



RECOVERY ACT

First-Time Homebuyer Credit Repayment Notices Were Incorrect, and the Method Used to Identify Dispositions Is Unreliable

September 15, 2011

Reference Number: 2011-41-097

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

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HIGHLIGHTS



FIRST-TIME HOMEBUYER CREDIT REPAYMENT NOTICES WERE INCORRECT, AND THE METHOD USED TO IDENTIFY DISPOSITIONS IS UNRELIABLE

Highlights

Final Report issued on September 15, 2011

Highlights of Reference Number: 2011-41-097 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Each of the laws which provide First-Time Homebuyer Credits (Homebuyer Credit) contains different Homebuyer Credit amounts, qualification requirements, and repayment requirements. Our review identified inaccuracies relating to the issuance of Homebuyer Credit repayment notices. In addition, the method used to identify individuals who may have disposed of their principal residence was not reliable.

WHY TIGTA DID THE AUDIT

TIGTA is required to monitor the Internal Revenue Service's (IRS) implementation of American Recovery and Reinvestment Act of 2009 provisions. The IRS reported a total of \$29.7 billion in Homebuyer Credit claims were made by more than 4 million individuals as of May 7, 2011. Our overall objective was to evaluate the effectiveness of IRS processes to ensure the accurate and timely repayment of the Homebuyer Credit.

WHAT TIGTA FOUND

The IRS is continuing to take actions to develop and implement Homebuyer Credit repayment processes and procedures. However, our review identified notice programming errors which resulted in 13,327 individuals (including deceased individuals) who received or would have received incorrect notices, 18,220 individuals not receiving notices, and 29,880 individuals receiving incorrect notices because

of incorrectly recorded home purchase dates. TIGTA also identified that the IRS's Recapture File sent to the third-party vendor for research to identify individuals who may have disposed of their principal residence did not include 31,062 individuals who received the Homebuyer Credit through February 2010.

In addition, our review found that the research methodology performed by the third-party vendor is incorrectly identifying current addresses. As a result, some individuals incorrectly received a Notice CP03c, which is sent to individuals when the IRS has information that there was a change to the individual's principal residence. For the 86,609 individuals who received a Notice CP03c, 53,558 (62 percent) received this notice because the third-party vendor incorrectly indicated the individual's address did not match the address in the IRS's Recapture File.

Finally, our review of the third-party vendor's research results for a statistically valid sample of 97 taxpayer accounts determined that for 40 (41 percent) of the taxpayer accounts, the information provided to the IRS had incomplete or inaccurate information.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, ensure Homebuyer Credit repayment notices are accurately issued, correct the purchase dates for the 2,535 tax accounts TIGTA identified as still having an incorrect purchase date recorded on the IRS's computer system, and discontinue using third-party vendor data to identify individuals who may have disposed of their principal residence unless the reliability can be significantly improved.

The IRS agreed with two recommendations and plans to refer the 2,535 tax accounts to the Accounts Management function for analysis and corrections, complete its evaluation of the use of third-party vendor data, and reevaluate the use of its own internal data. For the remaining recommendation, the IRS plans to replace the Notices CP03a and CP03b with a web-based tool that it plans to make available to taxpayers for the 2012 Filing Season.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 15, 2011

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Margaret E. Bezz

FROM: (for) Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – First-Time Homebuyer Credit Repayment Notices
Were Incorrect, and the Method Used to Identify Dispositions Is
Unreliable (Audit # 201040107)

This report presents the results of our review to evaluate the effectiveness of the Internal Revenue Service processes to ensure the accurate and timely repayment of the First-Time Homebuyer Credit, including individuals who do not self-identify a disposition of their primary residence. This review was included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Implementing Tax Law Changes.

The American Recovery and Reinvestment Act of 2009 (Recovery Act)¹ provides separate funding to the Treasury Inspector General for Tax Administration through September 30, 2013, to be used in oversight activities of Internal Revenue Service programs. This audit was conducted using Recovery Act funds.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendations. 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.

¹ Pub. L. No. 111-5, 123 Stat. 115 (2009).



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Abbreviations

IDRS	Integrated Data Retrieval System
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year



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Background

The Housing and Economic Recovery Act of 2008 (Housing Act)¹ introduced the new First-Time Homebuyer Credit (Homebuyer Credit) to help stimulate the housing industry by encouraging individuals to purchase their first homes. Subsequent legislation, the American Recovery and Reinvestment Act of 2009 (Recovery Act),² the Worker, Homeownership, and Business Assistance Act of 2009 (Assistance Act),³ and the Homebuyer Assistance and Improvement Act of 2010 (Homebuyer Act),⁴ revised, extended, and expanded the Homebuyer Credit in an attempt to remedy the struggling real estate market.

The Internal Revenue Service (IRS) reported a total of \$29.7 billion in Homebuyer Credit claims were made by more than 4 million individuals as of May 7, 2011.

The Homebuyer Credit reduced taxes or increased tax refunds depending on the tax owed. The Homebuyer Credit was a refundable credit which resulted in a tax refund even if no income tax was withheld or paid when the credit exceeded the tax liability. Figure 1 provides a breakdown of Homebuyer Credit claims by Legislation.

Figure 1: Comparison of Homebuyer Credit Claims by Legislation Through May 7, 2011

Legislation	Homebuyer Credit Claims	Amount of Homebuyer Credit Claimed
Housing Act	1,564,170	\$10.8 billion
Recovery Act	2,041,969	\$13.8 billion
Assistance Act	219,213	\$1.6 billion
Homebuyer Act	263,774	\$3.5 billion
Total	4,089,126	\$29.7 billion

Source: The IRS Submission Processing function.

¹ Pub. L. No. 110-289, 122 Stat. 2654 (2008).

² Pub. L. No. 111-5, 123 Stat. 115 (2009).

³ Pub. L. No. 111-92, 123 Stat. 2984 (2009).

⁴ Pub. L. No. 111-198, 124 Stat. 1356 (2010).



