MSP #5

FALSE POSITIVE RATES: The IRS's Fraud Detection Systems Are Marred by High False Positive Rates, Long Processing Times, and Unwieldy Processes Which Continue to Plague the IRS and Harm Legitimate Taxpayers

RESPONSIBLE OFFICIAL

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TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

In calendar year (CY) 2016, tax refund fraud cost the government approximately $1.6 billion.[2] The IRS's Return Integrity Operations office (RIO), which is housed in the Wage and Investment Division (W&I), is tasked with reducing this cost by detecting and preventing both identity theft (IDT) in the Taxpayer Protection Program (TPP) and non-IDT refund fraud in the Pre-Refund Wage Verification Program (WVP).[3] The IRS primarily does this using two systems: the Dependent Database (DDb) and the Return Review Program (RRP).[4] Although the fraud detection systems protected about $7.6 billion in revenue between January 1 and September 30, 2018, they also delayed the processing of almost $20 billion in legitimate refunds.[5] Between January 1 and October 3, 2018, the False Positive Rate (FPR) for non-IDT refund fraud filters was 81 percent, while the FPR for IDT refund fraud filters was 63 percent.[6]

Further, according to the IRS, 64 percent of returns selected into the non-IDT refund fraud program in 2018 were legitimate even though more than two weeks elapsed from the time of selection until the IRS

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1   *See* Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). *See* IRC § 7803(a)(3).

2   Government Accountability Office (GAO), GAO-18-224, Tax Fraud and Noncompliance: *IRS Can Strengthen Pre-Refund Verification and Explore More Uses* 1 (Jan. 30, 2018).

3   Although not all tax refund fraud involves identity theft (IDT), and not all IDT involves tax refund fraud (*e.g.*, employment-related IDT does not involve the theft of tax refunds), there are enough similarities between the two that it is appropriate to discuss them together.

4   The Dependent Database (DDb) and the Return Review Program (RRP) systems use filters, comprised of many rules or models, to score each return. If the return receives a certain score and is flagged as potentially fraudulent, the return goes to the Taxpayer Protection Program (TPP) or the Income Wage Verification (IWV) Program for further scrutiny. Internal Revenue Manual (IRM) 25.25.2.1, *Program Scope and Objectives* (May 7, 2018); IRM 25.25.6.1.7, *Taxpayer Protection Program Overview* (Aug. 28, 2018).

5   IRS response to TAS information request (Nov. 1, 2018).

6   A false positive occurs when a system selects a legitimate return and delays the refund past the prescribed review period. *See* IDT and IVO Performance Report, 19, 32 (Oct. 10, 2018).

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released the refund—in addition to a two-week screening time prior to selection—for a total of about four weeks. The IRS refers to this 64 percent figure as the "operational performance rate" (OPR).[7]

While the National Taxpayer Advocate is very supportive of the IRS's goal of detecting and mitigating refund fraud, she remains concerned about the fraud detection systems' high FPR, long processing times, and unwieldy processes that are aggravated by outdated systems.[8] More specifically, we have identified the following issues pertaining to the IRS's fraud detection systems:

- The IRS does not capture all the information necessary to evaluate the accuracy and efficiency of its non-IDT and IDT refund fraud programs, and the information that it does track reveals significant delays in refunds due a large number of legitimate taxpayers.

- Factors contributing to high FPRs and refund processing delays include the fraud detection systems' weekly check for third-party information, the IRS's failure to consider if revenue lost is truly at risk for a selected return, and the barriers taxpayers face in authenticating their identity.

- The Electronic Fraud Detection System (EFDS) contributes to long processing times because it lacks systemic verification capabilities.

- The high FPR and long delays resulted in a 287 percent increase in TAS Pre-Refund Wage Verification cases between January 1 and September 30, 2018, when compared to the same time period in the prior year. Further, in nearly half of the cases closed between January 15 and June 30, 2018, taxpayers ultimately received the refunds originally claimed on their returns.[9]

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7 The IRS defines the Operational Performance Rate (OPR) as returns that are selected and not released by the pre-wage verification program within two weeks of selection. As discussed below, the National Taxpayer Advocate believes the OPR is not an accurate measure of the post-screening/selection False Positive Rate (FPR).

