



*The 2009 Filing Season Was Successful
Despite Significant Challenges Presented by
the Passage of New Tax Legislation*

September 21, 2009

Reference Number: 2009-40-142

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:

1 = Tax Return/Return Information



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 21, 2009

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: *Michael R. Phillips*
Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The 2009 Filing Season Was Successful Despite Significant Challenges Presented by the Passage of New Tax Legislation (Audit #200940013)

This report presents the results of our review of the 2009 Filing Season. The overall objective of this review was to evaluate whether the Internal Revenue Service (IRS) timely and accurately processed individual paper and electronically filed (*e-filed*) tax returns during the 2009 Filing Season.¹ This review was part of the Treasury Inspector General for Tax Administration Fiscal Year 2009 Annual Audit Plan and relates to the Major Management Challenge of processing returns and implementing tax law changes.

Impact on the Taxpayer

Each year, legislated tax law changes create challenges for both the IRS and individual taxpayers. Moreover, the 2009 Filing Season presented additional challenges due to the passage of three significant tax laws in Calendar Years 2008 and 2009 after the filing season had started. Overall, the IRS implemented these changes correctly with no significant delays in the processing of tax returns during the 2009 Filing Season. Through May 29, 2009, the IRS had received more than 133.6 million individual tax returns. Of those, approximately 91.7 million were *e-filed* and approximately 41.9 million were filed on paper.

Synopsis

The IRS had a successful 2009 Filing Season despite the challenges presented by the enactment of new tax legislation and unusually high number of taxpayer errors resulting from confusion in

¹ See Appendix V for a glossary of terms.



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calculating the Recovery Rebate Credit. While we had some concerns that are discussed in this report, the IRS correctly implemented key tax law and administrative changes with no significant delays. Processing of tax returns was completed on schedule and refunds were issued within the required 45 calendar days of the April 15, 2009, due date.²

Total receipts for *e-filed* tax returns hit a record this year of approximately 91.7 million tax returns (69 percent of total tax returns filed) and exceeded IRS estimates. The increase resulted from taxpayers filing online from home computers (19.2 percent). However, use of the Free File Program decreased by 36.7 percent.

Individual tax returns were timely and accurately processed during the 2009 Filing Season.

Total paper-filed tax returns as of May 29, 2009, were nearly 41.9 million, which was a 27.1 percent decrease from the same time last year. As of May 29, 2009, the IRS issued approximately 104 million refunds totaling \$279.3 billion. Of the 104 million refunds issued, refunds that were direct deposited increased by 9.5 percent to almost 71 million.

In addition, although the IRS initiated a number of efforts to educate and assist individuals who were confused in computing the Recovery Rebate Credit, the credit resulted in a significant number of taxpayer errors. Of the 114.3 million tax returns processed as of April 17, 2009, 16.7 million (14.6 percent) included at least 1 error that needed to be addressed by the IRS Error Resolution function (8.4 million contained a Recovery Rebate Credit error). This exceeded the total number of tax returns the IRS estimated would go to the Error Resolution function by 9.8 million tax returns (142 percent). The Error Resolution function initiated a number of steps to ensure there were no delays in correcting the errors that would impact on the IRS' ability to meet its completion date for processing and issuing tax refunds.

As of May 29, 2009, we identified over 70,000 First-Time Homebuyer Credits totaling over \$489 million that were claimed by individuals who do not appear to qualify for the credit.

Further, the IRS faced challenges in administering the First-Time Homebuyer Credit (FTHC). We identified more than 1.1 million tax returns on which taxpayers were allowed more than \$7.8 billion in FTHCs. Of those, 958,058 (85 percent) were *e-filed* and 171,422 (15 percent) were filed via paper. IRS management disagreed with our recommendation that would have required taxpayers to

provide third-party documentation supporting the purchase of a home. IRS management concluded that such a requirement would be burdensome and would prevent up to 2 million taxpayers from *e-filing*.

² Internal Revenue Code Section 6611(e) (2002).



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The American Recovery and Reinvestment Act of 2009³ modified the FTHC by changing some of the eligibility criteria and increasing the maximum amount of the credit to \$8,000 from \$7,500. It also eliminated the repayment obligation included in the Housing and Economic Recovery Act of 2008⁴ for homes purchased in Calendar Year 2009 unless the purchased home is no longer the main home within the first 36 months of the purchase.

The IRS established the Special Processing Code “H” to assist computer programs in distinguishing FTHC claims for homes purchased in Calendar Year 2009, from homes purchased in Calendar Year 2008 because of the different rules regarding the repayment of the credit. This code should be recorded only when FTHC claims show the home is purchased in Calendar Year 2009. In limited testing of returns with the FTHC, we found that the code was not always recorded accurately. We reviewed the purchase dates shown on the 47,276 *e-filed* returns and found that 93 percent (43,967) did not have their IRS accounts properly coded. Since these taxpayers purchased their homes in Calendar Year 2009, they should not be required to repay the FTHC but may eventually be incorrectly identified as liable for repayment of the credit. Accuracy of processing is essential to future IRS efforts to collect the FTHC as required by the Housing and Economic Recovery Act of 2008. Taxpayers may be burdened by inaccurate notices and improper collection attempts if the IRS cannot accurately identify which credits must be repaid.

Finally, we determined the IRS has corrected and/or is in the process of addressing issues we previously reported as part of our 2008 Filing Season Review.⁵ These include ensuring individuals are not improperly claiming the Qualified Mortgage Insurance Premiums Deduction and claiming dual benefits of the Tuition and Fees Deduction and Education Credit.

Recommendation

We recommended the Commissioner, Wage and Investment Division, ensure Special Processing Code “H” is accurately used on taxpayer accounts by identifying previously processed tax returns that were not coded accurately and ensuring subsequently processed tax returns are properly coded. This could be accomplished by identifying tax returns claiming the FTHC and the amount of the claim and analyzing the accounts to determine if they were properly coded.

³ Pub. L. No. 111-5, 123 Stat. 115 (2009).

⁴ Pub. L. No. 110-289, 122 Stat. 2654 (2008).

⁵ *The 2008 Filing Season Was Generally Successful Despite the Challenges of Late and Unexpected Tax Legislation* (Reference Number 2008-40-183, dated September 30, 2008).



