Manual 3.12.3, Error Resolution – Individual Income Tax Returns. Adjustment notices for the First-Time Homebuyer Credit payment have been monitored

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[32] Our projection is based on a 95 percent confidence level, a point estimate of 174, and a range of 155 to 192 taxpayers.

[33] Our projection is based on a 95 percent confidence level, a point estimate of $999,489, and a range of $880,865 to $1,118,113.

closely. Monitoring will continue for the remainder of the year. Additionally, information on processing the First-Time Homebuyer Credit repayment is being included in the Error Resolution System function training at each submission processing site prior to the 2013 Filing Season.

Recommendation 3: Initiate a program to recover the $2.6 million in Homebuyer Credit installment payments erroneously refunded to 6,288 taxpayers.

Management's Response: The IRS agreed with this recommendation. Corrective programming and procedures have been implemented. An extract of impacted taxpayers is being compiled to identify those accounts to be subjected to recovery actions.

Recommendation 4: Initiate a program to recover more than $14.6 million in Homebuyer Credit repayments that were not properly assessed to taxpayers' accounts.

Management's Response: The IRS agreed with this recommendation. Corrective programming and procedures have been implemented. An extract of impacted taxpayers is being compiled to identify those accounts to be subjected to recovery actions.

Recommendation 5: Initiate a program to correct the 1,217 taxpayers' accounts that were incorrectly assessed more than $940,000.

Management's Response: The IRS agreed with this recommendation. Corrective programming and procedures have been implemented. An extract of impacted taxpayers is being compiled to identify those accounts to be subjected to corrective actions.

Taxpayers Received Nonbusiness Energy Property Credits in Excess of the Maximum Amount Allowed

In our 2011 Filing Season report,[34] we reported that the IRS had not developed processes to ensure taxpayers did not claim more than the $1,500 maximum amount allowed for the Nonbusiness Energy Property Credit for Tax Years 2009 and 2010. For Tax Year 2011, the maximum amount allowed for the credit over multiple years has been reduced to $500.[35] Again during the 2012 Filing Season, the IRS did not develop processes to ensure that taxpayers did not claim more than the maximum allowed $500 for the credit for Tax Years 2009, 2010, and 2011.

We notified the IRS of our concerns on May 3, 2012. IRS management responded that they agreed with our finding that some taxpayers were erroneously allowed the Nonbusiness Energy Property Credit in excess of the $500 maximum limit on their Tax Year 2011 return. The IRS performed additional analyses and determined that 125,684 taxpayers claimed more than the maximum $500 limit on the Nonbusiness Energy Property Credit. The total amount erroneously claimed was $29.7 million.

[34] See Appendix V, report Ref. No. 2011-40-128, p. 19.
[35] If a taxpayer and his or her spouse owned and lived apart in separate main homes, they may each qualify for $500.

The IRS reported that it plans to address this category of returns not previously caught by its suite of compliance detection tools through the Automated Questionable Credit (AQC) work stream. Plans are to begin this work during Processing Year 2012 when resources become available.

Recommendation

Recommendation 6: The Commissioner, Wage and Investment Division, should initiate a program to recover the $29.7 million in Nonbusiness Energy Property Credits erroneously allowed to 125,684 taxpayers who claimed more than the maximum $500 limit.

> ***Management's Response:*** The IRS agreed with this recommendation. It will initiate actions to recover Nonbusiness Energy Property Credits allowed to taxpayers who claimed more than the maximum lifetime amount.

Individuals Are Claiming Students for the American Opportunity Tax Credit Who, Based on Age, Are Unlikely to Be Pursuing an Undergraduate Degree or Vocational Certification.

The American Recovery and Reinvestment Act of 2009 (the Recovery Act)[36] provided funding to address college affordability and improve access to higher education. One tax provision amended the existing Hope Credit to allow a refundable tax credit, the American Opportunity Tax Credit (AOTC), for higher education expenses up to $4,000 for Tax Years 2009 and 2010. The maximum AOTC is $2,500 per student and the first 40 percent of the credit (up to $1,000) is fully refundable. Taxpayers can receive the credit only for students who attend at least half-time for at least one academic period and are pursuing an undergraduate degree or vocational certification. In our prior review of the AOTC,[37] we reported that as of May 28, 2010, 2.1 million taxpayers received $3.2 billion in education credits that appeared to be erroneous.