8 *See, e.g.,* National Taxpayer Advocate 2016 Annual Report to Congress 151-160; National Taxpayer Advocate 2015 Annual Report to Congress 45-55, 180-187; National Taxpayer Advocate 2014 Annual Report to Congress, vol. 2, 44-90; National Taxpayer Advocate 2013 Annual Report to Congress 75-83; National Taxpayer Advocate 2012 Annual Report to Congress 42-67, 95-110; National Taxpayer Advocate 2011 Annual Report to Congress 48-73; National Taxpayer Advocate 2009 Annual Report to Congress 307-317; National Taxpayer Advocate 2008 Annual Report to Congress 79-94; National Taxpayer Advocate 2007 Annual Report to Congress 96-115; National Taxpayer Advocate 2005 Annual Report to Congress 25-54, 180-191; National Taxpayer Advocate 2004 Annual Report to Congress 133-136; National Taxpayer Advocate 2003 Annual Report to Congress 175-181.

9 Data obtained from Taxpayer Advocate Management Information System (TAMIS) (Feb. 1, 2018, Mar. 1, 2018, Apr. 1, 2018, May 1, 2018, Jun. 1, 2018, and Jul. 1, 2018).

ANALYSIS OF PROBLEM

Background

The IRS's efforts to detect and prevent refund fraud is managed by the RIO of the W&I, which oversees both the TPP (IDT refund program) and the WVP (non-IDT refund program).[10]

In the early days of its fraud detection program, the IRS relied solely on EFDS for detecting and preventing fraud detection.[11] However, EFDS's numerous inefficiencies impeded its ability to keep pace with the rapidly changing world of fraud.[12] In 2017, the IRS retired EFDS for fraud detection purposes; however, EFDS still remains a critical part of the IRS's fraud detection program.[13] Two of the most significant EFDS components still in use are the final case selection function and the case management function. The outdated EFDS case management function poses significant problems for taxpayers and is further discussed below.

The IRS relies primarily on two systems to detect and prevent fraud: the DDb to detect IDT, and the RRP to detect IDT *and* non-IDT.[14] The DDb contains filters which are comprised of rules that are binary in nature, (*i.e.,* if the rule is broken, the return will be selected for further analysis; if the rule is not broken, the return will continue through normal processing).

The RRP, on the other hand, contains filters which are comprised of both rules and models.[15] The IRS uses the RRP rules and models in a variety of ways:

- **Predictive models.** The IRS develops many different models that help detect emerging fraud, outliers, and inconsistent, or suspicious behavior of taxpayers filing refund claims. These models also mine data and help IRS seek out patterns predictive of IDT and other refund fraud. For example, a model may use a combination of existing variables from the 1040 individual tax return, such as tax credits or income claimed.[16]

- **Business rules.** RRP contains over 1,000 rules (a "yes" or "no" outcome) developed by the IRS to flag returns for evidence of anomalous behavior. For example, RRP uses a business rule to distinguish between returns for which it has received an associated Form W-2, *Wage and Tax Statement (W-2),* from those which it has not.[17]

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10   *See* IRM 25.25.6.1.1, *Background* (Apr. 11, 2018); IRM 25.25.6.1 (1) and (3), *Program Scope and Objectives* (Apr. 11, 2018); and IRM 25.25.3.1(1), *Program Scope and Objectives* (May 10, 2018). For purposes of this Most Serious Problem, we have used "TPP" and "IDT refund fraud program" interchangeably, as well as the terms, "pre-refund wage verification program" and "non-IDT refund program."

11   In 1994, the IRS installed the Electronic Fraud Detection System (EFDS) system to identify questionable and potentially fraudulent returns. *See* Treasury Inspector General for Tax Administration (TIGTA) Report Ref. No. 2017-20-080, *The Return Review Program Increases Fraud Detection; However, Full Retirement of the Electronic Fraud Detection System Will Be Delayed* 7 (Sept. 25, 2017).

12   *Id*.