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The laws which provided Homebuyer Credits contain different repayment and/or waiver of repayment requirements

Each of the laws with Homebuyer Credit provisions contains different Credit amounts, qualification requirements, and repayment requirements. For example, individuals who received the Homebuyer Credit for a home purchased in 2008 are required to make mandatory repayments of the Homebuyer Credit. These individuals are required to pay back the total amount received for the Homebuyer Credit over 15 years. Annual repayment amounts are added to any other tax the individual owes on their Federal tax return beginning in Tax Year (TY) 2010. This could result in an additional tax owed or a reduced refund. There are some exceptions.

Individuals who received the Homebuyer Credit generally must repay the entire Homebuyer Credit amount they received if, during the 3-year period beginning on the purchase date and after the year for which the individual received the Homebuyer Credit, they dispose of their home or it ceases to be their principal residence. Figure 2 provides a comparison of the repayment requirements and some of the repayment exceptions in the four Homebuyer Credit provisions.

Figure 2: Comparison of Homebuyer Credit Repayment Provisions

	Housing Act	Recovery Act	Assistance Act	Homebuyer Act
Homebuyer Credit Repayment	Repayment is over 15 years beginning in TY 2010. Repayment of the outstanding Homebuyer Credit in the next tax year if the residence claimed for the Credit ceases to be the principal residence before the end of the 15-year recapture period (provided there is a gain on the sale of the home).	Repayment of the Homebuyer Credit in the next tax year if the residence claimed for the Credit is no longer the principal residence within 3 years of purchase date (provided there is a gain on the sale of the home).	Repayment of the Homebuyer Credit in the next tax year if the residence claimed for the Credit is no longer the principal residence within 3 years of purchase date (provided there is a gain on the sale of the home).	No change from Assistance Act.
Waiver of Homebuyer Credit Repayment	Death of the individual.	Death of the individual.	Death of the individual. Individuals (and spouses, if married) on qualified extended duty.	No change from Assistance Act.

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of legislation.

Individuals report Homebuyer Credit repayments and dispositions (may result in repayment of the Homebuyer Credit the following tax year) on Parts III and IV on the First-Time Homebuyer



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Credit and Repayment of the Credit (Form 5405). Figure 3 provides an example of Form 5405 Parts III and IV.

Figure 3: Form 5405, Parts III and IV

Form 5405 (Rev. 12-2010)		Page 2
<p>Note. Skip this page if you are not filing this form to (1) report a disposition or change in use of your main home for which you claimed the credit in 2008 or 2009, or (2) pay an installment of the credit you claimed for a home purchased in 2008.</p>		
Name(s) shown on return		Your social security number
Part III Disposition or Change in Use of Main Home for Which the Credit Was Claimed		
<p>11 Enter the date you disposed of, or ceased using as your main home, the home for which you claimed the credit (MM/DD/YYYY) (see instructions) ▶</p>		
<p>12 If you meet the following conditions, check here ▶ <input type="checkbox"/></p> <p>I (or my spouse if married) am, or was, a member of the uniformed services or Foreign Service, or an employee of the intelligence community. I sold the home, or it ceased to be my main home, in connection with Government orders for qualified official extended duty service. No repayment of the credit is required (see instructions). Stop here.</p>		
<p>13 Check the box below that applies to you. See the instructions for the definition of "related person."</p>		
<p>a <input type="checkbox"/> I sold (including through foreclosure) the home to a person who is not related to me and had a gain on the sale (as figured using the worksheet in the instructions). Go to Part IV below.</p>		
<p>b <input type="checkbox"/> I sold (including through foreclosure) the home to a person who is not related to me and did not have a gain on the sale (as figured using the worksheet in the instructions). No repayment of the credit is required. Stop here.</p>		
<p>c <input type="checkbox"/> I sold the home to a related person. Go to Part IV below.</p>		
<p>d <input type="checkbox"/> I converted the entire home to a rental or business use OR I still own the home but no longer use it as my main home. Go to Part IV below.</p>		
<p>e <input type="checkbox"/> I transferred the home to my spouse (or ex-spouse as part of my divorce settlement). The full name of my ex-spouse is ▶</p>		
<p>The responsibility for repayment of the credit is transferred to your spouse or ex-spouse. Stop here.</p>		
<p>f <input type="checkbox"/> My home was destroyed, condemned, or disposed of under threat of condemnation and I acquired or plan to acquire a new home within 2 years of the event (see instructions).</p>		
<p>g <input type="checkbox"/> My home was destroyed, condemned, or disposed of under threat of condemnation and I do not plan to acquire a new home within 2 years of the event (see instructions).</p>		
<p>h <input type="checkbox"/> The taxpayer who claimed the credit died in 2010. No repayment of the credit is required of the deceased taxpayer. If you are filing a joint return for 2010 with the deceased taxpayer, see instructions. Otherwise, stop here.</p>		
Part IV Repayment of Credit Claimed for 2008 or 2009		
14 Enter the amount of the credit you claimed on Form 5405 for 2008 or 2009. See instructions if you filed a joint return for the year you claimed the credit or sold your home under threat of condemnation. If you checked box 13a above, go to line 15. Otherwise, skip line 15 and go to line 16	14	
15 Enter the gain on the sale of your main home (as figured using the worksheet in the instructions)	15	
16 Check the box below that applies to you. (Check only one box.)		
<p>a <input type="checkbox"/> I am reporting a disposition or change in use of my main home. If you checked box 13a above, enter the smaller of line 14 or line 15. If you checked box 13g for an event that occurred before 2009, see instructions. Otherwise, enter the amount from line 14.</p>		
<p>b <input type="checkbox"/> I am paying an installment of the credit I claimed for a home purchased in 2008. Divide line 14 by 15.0 (but see instructions if you checked box 13g for an event that occurred after 2008). This is the minimum amount you must repay with your 2010 return. Enter this amount (or a larger amount if you choose) here. (see instructions)</p>		
	16	
<p>Next: Include the amount from line 16 on your 2010 Form 1040, line 59, or Form 1040NR, line 58. Check the "Form 5405" box on that line.</p>		
		Form 5405 (Rev. 12-2010)

Source: Page 2 of Form 5405.



