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Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters

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DEFINITION OF PROBLEM

The IRS's Questionable Refund Program (QRP), which detects and prevents false refunds, is an integral part of the IRS revenue protection program. The National Taxpayer Advocate first identified problems with the administration of the QRP in her 2005 Annual Report to Congress.¹ The report revealed that the data mining selection process used to identify questionable returns was flawed, resulting in too many legitimate refunds being frozen. The affected taxpayers waited inordinate amounts of time for their refunds while the IRS attempted to verify their returns.² Many of these taxpayers would never receive their refunds, as their accounts were among the 240,000 with permanent (hard) refund freezes languishing in the QRP inventory.³

Following the National Taxpayer Advocate's report and subsequent congressional and public criticism, the IRS agreed to dramatically alter the QRP, including moving it out of the Criminal Investigation (CI) unit and into the Wage and Investment (W&I) division in October 2009, under the Accounts Management Taxpayer Assurance Program (AMTAP). However, many of the problems we identified in 2005 persist today.

- In the second quarter of fiscal year (FY) 2012, the IRS reported that QRP inventory had increased three-fold over the previous year.⁴ As a result, the IRS has not been able to work this increased inventory within 70 calendar days, as agreed to between the National Taxpayer Advocate and Criminal Investigation in 2006, and began to apply hard freezes on these accounts.
- In FY 2012, AMTAP imposed a "hard freeze"⁵ on more than 142,000 returns because it could not complete the verification within the allotted time, not because the returns

¹ See National Taxpayer Advocate 2005 Annual Report to Congress 25 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress vol. 2 (*Criminal Investigation Refund Freeze Study*).

² The IRS uses third-party data in an attempt to verify wages and withholding reported on returns claiming refunds.

³ Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2007-10-076, *Actions Have Been Taken to Address Deficiencies in the Questionable Refund Program; However, Many Concerns Remain, with Millions of Dollars at Risk* 11 (May 2007).

⁴ Wage and Investment Division (W&I) Business Performance Review, 2nd Quarter 2012 (May 18, 2012).

⁵ A hard freeze (designated with transaction code 570) indicates an additional liability is pending and keeps the module from refunding or offsetting credit out (transferring funds to other federal debt owed by the taxpayer). A hard freeze may be released manually or when the refund request has been disallowed.

show “badges of fraud” or are otherwise suspect.⁶ In other words, AMTAP is using a hard freeze — normally designated for accounts in which potentially fraudulent activity has been “verified” — as an inventory management tool, without sufficient analysis of relative risk.

- TAS receipts of AMTAP cases — one indicator of flawed IRS procedures — rose approximately 468 percent since FY 2010, from 3,171 case receipts in FY 2010 to 18,012 in FY 2012. AMTAP cases currently constitute 8.2 percent of all TAS case receipts and are the second most common issue in TAS casework.⁷
- TAS is increasingly receiving cases from taxpayers who are experiencing crippling economic burden because of IRS AMTAP delays.
- Seventy percent of all taxpayers who sought TAS help with the refund freezes in 2012 were experiencing some kind of financial harm as a result of IRS actions (or inaction), compared to 38 percent in 2010.⁸
- A representative sample of TAS wage verification cases closed in 2012 found that 86 percent of these taxpayers were facing potential adverse impact.⁹
- Seventy percent of these taxpayers with hardships received full relief (with another two percent receiving partial relief).¹⁰
- In the same representative sample of TAS pre-refund cases, 53 percent of the taxpayers claimed and received the Earned Income Tax Credit (EITC). These taxpayers waited more than three months for a median refund of \$5,175. The refunds comprised 38 percent of their Adjusted Gross Income (AGI).¹¹

The National Taxpayer Advocate appreciates the need for revenue protection, but believes there should be no conflict between protecting revenue and providing due process to taxpayers whose returns are being questioned.

Despite improvements to the AMTAP program, the National Taxpayer Advocate remains extremely concerned with AMTAP’s continued lack of urgency with respect to assisting

⁶ Email from AMTAP (May 10, 2012). The National Taxpayer Advocate had requested IRS extend the “soft freeze” on these unworked accounts instead of placing a hard freeze on them, which would retain pressure on the IRS to work these cases quickly. The IRS stated that “systems limitations” prevent it from extending soft freezes. *Id.*

⁷ TAS Business Performance Review, 4th Qtr. 2010 thru 4th Qtr. 2012. TAS started using Primary Issue Code (PIC) 045 on March 24, 2010, to identify AMTAP pre-refund cases. FY 2010 PIC 045 receipts: 3,171; FY 2011 PIC 045 receipts: 21,286; FY 2012 PIC 045 receipts: 18,012. TAMIS/Business Objects (BOBJ) Report FY Receipts 2010, 2011, 2012.

⁸ TAMIS/Business Objects (BOBJ) Report FY Receipts 2010, 2011, 2012.

⁹ TAS 2012 analysis of Compliance Data Warehouse (CDW) data from the Individual Returns Transaction File of 474 closed TAS cases with PIC 045 (Pre-Refund Wage Verification) pulled on October 5, 2012 (hereinafter “TAS 2012 Study”). This was a representative sample of TAS cases and had a confidence level of 95 percent.

¹⁰ See TAS 2012 Study.