13   There are 11 EFDS components that remain in effect and will likely not be retired in the near future. *See* TIGTA Report Ref. No. 2017-20-080, *The Return Review Program Increases Fraud Detection; However, Full Retirement of the Electronic Fraud Detection System Will Be Delayed* 7 (Sept. 25, 2017).

14   IRM 25.25.6.1.7(1), *Taxpayer Protection Program Overview* (Aug. 28, 2018); IRM 25.25.3.1(1), *Program Scope and Objectives* (May 10, 2018).

15   IRS response to TAS information request (Aug. 3, 2018). RRP models were activated in 2016 for IDT fraud, and in 2017 for non-IDT fraud. RRP models had to be built from the ground up because EFDS and RRP run on two separate, incompatible platforms. Beginning in Filing Season 2019, nearly all of the models that were in EFDS will now be in RRP.

16   GAO Report, Ref. No. GAO-18-544, *Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement* 12 (July 2018).

17   *Id*.

- **Clustering.** RRP uses a tool that reveals patterns and relationships in masses of data, which allows the system to identify clusters of returns that share traits predictive of deceitful schemes and refund fraud. For example, the IRS could potentially use clustering to identify groups of returns that share the same geographic location, among other traits.[18]

Once the models complete their analysis using the techniques listed above, each return is given a score. The risk score is then fed into RRP filters, which will select returns based on whether the score exceeds a specified threshold, while considering other information in the system. If the score exceeds the threshold and other conditions are met, the return will be routed to either the TPP or WVP, whichever is most appropriate.

Figure 1.5.1 provides a simplified flow chart of the complicated processes the IRS uses to screen returns where a refund has been claimed and IDT or non-IDT refund fraud is suspected.
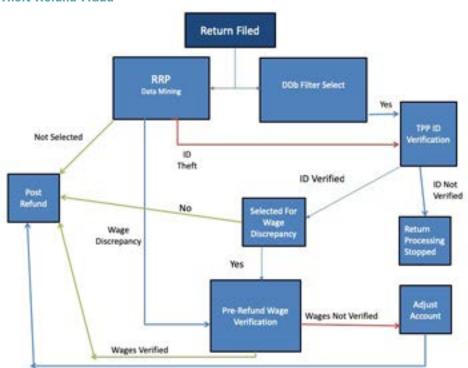
FIGURE 1.5.1, Flow Chart of Refund Return Screening for Identity Theft and Non-Identity Theft Refund Fraud

When a taxpayer's return is sent to the TPP process, the IRS will ask the taxpayer to authenticate his or her identity either over the phone, online, or by visiting a Taxpayer Assistance Center (TAC).[19] When taxpayers are sent to the pre-refund wage verification process, the information on their returns will be matched with third-party information provided by their employer(s) and payer(s). Beginning in Filing Season (FS) 2017, employers and most other payers were required to submit third-party reporting

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18 GAO Report, Ref. No. GAO-18-544, *Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement* 12 (July 2018).
19 IRM 25.25.6.1.7, *Taxpayer Protection Program Overview* (Aug. 28, 2018). International taxpayers can mail in documentation to authenticate their identity. Letter 5447C, *Potential Identity Theft during Original Processing; Foreign Address* (Sept. 2018).

information (*Forms W-2* and *Forms 1099-MISC-Nonemployee Compensation*) before or on January 31, thus providing the IRS more time to match the wage and tax information reported on the taxpayer's return against information submitted by third parties.[20]

Selecting Returns as Potentially Fraudulent Significantly Delays Refunds for Many Legitimate Taxpayers, Increasing Taxpayer Anxiety and Causing Financial Hardship

If a return is assigned to TPP, it will generally take about 40 days from the filing of the return for the refund to be issued.[21] From January 1 through June 30, 2018, more than 1.7 million returns were selected into TPP.[22] The timeframe for returns selected into TPP is as follows:

- Submission to selection: 2 days
- Notification to Resolution: 24 days

  (includes selection to notification: 5 days)

- Resolution to Refund: 14 days
  - **Total days = 40**[23]

If a return is assigned to the pre-refund wage verification process, it also takes about 38 days for a refund to be issued from the time the return was submitted.[24] From January 1 through June 30, 2018, approximately 1.2 million returns were selected into the pre-refund wage verification program.[25] The timeframe for returns selected into the pre-refund wage verification program is as follows:

- Submission to Refund Fraud Start: 14 days
- Notification to Resolution: 17 days

  (includes selection to notification: 7 days)

- Resolution to Refund: 7 days
  - **Total Days = 38**[26]

Returns can also be subject to both the TPP and the pre-refund wage verification processes. When returns display characteristics of both IDT and non-IDT fraud, a return will be processed through TPP first. Then, if the taxpayer authenticates his or her identity, the return will then be processed through the pre-refund wage verification process. From January 1 through June 30, 2018, 211,076 returns were selected into both the TPP and the WVPs.[27] On average, taxpayers' refunds were issued 46 days after

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20 Section 201 of the Protecting Americans From Tax Hikes (PATH) Act of 2015 amended IRC § 6071 to require that certain information returns be filed by January 31, generally the same date as the due date for employee and payee statements and are no longer eligible for the extended filing date for electronically filed returns under IRC § 6071(b). *See* Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 201 (2015).

21 IRS response to TAS information request (Aug. 3, 2018).

22 *Id.*

23 *Id.*

24 *Id.*

25 *Id.*

26 *Id.*

27 Compliance Data Warehouse (CDW) Individual Master File (IMF) Transaction Code 150 History file and CDW IMF Transaction History file (Nov. 20, 2018). About 10 percent of these accounts were manually selected into the TPP and may never have gone to the pre-refund wage program.

the return was submitted.[28] The timeframe for returns selected into both the TPP and pre-refund wage verification programs is as follows:

- Submission to IDT Selection: 2 days
- Notification to IDT Resolution: 24 days

    (includes selection to notification: 5 days)
- IDT Resolution to Refund Fraud Start: 7 days
- Start to Refund Fraud Resolution: 6 days
- Resolution to Refund: 7 days
    - **Total Days = 46**[29]

The IRS Does Not Capture All the Information Necessary to Evaluate the Accuracy and Efficiency of Its Non-IDT and IDT Refund Fraud Programs, and the Information That It Does Track Reveals Significant Delays in Refunds Due a Large Number of Legitimate Taxpayers

To evaluate the accuracy and efficiency of the non-IDT refund fraud program, the IRS tracks two data points to evaluate how accurate its filters are working in selecting fraudulent returns, and whether legitimate returns selected by the filters are being quickly resolved. These data points are the FPR and the operational performance rate.

False Positive Rate: This data point is the percentage of legitimate returns selected by the IRS as potentially fraudulent, divided by the total number of returns selected by the IRS as potentially fraudulent.

> **Example:** The IRS selected 100 returns as potentially fraudulent. Eighty of these returns turned out to be legitimate. Therefore, to determine the false positive rate, divide 80 by 100, which equals 80 percent.

Operational Performance Rate: The IRS's current formula for this rate is the false positive rate discounting those returns the IRS confirmed as legitimate within two weeks of selection (*i.e.,* no more than four weeks from filing, including the two weeks the IRS has to decide if the return should be selected as potentially fraudulent). Specifically, the OPR retains the same denominator as the FPR (the total number of returns selected by the IRS), but the numerator is decreased by the number of returns that the IRS clears as legitimate within two weeks of selection.

> **Example:** The IRS selected one hundred returns, with 80 returns determined to be legitimate (FPR). Twenty of these 80 legitimate returns were resolved within two weeks of selection (four weeks total). Thus, the OPR is 60 percent [(80 minus 20)/100 = 60 percent].

These data points are very useful in determining how this program impacts taxpayers but in order to fully capture that impact, one other data point should be added. This is a variation on the OPR. For purposes of this discussion, it will be referred to as the "Operational FPR".

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28   CDW IMF Transaction Code 150 History file and CDW IMF Transaction History file (Nov. 20, 2018).

29   *Id.*

Operational FPR: This data point is the ratio of the legitimate returns resolved after the four-week period (the numerator) and *the number of returns left after the four-week period* (the denominator).