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Recovery Act activities require a high level of scrutiny, and taxpayer dollars spent on economic recovery must be subject to unprecedented levels of transparency and accountability. Federal agencies are required to ensure Recovery Act funds are used for authorized purposes and appropriate measures are taken to prevent fraud, waste, and abuse. As such, the TIGTA is required to monitor the IRS's implementation of Recovery Act provisions, and this audit was conducted to meet those requirements.

This review was performed at the Wage and Investment Division Headquarters in Atlanta, Georgia, during the period August 2010 through June 2011. 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.



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Results of Review

The IRS is continuing to take actions to develop and implement Homebuyer Credit repayment processes and procedures. These actions include:

- Developing a comprehensive *First-Time Homebuyer Credit Recapture Strategy* that outlines the IRS's processes for handling repayments.
- Revising Form 5405 by adding Sections III and IV (see Figure 3) for use by individuals with mandatory repayments and dispositions of principal residences within 3 years that require repayment.
- Creating a Homebuyer Credit Entity Section on the tax account of each individual who received the Homebuyer Credit. The Entity Section contains Homebuyer Credit data for the primary and secondary taxpayer (for married taxpayers filing jointly) including the amount of the Homebuyer Credit received and the year in which the home was purchased. The Homebuyer Credit Entity Section will also show the cumulative amount of the Homebuyer Credit that has been repaid. The IRS plans to update the Entity Section when tax returns with an attached Form 5405 with entries in Part III or Part IV are processed.
- Creating a Recapture File that included more than 2.4 million individuals who received the Homebuyer Credit through February 2010. The Recapture File contains information relating to individuals who received the Homebuyer Credit. It includes the individual's name, Social Security Number, address, and the purchase year for the home used to claim the Homebuyer Credit. The Recapture File was provided to a third-party vendor to research third-party records and to provide information back to the IRS that identifies individuals who potentially disposed of their principal residence but did not report the disposition and repay the Homebuyer Credit.
- Mailing notices to individuals who received the Homebuyer Credit. These notices provide key information as to when individuals have to repay the Homebuyer Credit and include:
 - ***Notice CP03a, Repaying your First-Time Homebuyer Credit*** - sent to individuals who purchased a home in 2008 and are required to repay the credit over 15 years beginning in TY 2010. This notice will be sent to these individuals annually until the Homebuyer Credit is fully repaid. The notice lists the amount of the Homebuyer Credit the individual originally received and the amount still outstanding that has to be repaid as an additional tax. For the 2011 Filing Season, the IRS reported it issued 1,520,025 Notices CP03a.



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- **Notice CP03b, Courtesy message about your First-Time Homebuyer Credit** - sent to individuals for 3 years after the year they received the Homebuyer Credit for a 2009 or 2010 purchase. This notice informs individuals what to do if they sell their principal residence or if it is no longer their principal residence. For the 2011 Filing Season, the IRS reported it issued 3,746,397 Notices CP03b.
- **Notice CP03c, Important information regarding your First-Time Homebuyers Credit** - sent to individuals when the IRS has information that there was a change to the individual's principal residence. It reminds individuals to file a Form 5405 to report the sale or disposition of their principal residence and repay the credit. For the 2011 Filing Season, the IRS reported it issued 86,609 Notices CP03c.

The IRS accurately issued more than 5.2 million Notices CP03a and CP03b. However, our review identified that the IRS issued incorrect notices or did not send notices to 61,427 (1 percent) individuals. For example, because of programming errors, 13,327 individuals (including deceased individuals) received incorrect notices and 18,220 individuals did not receive their notice. In addition, 29,880 individuals received incorrect notices because the IRS's computer system showed incorrect home purchase dates.

In addition, our review also identified that the IRS's Recapture File sent to the third-party vendor was not complete; 31,062 individuals who received the Homebuyer Credit (through February 2010) were not included in this file. Finally, we identified that the methodology used to identify individuals who may have disposed of their principal residence was not reliable.

Programming Errors and Inaccurate Purchase Dates Resulted in Incorrect Notices

Our review identified that because of programming errors and inaccuracies related to the year of purchase on the Homebuyer Credit Entity Section of tax accounts, individuals did not receive notices or received incorrect notices.

Some individuals did not receive Homebuyer Credit notices

Our review identified 18,220 individuals who received the Homebuyer Credit for a 2008 purchase but were not included in the IRS's Notice CP03a issuance file. This resulted from a programming error in the IRS's notice issuance process. Individuals who did not receive this notice may not be aware of their repayment requirements, including the amount of Homebuyer Credit which needs to be repaid for TY 2010.

On October 29, 2010, we alerted IRS management that not all appropriate individuals were going to receive the Notice CP03a. We recommended that the IRS correct its notice programming to ensure these 18,220 individuals receive a Notice CP03a. In its response, the IRS noted that it had corrected its notice programming and would issue a Notice CP03a to the individuals



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identified by the TIGTA. As recently as April 14, 2011, we were assured by IRS executives that these notices had been issued. However, our review of an updated Notice Issuance File, dated December 25, 2010, identified that the IRS did not issue a Notice CP03a to 17,638 (97 percent) of these 18,220 individuals.

Some individuals received or would have received Homebuyer Credit notices with incorrect repayment amounts

Our review identified 12,495 Notices CP03a that incorrectly showed the individual's required repayment amount as \$0 when in fact these individuals had a repayment obligation. On October 22, 2010, we alerted IRS management that notices had incorrect repayment amounts. The IRS responded that 8,609 notices with incorrect repayment amounts had already been mailed; however, corrected notices would be reissued to these individuals. The cost of issuing the 8,609 incorrect notices was approximately \$29,701. In addition, the IRS responded it would halt the issuance of notices the week beginning October 24, 2010, to correct the programming error to ensure accurate repayment amounts were detailed on notices subsequently issued by the IRS.

As recently as April 14, 2011, we were assured by IRS executives that these notices had been issued with correct repayment amounts. However, our review of an updated Notice Issuance File, dated December 25, 2010, identified that the IRS did not issue correct notices to 3,472⁵ (28 percent) of these 12,495 individuals.