¹¹ See *id.* There were 241 EITC taxpayers in our random sample of 494 PIC 045 cases. The median AGI was \$14,101, median refund was \$5,175, and median refund hold was 99 days.

taxpayers ensnared by IRS refund fraud filters. This disregard for taxpayers' rights is evidenced by the IRS's decision to:

1. Auto-void certain suspicious returns without notifying the taxpayer;¹²
2. Extend refund holds on returns that do not exhibit badges of fraud or are otherwise suspect (*i.e.*, using refund freezes as an inventory control measure); and
3. Not effectively track the transferal of cases to the Exam function from AMTAP, thereby delaying notification of taxpayers and resolution of accounts, and imposing additional burden on taxpayers and IRS employees alike.

Finally, the IRS's failure to adequately address taxpayer service needs within this program causes:

- Increased inventory levels without the corresponding resources needed to resolve cases timely, as shown by the continued imposition of hard freezes;
- More taxpayers with legitimate refund claims being ensnared by filters each year;
- Frustrated taxpayers forced to deal with phone assistors who cannot advise them about the status of their refunds; and
- Confusion among IRS functions about whose responsibility it is to resolve cases.

ANALYSIS OF PROBLEM

Background

In 2005, the National Taxpayer Advocate identified the IRS's use of permanent refund freezes in connection with questionable refund claims as the most serious problem facing taxpayers. A 2005 TAS study of refund freeze cases in which taxpayers sought TAS assistance determined that approximately 66 percent of these taxpayers ultimately received the full amounts they originally claimed on their returns and over 80 percent received at least partial refunds,¹³ but only after waiting a median time of more than eight and one-half months.¹⁴ When we again analyzed AMTAP cases in TAS inventory in 2011, we found approximately 78 percent of taxpayers who came to TAS ultimately received the full relief.¹⁵ The median refund amount was \$4,062, which the taxpayer waited more than six months to receive.¹⁶

¹² When a return is auto-voided, the IRS does not process the return; rather, the IRS archives the return, either electronically in Tax Return Data Base (TRDB) or on paper in Files. If the taxpayer later comes forward and confirms his/her identity as a legitimate taxpayer with a filing obligation, the IRS will retrieve the return and process it as of the original filing date. All returns being suspected as part of the Operation Mass Mailing scheme are auto-voided.

¹³ See National Taxpayer Advocate 2005 Annual Report to Congress vol. 2, 2 (*Criminal Investigation Refund Freeze Study*).

¹⁴ See *id.* at 15.

¹⁵ See TAS analysis of CDW data from the Individual Returns Transaction File of 373 closed TAS cases with PIC 045 (Pre-Refund Wage Verification) and PIC 425 (Stolen Identity) with secondary issue code (SIC) 045 cases pulled on October 11, 2011 (hereinafter "TAS 2011 Study"). This was a representative sample of TAS cases and had a confidence level of 95 percent.

¹⁶ See TAS 2011 Study.

Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters

AMTAP's main objective is to identify and stop fraudulent refunds before they are paid out. AMTAP uses the Electronic Fraud Detection System (EFDS) to screen, score, and select returns suspected of fraud for review. The IRS updates its screens each year based on its experience with prior years' returns. Current-year returns requesting refunds are passed through the updated knowledge base and scored for likelihood of fraud. Returns that are flagged are diverted for further inspection before the IRS issues any refund.

The IRS states that the EFDS filters are 93 percent accurate in detecting potentially fraudulent returns.¹⁷ With EFDS selecting nearly one and one-half million returns, even if we take the 93 percent accuracy rate at face value, we note that the screens impact over 102,000 taxpayers with legitimate refund claims.¹⁸ Our continued case reviews reveal that a significant percentage of taxpayers who come to TAS for assistance with their refund holds have received full relief.

When EFDS selects a return for screening, it systemically holds the refund for 11 weeks.¹⁹ At that time, AMTAP sends a letter informing the taxpayer that income, withholding, or tax credits are being "reviewed" and that the IRS is holding the refund for a more thorough assessment.²⁰ The 11 weeks allows the IRS time for wage and withholding verification.

One method AMTAP uses to verify return information during this review period is to compare it with the Information Returns Master File (IRMF). The IRMF contains third-party information such as wage and withholding reported on Forms W-2, *Wage and Tax Statement*, and most Forms 1099, *U.S. Information Return*.²¹ If AMTAP cannot initially verify wage and withholding documents systemically via the IRMF, it moves on to a manual "verification" process. AMTAP employees attempt to contact the employer to verify the amounts reported on the return by disc, fax, or phone.²² If AMTAP verifies the wages and withholding as accurate, the IRS will release the refund.

If AMTAP cannot verify the information through internal records or by contacting the employer, the IRS sends the taxpayer a notice or a letter requesting documentation (*e.g.*, pay

¹⁷ See W&I response to TAS information request (Aug. 28, 2012).

¹⁸ There were 1,452,549 cases selected for verification in 2012 through October 15. Seven percent, or 102,236, were not verified "bad." See W&I response to TAS information request (Nov. 19, 2012).

¹⁹ The temporary freeze is automated within EFDS, and is evidenced by TC 971-134 on the taxpayer's account. IRM 21.9.1.2.3 (Mar. 1, 2012).

²⁰ Notice CP 05, *Information Regarding Your Refund*.

²¹ Under present law, issuers who file these forms electronically have until March 31 to file them with the government. Issuers send Forms 1099 directly to the IRS and Forms W-2 directly to the Social Security Administration (SSA), which in turn sends information extracted from the forms to the IRS each week, starting in late March. Internal Revenue Code (IRC) §§ 6051(a), 6049(a), 6042(a); see *IRS Instructions for Forms W-2 and W-3, Wage and Tax Statement and Transmittal of Wage and Tax Statements*; Social Security Administration, *Employer W-2 Filing Instructions & Information*, available at <http://www.ssa.gov/employer/gen.htm> (last visited Oct. 24, 2012). For a more detailed discussion of third-party information reporting and its uses, see Status Update: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*, *infra*.