As a follow up to this prior review, we notified the IRS on January 5, 2012, that we had identified approximately 35,000 individuals who were younger than the typical age of individuals to be enrolled in a four-year college degree program or vocational school certificate program who were claimed for the AOTC. It appeared that the individuals were used to erroneously claim the AOTC on Tax Year 2009 returns. Of the 35,000 individuals, 13,870 were age 10 and younger. We provided the information for the IRS's consideration to develop processes and procedures to identify similar claims to ensure erroneous education credits were not paid.

[36] Pub. L. 111-5, 123 Stat. 115 (2009).
[37] See Appendix V, report Ref. No. 2011-41-083.

Additional review identified 109,618 taxpayers as of May 2, 2012, who received refundable AOTC for Tax Year 2011 totaling more than $159 million for students who were of an age that are unlikely to be enrolled in a four-year college degree program. We identified:

- 39,901 taxpayers who received refundable AOTC totaling $69.7 million for students aged 10 and younger.
- 57,941 taxpayers who received refundable AOTC totaling $76.7 million for students aged 11 through 16.
- 11,776 taxpayers who received refundable AOTC totaling $12.6 million for students aged 80 and older.

Because it is improbable the students in these age groups are enrolled in either a four-year college degree program or a vocational school certificate program, these claims are potentially erroneous.

We again notified the IRS of this issue on April 30, 2012. The IRS responded that it had reviewed our analysis and agreed with the conclusion that the AOTC had been claimed by some taxpayers for students who are outside the typical age range for college or vocational school programs. A sample review of the accounts identified as claiming students in the 80 years or older age range indicated that approximately one-half were attributable to errors in entering the student's Social Security Number on the tax return. For example, transposed digits or a single incorrect digit caused the student to appear in the analysis to be of a questionable age. Other accounts in this age range had indications of potential identity theft and are being reviewed in more depth for filter enhancements and notification of potential victims.

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During the 2012 Filing Season, filters were implemented to identify potential Identity Theft returns and route them to the Taxpayer Protection Unit for review and resolution. On March 3, 2012, a filter was implemented to supplement the Identity Theft filters by detecting questionable AOTC claims by elderly taxpayers, because the combination of age and education credits are common indicators of potential identity theft. The IRS stated that it also began testing on the AQC program. The AQC program is a cost-efficient program intended to address returns where there is reasonable certainty an erroneous deduction or credit was claimed but the IRS does not have math error authority to deny the deduction or credit. The AQC program is emerging from the pilot phase and will be used to address questionable AOTC claims filed in Tax Year 2011 and earlier tax returns.

The IRS reported that as of June 22, 2012, it had frozen refunds exceeding $24 million on 2,517 accounts. It has corrected 2,672 accounts through correspondence or examination adjustments. Another 3,711 returns are in the examination process and 4,895 are being reviewed for potential identity theft, duplicate return conditions, or amended return consideration. Those claims not previously addressed will be reviewed and, as warranted, subjected to the examination processes.

In order to better identify questionable claims and prevent refunds from being issued on those found to be erroneous during the 2013 Filing Season, the IRS stated that it has developed and is testing an underage filter that will be implemented to supplement the existing Identity Theft and Elderly filters. The IRS will also use the AQC program to initiate correspondence to taxpayers and, if appropriate, issue the requisite Statutory Notices of Deficiency to disallow erroneous credit claims before payment. For those cases that are not appropriate for resolution through the AQC program, the IRS plans to continue to use existing examination resources to supplement its efforts to address erroneous claims.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 7: Require taxpayers who claim the AOTC for students who are not an appropriate age to be enrolled in a four-year college degree program or a vocational certificate program to provide proof of enrollment.

> ***Management's Response:*** The IRS agreed with this recommendation. It will explore the feasibility of using existing evaluative filters applied during return processing, or develop additional filters, that will consider the age of the student for purposes of identifying questionable claims for the AOTC. The law providing for the AOTC does not base eligibility for the credit on age; however, the age of the student can be used in evaluating the probable validity of the claim, and those that appear to be improbable may be referred for eligibility determination under deficiency procedures.
>
> With regard to determining proof of enrollment, Form 8863, *Education Credits (American Opportunity and Lifetime Leaning Credits)*, has been revised for Tax Year 2012 to require detailed education institution information that can be matched against IRS and third-party data.

Recommendation 8: Initiate a recovery program to recover the more than $159 million for the 109,618 individuals who received the AOTC for students who were of an age unlikely to be enrolled in a four-year college degree program.