Incorrect purchase dates resulted in some individuals receiving incorrect Homebuyer Credit notices

Our review identified 29,880 individuals who received an incorrect Notice CP03a or Notice CP03b that cost the IRS approximately \$103,086 to issue.

- 27,728 individuals incorrectly received a Notice CP03a indicating they had a repayment obligation despite having purchased their home in 2009 (only 2008 purchases have a repayment requirement). These individuals should have received a Notice CP03b.
- 2,152 individuals incorrectly received a Notice CP03b indicating that they did not have a repayment obligation for TY 2010 unless they sold their principal residence or it was no longer their principal residence. These individuals should have received a Notice CP03a because they had a 2008 home purchase and have a mandatory repayment obligation.

⁵ The 3,472 individuals who did not receive correct notices could be included in the 8,609 individuals who already received an incorrect notice and in the 3,886 individuals who had not been mailed a notice at the time we alerted the IRS.



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In a prior review,⁶ we alerted IRS management that, in some instances, the IRS did not accurately distinguish between individuals with a 2008 home purchase date and those with a 2009 home purchase date. The prior review identified 68,924 individuals who received the Homebuyer Credit that had incorrect purchase dates shown in the Homebuyer Credit Entity Section of their accounts. We recommended that the Commissioner, Wage and Investment Division, correct the purchase dates for these 68,924 accounts. The IRS agreed with this recommendation. The IRS indicated that it would use third-party property records to verify home purchase or disposition information and would refer discrepancies for appropriate resolution.

However, as we have previously described, the IRS has still not corrected all of these individuals' purchase dates. As a result, these individuals received and will continue to receive incorrect notices. On November 22, 2010, we again notified IRS management that individuals' accounts had incorrect purchase dates. IRS management responded they would systemically correct purchase dates in the Homebuyer Credit Entity Section of these accounts to reflect the correct year of the home purchase. The IRS further noted that it would filter to remove from this population any individual tax accounts with post-processing compliance actions present on the account and systemically correct the purchase dates by January 29, 2011.

Our review of the 29,880 tax accounts, as of February 26, 2011, still identified 2,535 tax accounts with an incorrect purchase date. In addition, the IRS did not issue corrected notices to the 29,880 individuals who received an incorrect notice.

Some deceased individuals would have incorrectly received a Homebuyer Credit notice

Our review identified 832 deceased individuals who would have incorrectly received a Homebuyer Credit notice. We determined that 832 of the 1,326 deceased individuals identified in a prior review⁷ were still included in the IRS's Notice CP03a and Notice CP03b issuance files. The law waives any repayment of the Homebuyer Credit for deceased individuals. These individuals should not receive Homebuyer Credit notices.

IRS guidelines require that when a tax return is filed on behalf of an individual who is recently deceased, the tax return must be appropriately notated so the individual's tax account can be properly coded. However, we found that not all deceased individual tax accounts were properly coded to indicate the individual who received the Homebuyer Credit was now deceased.

⁶ *A Comprehensive Strategy Is Being Developed to Identify Individuals With First-Time Homebuyer Credit Repayment Requirements* (Reference Number 2010-41-086, dated August 16, 2010).

⁷ *A Comprehensive Strategy Is Being Developed to Identify Individuals With First-Time Homebuyer Credit Repayment Requirements* (Reference Number 2010-41-086, dated August 16, 2010).



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On November 4, 2010, we alerted IRS management of the potential that Homebuyer Credit notices would be incorrectly sent to deceased individuals. The IRS responded that actions were taken to remove deceased individuals from the Homebuyer Credit Entity Section of the accounts. For Filing Season 2011, when final tax returns for deceased individuals are filed, a code will be input on the tax return that will result in an adjustment to the individual's tax account which will waive any repayment of the Homebuyer Credit and ensure no notices are issued. For future processing, to remove deceased individuals from the Homebuyer Credit Entity Section, the IRS will use the Social Security Administration decedent data to systemically identify, suspend notices, and adjust these tax accounts. This future process will be performed bi-annually beginning July 2011.

As recently as April 14, 2011, we were assured by IRS executives that these notices had not been issued. However, our review of an updated Notice Issuance File, dated December 25, 2010, identified that the IRS failed to suppress the issuance of notices to 738 (89 percent) of the 832 deceased individuals. The cost of issuing the 738 notices was approximately \$2,546.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Ensure notice issuance programming accurately identifies individuals who should receive a Notice CP03a or CP03b and ensure information contained in these notices is accurate.

Management's Response: In response to our recommendation, the IRS stated it is discontinuing the use of Notices CP03a and CP03b and replacing them with a web-based tool that will be available to taxpayers for the 2012 Filing Season. The IRS is publicizing the availability of the tool to tax software and return preparer communities and will conduct additional outreach to inform taxpayers for the filing season.

Recommendation 2: Correct the purchase dates for the 2,535 tax accounts we identified as still having an incorrect purchase date recorded on their Homebuyer Credit Entity Section on the IRS's computer system.

Management's Response: IRS management agreed with this recommendation; however, their preliminary reviews indicate that a high percentage of these accounts appear to be correct. Purchase dates have been updated from the original return values by subsequent examination or adjustment activity on the tax return. These accounts have been referred to the Accounts Management function, which is analyzing the accounts and making necessary corrections.



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The Homebuyer Credit Recapture File Was Incomplete

We identified 31,062 individuals who received the Homebuyer Credit as of February 2010, that were not included in the IRS's Recapture File. The Recapture File was sent to a third-party vendor for research to identify potential dispositions of an individual's principal residence. On January 19, 2011, we alerted IRS management that the Recapture File was incomplete. IRS management responded that they were aware that the Recapture File was incomplete and had previously notified the TIGTA there were secondary tax accounts⁸ of individuals who filed jointly with their spouse that were not included. The IRS noted that these individuals were not included because of programming issues and would be included in the next Recapture File.