²² IRM 21.9.1.8(1) (May 4, 2012). The IRS employs several methods to contact employers for verification of wages, adhering to the employer preference if one exists. Letters are sent annually to certain large employers, requesting them to provide wage information on a computer disc. Requests for verification are automatically generated by fax; phone calls are made based on employer preference.

Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters

MSP #6

stubs, Forms W-2), and extends the refund hold.²³ AMTAP will also convert the hold from a temporary (soft) hold to a permanent (hard) one when it has not completed the verification process before the temporary hold expires.²⁴

AMTAP Employees Given Early Access to Information Reporting Data.

Traditional manual verification of wage information is a time-consuming process, making it difficult for AMTAP to meet the 70-day response time promised to taxpayers. One of the tools used to verify wage withholding on questionable returns is the Information Returns Processing Transcript Requests (IRPTR) command code.²⁵ Historically, current tax year IRPTR information was not available until mid-May of the following year.

The National Taxpayer Advocate has previously noted that taxpayers would benefit greatly if the IRS could find a way to utilize IRPTR data in real time, or even a month earlier.²⁶ Beginning in the 2012 filing season, AMTAP employees were given access to IRPTR in March, which enabled AMTAP to systemically verify wages and withholding on almost 530,000 questionable refund claims (34 percent of all returns verified) much more efficiently.²⁷

Lack of Resources and Increasing Inventory Selection Are Reminiscent of Problems Identified in 2005.

The old adage that history repeats itself appears to apply to the QRP, regardless of whether AMTAP or CI is responsible for the program. Even though AMTAP staffing has increased, it appears the growth is not sufficient to handle the volume of cases the program selects for screening and verification, a number that rises each year.²⁸ In FY 2012, AMTAP selected over 1.4 million information documents for verification, compared to just over 430,000 in 2010.²⁹ This represents a 238 percent increase over the last three years. Thus, it is not surprising that AMTAP cannot complete the verification process in the agreed-upon time.³⁰

²³ IRM 21.9.1.8(1) (May 4, 2012). Letter 4115 requests income documentation from the taxpayer/employee (e.g., copies of checks, bank statements, pay statements, check stubs, and employer letters).

²⁴ Email from AMTAP analyst (Sept. 28, 2011).

²⁵ The IRPTR command code allows IRS employees to request either online or hardcopy Information Returns Processing transcripts from the Information Returns Master File. IRM 2.3.35.1 (Aug. 1, 2003).

²⁶ See National Taxpayer Advocate 2011 Annual Report to Congress 32, 47.

²⁷ As of June 30, 2012, IRS used IRPTR to verify 529,842 returns, 34 percent of the total returns verified as of that date. See W&I response to TAS information request (Aug. 28, 2012).

²⁸ AMTAP was staffed with 336 full-time equivalents in 2010 and 477 full-time equivalents in 2012. See W&I response to TAS information request (Aug. 28, 2012).

²⁹ See W&I response to TAS information request (Nov. 19, 2012).

³⁰ On October 17, 2012, TAS requested information from the IRS showing the number of returns over a period of years that AMTAP selected for screening, the volume selected for manual verification, and the volume ultimately cleared for refund. AMTAP instead provided TAS with the volume of information documents (IDOCs) selected for verification. As TAS cannot directly correlate the number of IDOCs to the number of returns, we are unable to show the relationship of selected/verified/released returns. See W&I response to TAS information request (Nov. 19, 2012).

Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters

The IRS Should Use Hard Refund Freezes Only When There Is an Indication of Fraud, Not as an Inventory Management Tool.

Given the importance of protecting taxpayers and the tax system from refund fraud and improper payments, the National Taxpayer Advocate believes the IRS should have a reasonable time to determine whether a refund claim bears the “badges of fraud” or is otherwise suspect, such that it should be held for further investigation or examination. As provided in the 2006 memorandum, the IRS and the National Taxpayer Advocate agreed that, unless IRS referred the claim for criminal investigation, releasing refunds systemically within 70 calendar days of the initial claim struck an appropriate balance between revenue protection and taxpayer burden.³¹ As a consequence, CI issued guidance stating that claims “must be resolved within 70 calendar days; if not, the refund will be automatically released through master file programming.”³²

However, when the QRP transferred from CI to W&I, the IRS reneged on its commitment to release refunds if it cannot determine in a reasonable time that a claim requires additional investigation. Current procedures advise IRS employees that “[i]t may be necessary to take additional actions to hold the refund after the 11 cycle freeze [77 days] if a permanent freeze has not posted and the final return disposition still is uncertain.”³³ In practice, the IRS *routinely* extends refund freezes by placing hard freezes on accounts, as evidenced by the subsequent freeze applied to 142,000 taxpayer accounts in FY 2012 — almost 10 percent of all taxpayer accounts selected for verification by AMTAP.³⁴ Instead of releasing refunds after 11 weeks when it cannot determine they warrant deeper scrutiny, AMTAP is placing hard freezes on the accounts in which fraudulent activity is suspected, because it could not verify wages and withholding within the established timeframe. In other words, AMTAP is using a hard freeze as an inventory management tool, without sufficient analysis of relative risk.