> **Example**: The IRS selected 100 returns, and it determined 80 were legitimate. Twenty of the 80 legitimate returns were resolved within two weeks of selection. That means the "Operational FPR" would be 75 percent [(80 minus 20)/(100 minus 20) = 75 percent].

This formula is a more accurate depiction of the number of legitimate returns that took more than two weeks to be resolved from the time of selection than the OPR, because the numerator and denominator mirror one another. Specifically, both numbers exclude the number of returns resolved within two weeks of selection. On the other hand, the OPR does not exclude the number of returns resolved within two weeks of selection from the formula's denominator, which distorts the percentage and gives an inaccurate appearance of improved performance. In fact, when TAS Research applied the above-discussed formula for Operational FPR and excluded the number of returns resolved within two weeks of selection from both the numerator and the denominator, it found that the Operational FPR is 77 percent.[30]

These three data points (FPR, OPR, and Operational FPR) will assist the IRS in identifying problems and finding solutions (*i.e.,* do the fraud detection filters need to be refined, or is there a need for additional staffing to resolve the selected cases faster?). More specifically, it will tell the IRS the following:

(1) Whether the IRS is quickly resolving the legitimate returns on the front end; or

(2) Whether the IRS is *not* quickly resolving the legitimate returns on the front end but rather has a very high number of legitimate returns that have slipped through the four-week period and thus are creating both taxpayer and IRS burden.

Therefore, these data points will assist the IRS in determining whether it is quickly resolving these issues so they don't create taxpayer burden, generate phone calls to the IRS, or create TAS cases. When analyzing the FPR and OPR for the non-IDT refund fraud program during FY 2018, it is clear that the program affected a large number of taxpayers who filed legitimate returns and whose refunds were delayed more than four weeks beyond the date of filing. As mentioned earlier, the FPR for non-IDT refund fraud was 81 percent from January 1 through October 3, 2018.[31] For the same time period, the non-IDT refund fraud program had an OPR of 64 percent of returns selected into the program that were legitimate even though more than two weeks elapsed from the time of selection until the refund was released. As discussed, this figure understates the number of legitimate returns that were delayed beyond two weeks from the time of selection.[32] In 2018, many more taxpayers were impacted by these delays than in past years as non-IDT refund fraud filters selected in excess of one million returns from January 1 through October 3, 2018, a roughly 400 percent increase when compared to the same time period last year.[33]

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30 TAS used the following formula to reach the 77 percent figure: Selections: 1,312,439. FPR = 63 percent (calculated (826,837/1,312,439). Fraud Detection rate (refile rate): 81 percent (calculated (1,063,076/1,312,439). The numerator of the "Operational FPR" would be 826,837. The denominator of the "Operational FPR" calculation = 1,312,439 minus 236,239 (the number of returns cleared within two weeks) = 1,076,200. Therefore, the "Operational FPR" then equals 826,837/1,076,200 = 77 percent.

31 IDT & IVO Selections Performance Report 32 (Oct. 10, 2018).

32 *Id.*

33 *Id.*

> When TAS Research excluded the number of returns resolved within two weeks of selection from both the numerator and the denominator, it found that the "Operational False Positive Rate" is 77 percent.

The IDT refund fraud program's FPR was lower than that of the non-IDT refund fraud program but was still well above 50 percent at 63 percent.[34] Unlike the non-IDT refund fraud program, the IDT refund fraud program does not track an OPR. This is because IDT processing is quite different than non-IDT processing. When the return is selected for possible IDT, processing is suspended, and a letter is sent to the taxpayer asking him or her to authenticate his or her identity. Thus, time must be allowed for the letter to be received by the taxpayer, and the taxpayer must take action to authenticate his or her identity for return processing to continue so that the refund can be released.

Conversely, the release of selected non-IDT refunds does not rely on the taxpayer to take any action. Despite these differences, it is imperative that the IDT refund fraud program track the number of cases that take more than a specified period of time to be resolved. It is reasonable that the IDT program would use different criteria to establish this data point. Although the criteria might vary from that of the non-IDT refund fraud program, the formula applied should be similar to the Operational FPR described above. Further, the IRS should consider conducting a study to identify why taxpayers do not authenticate more quickly.