The IRS had informed us there were a few thousand individuals who would not be included in the Recapture File because of the reasons previously stated. We acknowledge that some of the individuals not included in the file were the result of secondary tax accounts. This does not, however, account for all of the 31,062 individuals we identified that were not included in the Recapture File. We raised this concern in discussions with the IRS and were provided a subsequent response dated April 21, 2011. In this response, the IRS indicated that the methodology it used to populate the Recapture File differed from the TIGTA's methodology, which resulted in the file being incomplete. The difference is that the IRS's methodology limited inclusion of individuals in the Recapture File to only those individuals who both had received the Homebuyer Credit and had their TY 2009 U.S. Individual Income Tax Return (Form 1040) processed by February 2010. We believe the 31,062 individuals who we identified should have been included in the Recapture File. The IRS has informed us that the individuals we identified will be included in the next IRS Recapture File scheduled for June 2011.

The Method Used to Identify Individuals Who Disposed of Their Principal Residence Is Unreliable

Our review found that the method used to identify individuals who disposed of their principal residence is not reliable. The research performed by the third-party vendor incorrectly identified current addresses. Because of this, some individuals incorrectly received a Notice CP03c, which is sent to individuals when the IRS has information that there was a change to the individual's principal residence. For the 86,609 individuals who received a Notice CP03c, 53,558 (62 percent) received this notice because the third-party vendor incorrectly indicated the individual's address did not match the individual's address in the IRS's Recapture File.

⁸ A taxpayer account can include one individual (e.g., an individual files a tax return using the "single" filing status) or two individuals (e.g., two people file a tax return using the "married filing joint" filing status). The IRS refers to the first person on a joint return as the "primary taxpayer" and the second person on a joint return as the "secondary taxpayer."



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Based on our identification of the inaccurate and incomplete results provided by the third-party vendor, we recommend that the IRS discontinue using a vendor to identify individuals who may have disposed of their principal residence. In fact, tax records the IRS maintains seem to be more reliable in identifying individuals who disposed of their principal residence.

Third-party address research is resulting in the incorrect identification of individuals who disposed of their principal residence

Our statistically valid sample of 97 individuals included in the IRS's Recapture File included 8 individuals who received a Notice CP03c based on third-party research indicating these individuals may have disposed of their principal residence. The third-party vendor indicated these eight individuals' current address did not match the individual's address that was provided in the IRS's Recapture File.

However, our review of IRS information and information provided by the third-party vendor identified that these individuals incorrectly received a Notice CP03c. The information showed that the individuals' principal residence was still the address provided by the IRS in its Recapture File. The IRS requested that the third-party vendor research third-party data including public property records (e.g., tax assessor, deed) and provide back to the IRS information indicating whether the individual has a different address than the address provided by the IRS. For each of these eight individuals, the third-party vendor provided back that the individual had a different current address. However, our research of IRS records and current tax assessor and deed records showed that these individuals lived at the principal residence address that was included in the IRS's Recapture File. Our discussions with the third-party vendor found that the method it used to identify a different address for these eight individuals incorrectly identified the current address based on what they indicated was the presence of an active landline telephone number. This is despite third-party property records showing that the individual resided at the address included in the IRS's Recapture File.

Figure 4 shows that the principal residence address provided by the third-party vendor was not included in any IRS tax records or tax assessor and deed records.



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Figure 4: Comparison of Current Address Provided by Third-Party Vendor to Address on Tax Returns and Property Records

Individual	Does the Individual's Current Address From the Third-Party Vendor Match the Individual's Address on:				
	2008 Tax Return	2009 Tax Return	2010 Tax Return	Current Tax Assessor Record	Current Deed Record
1	**1**	**1**	**1**	**1**	**1**
2	**1**	**1**	**1**	**1**	**1**
3	**1**	**1**	**1**	**1**	**1**
4	**1**	**1**	**1**	**1**	**1**
5	**1**	**1**	**1**	**1**	**1**
6	**1**	**1**	**1**	**1**	**1**
7	**1**	**1**	**1**	**1**	**1**
8	**1**	**1**	**1**	**1**	**1**

Sources: Current address data provided by third-party vendor, the IRS's Individual Income Tax data, and the third-party vendor's system of property records (e.g., tax assessor and deed records).

Information provided to the IRS from the third-party vendor was incomplete and/or inaccurate

Our review of the third-party vendor's research results for a statistically valid sample of 97 taxpayer accounts determined that for 40 (41 percent) of the taxpayer accounts, the information provided to the IRS had incomplete or inaccurate information.

- 19 tax accounts – Third-party vendor did not provide the most current or relevant tax assessor record or deed record for the individual.
- 7 tax accounts – Third-party vendor provided information not relating to the individual for whom the research was to be conducted. For example, the individual's name provided by the IRS (e.g., Jane A. Doe) in the Recapture File did not match the name on the associated tax assessor and/or deed record included in the third-party vendor's results (e.g., Jane A. Smith).



First-Time Homebuyer Credit Repayment Notices Were Incorrect, and the Method Used to Identify Dispositions Is Unreliable



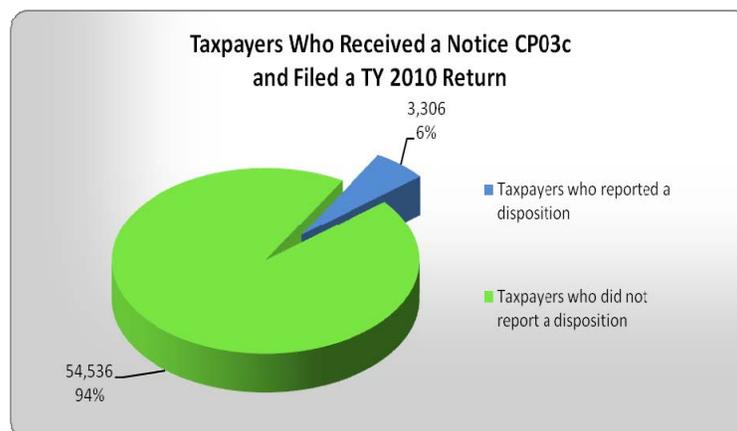
- 8 tax accounts⁹ – Third-party vendor provided an incorrect current address for the individual and indicated the individual did not live at the address provided in the IRS’s Recapture File.
- 6 tax accounts – Third-party vendor did not provide the current or relevant property record and the individual’s name provided by the third party did not match the individual’s name in the IRS’s Recapture File. These six accounts included multiple inaccuracies.