Management's Response: The IRS agreed with this recommendation. It will complete its analysis of the individuals identified by the TIGTA and determine the extent to which recovery actions should be initiated. As noted in the report, the list contained individuals with transposed or erroneous digits in the student's Social Security Numbers. These errors, made on the tax returns, caused those individuals to appear to be outside the typical student age range when the data were analyzed; however, upon further review of prior-year tax returns, the IRS was able to identify where the error occurred and ascertain that the subject student was, in fact, within the traditional student age range.

Office of Audit Comment: While IRS management agreed to consider students' ages when assessing the probable validity of an AOTC claim, they did not agree with our estimate of the revenue that can be protected by doing so. IRS management does not believe our estimate adequately considers ongoing efforts to identify questionable tax refunds. However, the IRS based its disagreement on ongoing activity of fewer than 14,000 of the more than 109,000 tax returns we identified with questionable AOTC claims. In addition, the results of the IRS's examination program, as well as the questionable AOTC claims identified in the IRS's Identity Theft and Questionable Refund programs, demonstrate that these claims are most likely erroneous.

Recommendation 9: ***********************2(f)**
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Management's Response: ***********************2(f)*****************
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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to evaluate whether the IRS timely and accurately processed individual paper and e-filed tax returns during the 2012 Filing Season.[1] To accomplish this objective, we:

I. Identified volumes of paper and e-filed tax returns received through April 28, 2012, from the IRS Weekly Filing Season reports that provide a year-to-date comparison of scheduled return receipts to actual return receipts. The reports also provide a comparison to 2011 receipts for the same time period.

II. Determined if the IRS has correctly implemented selected tax legislation that affects the processing of individual taxpayer returns during the 2012 Filing Season.

   A. Determined if the selected tax law provisions were correctly implemented into tax return processing systems at the submission processing sites by assessing the accuracy of tax returns processed with the new changes. We used computer analysis of 100 percent of the Tax Year 2011 individual income tax returns processed nationally on the Individual Return Transaction File between January 1 and May 2, 2012.[2]

   B. Electronically identified 359,905 tax returns claiming $774 million in EITCs on Form 1040, *U.S. Individual Income Tax Return*, Line 64a, that were prepared by paid tax return preparers and determined if the due diligence penalty for paid tax return preparers was assessed when Form 8867, *Paid Preparer's Earned Income Credit Checklist*, was not attached.

   C. Electronically identified and evaluated 9,993 tax returns claiming the Homebuyer Credit on Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit*, to determine if tax returns were processed correctly.

   D. Electronically identified and evaluated 745,671 tax returns reporting installment payments of $316,309,424 of Homebuyer Credit on Form 5405 for homes purchased in 2008 to determine whether the installment payment was properly posted to the Individual Master File account.

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

[2] To assess the reliability of computer-processed data, programmers in the TIGTA Office of Strategic Data Services validated the data that were extracted and we verified the data with appropriate documentation. Judgmental samples were selected and reviewed to ensure that the amounts presented were supported by external sources.

E. Electronically identified 54,350 taxpayers disposing of a residence in Tax Year 2010 and 46,708 taxpayers disposing of a residence in Tax Year 2011 that was used to claim the Homebuyer Credit to determine if the taxpayers accurately reported the disposition and associated repayment amount and determined if the dispositions were processed correctly. We reviewed a statistical sample of 189 accounts to determine if the IRS identified taxpayers' errors in reporting the amount of Homebuyer Credit that was to be repaid. Our sample size was based on a population of 369, a confidence level of 95 percent, an expected error rate of 50 percent, and a precision of ±5 percent.

F. Interviewed IRS management responsible for processing Nonbusiness Energy Property Credit claims to determine the controls and procedures the IRS had in place to identify individuals who claimed more than the $500 aggregate limit of Nonbusiness Energy Property Credits for Tax Years 2010, 2011, and 2012. We electronically identified and evaluated 1,475,919 e-filed Tax Year 2011 tax returns claiming the Nonbusiness Energy Property Credit on Form 5695, *Residential Energy Credits*, and on Form 1040, line 52, to determine whether the individual previously claimed the Nonbusiness Energy Property Credit in Tax Years 2009 and 2010. We performed computer analysis to determine if taxpayers were allowed to claim more than the $500 aggregate limit of Nonbusiness Energy Property Credits for the three years.

G. Electronically identified 11,452,287 Tax Year 2011 tax returns claiming the AOTC on Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*, Line 14 and on Form 1040, Line 66 and analyzed the ages of students' claimed for this credit.