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Response

IRS management disagreed with this recommendation. The IRS stated that it has gone to considerable lengths to mark accounts with the year of purchase and the dollar value of the credit issued and intends to track this information on the Master File for taxpayers who are required to pay back the credit. As the IRS determines what compliance activities will be conducted, it will validate the information it has to ensure only those taxpayers who have not met their responsibilities are contacted. This will include ensuring the date of purchase was accurately captured. Management's complete response to the draft report is included as Appendix VI.

Office of Audit Comment

Although management indicated in their response that they went through considerable lengths to mark accounts with the year of purchase that will be used in determining if recapture is required, our review of 47,276 *e-filed* returns found that 93 percent (43,967) did not have their accounts properly coded. We recently initiated an audit that will evaluate the effectiveness of IRS efforts to distinguish between filers claiming the credit for a purchase in Calendar Year 2008 versus those claiming the credit for a purchase in Calendar Year 2009.

Copies of this report are also being sent to the IRS managers affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



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Abbreviations

AGI	Adjusted Gross Income
ARRA	American Recovery and Reinvestment Act of 2009
<i>e-file(d); e-filing</i>	Electronically file(d); electronic filing
FTHC	First-Time Homebuyer Credit
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration



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Background

The filing season¹ is critical for the Internal Revenue Service (IRS) because it is the time when most individuals file their income tax returns and contact the IRS if they have questions about specific tax laws or filing procedures. The IRS had received more than 133.6 million individual tax returns as of May 29, 2009. Generally, Congress makes changes to the tax law each year. Changes to the tax law have a major impact on how the IRS conducts its activities, how many resources are required, and how quickly the IRS can meet strategic goals. Before the filing season begins, the IRS must identify the tax law changes and administrative changes; revise the various tax forms, instructions, and publications; and reprogram its computer system to ensure tax returns are accurately processed. Tax return processing problems could delay refunds, affect accuracy of accounts, and result in the generating of incorrect notices.

***The IRS received more than
133.6 million tax returns as of
May 29, 2009.***

Along with the usual required updates,² the passage of three significant tax laws in Calendar Years 2008 and 2009, after the filing season had started, presented challenges for the IRS.

- The Housing and Economic Recovery Act of 2008³ included a refundable First-Time Homebuyer Credit (FTHC) and an additional standard deduction for real property taxes. Congress allocated \$13.6 billion for the FTHC to encourage an estimated 2 million first-time homebuyers into the declining housing market. This credit is similar to an interest-free loan that must be repaid over a 15-year period. It allows a taxpayer who is a first-time homebuyer⁴ a refundable tax credit equal to the lesser of \$7,500 (\$3,750 for Married Filing Separately) or 10 percent of the purchase price of a principal residence.
- The Emergency Economic Stabilization Act of 2008⁵ included changes to extend certain expiring provisions and included relief from the Alternative Minimum Tax. Signed on October 3, 2008, the Act also provided incentives for energy production and conservation and provided relief for certain taxpayers affected by natural disasters.

¹ See Appendix V for a glossary of terms.

² Each year, the tax products must be updated to reflect current tax rates, exemption amounts, and cost of living adjustments as shown in Revenue Procedures.

³ Pub. L. No. 110-289, 122 Stat. 2654 (2008).

⁴ Defined within the Housing and Economic Recovery Act of 2008 as taxpayers who bought a main home in the United States after April 8, 2008, and did not own any other main home during the prior 3 years.

⁵ Pub. L. No. 110-343, 122 Stat. 3766 (2008).



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- The American Recovery and Reinvestment Act of 2009 (ARRA)⁶ increased the maximum amount and modified the qualifications of the FTHC enacted 7 months earlier. The ARRA also eliminated the repayment obligation in the Housing and Economic Recovery Act of 2008 for homes purchased in Calendar Year 2009 unless the purchased home is no longer the main home within the first 36 months after the purchase.

In addition, much like the 2008 Filing Season, the IRS was responsible for processing tax returns that included the Recovery Rebate Credit. Last filing season, the Economic Stimulus Act of 2008⁷ provided economic stimulus payments to millions of taxpayers. During the 2009 Filing Season, the Recovery Rebate Credit was available to eligible taxpayers who did not receive an economic stimulus payment or who were entitled to an additional payment based on information on their Tax Year 2008 individual income tax returns.

During the 2009 Filing Season, the IRS processed individual income tax returns in five Wage and Investment Division Submission Processing sites located throughout the country.⁸ All of the

The IRS processed individual income tax returns in five Wage and Investment Division Submission Processing sites.

five sites processed paper individual income tax returns, and all but the Atlanta, Georgia, Submission Processing Site processed electronically filed (*e-filed*) individual income tax returns. Both paper and *e-filed* tax returns and related schedules are processed through the IRS computer systems and recorded on each individual's tax account at the Submission Processing sites. The IRS computer

systems are made up of a complex series of processing subsystems that are linked and programmed nationally to check the validity and mathematical accuracy of the tax return data provided. If an error is found, the taxpayer is sent a notice that requests additional information or explains any change that is made to the amount of tax due or to the refund.

This review was performed at the Wage and Investment Division Headquarters in Atlanta, Georgia, the Submission Processing function offices in Lanham, Maryland, and Cincinnati, Ohio, and the Austin Submission Processing Site in Austin, Texas, during the period November 2008 through June 2009. 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.

⁶ Pub. L. No. 111-5, 123 Stat. 115 (2009).

⁷ Pub. L. No. 110-185, 122 Stat. 613.

⁸ Submission Processing Sites in Fresno, California; Atlanta, Georgia; Andover, Massachusetts; Kansas City, Missouri; and Austin, Texas.



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Results of Review

Individual Tax Returns Were Timely and Accurately Processed During the 2009 Filing Season

The IRS had a successful 2009 Filing Season despite the challenges presented by the enactment of new tax legislation and unusually high taxpayer errors resulting from confusion in calculating the Recovery Rebate Credit. While we had some concerns that are discussed in this report, the IRS correctly implemented key tax law and administrative changes with no significant delays. Processing of tax returns was completed on schedule and refunds were issued within the required 45 calendar days of the April 15, 2009, due date.⁹

E-filed returns hit a record high this year of approximately 91.7 million returns as of May 29, 2009.

Total tax return receipts for *e-filed* tax returns hit a record this year of approximately 91.7 million tax returns (69 percent of total tax returns filed) and exceeded IRS estimates. The increase resulted from taxpayers filing online from home computers (19.2 percent). However, use of the Free File Program decreased by 36.7 percent.