We identified the 40 taxpayer accounts with incomplete or inaccurate information by researching the taxpayers’ address information, tax assessor records, and deed records maintained on the third-party vendor’s database of public records, and comparing our research results to the information provided by the third-party vendor to the IRS. The incomplete or inaccurate information could result in the IRS erroneously mailing a Notice CP03c to individuals who did not dispose of their principal residence, or failing to mail a Notice CP03c to individuals who disposed of their principal residence.

Information maintained in IRS records provides more reliable identification of individuals potentially disposing of their principal residence

Based on our identification of the inaccurate and incomplete results provided by the third-party vendor, we recommend that the IRS discontinue using a third-party vendor to identify individuals who may have disposed of their principal residence. In our opinion, tax records and information that the IRS maintains is more reliable in identifying individuals who disposed of their principal residence.

As of April 27, 2011, the third-party vendor had not billed the IRS for its research results, but the IRS informed us the amount due the third party was approximately \$214,000. Further indication that the research provided by the third-party vendor was not reliable is that only 3,306 (6 percent) of the 57,842 individuals who received a Notice CP03c and who filed a TY 2010 tax return as of April 23, 2011, reported a disposition.



⁹ The IRS issued Notice CP03c to eight individuals on six of the eight taxpayer accounts.



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Even though IRS management knew that third-party information was inaccurate, a decision was made to mail Notices CP03c

The IRS informed us that it received the third-party vendor results in November 2010. The IRS’s review of the results identified that the information provided contained “minor errors that impacted a relatively small number of records.”

When the third-party vendor could not deliver improved results by mid-December 2010, the IRS decided to use the November 2010 results to identify individuals who should receive a Notice CP03c. The IRS believed it was critical to mail the Notice CP03c to individuals prior to the 2011 Filing Season to alert the individuals that they might need to report the disposition. See Figure 5 for a timeline on the providing of results to the IRS from the third-party vendor.

Figure 5: Timeline for Receiving Third-Party Research Data

Date	Action
June – July 2010	Test sample of 5,000 records provided by the IRS to the third-party vendor. The purpose of providing the test sample was to identify and correct programming errors in the third-party vendor’s research program.
July 2010	The IRS’s Recapture File was provided to the third-party vendor to conduct research.
August 2010	The IRS received the preliminary research results from the third-party vendor. The IRS’s quality review of the information identified errors.
August – November 2010	Results were provided to the IRS from the third-party vendor for evaluation. Based on the IRS’s evaluation, programming changes were performed.
November – December 2010	The IRS received a file from the third-party vendor containing what the IRS referred to as “minor errors.” The file contained minor errors that affected a relatively small number of records and were considered when the IRS used the third-party vendor’s research results to identify individuals with a potential disposition. The IRS notified the vendor of the errors and requested a revised file with corrected information.
December 2010	The IRS believed that it was crucial to mail Notice CP03c prior to the 2011 Filing Season. When the third-party vendor could not deliver revised results by mid-December 2010, the IRS decided to use the November 2010 third-party research results for purposes of mailing the Notices CP03c.
January 2011	The IRS mailed Notice CP03c to 86,609 individuals.



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Date	Action
January – February 2011	The IRS requested the third-party vendor to take the following actions to correct the information: <ul style="list-style-type: none">• Revise programming to provide the IRS with the two most current sales or foreclosure deed for the property of interest.• Revise programming to provide the IRS with the most current tax assessor property record.
February 22, 2011	The third-party vendor was still conducting a quality review of its programming. The vendor estimated sending the IRS final results for individuals included in the IRS's July 2010 Recapture File by March 4, 2011.

Source: *The IRS Electronic Tax Administration and Refundable Credits function.*

Our review of email correspondence between the IRS and the third-party vendor showed the problems with the third-party vendor research provided to the IRS and the IRS's concerns regarding these data. Emails from IRS employees responsible for reviewing the third-party data raised concerns regarding the completeness and accuracy of the information provided to the IRS. These concerns noted that records seemed to be inaccurate, data were missing in the files delivered, and information provided did not match information on the third-party vendor web site database that can be researched by the IRS. These concerns were being raised as late as November 2010, yet IRS management went forward with the decision to mail notices to individuals based on the known inaccurate and incomplete data. We believe the IRS should not have issued these notices using the information provided by the third-party vendor.

Recommendation

Recommendation 3: The Commissioner, Wage and Investment Division, should discontinue using third-party vendor data to identify individuals who may have disposed of their principal residence unless the reliability can be significantly improved. The IRS should develop a methodology that uses the IRS's tax return data and information to identify individuals who have an indication of a disposition of their principal residence.

Management's Response: IRS management agreed with this recommendation. The IRS will complete its evaluation of the use of the third-party vendor data and reevaluate the use of its own internal data which was considered when its *First-Time Homebuyer Credit Recapture Strategy* was first developed.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the effectiveness of IRS processes to ensure the accurate and timely repayment of the First-Time Homebuyer Credit (Homebuyer Credit) including individuals who do not self-identify a disposition of their primary residence. To accomplish this objective, we:

- I. Assessed the completeness and accuracy of the IRS's Recapture File.
 - A. Interviewed responsible IRS officials to determine how the IRS's Recapture File was created and the criteria used to identify the individual tax accounts to be included in the Recapture File.
 - B. Created a duplicate (TIGTA) Recapture File based on the criteria used by the IRS and matched it to the IRS's Recapture File to see if the data in both files were the same.
 - C. Validated 40 records in the IRS's Recapture File against taxpayer data on the IRS's Integrated Data Retrieval System (IDRS).¹ We validated 36 records in TIGTA's Recapture File against taxpayer data on the IDRS.
- II. Assessed the IRS's development and accuracy of Notice CP03a, *Repaying your First-Time Homebuyer Credit*, and Notice CP03b, *Courtesy message about your First-Time Homebuyer Credit*.
 - A. Reviewed the process to ensure individuals who claimed the Homebuyer Credit for Calendar Year 2008 home purchases received the proper notification (Notice CP03a).
 1. Interviewed responsible IRS officials to determine how the individuals requiring notification are being identified.
 2. Obtained the IRS's file of Notices CP03a and CP03b through September 25, 2010, and validated five records in the notice file against the IDRS.
 3. Obtained an extract of the Individual Master File² Homebuyer Credit Entity Section data through October 2, 2010, from TIGTA's Information Services staff. We validated five records in the extract against the IDRS.