These figures, the non-IDT and IDT refund fraud FPRs, and the OPR for non-IDT refund fraud, albeit limited in the information they provide, illustrate that these programs select too many legitimate returns, and take too long to release the refunds. A false positive rate of around 50 percent is generally accepted among those in the private sector.[35] With current FPRs of 81 and 63 percent, there is plenty of opportunity for the IRS to improve its refund fraud filters, without jeopardizing revenue protection.[36]

Factors Contributing to High False Positive Rates and Refund Processing Delays Include the Fraud Detection Systems' Weekly Check for Third-Party Information, the IRS's Failure to Consider If Revenue Lost Is Truly at Risk for a Selected Return, and the Barriers Taxpayers Face in Authenticating Their Identity

For non-IDT refund fraud, refunds associated with returns selected by a filter are generally frozen until the taxpayer's employer or payer provides third-party data to the IRS or Social Security Administration (SSA), which forwards the information to the IRS. Once the taxpayer's third-party information is posted, it can be matched with information on the taxpayer's return, and the refund will be released. However, this process is dependent upon employers' timely submission of the required information to the SSA or payers' timely submission to the IRS. For FY 2018, the IRS received 42 percent of expected employer/employee documentation on or by February 5, representing 43 percent of employee information documents.[37]

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34 IDT & IVO Selections Performance Report 32 (Oct. 10, 2018).
35 *Fraud and False Declines: Fighting the Downward Spiral with Collaboration*, (April 28, 2017), https://www.thepaypers.com/expert-opinion/fraud-and-false-declines-fighting-the-downward-spiral-with-collaboration/768755.
36 *Id.*
37 *Id.* at 40.

Although employers' late submissions of employee information delay the process, the IRS can take additional steps to verify returns even without an employer's submission. For example, the IRS could review the employer's history and determine if there is a pattern of submitting employee information late. If so, and the information on the return is largely consistent with prior year returns, the IRS could presume the return is legitimate and release the refund.

Another issue regarding missing wage information is the frequency at which IRS systems check for the posting of this information, which was checked weekly during FS 2018, instead of daily. Thus, a fraud detection filter may select the return because there is no third-party information available to verify the return. However, the IRS may receive the employer information within a day or two of selecting the return, but the IRS would not be aware that it received that third-party information for at least a week due to IRS systems weekly check for third-party information. For the 2019 filing season, the IRS has made adjustments to several of its filters to systemically check for the posting of third-party information daily instead of weekly.

Other examples where enhancements can be made include releasing returns, particularly if the third-party information is either inconsequential to the refund or would result in a larger refund to the taxpayer. For instance, TAS has handled cases where the return was held because third-party information did not match the information on the return, yet the third-party information would only have served to increase the refund amount.[38] When the return is being selected due to a mismatch between the information on the return and the third-party information, refund fraud systems should be developed to conduct a refund analysis and, if the third-party information would either have no impact on the amount of the refund or would increase the amount of the refund, the refund should be released immediately. Simple adjustments to the selection process such as these could very well prevent taxpayers from being selected into the pre-refund wage verification process, or could expedite the release of the return if they are selected. This would allow the IRS to better utilize its resources to verify returns where there is a substantial potential for fraud.

For IDT, the taxpayer is required to authenticate his or her identity either over the phone, online, or in person at a TAC.[39] Since taxpayers' refunds are being delayed, the expectation is that taxpayers would authenticate their identity as quickly as possible. However, the process on average still takes about 40 days.[40] The IRS would be well-advised to follow up with taxpayers who take longer than average to authenticate by inquiring into their reasons for delaying their identity authentication. This information is critical to determine if taxpayers experienced any difficulties authenticating that may be alleviated through changes to IRS procedures. Some possible barriers taxpayers may face when trying to authenticate include difficulty in reaching a customer service representative (CSR) to authenticate their identity over the phone.

Additionally, taxpayers may have difficulty obtaining assistance at a TAC, since generally, TACs will only see taxpayers by appointment.[41] During FS 2018, TACs were overwhelmed with appointments. TAS received complaints that taxpayers were waiting for up to three months to obtain an appointment

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38   TAS Systemic Advocacy Management System (SAMS) issues 37230 and 37347.