H. Determined whether examinations for 5,722 individual tax returns previously identified by the TIGTA[3] with potentially erroneous Qualified Motor Vehicle deductions have been initiated and the amount of the assessments.

III. Compiled statistical information that is of interest to external stakeholders.

A. Obtained the results of Return Integrity and Correspondence Services Fraudulent Revenue Protected as of April 28, 2012.

B. Obtained the number of prisoner tax returns identified for screening during the 2012 Filing Season and compared statistics to the same period for the 2011 Filing Season.

C. Determined whether taxpayers were using the savings bond option for direct purchase of savings bonds from their tax refunds and whether taxpayers significantly increased their use of the split tax refund option by electronically identifying and counting the

[3] See Appendix of V, report Ref. No. 2011-41-037.

tax returns filed with Form 8888, *Allocation of Refund (Including Savings Bond Purchases).*

IV. Identified interim results for the IRS Taxpayer Assistance Center Program.

A. Obtained from the IRS Field Assistance Office statistics on taxpayers served at the Taxpayer Assistance Centers.

B. Reviewed the IRS Weekly Filing Season Report, which provides a year-to-date comparison of various Taxpayer Assistance Center activity levels for the 2009 through 2012 Filing Seasons.

V. Identified interim results for the IRS Toll-Free Telephone Assistance Program by reviewing Performance Templates and Executive Level Summary reports from the Enterprise Telephone Data Warehouse for results as of April 21, 2012.

VI. Identified interim results for the Volunteer Program by reviewing interim results from TIGTA visits to Volunteer Program sites. A total of 39 tax returns had been prepared as of April 21, 2012.[4]

VII. Identified interim results for IRS self-assistance through IRS.gov from the IRS Weekly Filing Season Report of IRS.gov activity levels for the 2010 and 2011 Filing Seasons, through April 21, 2012.

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 the following internal controls were relevant to our audit objective: the processes for planning, organizing, directing, and controlling program operations for the 2012 Filing Season. We accomplished this by monitoring the IRS weekly production meetings, reviewing IRS procedures, and interviewing IRS management. We also evaluated the controls that are incorporated directly into computer applications to help ensure the validity, completeness, accuracy, and confidentiality of transactions and data during application processing of tax returns for the 2012 Filing Season.

[4] See Appendix V, report Ref. No. 2012-40-088.

Appendix II

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Brian Hattery, Information Technology Specialist
Steven Vandigriff, Information Technology Specialist
Joseph L. Katz, Ph.D., Contractor, Statistical Sampling Consultant

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Services and Operations, Wage and Investment Division SE:W
Director, Business Modernization Office, Wage and Investment Division SE:W:BMO
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division SE:W:CAR
Director, Electronic Tax Administration and Refundable Credits, Wage and Investment Division SE:W:RICS
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM
Director, Field Assistance, Wage and Investment Division SE:W:CAR:FA
Director, Joint Operations Center, Wage and Investment Division SE:W:CAS:JOC
Director, Stakeholder Partnership, Education, and Communications, Wage and Investment Division SE:W:CAR:SPEC
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
Chief, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PEI
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Chief, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PEI

Appendix IV

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.

For most of the outcomes in this appendix, we conducted computer analysis of Tax Year 2011 individual income tax returns that were processed by the IRS submission processing sites[1] between January 1 and May 2, 2012, and were posted to the Individual Master File. We have also included one outcome that was a follow-up issue from a prior review. For this outcome, we conducted computer analysis of Tax Year 2009 Individual Master File transactions that posted between May 29, 2011, and May 2, 2012.

Type and Value of Outcome Measure:

- Revenue Protection – Actual; $3,587,953 in tax has been assessed for 1,563 taxpayers previously identified in another review[2] with excessive Qualified Motor Vehicle deductions (see page 4).

Methodology Used to Measure the Reported Benefit:

We previously reported that the process to identify potentially erroneous Qualified Motor Vehicle deductions was not effective and identified 7,756 taxpayers with potentially erroneous Qualified Motor Vehicle deductions. We reported that we planned to monitor the IRS's progress in verifying the 7,756 potentially erroneous Qualified Motor Vehicle deductions we identified and report the amount of increased tax liability for those Qualified Motor Vehicle deductions disallowed during our 2011 Filing Season review. In our 2011 Filing Season review, we reported that the IRS had assessed 2,034 taxpayers for erroneous Qualified Motor Vehicle deductions and recovered more than $3 million. We performed additional analysis of tax records during this review and determined that the IRS had assessed an additional 1,563 taxpayers for erroneous Qualified Motor Vehicle deductions and assessed an additional $3,587,953.