Concerned about the increasing delay in AMTAP’s review of these cases, the National Taxpayer Advocate asked that AMTAP extend the “soft” freeze, rather than applying a hard freeze on these 142,000 accounts. EFDS systems limitations prevent AMTAP from extending the soft freeze of 11 weeks originally placed on the accounts, and a “hard” freeze must be applied to prevent the systemic release of these refunds.³⁵ The inherent problem with a hard freeze is that once it is placed on an account, the IRS faces no external pressure to

³¹ See Memorandum Regarding IRS Criminal Investigation Questionable Refund Program Procedures (Feb. 3, 2006); National Taxpayer Advocate 2006 Annual Report to Congress 412; IRS, *Fraud Detection Center - FDC Guidelines for Processing Year 2007 Issued by Refund Crimes and the Fraud Detection Centers* 17 (Dec. 2006). When AMTAP inputs a TC 971 AC 134, the module is systemically frozen from refunding for 11 weeks. If AMTAP has missed the cutoff to input the TC 971 AC 134, it must input a “hard” freeze, which has no systemic release.

³² See IRS, *Fraud Detection Center - FDC Guidelines for Processing Year 2007 Issued by Refund Crimes and the Fraud Detection Centers* 17 (Dec. 2006). At that time, returns underwent a one-week “re-sequencing” period (now two weeks) while processing, so the refund hold was for 77 days.

³³ IRM 21.9.1.2.3 *Stopping the Refund* (Mar. 1, 2012). Generally, returns selected for verification before the refund stop date will follow an automatic EFDS process to stop the refund for 11 weeks (with input of the TC 971-134). Returns that require manual verification or have unsubstantiated withholding, etc., will require a manual hold or “hard” freeze, which holds the refund permanently (until another action is taken to release the refund).

³⁴ Email from AMTAP (May 10, 2012).

³⁵ *Id.*

work the case quickly. These returns can be left to languish while IRS works subsequent returns, re-creating the 2005 debacle all over again.³⁶

As Yearly Screening Volumes Increase, Imperfect Screens Trap and Harm Taxpayers.

As the total volume of tax returns selected for screening has increased over the past several years, so has the volume of information documents selected for manual verification of wages. The number of information documents (IDOC's) that IRS selects for verification has risen 238 percent from 2010 to 2012. See Figure 1.6.1 below.³⁷

FIGURE 1.6.1, Increase in AMTAP Verification of Information Documents (IDOCs)

	2009	2010	2011	2012 thru 10/15
Selected for Verification	361,313	432,752	882,516	1,460,526
Verification Completed	285,417	386,756	769,607	1,452,549
Verified Bad	193,333	328,756	684,907	1,345,532
% Bad	68%	85%	89%	93%

Note: These are IDOC volumes, not tax return volumes.³⁸

Correspondingly, the number of taxpayers caught up in the EFDS filters that AMTAP ultimately determined were entitled to the refunds they claimed also rose. AMTAP's reports show that the number of legitimate refund claims that the system potentially impacted has risen from 58,013 in 2010 to 84,656 in 2011 and to 101,678 in 2012.³⁹ This represents a 75 percent increase in the last three years.

As the IRS stops refunds, TAS receives more requests for help from the taxpayers. Between FY 2010 and FY 2012, TAS pre-refund cases rose 468 percent and constituted 8.2 percent of TAS case receipts in FY 2012.⁴⁰

³⁶ See National Taxpayer Advocate 2005 Annual Report to Congress 25.

³⁷ See W&I responses to TAS information requests (Aug. 28, 2012, and Nov. 19, 2012).

³⁸ On October 17, 2012, TAS requested information from the IRS showing the number of returns over a period of years that AMTAP selected for screening, the volume selected for manual verification, and the volume ultimately cleared for refund. AMTAP instead provided TAS with the volume of IDOCs selected for verification. AMTAP stated that data mining modeling is applied against "returns" and "returns" are selected for screening. Verification is performed on "Information Documents" associated to those returns that were determined to need verification. See W&I response to TAS information request (Aug. 28, 2012); see email from AMTAP (Oct. 29, 2011).

³⁹ See W&I response to TAS information request (Nov. 19, 2012). AMTAP reports that 93 percent of information return documents in FY 2012 could not be verified as accurate (the IRS refers to these as "verified bad"). The remaining seven percent may include information return documents that are inconclusive or take longer to verify as inaccurate. However the National Taxpayer Advocate has repeatedly questioned what the IRS means by "verified bad." A significant percentage of taxpayers who come to TAS for assistance with AMTAP-related cases subsequently receive full refunds, as the information reported on their returns is ultimately verified as accurate. See TAS 2011 Study and TAS 2012 Study.

⁴⁰ TAMIS/Business Objects (BOBJ) Report FY Receipts 2010, 2011, and 2012.

Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters

FIGURE 1.6.2, TAS Pre-Refund Wage Verification Case Receipts, FY 2010–FY 2012

	FY 2010	FY 2011	FY 2012
AMTAP QRP Receipts	3,171	21,286	18,012
TAS Total Case Receipts	289,933	295,904	219,666
AMTAP QRP Receipts as a Percentage of TAS Receipts	1.1%	7.2%	8.2%

TAS conducted studies in 2011 and 2012 to determine, among other things, the reason these taxpayers seek our assistance. And as previously mentioned, the studies revealed the number of taxpayers seeking TAS help because of financial difficulties attributable to IRS action or inaction rose from 50 percent in 2011 to 86 percent in 2012.⁴¹ On average, it took six months in 2011 and three months in 2012 for these taxpayers to receive their refunds.⁴² (The 2011 study population included returns from tax years 2009 and 2010, while the 2012 study population included returns from tax year 2011 alone. Thus, the 2012 study reflected a shorter cycle time because it did not include prior year returns.)