39   IRM 25.25.6.1.7, *Taxpayer Protection Program Overview* (Aug. 28, 2018).

40   IRS response to TAS information request (Aug. 3, 2018).

41   IRS News Release IR-2016-172, Tax Preparedness Series: *IRS Face-To-Face Help Now by Appointment* (Dec. 20, 2016). IRS response to TAS fact check (Dec. 20, 2016); IRS, Fact Sheet: *Internal Revenue Service Appointment Service Test* (Feb. 26, 2015). The IRS began a pilot during filing season (FS) 2015 whereby taxpayers needed to call for an appointment at 44 sites. The IRS expanded the pilot to more locations during FS 2016, and in November 2016, it completed a transition to appointment-only service at all Taxpayer Assistance Centers (TACs).

in some TACs.[42] Initially, taxpayers selected for possible IDT, who were trying to authenticate their identities at a TAC, could not get appointments until May, after the filing season had concluded.[43] To address this issue, the IRS solicited volunteers from other IRS business units to work at TACs so taxpayers could get appointments to authenticate their identities before the conclusion of the filing season.[44]

The IRS's Outdated Electronic Fraud Detection System (EFDS) Contributes to Long Processing Times Because It Lacks Systemic Verification Capabilities

One of the new non-IDT filters for FS 2018 selected about 303,000 Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC) returns as potentially fraudulent because no third-party income information had been posted as of February 15, 2018, about two weeks after the January 31 deadline established by law.[45] Once these accounts were selected as potentially fraudulent, the IRS anticipated that the EFDS would be able to release refunds in bulk when income on the return could be verified with third-party information. However, because EFDS does not interact with the IRS system that maintains third-party income information, employees must enter the third-party information into EFDS one document at a time, and then manually release the refunds. What makes this so exasperating is that the IRS has been claiming for more than a decade that it will retire its EFDS in favor of a more modern, sophisticated system.[46] This is just the latest example of how old systems harm taxpayers and create more work for the IRS.[47] The frustration of this delay is compounded by the fact that taxpayers cannot receive information about their refunds that are being held when they call the IRS because IRS

> Because Electronic Fraud Detection System (EFDS) does not interact with the IRS system that maintains third-party income information, employees must enter the third-party information into EFDS one document at a time, and then manually release the refunds.

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42 TAS Systemic Advocacy Management System Issue 37305.

43 Memorandum from Director of IRS Field Assistance (Apr. 2, 2018).

44 *Id.* See also Wage & Investment, Business Performance Review 3 (Aug. 2018).

45 IDT and IVO Selection Performance Report (Feb. 28, 2018); *Continued Oversight Over the Internal Revenue Service: Joint Hearing Before the H. Subcomm. on Health Care, Benefits, and Administrative Rules and H. Subcomm. on Government Operations*, 115th Cong. (2018) (statement of Nina E. Olson, National Taxpayer Advocate).

46 *See* TIGTA Report Ref. No. 2017-20-080, *The Return Review Program Increases Fraud Detection; However, Full Retirement of the Electronic Fraud Detection System Will Be Delayed* 7 (Sept. 25, 2017); *see also* National Taxpayer Advocate 2016 Annual Report to Congress 109-120 (Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project*).

47 See Legislative Recommendation: *IT Modernization: Provide the IRS with Additional Dedicated, Multi-Year Funding to Replace Its Antiquated Core IT Systems Pursuant to a Plan that Sets Forth Specific Goals and Metrics and Is Evaluated Annually by an Independent Third Party, infra*; National Taxpayer Advocate 2016 Annual Report to Congress 109-120 (Most Serious Problem: *Enterprise Case Management (ECM): The IRS's ECM Project Lacks Strategic Planning and Has Overlooked the Largely Completed Taxpayer Advocate Service Integrated System (TASIS) As a Quick Deliverable and Building Block for the Larger ECM Project*).