[1] See Appendix VI for a glossary of terms.
[2] See Appendix V, report Ref. No. 2011-41-037.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; $2,571,492 from 6,288 taxpayers who received erroneous refunds of their Homebuyer Credit repayments (see page 16).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify 6,288 taxpayers who correctly reported the required repayment amount of their Homebuyer Credit on their tax returns processed during the period January 1 through May 2, 2012, and had $2,571,492 in Homebuyer Credit repayments erroneously refunded.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 1,081 taxpayers were erroneously assessed $290,360 more in Homebuyer Credit installment payments than they were required to pay (see page 16).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify 1,081 taxpayers who were erroneously assessed $290,360 more in additional Homebuyer Credit installment payments than they were required to repay on tax returns processed during the period January 1 through May 2, 2012, because the repayment amount was incorrectly assessed as an additional amount.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $557,600 from 109 taxpayers who reported property dispositions that were under-assessed Homebuyer Credit repayment amounts (see page 16).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify 109 taxpayers who reported dispositions of property and were erroneously not assessed $557,600 more in Homebuyer Credit amounts from tax returns processed during the period January 1 through December 31, 2011, because the disposition was incorrectly processed.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 60 taxpayer accounts that were not credited $137,259 for Homebuyer Credit installment payments amounts that were paid (see page 16).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify 60 taxpayers who correctly reported the required repayment amount of their Homebuyer Credit on their tax returns processed during the period January 1 through December 31, 2011. These taxpayers' accounts were not credited $137,259 for the amount of Homebuyer Credit installment payment that was paid.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Potential; 76 taxpayers were erroneously assessed $512,905 more in Homebuyer Credit repayments than they were required to repay (see page 16).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify 76 taxpayers who reported a property disposition of their Homebuyer Credit on their tax returns processed during the period January 1 through December 31, 2011. These taxpayers were erroneously assessed $512,905 in additional amounts of the Homebuyer Credit because the disposition was incorrectly processed.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; $12,611,937 from 3,574 taxpayers whose accounts were credited for more than the amount of Homebuyer Credit repayment made (see page 16).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify 3,574 taxpayers who reported a property disposition of their Homebuyer Credit on their tax returns processed during the period January 1 through December 31, 2011. These taxpayers' accounts were credited $12,611,937 more than the amount of Homebuyer Credit repayment made because the disposition was incorrectly processed.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; estimated $459,754 from 96 taxpayers whose accounts were not assessed for Homebuyer Credit when a disposition of the property was reported (see page 16).

Methodology Used to Measure the Reported Benefit:

Our review of a statistically valid sample of tax returns reporting both dispositions of the property and an installment payment identified 49 (26 percent) tax returns reporting an installment payment instead of repaying $235,484 that represents the full amount of Homebuyer Credit outstanding for the period January 1 through December 31, 2010. These taxpayers have not been assessed the amount of Homebuyer Credit that was not repaid as of May 21, 2012. We estimate that 96[3] taxpayers were not properly assessed approximately $459,754[4] for the balance of outstanding Homebuyer Credits.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; $999,489 from 174 taxpayers whose accounts were not assessed for the Homebuyer Credit when a disposition of the property was reported (see page 16).

Methodology Used to Measure the Reported Benefit:

Our review of a statistically valid sample of tax returns reporting both dispositions of the property and an installment payment identified 89 taxpayers who understated the amount of their original Homebuyer Credit claim when a disposition of the property was reported for the period January 1 through December 31, 2010. These taxpayers were not properly assessed $511,933 for the full amount of Homebuyer Credit that should have been repaid when the taxpayer reported the disposition of the property. We estimate that 174[5] taxpayers understated the amount of Homebuyer Credit claimed by $999,489[6] when reporting the disposition of the property.

Type and Value of Outcome Measure:

- Revenue Protection – Potential; $29,711,334 from 125,684 taxpayers claiming erroneous Nonbusiness Energy Property Credits (see page 21).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify 176,954 taxpayers who erroneously claimed $35,748,513 in Nonbusiness Energy Property Credits on tax returns processed during the period January 1 through May 2, 2012. These taxpayers claimed more than the maximum $500 allowed for the Nonbusiness Energy Property Credit for Tax Years 2009, 2010, and 2011.[7] The IRS performed its own analysis and determined that 125,684 taxpayers claimed more than the maximum $500 limit on the Nonbusiness Energy Property Credit, and that the total amount claimed was $29,711,334, or 16.8 percent less than we identified.