Returns claiming the EITC made up nearly 17 percent of all cases the IRS selected for verification in calendar year (CY) 2012.⁴³ When the IRS holds legitimate refunds for extended periods, it further exacerbates the taxpayers' hardships, especially for low income taxpayers who may need the refunds for food, medical care, rent, or utilities. Previous studies of AMTAP cases revealed that the frozen refunds on cases claiming EITC and showing low income strata represented over 25 percent of the taxpayers' yearly incomes.⁴⁴

In TAS's 2012 review of pre-refund cases, 53 percent of the taxpayers claimed and received EITC. These taxpayers waited more than three months for a median refund of \$5,175. The refunds comprised 38 percent of their adjusted gross income.⁴⁵

The IRS Does Not Always Send Notices or Verify Returns When It Identifies Questionable Refund Claims, Contrary to its 2006 Agreement with the National Taxpayer Advocate.

The IRS encounters many different types of schemes designed to defraud the government and its taxpayers. One significant scheme, identified by the IRS in 1999, has been dubbed "Operation Mass Mail" (OMM). Originally, the perpetrators used Social Security numbers (SSNs) from Puerto Rican residents due to the unlikely probability that those individuals

⁴¹ See TAS 2011 Study; TAS 2012 Study. The 2011 TAS study included 2009 and 2010 tax returns closed in 2011.

⁴² See *id.* The 2012 study included only 2011 tax returns closed in 2012. As the 2012 study did not include prior year returns, the refund hold time was considerably shorter than in the 2011 study. In the 2012 study, 71 percent of taxpayers received full relief and waited on average more than three months to receive that refund.

⁴³ See W&I response to TAS information request (Nov. 19, 2012).

⁴⁴ National Taxpayer Advocate 2005 Annual Report to Congress vol. 2, 2, 12 (*Criminal Investigation Refund Freeze Study*). Over half of the taxpayers in this study had an adjusted gross income of less than \$13,000. On average, the frozen refunds represented 25 percent of the taxpayers' yearly income. Nearly 75 percent of the taxpayers who claimed the EITC were allowed the credit after IRS processing. The average amount of the EITC initially claimed was \$2,853. Overall, 80 percent of the taxpayers in the study received at least a partial refund, after waiting on average nine months.

⁴⁵ TAS 2012 study. There were 241 EITC taxpayers in our random sample of 494 PIC 045 cases. The median AGI was \$14,101, median refund was \$5,175, and median refund hold was 99 days.

will file a U.S. tax return. In recent years, perpetrators have been using SSNs from U.S. territories as well as the 50 states. As a way to combat this scheme, the IRS looks for tax returns containing certain characteristics. If a return fits this profile, it is not processed (in IRS parlance, it is “auto-voided”).⁴⁶ When a return is auto-voided, the IRS does not process the return; rather, the IRS archives the return. If the taxpayer later comes forward and confirms his/her identity as a legitimate taxpayer with a filing obligation, the IRS will retrieve the return and process it as of the original filing date.

The IRS stops hundreds of thousands of OMM returns each year, and believes the OMM matrix it developed to combat the scheme is highly effective. In CY 2012, AMTAP identified approximately 934,504 returns that fit OMM criteria.⁴⁷

The National Taxpayer Advocate commends the IRS for taking proactive measures to protect the public fisc from fraudulent refund claims. However, we are concerned that the criteria used to identify an OMM return are sweeping in their reach and could ensnare legitimate taxpayers.⁴⁸

As the IRS does not send notices to OMM-affected taxpayers or verify the information on returns that it suspects may belong to the OMM scheme, taxpayers only learn their returns were auto-voided when they call to inquire about their refunds. At that point, the IRS Customer Service Representative (CSR) will instruct the taxpayer to re-submit the return, but will not tell him or her about its auto-void status.⁴⁹ When the taxpayer resubmits the return (*e.g.*, TAS secures and forwards the taxpayer’s return), AMTAP will screen and verify it. If the return verifies as good, AMTAP will code it with a Special Processing Code (SPC) “B” and forward it to be processed. However, the resubmitted return will not post and must be manually “forced” to post.⁵⁰

The IRS has an obligation to expedite the processing of a resubmitted return when it is known to be legitimate. These taxpayers have already been harmed by the IRS’s failure to notify them that their returns have been deemed invalid and auto-voided. The IRS should institute programming that will allow the taxpayers’ subsequent valid returns, once verified, to post immediately. Instead, returns identified as OMM will not automatically be processed, even after they are reviewed and coded as “good.” The IRS has indicated that it planned to revise its programming to allow the returns with SPC B to be processed

⁴⁶ IRM 3.12.2.279.7 (Jan. 1, 2012). Auto-voided or auto-rejected cases are closed automatically without human intervention. These processes apply to all unpostable areas/functions. See IRM 3.12.179.4.6 (Jan. 1, 1998).

⁴⁷ AMTAP identified 934,504 OMM returns through October 15, 2012. See W&I response to TAS information request (Nov. 19, 2012).

⁴⁸ The National Taxpayer Advocate is not at liberty to disclose these OMM criteria, but has expressed her concern to the highest levels of the IRS about the sweep of these rules and their underlying assumptions.

⁴⁹ See IRM 21.5.6.4.35.3 (May 9, 2012).

⁵⁰ IRM 10.5.3.2.2.4.4 (Nov. 15, 2011). Some of the taxpayers whose returns were marked “OMM” came to TAS for help in obtaining their refunds. In the 2011 TAS study, 23 out of 373 cases (six percent) were identified as OMM cases. Of these, TAS was able to obtain relief in 17 cases, or 74 percent of the time (with full relief in 16 cases, 70 percent of the time). For further details, see National Taxpayer Advocate 2011 Annual Report to Congress 36-37.

Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters

without further delay.⁵¹ However, the IRS has not committed resources to change the programming.

To summarize, after waiting months for a refund, not knowing that the IRS voided the return, calling, and re-submitting the return, the taxpayer must still wait. The resubmitted return will automatically go unpostable, even after verification shows it is correct, because the IRS has not made it a priority to allow these returns to post. Thus, the IRS's inaction continues to harm these taxpayer-victims of IRS processes, and creates re-work for its own employees.

Lack of Transparency in the AMTAP Operation Leaves Both IRS Employees and Taxpayers in the Dark, and Generates Downstream Work.

The Electronic Fraud Detection System allows AMTAP to screen and verify returns suspected of fraud, but it is much more. EFDS is AMTAP's inventory management program and records actions taken on returns. There is one big disadvantage to this approach, though — for the most part, only AMTAP employees have access to EFDS.

Under the 2006 agreement with the National Taxpayer Advocate, EFDS now automatically generates a notice to a taxpayer when his or her return is selected for screening. The letter advises the taxpayer that the refund is being held for additional review, lists four items that may be reviewed (income, withholding, credits, and business income), and includes a toll-free number that the taxpayer can call if he or she does not receive the refund or hear from the IRS within 45 days.⁵² The number will connect the taxpayer with an AM customer service representative.⁵³

Almost 25 percent of those receiving these notices called the IRS in 2012.⁵⁴ As of October 8, 2012, the IRS had issued over one million such notices and the CSRs in AM had received almost 265,000 calls about them.⁵⁵ When a taxpayer calls, the CSR cannot advise the taxpayer about the status of the review, as only AMTAP has access to that information. Instead, the taxpayer, who has already waited 45 to 60 days, must wait again while the CSR completes and sends Form 4442 (which CSRs use to record a taxpayer's request in regard to a tax return) to AMTAP to inform it that the taxpayer has called.⁵⁶ If after another 45 days have passed, the taxpayer still does not receive a response from AMTAP, and the case

⁵¹ IRM 10.3.2.2.4.4 (July 8, 2010). Special Processing Code "B will bypass the UPC 147.

⁵² See IRS CP05 notice.

⁵³ *Id.*

⁵⁴ See W&I response to TAS information request (Nov. 19, 2012).

⁵⁵ The volume of CP05 notices was as of October 8, 2012. The call volumes are estimates. See W&I response to TAS information request (Nov. 19, 2012). Note: Some calls received on these issues may be from perpetrators posing as legitimate taxpayers in a further attempt to receive a fraudulent refund.

⁵⁶ IRM 21.5.6.4.35.3 (Oct. 3, 2012).

involves identity theft, the CSR will send a second Form 4442 to the AM Identity Protection Specialized Unit (IPSU).⁵⁷ Cases that do not involve identity theft are referred to TAS.⁵⁸

Delays in the AMTAP process generate additional calls and paperwork, and consume the resources of multiple IRS units.⁵⁹ The IRS should revamp and streamline its process to more efficiently assist taxpayers whose returns have been selected for review by EFDS. Phone calls in response to notices should be directed to AMTAP in real time, as only AMTAP employees can apprise the taxpayer of the status of his or her account. Not only is it a waste of IRS resources for the taxpayer to speak to IRS employees from various functions, but the taxpayers are more likely to be confused about what documentation the IRS needs, or may have to submit documentation multiple times, or they may just give up — not because they aren't entitled to the refund, but because they just don't have the wherewithal to handle the runaround.

Coordination Between Business Functions Is Imperative to the Efficient and Smooth Transfer of Case Work.

Few things are more frustrating for taxpayers than calling the IRS about their refunds and being told that the IRS cannot locate their cases. It is understandable that different functions within the IRS will need to work on a case, but the IRS must ensure that the transfer is seamless, and cases do not get lost.

In 2011 and 2012, TAS worked with AMTAP and Examination (“Exam”) trying to locate taxpayer returns targeted for transfer to Exam from AMTAP. AMTAP could not tell TAS what campus Exam office received the work, because the case had not opened up on Exam’s Audit Information Management System. It was ascertained that Exam’s case codes did not match the issues on the returns that needed to be examined, and conversely the returns could not be systemically transferred to Exam. Some were rejected back to AMTAP, where they languished without being reviewed; others just remained in limbo. TAS case advocates endured months of not being able to respond substantively to taxpayers’ inquiries, increasing taxpayer and TAS burden. This problem continues, revealing both a lack of recordation and coordination to ensure the successful transfer of returns from one function to another.

⁵⁷ In general, cases will be forwarded to IPSU if the taxpayer is a victim of identity theft and the case meets TAS criteria 5-7 (systemic burden). See *Memorandum of Understanding Between the National Taxpayer Advocate and the Commissioner, Wage & Investment to Transition TAS Criteria 5-7 Identity Theft Cases to Wage & Investment Identity Protection Specialized Unit (IPSU)* (Mar. 31, 2010).

⁵⁸ IRM 21.5.6.4.35.3 (Oct. 3, 2012).