Total paper-filed tax returns as of May 29, 2009, were nearly 41.9 million which was a 27.1 percent decrease from the same time last year. As of May 29, 2009, the IRS issued approximately 104 million refunds totaling \$279.3 billion. Of the 104 million refunds issued, refunds that were direct deposited increased by 9.5 percent to almost 71 million. Figure 1 presents a summary of tax return filing statistics.

⁹ Internal Revenue Code Section 6611(e) (2002).



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Figure 1: Comparative Filing Season Statistics

Cumulative Filing Season Data	2008 Actual As of May 31	2009 Actual As of May 29	Percentage Change
Individual Income Tax Returns			
Total Returns Received (in thousands)	144,150	133,635	-7.3%
Paper Returns Received (in thousands)	57,476	41,892	-27.1%
Electronic Returns Received (in thousands)	86,674	91,743	5.8%
Practitioner Prepared	60,231	60,221	0.0%
Home Computer	26,444	31,522	19.2%
Free File (also included in Home Computer total)	4,652	2,944	-36.7%
Fillable Tax Forms (also included in Home Computer total)	N/A	264	NA
Refunds			
Total Number Issued (in thousands)	100,094	104,458	4.4%
Total Dollars (in millions)	\$234,923	\$279,280	18.9%
Average Dollars	\$2,347	\$2,674	13.9%
Total Number of Direct Deposits (in thousands)	64,767	70,907	9.5%
Total Direct Deposit Dollars (in millions)	\$173,684	\$209,163	20.4%

Source: IRS 2009 Filing Season Weekly Reports. Totals may not compute to those presented due to rounding.

The IRS implemented key tax law and administrative changes for the 2009 Filing Season

Each year, the IRS must update a considerable number of tax forms and publications to provide the most current tax guidance to the public. We selected and reviewed 42 tax products to determine whether the tax products associated with recent legislation had been updated and made available to the public timely. Overall, the IRS correctly updated the 42 tax products related to tax relief for taxpayers in the Midwestern disaster area, tax provisions that became effective in Tax Year 2008, and various inflation adjustments. However, five publications and one form were not available to the public for the start of the 2009 Filing Season and one other publication did not contain updated information. After we notified the IRS on January 23 and February 12, 2009, it made the tax products available and/or corrected the incomplete or missing information.¹⁰ The IRS advised us that products were not available because they were being updated to reflect recent legislation or being held because of pending legislation. The IRS

¹⁰ See Appendix IV for a listing of the tax products that were not timely available or had incomplete information.



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released the form and publications as soon as they were accurately completed and quickly revised the publication with the updated information.

In addition, the IRS properly implemented tax law and administrative changes including the following provisions:

- Providing for an additional standard deduction for State and local real property taxes. This allows taxpayers who did not itemize but paid certain State or local real estate taxes to increase their standard deduction up to \$500 if filing as a single taxpayer or by \$1,000 if married and filing jointly. In addition, if a taxpayer had a net disaster loss attributable to a Federally declared disaster, this loss could be used to increase the taxpayer's standard deduction.
- Decreasing earned income tax thresholds for claiming the Additional Child Tax Credit from \$10,000 to \$8,500 so the Credit would be available to more taxpayers.
- Providing for an additional exemption amount of \$500 (up to \$2,000) for housing individuals displaced as a result of a natural disaster.
- Increasing:
 - Phase-out limitations for the Education Credit and the Student Loan Interest Deduction.
 - The maximum Hope Credit.
 - Modified Adjusted Gross Income (AGI) limits for the Retirement Savings Contribution Credit.
 - Earned Income Tax Credit, standard deduction, and exemption amounts.

Electronic Filing Continues to Increase, but Use of Free File Is Down

The IRS has continued to see a steady growth in the *e-filing* of tax returns over the past several years. The IRS began receiving *e-filed* tax returns January 16, 2009. As of May 29, 2009, *e-filing* overall had increased by 5.8 percent compared to the same period in 2008. The increase came from taxpayers filing online from home computers (a 19.2 percent increase). The percentage of *e-filed* returns has increased to 69 percent of the total individual income tax returns received.

However, the use of Free File decreased by 36.7 percent from almost 4.7 million returns in the 2008 Filing Season to less than 3 million tax returns using this option during the 2009 Filing Season. The Free File Program offers 20 different software options that can assist taxpayers with an AGI of \$56,000 or less in 2008 to *e-file* their Federal tax returns for free. That means 70 percent of all taxpayers (i.e., 98 million) can take advantage of tax software that will help



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them complete their returns through the Free File Program. Three companies are offering their products in Spanish.

A new option, Free File Fillable Tax Forms, was provided this year opening up the Free File Program to nearly everyone, even those with incomes exceeding \$56,000. These Fillable Tax Forms allow taxpayers to fill out and *e-file* their tax forms with the IRS at no cost. These forms are only available through the Free File Program link on IRS.gov (the public IRS Internet web site); however, some taxpayers may not have benefited from this option because they were unaware of the Fillable Tax Forms availability. This option does not include the step-by-step question and probe process, but it does allow taxpayers to enter their tax data, perform basic math calculations, sign their tax returns electronically, print their returns for recordkeeping, and *e-file* their returns. This option may be right for those who are familiar with the tax law, know what

The Free File Program was expanded to provide most individual filers with free e-file; however, taxpayers are not taking advantage of this filing option.

forms they want to use, and do not need assistance.

Despite the availability of the Free File Program to nearly all individual filers, taxpayers are not taking advantage of the Free File Program. IRS officials believe there are a number of reasons for the decreased volumes, such as a later start to the filing season this year, the migration of taxpayers to other free offers in the marketplace, and the elimination of *e-filing* fees by some software providers. We reviewed the 2009 filing patterns for more than 5.4 million taxpayers who used the Free File Program during 2008 and found that only 26 percent continued to use Free File in the 2009 Filing Season. Less than 5 percent of the taxpayers who stopped using the Free File Program filed paper returns. The most preferred method (39 percent) was *e-filing* via a personal computer. Figure 2 shows how the taxpayers who used Free File in 2008 filed in 2009.

Figure 2: Filings in 2009 by Taxpayers Who Used Free File in 2008

How Return Was Filed in Calendar Year 2009	Percentage of Taxpayers Who Used This Option
Personal Computer Software	38.93%
Free-File - not Fillable Tax Forms	25.18%
No Return Found	21.86%
E-File - not Free File	8.81%
Paper Return - Self Prepared	3.90%
Paper Filing by Paid Preparer	0.74%
Free-File - Fillable Tax Forms	0.53%
IRS Program	0.05%

Source: Treasury Inspector General for Tax Administration (TIGTA) electronic analysis of tax return filings by taxpayers who used the 2008 Free File Program.