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[3] Our projection is based on a 95 percent confidence level, a point estimate of 96, and a range of 80 to 112 taxpayers.

[4] Our projection is based on a 95 percent confidence level, a point estimate of $459,754, and a range of $365,747 to $553,760.

[5] Our projection is based on a 95 percent confidence level, a point estimate of 174, and a range of 155 to 192 taxpayers.

[6] Our projection is based on a 95 percent confidence level, a point estimate of $999,489, and a range of $880,865 to $1,118,113.

[7] If a taxpayer and his or her spouse owned and lived apart in separate main homes, they may each qualify for $500.

Type and Value of Outcome Measure:

- Cost Savings, Funds Put to Better Use – Potential; $159,031,326 from 109,618 taxpayers claiming refundable AOTC for Tax Year 2011 for students who are of an age that are unlikely to be enrolled in a four-year college program (see page 22).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify 109,618 taxpayers who erroneously claimed $159,031,326 in AOTCs on tax returns processed during the period January 1 through May 2, 2012. These taxpayers received tax refunds for the AOTC for students who are age 16 and younger or age 80 and older.

Appendix V

Prior Treasury Inspector General for Tax Administration Reports

Electric and Alternative Motor Vehicle Credits

TIGTA, Ref. No. 2011-41-011, *Individuals Received Millions of Dollars in Erroneous Plug-in Electric and Alternative Motor Vehicle Credits* (Jan. 2011).

TIGTA, Ref. No. 2010-41-128, *Verifying Eligibility for Certain New Tax Benefits Was a Challenge for the 2010 Filing Season* (Sept. 2010).

2011 Filing Season

TIGTA, Ref. No. 2011-40-128, *The Passage of Late Legislation and Incorrect Computer Programming Delayed Refunds for Some Taxpayers During the 2011 Filing Season* (Sept. 2011).

Education Credits

TIGTA, Ref. No. 2011-41-083, *Billions of Dollars in Education Credits Appear to Be Erroneous* (Sept. 2011).

Fraudulent Returns

TIGTA, Ref. No. 2010-40-129, *Expanded Access to Wage and Withholding Information Can Improve Identification of Fraudulent Tax Returns* (Sept. 2010).

TIGTA, Ref. No. 2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income Tax Credit Payments Each Year* (Feb. 2011).

Customer Service

TIGTA, Ref. No. 2011-40-087, *Increased Call Demand and Limited Resources Continue to Adversely Affect the Toll-Free Telephone Level of Service* (Aug. 2011).

TIGTA Ref. No. 2012-40-088, *Ensuring the Quality Review Process Is Consistently Followed Remains a Problem for the Volunteer Program* (Jul. 2012).

Qualified Motor Vehicle Deductions

TIGTA, Ref. No. 2011-41-037, *Millions of Dollars in Questionable Qualified Motor Vehicle Deductions Are Being Allowed* (Apr. 2011).

Appendix VI

Glossary of Terms

American Opportunity Tax Credit	A partially refundable Federal tax credit to help parents and college students offset the costs of college.
Automated Questionable Credit	A treatment process to cover more credits and under-tolerance refunds.
Electronic Fraud Detection System	An automated system used to maximize fraud detection at the time tax returns are filed to eliminate the issuance of questionable tax refunds.
Filing Season	The period from January 1 through mid-April when most individual income tax returns are filed.
Fiscal Year	A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Free File Program	A free Federal tax preparation and e-filing program for eligible taxpayers developed through a partnership between the IRS and the Free File Alliance, LLC. The Alliance is a group of private-sector tax software companies.
Individual Master File	The IRS database that maintains transactions or records of individual tax accounts.
Individual Return Transaction File	Contains all edited, transcribed, and error-corrected data from the Form 1040, *U.S. Individual Income Tax Return*, series and related forms for the current processing year and two prior years.
Master File	The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
Modernized E-File System	The MeF system provides electronic filing and payment options for corporations, exempt organizations, individuals, partnerships, and filers of excise tax returns.
Processing Year	The calendar year in which the tax return or document is processed by the IRS.

Submission Processing Site	The data processing arm of the IRS. The sites process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Tax Year	The 12-month period for which tax is calculated. For most individual taxpayers, the tax year is synonymous with the calendar year.