⁵⁹ See Most Serious Problem: *The IRS Telephone and Correspondence Services Have Deteriorated Over the Last Decade and Must Improve to Meet Taxpayer Needs, infra.*

Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters

CONCLUSION

The IRS must deal with the challenging combination of increasing opportunities for refund fraud and decreasing resources to combat such activities. However, in using new screens and programs, the IRS must be careful not to repeat the mistakes identified in the QRP program in 2005. When the IRS deletes returns without notifying taxpayers or imposes extended delays on refunds, taxpayers will call. Exacerbating the situation, the taxpayer often cannot get through, or must wait extended periods to speak to a phone assistor, only to find that the assistor cannot tell the taxpayer anything about the status of the account. This situation creates both downstream work and taxpayer burden. Taxpayers need timely notice of refund holds, the ability to talk to a phone assistor when calling, accurate accounting of their return status, clear notification that explains consequences, and prompt and accurate resolution of legitimate claims. The fact that over 100,000 taxpayers, many of whom are low income and waiting for refunds that make up more than a third of their AGI, are ensnared in these processes, should drive the IRS to resolve these problems immediately, with a sense of urgency.

In conclusion, the National Taxpayer Advocate offers these preliminary recommendations:

1. Provide the AMTAP unit sufficient staff and systems resources to work its inventory timely.
2. Adhere to the policy of systemically releasing refunds after 70 days if the IRS cannot determine that the return is part of a known scheme or requires greater scrutiny; and if additional time is needed, program systems so the soft freeze can be extended for 30 day intervals.
3. When taxpayers call inquiring about refunds, direct them to the personnel with access to the most current information regarding their account.
4. Notify taxpayers with legitimate refund claims that become ensnared in the OMM scheme that their returns have been voided, and institute programming that will allow their re-submitted returns to be processed without further delays.
5. Track the number of tax returns “verified bad” by the Electronic Fraud Detection System, in addition to the number of information documents.
6. Develop a system for recordation of case transfers to Exam and scheduled reviews to address rejected referrals.

IRS COMMENTS

The Taxpayer Assurance Program, known as AMTAP, recently completed its third filing season, and its first as part of the new Return Integrity and Correspondence Services (RICS) organization. RICS was established in October 2011 to create a centralized organization for ensuring revenue protection and refund compliance. The new RICS office has quickly moved to balance the taxpayer experience, revenue protection and resource efficiency. For filing season 2012, RICS increased AMTAP staffing significantly and trained all AMTAP

permanent employees on account work to dedicate more highly skilled employees to successfully tackle the complex challenges of refund fraud and identity theft work. To further protect taxpayers and their refunds, the RICS organization deployed a specialized identity theft unit in FY 2012.

The IRS recognizes the need to always protect taxpayer rights. We must continually balance the rights of taxpayers with our responsibility to protect the interests of the United States and the majority of taxpayers who accurately file and pay their federal taxes. The voluntary compliance design of America's tax system requires the IRS to take efforts to support compliant taxpayers by detecting fraud and errors of those looking to be noncompliant. It is a continuous challenge to quickly identify perpetrators and individuals who use sophisticated methods to defraud the nation's tax system. This detection can be more time-consuming when individuals are not associated with a known scheme, and cases require analysis, third-party information, and actions to assure that legitimate taxpayers are protected.

As those attempting to commit refund fraud become more sophisticated, the IRS must take steps to respond accordingly. As discussed above, the IRS continues to recognize the importance of taxpayer rights, but we must ensure that processes are in place to effectively stop refund fraud. We consistently work to improve our fraud detection methods by developing improved system models to combat new fraud trends.

Those looking to defraud the government have become more brazen and are availing themselves to a variety of resources both outside and within the system to try to force the release of false refunds. In some cases, this even includes calling Taxpayer Assistance toll-free telephone numbers or seeking support through the Taxpayer Advocate Service. One example involves over 200 filings that IRS deemed fraudulent with associated revenue protected of more than \$800,000. Thirty of those false returns had an open TAS case; meaning that perpetrators have contacted the IRS through TAS to try to force the release of the associated refunds. As another example, Operation Mass Mail is a scheme where perpetrators contact toll-free assistors and TAS to force refund release. In dealing with these situations, the IRS follows established taxpayer support requirements, which require use of valuable resources to ensure that the fraud determination is correct. These two examples are just a snapshot of the challenges to the IRS in maintaining a balance between protecting federal revenue and providing valid taxpayer support while minimizing taxpayer burden.

The IRS has increased its AMTAP staffing for the upcoming filing season and will assess the efficiencies gained from accelerated availability of Information Returns data to determine appropriate resource utilization and allocation for handling inventory. We will explore options to direct taxpayers to the personnel who can provide them with the most recent account status information.

With respect to the recommendation that the IRS track the number of tax returns "verified bad" by EFDS in addition to information documents, note that returns are verified as "bad" through the verification process, not by EFDS. Returns are selected for screening

Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters

while verification occurs based upon the information documents associated with the return. AMTAP does track the number of bad/stopped returns in addition to information documents.

With respect to case transfers, a system exists for tracking referrals to Exam. Any return referred to Exam in a particular processing year can be tracked via EFDS. Reviews of rejected returns currently occur on a regular basis. RICS performed an in-depth analysis surrounding the specific reject reasons in 2012. For 2013, a work request has been submitted for system updates to help facilitate with the processing of rejected returns.

While the IRS strives to release all valid returns as soon as possible, we cannot commit to an automatic release in cases in which issues are suspected. The IRS developed revenue protection processes over many years using historical data to determine that fraud is indicated. The IRS refines fraud models each year based on performance and new characteristics and updates procedures for reviewing and processing revenue protection inventory accordingly to ensure that there are indications of fraud before holding a refund. Manual screening processes also ensure that a return meets established fraud characteristics before designation for verification and refund hold. Due to the historical evidence of known fraud, the explosion in fraud and identity theft in the past two years, and the consistent amount of revenue protected by IRS fraud detection efforts developed from this analysis, the IRS must maintain the right to determine when a hard refund freeze is appropriate. The IRS is exploring options to extend the soft freeze in increments. Note that the IRS corresponds with taxpayers when returns are sent through the fraud verification process.