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The Internal Revenue Service Timely Processed Tax Returns; However, Taxpayer Confusion in Calculating the Recovery Rebate Credit Resulted in Significant Increases in Error Tax Returns

The IRS timely processed tax returns despite an unusually large number of taxpayer errors. The IRS had to develop processes to calculate and provide the Recovery Rebate Credit. However, unlike the issuance of the economic stimulus payments last year, the potential for errors was much greater because the calculation of the Recovery Rebate Credit was based upon several factors, including the taxpayer's filing status, income, and tax liability. In contrast to the economic stimulus payment, the taxpayer, and not the IRS, had to calculate and claim the Credit.

Although the IRS initiated a number of efforts to educate and assist individuals who were confused in computing the Recovery Rebate Credit, the Credit resulted in a significant number of taxpayer errors. Of the 114.3 million tax returns processed as of April 17, 2009, 16.7 million (14.6 percent) included at least 1 error that needed to be addressed by the IRS Error Resolution function (8.4 million contained a Recovery Rebate Credit error). This exceeded the total number of tax returns the IRS estimated would go to the Error Resolution function by 9.8 million tax returns (142 percent). The IRS assumed taxpayers would understand that they generally were not eligible for the Credit if they had already received an economic stimulus payment. However, taxpayers did not understand that the economic stimulus payment and the Recovery Rebate Credit were one and the same or they did not know how to correctly compute and claim the credit.

In addition, as of April 17, 2009, the IRS rejected almost 1.3 million *e-file* tax returns because of an error relating to the Recovery Rebate Credit.¹¹ This represents 7.7 percent of total *e-file* rejects. The most common reason tax returns with recovery rebate claims were rejected was because the taxpayer already received the maximum stimulus payment and tried to claim the Credit.

However, the Error Resolution function initiated a number of steps to ensure there were no delays in correcting the errors that would impact on the IRS' ability to meet its completion date for processing and issuing tax refunds. The IRS took the following actions to manage the increased inventory in the Error Resolution function:

- Added more Error Resolution function personnel to work cases.
- Developed and implemented a new analysis tool to assist in the resolution of error cases. One module in the new Integrated Data Retrieval System Decision Assisting Program¹² computer application automates research and resolution of simple errors related to the

¹¹ The number of rejects will be higher than the number of returns rejected since a return can be rejected more than once.

¹² The Integrated Data Retrieval System is an IRS computer subsystem capable of retrieving or updating stored information for a taxpayer's account records.



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amount of the Recovery Rebate Credit caused by inaccurate reporting of stimulus payments. The tool automated the research of taxpayer accounts to identify actions that needed to be taken to correct errors. The tool assisted in the resolution of more than 3 million returns, at a rate of up to 200 cases an hour, without employees having to manually handle the returns in the Error Resolution System.

We initiated a separate review to evaluate the effectiveness of IRS efforts to plan and implement the Recovery Rebate Credit.¹³ As such, we are not including specific recommendations in this audit report.

The Internal Revenue Service Faced Challenges in Administering the First-Time Homebuyer Credit

We identified more than 1.1 million tax returns on which taxpayers were allowed more than \$7.8 billion in FTHCs. Of those, 958,058 (85 percent) were *e-filed* and 171,422 (15 percent) were paper returns.

On November 25, 2008, we issued a memorandum to the Commissioner, Wage and Investment Division, outlining our concerns that controls would not be adequate to prevent an individual

As of May 29, 2009, we identified more than 70,000 FTHCs totaling more than \$489 million that were claimed by individuals who do not appear to qualify for the credit.

from erroneously or fraudulently claiming the credit and receiving the maximum \$7,500 credit. IRS management disagreed with our recommendation that would have required taxpayers to provide third-party documentation supporting the purchase of a home. IRS management concluded that such a requirement would be burdensome and would prevent up to 2 million taxpayers from filing electronically. Management further stated that the IRS would audit tax returns when a FTHC claim is identified

by criteria in the Questionable Refund Program. The IRS is also considering a discretionary audit program to review returns when taxpayers appear to be disqualified from the credit by owning a house within the past 3 years.

Because of the significant amount of dollars associated with the FTHC, we initiated a separate review to assess the effectiveness of IRS efforts to identify potentially erroneous/fraudulent claims for the FTHC.¹⁴

¹³ *Evaluation of the Planning, Computation, and Issuance of the Recovery Rebate Credit* (Reference Number 2009-40-129, dated September 9, 2009).

¹⁴ *The Internal Revenue Service Faces Significant Challenges in Verifying Eligibility for the First-Time Homebuyer Credit* (Audit Number 200940138, Draft Report Issued August 31, 2009).



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The IRS developed processes to identify FTHC claims that did not meet certain requirements

In an attempt to ensure the accuracy of FTHC claims, the IRS:

- Created the new First-Time Homebuyer Credit (Form 5405) for eligible taxpayers to calculate and claim the credit as well as provide the address and purchase date of the qualifying home.
- Developed programming that selects paper tax returns for correction or rejects *e-filed* tax returns when certain conditions exist. These include:
 - FTHC claims exceeding the maximum allowable credit amount, errors in computing the phase-out of the credit when modified AGI is between \$75,000 and \$95,000 for Single or Married Filing Separately (\$150,000 and \$170,000 for Married Filing Jointly) filing statuses.
 - FTHC claims when the Form 5405 is not included with the tax return.

We found that the programming was correctly identifying the above conditions for correction. Specifically, as of May 29, 2009, the IRS had rejected more than 28,000 *e-filed* returns with these conditions. Figure 3 provides a breakdown of the error conditions.