¹ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

² The IRS database that maintains transactions or records of individual tax accounts.



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4. Compared the records on the Homebuyer Credit Entity Section to the records on the file of Notices CP03a and CP03b.
 - a. Identified individuals not included in the notice file for issuance of the Notice CP03a and determined the effect on individuals and the IRS.
 - b. Assessed the accuracy of the amounts reported on the Notices CP03a.
 - c. Identified individuals not included in the notice file for issuance of the Notice CP03b and determined the effect on individuals and the IRS.
 - B. Followed up on management's corrective actions in response to the findings contained in the most recent TIGTA report on the Homebuyer Credit.³
 1. Determined if the IRS sent Notice CP03b to 49,480 individuals who purchased a home in 2009, but the IRS incorrectly recorded the purchase date as 2008 on the individuals' Homebuyer Credit Entity Section.
 2. Determined if the IRS sent Notice CP03a to the 6,541 individuals who purchased a home in 2008, but the IRS incorrectly recorded the purchase date as 2009 on the individuals' Homebuyer Credit Entity Section.
 3. Determined if the IRS excluded the 1,326 deceased individuals from its file of CP03a and CP03b notices.
 - C. Obtained the IRS's revised file of Notices CP03a and CP03b through December 25, 2010, and analyzed the file to determine if it contained corrected notices for the issues identified in our review.
- III. Evaluated the effectiveness of the IRS's use of a third-party vendor to identify individuals who do not self-report a disposition of their primary residence.
- A. Interviewed the third-party vendor for background information about its database of public records and how the taxpayer's current address was identified.
 - B. Obtained the third-party vendor's research results for the IRS's Recapture File.
 - C. Researched IRS data and the third-party vendor's database of public records for a statistical sample of 97 records from the third-party research results. Our sample size was determined using the following sampling criteria:
 - 1,762,353 population (e.g., number of records in the IRS's Recapture File).
 - 90 percent confidence level.
 - 10 percent actual error rate (based on the review of 10 records).
 - ±5 percent precision.

³ A Comprehensive Strategy Is Being Developed to Identify Individuals With First-Time Homebuyer Credit Repayment Requirements (Reference Number 2010-41-086, dated August 16, 2010).



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- D. Matched the 97 sample records against the IRS's Notice CP03c file to determine how many taxpayers in the sample were issued Notice CP03c.
- E. Matched the third-party vendor's research results for the IRS's Recapture File against the IRS's Notice CP03c file to identify individuals receiving a Notice CP03c solely because the third-party vendor's results showed the individuals do not reside at the addresses included in the IRS's Recapture File.
- F. Matched the individuals who received a Notice CP03c against TY 2010 returns processed through April 23, 2011, to identify individuals who did not report a disposition on First-Time Homebuyer Credit and Repayment of the Credit (Form 5405).

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: IRS Wage and Investment Division's policies, procedures, and practices for developing and implementing the First-Time Homebuyer Credit Recapture Strategy. We evaluated these controls by interviewing IRS management and third-party vendor personnel, reviewing documentation, analyzing IRS Notices CP03a, CP03b, and CP03c, and analyzing IRS data and public records for taxpayers who received the Homebuyer Credit.



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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
Sharon Buford, Lead Auditor
Karen Fulte, Senior Auditor
Van Warmke, Senior Auditor
Denise Gladson, Auditor
Lance Welling, Auditor
Martha Stewart, Senior Information Technology Specialist



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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Operations Support OS
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Wage and Investment Division SE:W
Chief Technology Officer OS:CTO
Director, Compliance, Wage and Investment Division SE:W:CP
Director, Electronic Tax Administration and Refundable Credits, Wage and Investment Division
SE:W:ETARC
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Director, Reporting Compliance, Wage and Investment Division SE:W:CP:RC
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Chief, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PEI
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
 Senior Operations Advisor, Wage and Investment Division SE:W:S
 Chief, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PEI



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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 18,220 taxpayers received the First-Time Homebuyer Credit (Homebuyer Credit) for a 2008 home purchase but were not included in the IRS’s Notice CP03a issuance file (see page 6).

Methodology Used to Measure the Reported Benefit:

Our review identified 18,220 taxpayers who received the Homebuyer Credit for a 2008 purchase but were not included in the IRS’s Notice CP03a issuance file. As a result, these taxpayers would not receive the Notice CP03a showing the amount of the credit the taxpayer would have to repay as additional tax for TY 2010. The 18,220 is the sum of 17,246 + 292 + 682 taxpayers.

- The 17,246 are secondary taxpayers on TY 2008 joint returns for which the Homebuyer Credit was claimed. However, these taxpayers filed as either single or head of household for TY 2009 with no cross-reference to the primary taxpayer they filed with for TY 2008. Notice CP03a was not issued to the 17,246 secondary taxpayers because their Homebuyer Credit Entity Section was included under the primary taxpayers Homebuyer Credit Entity Sections.
- The 292 are secondary taxpayer records of primary taxpayers who filed as either single or head of household on TY 2008 returns and claimed the Homebuyer Credit. These same taxpayers filed as single or head of household for TY 2009, but were also shown as a secondary taxpayer on TY 2009 returns for primary taxpayers filing as married filing separate. Notice CP03a was not issued to the 292 secondary taxpayers because their Homebuyer Credit Entity Section was included under the primary taxpayers Homebuyer Credit Entity Sections.
- The 682 are primary taxpayers who claimed the Homebuyer Credit on TY 2008 returns, but Notice CP03a was not issued to them.