CSRs do not have access to the EFDS case management system for the WVP.[48] The IRS could give CSRs the ability to view information about why the return was flagged, which in turn, would help taxpayers resolve issues more quickly.[49]

The High FPR and Long Delays Resulted in a 287 Percent Increase in Taxpayer Advocate Service Pre-Refund Wage Verification Cases From January 1 through September 30, 2018, When Compared to the Same Time Period in the Prior Year, and in Nearly Half of the TAS Cases Closed Between January 15 and June 30, 2018, Taxpayers Ultimately Received the Refunds Originally Claimed on Their Returns

The increase in returns being selected as potentially fraudulent, the high FPRs, and the large number of selected returns being delayed beyond two weeks, have all contributed to a significant increase in TAS's case receipts.

FIGURE 1.5.2, TAS Pre-Refund Wage Verification Hold Receipts

TAS Pre-Refund Wage Verification Hold Monthly Receipts for 2017 and 2018 (January through September)									
Year	January	February	March	April	May	June	July	August	September	Total
2017	692	1,989	4,169	2,070	2,017	1,768	1,487	1,358	882	**16,432**
2018	712	3,628	13,361	10,056	9,223	5,811	7,797	7,786	5,263	**63,637**

As shown in Figure 1.5.5, TAS pre-refund wage verification refund hold case receipts from January 1 through September 30, 2018, increased from 16,432 to 63,637 cases, or 287 percent, when compared to the same period last year.[50] To evaluate this significant increase, TAS research analyzed all the non-IDT refund fraud cases that were closed in TAS inventory between January 15 and June 30, 2018, that were related to issues arising out of taxpayer's tax year 2017 returns. During this time period, TAS closed 42,120 cases, and out of this number, 18,816 or 45 percent of the taxpayers received the refund that was originally shown on their return.[51] Fifty-five percent of the 18,816 cases that were identified by the RRP system were selected solely by one filter.[52] These findings are consistent with the high 81 percent FPR and the 77 percent for Operational FPR for non-IDT refund fraud. It further illustrates how a problem with one single filter can affect thousands of taxpayers who file legitimate returns. The National Taxpayer Advocate urges the IRS to work with her and her staff to review the findings of TAS's research to prevent a similar situation from occurring in future filing seasons.

48 IRM 21.5.6.4.35.3.1, *-R Freeze Phone Procedures for Accounts with Integrity and Verification Operations (IVO) Involvement* (Jun. 15, 2018); *Continued Oversight Over the Internal Revenue Service: Joint Hearing Before the H. Subcomm. on Health Care, Benefits, and Administrative Rules and H. Subcomm. on Government Operations*, 115th Cong. (2018) (statement of Nina E. Olson, National Taxpayer Advocate).

49 Notes from National Taxpayer Advocate Meeting with SAS (Apr. 25, 2018).

50 Data obtained from TAMIS (Feb. 1, 2017; Oct. 1, 2017; Feb. 1, 2018; Oct. 1, 2018).

51 CDW IMF Transaction Code 150 History file and CDW IMF Transaction History file (Nov. 20, 2018). The 18,816 included cases where the refund issued was the same amount as the refund shown on the return, less a math error adjustment.

52 Match of TAMIS data to RRP selection file, 2018 IWV Selection, provided by the IRS.

CONCLUSION

The National Taxpayer Advocate acknowledges the importance of reducing tax fraud and recognizes that robust fraud detection systems are required to meet this objective. However, when these systems routinely have FPRs above 60 percent, they harm legitimate taxpayers and create unnecessary work for the IRS. Equally important is the IRS's efforts in designing a process that can quickly analyze returns and release refunds to legitimate taxpayers.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Calculate an "Operational FPR" in addition to the FPR and OPR for non-IDT accounts.

2. Develop criteria to be used in measuring OPR for IDT accounts.

3. Conduct a study to determine why it takes some taxpayers longer to authenticate their identities and what barriers they may encounter when attempting to do so.

4. Design the refund fraud system to consider if applying the third-party information to the return would actually result in a larger refund when there is a mismatch between third-party information and the information on a taxpayer's return.

5. Request from outside vendors information on ways to improve the FPR, along with proposals to determine the factors that are contributing to high FPRs.

6. Establish a maximum acceptable FPR goal within industry accepted standards and an actionable timeline to achieve that goal, based on the information and proposals received from outside vendors.