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Figure 3: First-Time Homebuyer Credit E-File Error Conditions and Associated Volumes from January 16, 2009, through May 29, 2009

E-File Error Reject Code	Error Situation	Number of Errors
355	The FTHC amount claimed on U.S. Individual Income Tax Return (Form 1040) does not match the amount on Form 5405 or Form 5405 is not attached.	558
356	The FTHC exceeds \$3,750 when Married Filing Separate and \$7,500 for all other filing statuses when the date acquired on Form 5405 is between April 8, 2008, and January 1, 2009. Or the FTHC is claimed on Form 1040 and the AGI exceeds \$169,999 when filing status is Married Filing Joint and \$94,999 for all other filing statuses.	18,050
357	Both Form 5405 and District of Columbia First-Time Homebuyer Credit (Form 8859) are present.	220
365	The Form 5405 is present and the Date Acquired is blank or the date is not between April 8, 2008, and December 1, 2009. Also, the Date Acquired cannot be greater than the current processing date (return received date).	9,628
371	The amount of FTHC cannot exceed \$4,000 when Married Filing Separate and \$8,000 for all other filing statuses when the year of Date Acquired on Form 5405 is 2009. The FTHC is claimed then the AGI cannot exceed \$169,999 when Married Filing Joint and \$94,999 for all other filing statuses.	8
	TOTAL	28,464

Source: IRS Tax Year 2008 Publication 1346 and internal IRS E-file reports.

The ARRA required modifications to IRS programming and forms resulting in delays in processing some tax returns

The ARRA modified the FTHC by changing some of the eligibility criteria and increasing the maximum amount of the credit to \$8,000. In addition, taxpayers who purchase a home in Calendar Year 2009 generally are not required to repay the credit. These modifications required the IRS to suspend the processing of tax returns for those filers claiming the FTHC for a Calendar Year 2009 purchase. The IRS had to update programming to distinguish between 2008 and 2009 purchase dates. For example:

- The IRS established the Special Processing Code “H” to assist computer programs in identifying whether the FTHC was for a 2008 purchase that taxpayers must repay or for a 2009 purchase that does not require repayment. This code is input on FTHC claims for homes purchased in 2009 and ensures the computer will accept up to an \$8,000 credit amount.



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- Through March 30, 2009, *e-file* programming rejected all tax returns with FTHC claims in excess of \$7,500. Implementation of the Special Processing Code allowed computer programs to accept *e-filed* returns with FTHC amounts up to \$8,000 if the purchase date was in Calendar Year 2009. As of June 5, 2009, the IRS had processed 101,943 *e-filed* returns with the new Special Processing Code.
- During the period March 5 to March 19, 2009, processing was suspended for paper tax returns with a FTHC for Calendar Year 2009 home purchases. As of June 5, 2009, the IRS had processed 44,416 paper returns with the new Special Processing Code.

The revisions to the IRS' computer programs allow taxpayers to receive the increased FTHC in accordance with the ARRA legislation. Before March 5, 2009, taxpayers who claimed more than \$7,500 in the FTHC for a Calendar Year 2009 purchase would not have received the additional credit to which they may have been entitled. These taxpayers still have the opportunity to file an amended tax return to claim up to \$500 to which they may be entitled. In addition, the IRS revised Form 5405 to incorporate the ARRA changes. Specifically:

- In Part I – the end date for claiming the credit was changed from “before July 1, 2009” to “before December 1, 2009.”
- In Part II, line 1 – the maximum amount of credit, \$8,000 for Calendar Year 2009 purchases, was added.

In the General Instructions—under *Who Cannot Claim the Credit*—the IRS added that a rule denying the FTHC to taxpayers who are eligible for the District of Columbia first-time homebuyer credit does not apply if the home is purchased in Calendar Year 2009.¹⁵ Under the Repayment of Credit Section, an entire section for homes purchased in Calendar Year 2009 was added to explain the different repayment criteria.

Action by the IRS is needed to ensure the reliability of codes for identifying purchase dates for the FTHC

The IRS established the Special Processing Code “H” to distinguish FTHC claims for homes purchased in Calendar Year 2009 from homes purchased in Calendar Year 2008 because of the different rules regarding the repayment of the FTHC. Tax returns should be processed with this Special Processing Code when the FTHC claim shows the home was purchased in Calendar Year 2009. In limited testing of tax returns with the FTHC, we found that the code was not always recorded accurately. As of May 29, 2009, we identified 47,276 tax returns of taxpayers who appear to have not claimed the full amount of the FTHC to which they may have been

¹⁵ Pre-ARRA law did not allow the FTHC to taxpayers who were ever eligible for or had *ever* claimed the District of Columbia first-time homebuyer credit in *any* year. The ARRA legislation eliminated this provision and added, for 2009 purchases, that if a taxpayer is eligible to claim the FTHC, they cannot also claim the District of Columbia first-time homebuyer credit.



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entitled. These taxpayers claimed \$7,500 rather than the \$8,000 allowable for homes purchased in Calendar Year 2009. The lesser amounts were claimed most likely because either the taxpayers filed before the ARRA was passed or they did not realize that the new law increased the maximum amount of the credit.

We reviewed the purchase dates shown on the 47,276 *e-filed* returns and found that 93 percent (43,967) did not have their IRS accounts properly coded with the Special Processing Code “H” to indicate their home was acquired in 2009. Since these taxpayers purchased their home in Calendar Year 2009, they should not be required to repay the FTHC. However, unless the IRS properly codes their accounts, these taxpayers may eventually be subject to the IRS collection process. We plan to determine why the Special Processing Code was not properly recorded in a future review. In addition, we reviewed a sample of 14 paper tax returns and found that



The accurate processing of FTHCs is essential to future IRS efforts to collect the credits as required by the Housing and Economic Recovery Act of 2008. Taxpayers may be burdened by inaccurate notices and be faced with improper collection attempts if the IRS cannot accurately identify which credits must be repaid.

Recommendation

The Commissioner, Wage and Investment Division, should

Recommendation 1: Ensure Special Processing Code “H” is accurately used on taxpayer accounts by identifying previously processed tax returns that were not coded accurately and ensuring subsequently processed tax returns are properly coded. This could be accomplished by identifying returns claiming the FTHC and the amount of the claim and analyzing the accounts to determine if they were properly coded.

Management's Response: The IRS disagreed with this recommendation. The IRS has gone to considerable lengths to mark accounts with the year of purchase and the dollar value of the credit issued. The IRS intends to track this information on the Master File for taxpayers who are required to pay back the FTHC based on the legal requirements in the legislation. As the IRS determines what compliance activities will be conducted, it will validate the information to ensure only those taxpayers who have not met their responsibilities are contacted. This will include ensuring the date of purchase was captured accurately.

Office of Audit Comment: Although management indicated in their response that they went through considerable lengths to mark accounts with the year of purchase that



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will be used in determining if recapture is required, our review of 47,276 *e-filed* returns found that 93 percent (43,967) did not have their accounts properly coded. We recently initiated an audit that will evaluate the effectiveness of IRS efforts to distinguish between filers claiming the credit for a purchase in Calendar Year 2008 versus those claiming the credit for a purchase in Calendar Year 2009.