Appendix VII

Management's Response to the Draft Report

COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

September 14, 2012

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Peggy Bogadi
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season (Audit # 201240010)

We have reviewed your draft report and appreciate TIGTA's recognition of our successes and improvements this filing season. For the 2012 Filing Season, the IRS received and timely processed in excess of 133 million individual income tax returns. For this filing season, we also implemented two major business systems upgrades, and effectively responded to an increase in filings of fraudulent claims for refund. We are assessing our performance, noting lessons learned, and preparing to meet the challenges to be addressed in the next year.

In 2012, the Modernized e-File System (MeF) became the primary platform for receiving electronically filed tax returns. MeF demonstrated that it can successfully receive, process, and acknowledge the large volumes of returns transmitted at peak times. As of April 17, 2012, the MeF achieved a 732 percent increase in the number of returns processed compared to the same time last year. The Customer Account Data Engine 2 (CADE 2) Transition State 1 also deployed, in January 2012, allowing the IRS to move its core account processing cycle from weekly to daily. This achievement accelerated refund and transactional processing contributing to timely and improved service to taxpayers.

At the same time, we implemented several new fraud detection filters this year, more than doubling the number of fraudulent returns identified and refunds prevented. Throughout the IRS, organizational units are collaborating to improve our ability to detect fraudulent returns filed by identity thieves, stop those returns, and assist the victims. New initiatives underway include the formation of the Taxpayer Protection Unit to address reported or suspected occurrences of identity theft, as well accelerating the availability of third-party data to our employees charged with reviewing and evaluating questionable returns.

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In limited circumstances, the IRS has the statutory authority to deny erroneous claims for refund, commonly known as Math Error Authority (MEA). When the circumstances do not fall under the purview of MEA, we must follow deficiency procedures to question the claim. This has traditionally required the referral of returns to our Examination function, which is limited in capacity and is resource intensive. This year, we have piloted the Automated Questionable Credit (AQC) program, which leverages automated data analysis and processes to assist in addressing potentially fraudulent or erroneous refundable credit claims. The pilot has been a success and our current intention is to transition the AQC program to full production mode. This will expand our ability to address non-MEA issues in both a pre-refund and post-processing environment.

As previously mentioned, we are reviewing lessons learned and developing tools to continue improving our ability to detect and stop questionable claims for refund. With regard to the discussion on the American Opportunity Tax Credit (AOTC) claimed for students of an age outside the typical college or vocational student range, it should be noted that age is not a legal eligibility criterion for receiving the credit. We agree that considering the age of the student can assist in the overall evaluation of the probable validity of a claim, but we cannot lawfully deny a claim based on age. We will use our screening process as well as implement new filters, as necessary, to consider the student age when processing returns. Those identified as questionable will be referred for pre-refund review.

We also note the analysis that identified 109,618 taxpayers receiving the AOTC based on improbable student ages was derived strictly from data matching and, upon closer review, was found to contain students with incorrect Social Security Numbers (SSN). In most cases, reviewing prior-year tax return information indicated the taxpayer or return preparer had entered an incorrect SSN for the student due to the transposition of digits, or a keystroke error causing one digit of the number to be different. As noted in the report, as of June 22, 2012, corrections had been made on 2,672 accounts through correspondence or examination adjustments, examinations were in process on another 3,711 accounts, and 4,895 accounts were being reviewed for potential identity theft, duplicate filings, or amended returns. Most significantly, $24 million in questionable refunds had been frozen on another 2,517 accounts. We do not agree with the proposed outcome measure of $159 million associated with this finding as it does not consider the effect of returns corrected, refunds frozen, or SSN errors where the student, nevertheless, is eligible for the credit and would still be entitled after correction of the identification number.

Attached are our comments to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Peter J. Stipek, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment

Attachment

RECOMMENDATIONS

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1
Ensure that the required Homebuyer Credit repayment field in taxpayers' tax accounts is accurately populated with the amount that must be repaid by each taxpayer.

CORRECTIVE ACTION
On February 28, 2012, programming changes were made to ensure the required Homebuyer Credit repayment field in taxpayers' tax accounts is accurately populated. There have been no further reports of problems since the program correction was implemented.

IMPLEMENTATION DATE
Implemented

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

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 2
Ensure that tax examiners processing Homebuyer Credit repayments and installment payments process the payments accurately and make correct adjustments to the taxpayers' accounts.