With respect to the OMM scheme, IRS developed the policy to “auto-archive” returns based on historical analysis of repeated fraud characteristics. For example, the Operation Mass Mail scheme is a very high volume scheme attempted annually. Part of the scheming effort is to inundate IRS with returns to force release of some of the refunds. In calendar year 2012, we received 363,837 OMM returns through EFDS and only 0.7 percent of these were valid. Because of the low incidence that valid returns are impacted, attempting to correspond on these fraudulent returns would be an ineffective use of resources and taxpayer dollars. These returns often have an address not associated to the Social Security number owner or may use a decedent SSN or be a first-time filing where there is no good address. Experience with corresponding on other types of revenue protection inventory shows us that it is highly likely that correspondence would come back as undeliverable, resulting in a waste of the resources used to create and mail the correspondence, as well as the creation of unnecessary back-end. Expending our limited resources on this work is not prudent. In addition, corresponding provides those committing fraud with additional or new avenues to try to force refund release by giving them toll-free numbers to contact. By auto-archiving the massive volumes of these fraud returns and only processing a return when a true SSN owner is known and submits a valid filing, the IRS saves taxpayer dollars and reduces negative impact that would result from trying to treat them as legitimate filings when they meet well-established, known fraud markers. We have found that where a real taxpayer exists, they will contact the IRS. At that point we will work with the taxpayer to issue the refund.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate fully recognizes the need for the IRS to thoroughly screen refund claims before processing payments to taxpayers. We do not disagree that perpetrators have become more crafty, bold, and persistent in their attempts to obtain refunds to which they are not entitled. We encourage the IRS to continue improving its fraud detection filters to combat refund fraud more effectively.

Yet even in this environment, the National Taxpayer Advocate is compelled to remind the IRS that all taxpayers are entitled to due process. Assuming that the IRS is accurate when it estimates 93 percent of the 1.4 million returns stopped by EFDS contain inflated refund claims, that could leave more than 100,000 taxpayers whose legitimate claims will be held up unnecessarily. Although the IRS may view EFDS scoring or OMM matrices as reliable indicators of fraud, it is important that the taxpayer be given an opportunity to present facts to support his or her claim. Even the most reliable filters will ensnare legitimate filers. The IRS must be prepared to assist these honest taxpayers as quickly as possible.

In 2006, the National Taxpayer Advocate met with IRS leadership to discuss what would be an acceptable amount of time for a taxpayer whose return has been frozen to wait for the IRS to complete its verification. All parties agreed that 70 days should be sufficient, and if the verification could not be finished within that period, the IRS would release the refund freeze unless it had reason to believe further investigation was necessary. Today, the IRS is saying that 70 days is not long enough, and is routinely applying hard freezes on taxpayer accounts, in violation of the 2006 memorandum of understanding.

The National Taxpayer Advocate has never questioned the IRS's right to impose a "hard freeze" where the facts of the case warrant one. However, in its response, the IRS is maintaining that it should have the ability to impose a "hard freeze" even where the facts *do not* warrant. The IRS bases this position on what it calls "historical evidence of known fraud." Yet in justifying its position, the IRS ignores the most compelling "historical evidence" cited in our report — namely, that the number of legitimate tax returns ensnared in IRS anti-fraud filters has increased by 75 percent over the last three years, from 58,013 in 2010 to 101,678 in 2012. If the IRS cared about providing relief to these legitimate taxpayers as much as it cared about stopping fraud, TAS would have far fewer refund fraud cases in its inventory.

If AMTAP is truly inundated by so many questionable refund claims that the unit cannot keep up with its verification inventory, then the IRS should bring all parties together and propose an adjustment to the 70-day timeframe. At a minimum, the IRS should institute programming that would allow AMTAP to extend the temporary freeze by 30 days on a case-by-case basis. Instead, AMTAP unilaterally decided to permanently freeze accounts — more or less as an inventory management tool. The National Taxpayer Advocate

is concerned that when AMTAP applies a permanent freeze, the unit will feel no external pressure to complete the verification in a timely manner, and taxpayers will be harmed by waiting significantly longer than the 70 days agreed upon in 2006.

In this Most Serious Problem discussion, the National Taxpayer Advocate has proposed several extremely reasonable recommendations that will bring relief to legitimate taxpayers who are caught up in the IRS' necessary fraud protection actions while still allowing the IRS to vigorously protect revenue. The IRS's dismissal of these recommendations in its response demonstrates its lack of commitment to taxpayers who are the victims of its processes. The National Taxpayer Advocate wonders how many more taxpayers must be harmed in this way before the IRS decides it is "worth" acting.

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Provide the AMTAP unit sufficient staff and systems resources to work its inventory timely.
2. Adhere to the policy of systemically releasing refunds after 70 days if the IRS cannot determine that the return is part of a known scheme or requires greater scrutiny.
3. If the IRS requires additional time to research a questionable refund claim, enable AMTAP to extend soft freezes in 30-day intervals.
4. Institute programming that will allow immediate processing of tax returns re-submitted by legitimate taxpayers caught by the OMM filters.
5. When taxpayers call inquiring about refunds, direct them to the personnel with access to the most current information regarding their account.
6. Track the number of tax returns "verified bad" by AMTAP, in addition to the number of information documents.
7. Develop a system (apart from EFDS) for tracking case referrals to Exam, as not all employees have access to EFDS.