Taxpayers Make Limited Use of the Split Refund Option

Beginning in the 2007 Filing Season, individual taxpayers could file a Direct Deposit of Refund (Form 8888) to have their refunds split and electronically deposited into accounts at up to three different United States financial institutions, including banks, brokerage firms, or credit unions. The accounts can be checking, savings, or Individual Retirement Arrangements.

While the number of tax returns through May 29, 2009, on which taxpayers chose to split their refunds was 68 percent higher than last year (379,717 compared to 225,364), split refunds still represent less than 1 percent of all direct deposits. The 379,717 split refunds totaled nearly \$1.6 billion, for an average of \$2,050 per refund. Only \$207 million of the \$1.6 billion in refunds was designated for deposit to savings accounts.

The Internal Revenue Service Corrected or Is in the Process of Correcting Issues Identified in Prior Filing Season Reviews

We determined the IRS has addressed issues we reported during the 2008 Filing Season¹⁶ or is in the process of correcting the issues. These include ensuring individuals are not improperly claiming:

- Qualified Mortgage Insurance Premiums (QMIP) Deduction – In last year’s filing season report, we identified 4,988 tax returns on which taxpayers were improperly allowed a Qualified Mortgage Insurance Premiums deduction when the taxpayers’ AGI exceeded the maximum limit.

The IRS requested computer programming to limit the Qualified Mortgage Insurance Premiums deduction when the AGI limits are exceeded. Programming for the 2009 Filing Season rejected *e-filed* tax returns when the limits were exceeded. As of May 29, 2009, we identified 9,046 tax returns¹⁷ that were allowed a Qualified Mortgage Insurance Premiums deduction when the taxpayer’s AGI exceeded the maximum limit. During the 2010 Filing Season, paper tax returns will be forwarded to the Error

¹⁶ *The 2008 Filing Season Was Generally Successful Despite the Challenges of Late and Unexpected Tax Legislation* (Reference Number 2008-40-183, dated September 30, 2008).

¹⁷ The returns included 9,037 paper tax returns and 9 *e-filed* tax returns. Some *e-filed* tax returns were not rejected because the AGI did not exceed the maximum limit when received but were changed during error processing.



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Resolution System for correction. The IRS is in the process of finalizing the programming request.

- Dual Benefits of the Tuition and Fees Deduction and the Education Credit – Through 2009, a taxpayer may deduct up to \$4,000 for qualified tuition and fees expenses. A taxpayer may also claim an Education Credit for qualified education expenses. However, taxpayers may not receive a dual benefit by taking both the tuition and fees deduction and the Education Credit for the same student in the same year. If the Education Credit is elected, the tuition and fees deduction is not allowed.

This issue was reported for six filing seasons and corrective actions were implemented in response to our 2007 Filing Season report. Improved forms and instructions to the taxpayer have considerably decreased the number of taxpayers claiming a dual benefit. In addition, current programming and Internal Revenue Manual procedures considerably reduced the allowance of these erroneous claims. To assist in reducing the residual employee errors, procedures were implemented in August 2008 to instruct employees to review tax returns claiming both the credit and the deduction for the dual benefit conditions. As of May 29, 2009, we identified 3,016 returns claiming both the tuition and fees deduction and the Education Credit for the same student, a 23 percent decrease from the same time last year.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate whether the IRS timely and accurately processed individual paper and *e-filed* tax returns¹ during the 2009 Filing Season. The audit focused on implementation of new tax law changes and administrative changes that affected Tax Year 2008 tax returns. In addition, we reviewed certain corrective actions taken for the conditions identified in our review of the 2008 Filing Season² to determine whether they were adequate. To accomplish our objective, we:

- I. Identified new tax legislation and administrative changes for the 2009 Filing Season that will have the greatest potential effect on individual taxpayers.
 - A. Reviewed tax forms, instructions, and publications to determine whether they were accurately updated with the changes.
 - B. Identified tax legislation that was pending before Congress and determined what preparations were made by the IRS and the potential effect on taxpayers if the legislation was passed.
- II. Determined whether the IRS correctly implemented new tax legislation and administrative changes that affected the processing of individual tax returns during the 2009 Filing Season.
 - A. Used computer analysis of 100 percent of the Tax Year 2008 individual income tax returns processed nationally on the Individual Return Transaction File between January 1 and May 29, 2009,³ to identify returns affected by recent tax legislation and administrative changes. We used random sampling for some tests to ensure that each return had an equal chance of being selected. We also used judgmental sampling if we needed to ensure that the original returns could be quickly obtained to evaluate the accuracy of processing. We determined whether changes to tax products were correctly implemented in return processing systems at the Submission Processing sites by assessing the accuracy of returns processed with the following changes.

¹ See Appendix V for a glossary of terms.

² *The 2008 Filing Season Was Generally Successful Despite the Challenges of Late and Unexpected Tax Legislation* (Reference Number 2008-40-183, dated September 30, 2008).

³ To assess the reliability of computer-processed data, programmers in the TIGTA Office of Information Technology 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. As appropriate, data in the selected data records were compared to the physical tax returns to verify that the amounts were supported.



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1. Electronically identified 1,129,480 returns processed with the First-Time Homebuyer Credit (Form 5405) through June 5, 2009, and analyzed 58,741 early filed returns to determine whether certain programming was in place.
 2. Electronically identified and evaluated returns claiming an additional standard deduction on line 39c of the U.S. Individual Income Tax Return (Form 1040) and selected a judgmental sample of 30 returns from 32,184 early filed returns to determine if they were accurately processed.
 3. Electronically identified and evaluated returns with earned income of \$8,500 or less to determine if the taxpayer qualified for the Additional Child Tax Credit and selected a random sample of 30 returns from 2,914 early filed returns to determine if the IRS properly processed the returns and allowed the correct amount of Additional Child Tax Credit.
 4. Electronically identified and evaluated 2,334 individual tax returns processed through April 4, 2009, with an exemption amount for Taxpayers Housing Midwestern Displaced Individuals (Form 8914). We selected a random sample of 30 of these returns to review for processing accuracy.
 5. Electronically identified and evaluated returns processed with an Education Credit, Student Loan Interest deduction, or Hope Credit to verify the deduction or credit was properly limited. We reviewed random samples of 30 returns from 26,491 with a Student Loan Interest deduction; 22 returns from 102,227 with Education Credits; and 8 returns from 2,717 returns claiming Hope Credits.
 6. Electronically identified 4.2 million individual tax returns processed through March 20, 2009, with a Retirement Savings Contributions Credit and determined if the credit was properly disallowed if the AGI limits were exceeded.
 7. Electronically identified and evaluated returns where the taxpayer claimed an amount that exceeded the maximum Earned Income Credit based on filing status, number of qualifying children, and AGI limits. We selected a judgmental sample of 45 returns from 32,184 processed through February 20, 2009, to verify whether the returns were accurately processed.
 8. Electronically identified and selected a judgmental sample of 45 returns from 32,184 early filed returns to verify the correct standard deduction and exemption amounts were used. We also electronically analyzed returns processed through May 2009 to verify that itemized deductions were properly adjusted when AGIs exceeded the amount at which the deductions should be limited.
- B. Determined the numbers of taxpayers affected by the new tax legislation and administrative changes identified in Step I. by counting the numbers of returns and dollar amounts of the applicable deductions or credits claimed by taxpayers.