CORRECTIVE ACTION
On May 4, 2012, Servicewide Electronic Research Program Alert #12A0329 was issued to advise Error Resolution System (ERS) Tax Examiners of the correct procedures as stated in Internal Revenue Manual 3.12.3, *Error Resolution – Individual Income Tax Returns*. Adjustment notices for the First-Time Homebuyer Credit (FTHBC) payment have been monitored closely. Monitoring will continue for the remainder of the year. Additionally, information on processing the FTHBC repayment is being included in the ERS training at each Submission Processing Center prior to the 2013 Filing Season.

IMPLEMENTATION DATE
March 15, 2013

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

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 3
Initiate a program to recover the $2.6 million in Homebuyer Credit installment payments erroneously refunded to 6,288 taxpayers.

CORRECTIVE ACTION
Corrective programming and procedures have been implemented. An extract of impacted taxpayers is being compiled to identify those accounts to be subjected to recovery actions.

IMPLEMENTATION DATE
October 15, 2013

RESPONSIBLE OFFICIAL
Director, Earned Income Tax Credit Office, Return Integrity & Correspondence Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 4
Initiate a program to recover more than $14.6 million in Homebuyer Credit repayments that were not properly assessed to taxpayers' accounts.

CORRECTIVE ACTION
Corrective programming and procedures have been implemented. An extract of impacted taxpayers is being compiled to identify those accounts to be subjected to recovery actions.

IMPLEMENTATION DATE
October 15, 2013

RESPONSIBLE OFFICIAL
Director, Earned Income Tax Credit Office, Return Integrity & Correspondence Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 5
Initiate a program to correct the 1,217 taxpayers' accounts that were incorrectly assessed more than $940,000.

CORRECTIVE ACTION
Corrective programming and procedures have been implemented. An extract of impacted taxpayers is being compiled to identify those accounts to be subjected to corrective actions.

IMPLEMENTATION DATE
October 15, 2013

RESPONSIBLE OFFICIAL
Director, Earned Income Tax Credit Office, Return Integrity & Correspondence Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 6
The Commissioner, Wage and Investment Division, should initiate a program to recover the $29.7 million in Nonbusiness Energy Property Credits erroneously allowed to 125,684 taxpayers who claimed more than the maximum $500 limit.

CORRECTIVE ACTION
We will initiate actions to recover Nonbusiness Energy Property Credits allowed to taxpayers who claimed more than the maximum lifetime amount.

IMPLEMENTATION DATE
October 15, 2013

RESPONSIBLE OFFICIAL
Director, Earned Income Tax Credit Office, Return Integrity & Correspondence Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 7
Require taxpayers who claim the AOTC for students who are not an appropriate age to be enrolled in a four-year college degree program or a vocational certificate program to provide proof of enrollment.

CORRECTIVE ACTION

We will explore the feasibility of using existing evaluative filters applied during return processing, or develop additional filters, that will consider the age of the student for purposes of identifying questionable claims for the American Opportunity Tax Credit (AOTC). The law providing for the AOTC does not base eligibility for the credit on age; however, the age of the student can be used in evaluating the probable validity of the claim and those that appear to be improbable may be referred for eligibility determination under deficiency procedures.

With regard to determining proof of enrollment, Form 8863, *Education Credits (American Opportunity and Lifetime Learning Credits)*, has been revised for Tax Year 2012, to require detailed education institution information that can be matched against IRS and third-party data.

IMPLEMENTATION DATE

October 15, 2013

RESPONSIBLE OFFICIAL

Director, Earned Income Tax Credit Office, Return Integrity & Correspondence Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 8

Initiate a recovery program to recover the more than $159 million for the 109,618 individuals who received the AOTC for students who were of an age unlikely to be enrolled in a four-year college degree program.

CORRECTIVE ACTION

We will complete our analysis of the individuals identified by the Treasury Inspector General for Tax Administration and determine the extent to which recovery actions should be initiated. As noted in the report, the list contained individuals with transposed or erroneous digits in the student's Social Security Numbers (SSN). These errors, made on the tax returns, caused those individuals to appear to be outside the typical student age range when the data was analyzed; however, upon further review of prior-year tax returns, we were able to identify where the error occurred and ascertain that the subject student was, in fact, within the traditional student age range.

IMPLEMENTATION DATE

October 15, 2013

RESPONSIBLE OFFICIAL
Director, Earned Income Tax Credit Office, Return Integrity & Correspondence Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 9
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CORRECTIVE ACTION
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IMPLEMENTATION DATE
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RESPONSIBLE OFFICIAL
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CORRECTIVE ACTION MONITORING PLAN
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