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- III. Determined whether the IRS monitoring systems indicated that individual returns were being processed accurately and in a timely manner.
- A. Monitored various Submission Processing site production reports, inventory reports, and return error inventories between January 23 and May 29, 2009, for key indicators of return processing and compared the statistics to those for the 2008 Filing Season.
 - B. Monitored the IRS Program Completion Date reports from April 28 through May 14, 2009, to determine whether the Submission Processing sites processed all refund returns in a timely manner.
 - C. Monitored Error Resolution System inventories (for delays or capacity problems) and the transshipment of returns between Submission Processing sites.
 - D. Monitored weekly 2009 Filing Season Wage and Investment Division Production meetings between January 22 and May 28, 2009, and monitored the IRS Submission Processing function web site, to identify potentially significant issues.
- IV. Determined whether the IRS had corrected problems identified in the 2008 Filing Season. From returns processed by the Submission Processing sites between January 1 and May 29, 2009, we electronically identified Tax Year 2008 returns that met specific criteria.
- A. Identified 9,046 returns through May 29, 2009, incorrectly processed with a Qualified Mortgage Insurance Premiums deduction on line 13 of Itemized Deductions (Schedule A) Form 1040 for taxpayers with AGIs in excess of the allowable limit.
 - B. Identified through May 29, 2009, 3,016 returns with the dual benefit condition where the IRS allowed the Education Credit and the tuition and fees deduction for the same student. We identified and reviewed new procedures regarding the processing of Education Credit and tuition and fees deduction returns. We ensured that employees have been alerted to the new procedures.
 - C. Identified volumes of returns received through May 29, 2009, with split refunds by analyzing weekly extracts of the Individual Return Transaction File.



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Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)

Russell Martin, Director

Tina Parmer, Audit Manager

Lawrence White, Lead Auditor

Sharon Buford, Senior Auditor

John Hawkins, Senior Auditor

Bonnie Shanks, Senior Auditor

Steven Vandigriff, Senior Auditor

Kim McMenamin, Program Analyst

Joseph Butler, Information Technology Specialist

Robert Carpenter, Information Technology Specialist

Michele Cove, Information Technology Specialist

Martha Stewart, Information Technology Specialist



The 2009 Filing Season Was Successful Despite Significant Challenges Presented by the Passage of New Tax Legislation

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, Wage and Investment Division SE:W
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division
SE:W:CAR
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Director, Media and Publications, Wage and Investment Division SE:W:CAR:MP
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
Director, Tax Forms and Publications, Wage and Investment Division SE:W:CAR:MP:T
Chief, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PRA: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:PRA:PEI



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Appendix IV

Tax Products Not Timely Available/Updated

Tax Product	Issue	Date Posted¹ Prior to TIGTA Alert	Date of TIGTA Alert	Updated and Posted
<i>Tax Guide for Seniors (Publication 554)</i>	Posted, but not with new Midwestern Disaster information	Before 1/22/09	1/23/09	2/12/09
<i>Charitable Contributions (Publication 526)</i>	Not posted with new Midwestern Disaster information	none	1/23/09	1/27/09
<i>Individual Retirement Arrangements (IRAs) (Publication 590)</i>	Not posted with new Midwestern Disaster information	none	1/23/09	2/5/09
<i>Application for Tentative Refund (Form 1045) and related Instructions</i>	Not posted with new Midwestern Disaster information	none	1/23/09	3/16/09
<i>Selling Your Home (Publication 523)</i>	Not posted with new FTHC information	none	2/12/09	2/14/09
<i>Net Operating Losses (NOLs) for Individuals, Estates, and Trusts (Publication 536)</i>	Not posted with Midwestern Disaster information	none	2/12/09	3/24/09

¹ The term “posted” refers to the availability of a tax product to the public on IRS.gov.



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Tax Product	Issue	Date Posted ¹ Prior to TIGTA Alert	Date of TIGTA Alert	Updated and Posted
<i>U.S. Tax Guide for Aliens (Publication 519)</i>	Not posted with information on changes to: <ul style="list-style-type: none"> ▪ Phase-outs for personal exemptions and itemized deductions ▪ IRA contributions ▪ Capital Gains/Qualified Dividend Rate 	none	2/12/09	4/19/09



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Appendix V

Glossary of Terms

Term	Definition
Adjusted Gross Income	Calculated after certain adjustments are made but before standard or itemized deductions and personal exemptions are subtracted.
American Recovery and Reinvestment Act of 2009	Legislation making supplemental appropriations for job preservation and creation, infrastructure investment, energy efficiency and science, assistance to the unemployed, and State and local fiscal stabilization for the fiscal year ending September 30, 2009, and for other purposes. Became Public Law 111-005 on February 17, 2009.
Economic Stimulus Act of 2008	Legislation to provide economic stimulus through recovery rebates to individuals, incentives for business investment, and an increase in conforming and Federal Housing Authority loan limits. Became Public Law 110-185 on February 13, 2008.
Economic Stimulus Payment	The Economic Stimulus Act of 2008 directed the Department of the Treasury to send to eligible taxpayers advance payments of the 2008 Recovery Rebate Credit. The IRS calculated economic stimulus payments based upon information from taxpayers' 2007 Federal tax returns and issued checks or direct deposits to taxpayers over several weeks starting in May 2008.
Emergency Economic Stabilization Act of 2008	Legislation providing authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system and protecting taxpayers, to amend the Internal Revenue Code of 1986 to provide incentives for energy production and conservation, to extend certain expiring provisions, to provide individual income tax relief, and for other purposes. Became Public Law 110-343 on October 3, 2008.



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Term	Definition
Error Resolution System	Provides for the correction of errors associated with input submissions. The error inventory is managed on an Error Resolution System database, and corrected documents are validated by Generalized Mainline Framework modules.
Filing Season	The period from January 1 through April 15 when most individual income tax returns are filed.
First-Time Homebuyer Credit	A credit available to taxpayers who bought a main home in the United States after April 8, 2008, and did not own any other main home during the 3-year period ending on the date that the home was bought.
Free File Program	A free Federal tax preparation and <i>e-filing</i> 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.
Generalized Mainline Framework	Validates and perfects data from a variety of input sources (e.g., tax returns, remittances, information returns, and adjustments). Updated transactions are controlled, validated, and corrected.
Housing and Economic Recovery Act of 2008	Legislation providing needed housing reform and for other purposes. Became Public Law 110-289 on July 30, 2008.
Individual Paper and Electronic Returns	U.S. Individual Income Tax Returns (Forms 1040 and 1040A) and Income Tax Return for Single and Joint Filers With No Dependents (Form 1040EZ).
Individual Return Transaction File	Contains data transcribed from initial input of the original individual tax returns during return processing.
Integrated Data Retrieval System Decision Assisting Program	Automation tool that provides processes to IRS employees to simplify research, reduce keystrokes, and increase the accuracy of regular work processes.



The 2009 Filing Season Was Successful Despite Significant Challenges Presented by the Passage of New Tax Legislation

Term	Definition
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.
Modified Adjusted Gross Income	Calculated without regard to certain deductions or exclusions, unlike AGI.
Phase-out Limitations	The maximum allowable amount for certain credits and deductions is decreased once the AGI of the taxpayer reaches a specified level. The allowable amount is progressively reduced to zero depending upon the AGI.
Program Completion Date	The date determined by the IRS for the completion of any program. Completion dates are set for processable returns received by specific dates, including timely, prior period, and delinquent returns.
Qualified Mortgage Insurance Premiums Deduction	An itemized deduction allowable for mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, the Rural Housing Service, or private mortgage insurance issued in 2007 or later for debt secured by a first or second home.
Recovery Rebate Credit	A one-time benefit for people who did not receive the full economic stimulus payment in Calendar Year 2008 and whose circumstances may have changed, making them eligible for some or all of the unpaid portion.
Special Processing Code	Code used to identify special conditions or computations for IRS computer processing systems to actuate or suppress actions. Used by the Service Center computer, the code does not post to the Master File.
Submission Processing Sites	Process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts. These sites are located in Fresno, California; Atlanta, Georgia; Andover, Massachusetts; Kansas City, Missouri; and Austin, Texas.



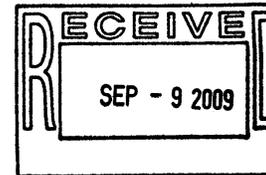
The 2009 Filing Season Was Successful Despite Significant Challenges Presented by the Passage of New Tax Legislation

Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308



SEP 09 2009

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr.
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The 2009 Filing Season Was Successful,
Despite Significant Challenges Presented by the Passage of
New Tax Legislation (Audit #200940013)

I reviewed the subject draft report and appreciate your acknowledgement of our delivery of another successful filing season in 2009. This achievement is especially significant in light of the challenges resulting from the economic downturn, enactment of legislation such as the American Reinvestment and Recovery Act (ARRA), and additional service demand relating to the Recovery Rebate Credit. The Wage and Investment Division aligned resources to meet the increased demand for services, increased taxpayer access to assistance, reviewed processes to improve efficiency, and delivered modernized systems to help taxpayers meet their tax obligations.

As of July 31, 2009, the IRS has received 136.9 million total individual tax returns. Last year at this time, the IRS had received 147.9 million returns. The drop in filing is partially due to the number of returns filed to claim Economic Stimulus Payments last year. Of the total returns filed, 92.8 million were electronic returns, as compared to 87.7 million electronic returns through this same week last year. The IRS has issued 107.4 million refunds for a total of \$289.4 billion through July 31, 2009. The average dollar refund totaled \$2,693 as compared to \$2,342 for the same week last year, an increase of 15 percent. As of July 31, 2009, the IRS direct deposited 71.8 million refunds, as compared to 65.5 million last year. The processing of tax returns was completed on schedule and refunds were issued timely.

The passage of new legislation is always a challenge. In 2008 and 2009, three pieces of legislation were passed late in our planning process affecting return processing and form revisions. These are:

- The Housing and Economic Recovery Act of 2008 (HERA)
- The Emergency Economic Stabilization Act of 2008
- The American Recovery and Reinvestment Act of 2009 (ARRA)



The 2009 Filing Season Was Successful Despite Significant Challenges Presented by the Passage of New Tax Legislation

2

Despite the timing of these new tax law provisions, we successfully provided computer programming, procedural changes, and revisions to the tax forms with no significant delays. However, we did have a number of taxpayer errors resulting from confusion in calculating the Recovery Rebate Credit and the elimination of Form 8453-OL, *U.S. Individual Income Tax Declaration for an Online e-file Return*, but the majority of taxpayers filed their returns without complications.

Attached are our comments to your recommendation. If you have any questions, please call me at (404) 338-7060, or a member of your staff may contact Peter J. Stipek, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment



The 2009 Filing Season Was Successful Despite Significant Challenges Presented by the Passage of New Tax Legislation

Attachment

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1

Ensure the SPC "H" is accurately used on taxpayer accounts by identifying previously processed tax returns that were not coded accurately and ensuring subsequently processed tax returns are properly coded. This could be accomplished by identifying returns claiming the FTTC and the amount of the claim and analyzing the account to determine if they were properly coded.

CORRECTIVE ACTION

We disagree with the recommendation. The IRS has gone to considerable lengths to mark accounts with year of purchase and the dollar value of the credit issued. We intend to track this information on the Master File for taxpayers who are required to pay back the First Time Homebuyers credit based on the legal requirements in the legislation. As we determine what compliance activities will be conducted, we will validate the information we have to ensure only those taxpayers who have not met their responsibilities are contacted. This will include ensuring the date of purchase was accurately captured.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A