To identify the 18,220 taxpayers, we obtained an extract of the Homebuyer Credit Entity Section for taxpayers claiming the credit through October 2, 2010, from TIGTA’s Information Services staff. We used computer analysis to identify 1,065,465 primary taxpayers



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and 478,468 secondary taxpayers with a 2008 home purchase year. We also obtained an IRS file of Notices CP03a and CP03b as of September 25, 2010, and used computer analysis to identify 1,506,259 Notices CP03a.

We matched the taxpayers with a 2008 home purchase year against the Notices CP03a and identified 10,552 primary and 21,038 secondary taxpayers who did not have a Notice CP03a. We eliminated 9,466 primary and 2,131 secondary taxpayers who had a deceased indicator, a credit amount of \$0, or a recapture amount that equaled the credit amount because a Notice CP03a would not be issued to taxpayers with these conditions. There were 1,086 primary and 18,907 secondary taxpayers remaining after these eliminations.

We used TIGTA's Data Center Warehouse to extract a file of taxpayers who received the Homebuyer Credit¹ for TY 2008 or TY 2009. We matched the Data Center Warehouse extract against the 18,907 secondary taxpayers and eliminated 1,661 secondary taxpayers who received the credit, or had an adjustment that changed a 2009 purchase to a 2008 purchase, after the IRS's notice file was created (September 25, 2010). The result was 17,246 taxpayers who filed as a secondary taxpayer on TY 2008 returns and claimed the Homebuyer Credit but no Notices CP03a were issued to them. We also determined that 292 of the taxpayers filed as a primary taxpayer on TY 2008 returns and claimed the Homebuyer Credit but no CP03a notices were issued to them.

We matched the Data Center Warehouse file against the 1,086 primary taxpayers and eliminated 404 primary taxpayers who received the credit, or had an adjustment that changed a 2009 purchase to a 2008 purchase, after the IRS's notice file was created (September 25, 2010). The result was 682 taxpayers who filed as primary taxpayers on TY 2008 returns and claimed the Homebuyer Credit but no Notices CP03a were issued to them.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 12,495 taxpayers received or would have received Notices CP03a that incorrectly showed the taxpayer's required repayment amount as \$0 when in fact these taxpayers had a repayment obligation (see page 6).

Methodology Used to Measure the Reported Benefit:

Our review identified 12,495 Notices CP03a that incorrectly showed the taxpayer's required repayment as \$0 when in fact these taxpayers had a repayment obligation. This occurred on records where the primary taxpayer on the Homebuyer Credit Entity Section did not have a credit, but the secondary taxpayer on the Homebuyer Credit Entity Section did.

¹ We used the Individual Master File and Other Modules Transactions Table on the TIGTA's Data Center Warehouse to extract records with Transaction Code 766 and Credit Reference Number 258, which are used to allow the Homebuyer Credit on a taxpayer's account.



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To identify the 12,495 taxpayers, we obtained an extract of the Homebuyer Credit Entity Section for taxpayers claiming the credit through October 2, 2010, from TIGTA's Information Services staff. We used computer analysis to identify 478,468 secondary taxpayers with a 2008 home purchase year. We eliminated 1,744 secondary taxpayers who had a \$0 credit amount. For the remaining 476,724 secondary taxpayers, we computed the annual repayment amount.²

We obtained an IRS file of Notices CP03a and CP03b as of September 25, 2010, and used computer analysis to identify 1,506,259 Notices CP03a. We matched the 476,724 secondary taxpayers against the Notices CP03a and identified 457,545 secondary taxpayers.

For the 457,545 secondary taxpayers, we compared the annual repayment amount that we computed using the Homebuyer Credit Entity Section data to the amount of credit to be repaid on the Notice CP03a. We identified 12,495 secondary taxpayers with an incorrect repayment amount of \$0 on Notice CP03a. In its response to our email alert, the IRS informed us that incorrect notices had been mailed to 8,609 taxpayers.

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 738 taxpayers who were identified as deceased; however, the IRS failed to suppress the issuance of notices to these taxpayers (see page 6).

Methodology Used to Measure the Reported Benefit:

Our review of an updated Notice Issuance File, dated December 25, 2010, identified that the IRS failed to suppress the issuance of notices to 738 of 1,326 deceased taxpayers identified in a prior review.³

Type and Value of Outcome Measure:

- Inefficient Use of Resources – Potential; \$135,333 cost of issuing 39,227 incorrect notices (see page 6).

Methodology Used to Measure the Reported Benefit:

The 39,227 is the sum of:

- 8,609 Notices CP03a with incorrect repayment amounts the IRS had already mailed.
- 27,728 Notices CP03a for individuals with an incorrect 2008 home purchase year.

² The annual repayment amount is the credit amount shown on the individual's Homebuyer Credit Entity Section divided by 15.

³ A *Comprehensive Strategy Is Being Developed to Identify Individuals With First-Time Homebuyer Credit Repayment Requirements* (Reference Number 2010-41-086, dated August 16, 2010).



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- 2,152 Notices CP03b for individuals with an incorrect 2009 purchase year.
- 738 Notices for deceased individuals.

We used the IRS's Fiscal Year 2010 cost estimate reference for the Notice Review function to calculate the cost of issuing the 39,227 incorrect notices. The Notice Review total cost estimate for 1,000 notices is \$3,451. The unit cost is \$3.45 (\$3,451 divided by 1,000). We multiplied the \$3.45 unit cost by the 39,227 incorrect notices for a total cost estimate of \$135,333.



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Appendix V

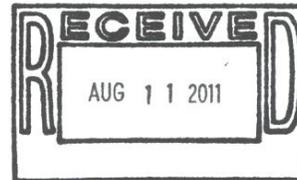
Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

August 11, 2011



MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report - First-Time Homebuyer Credit Repayment
Notices Were Incorrect, and the Method Used to Identify
Dispositions Is Unreliable (Audit # 201040107)

We have reviewed the subject draft audit report evaluating the effectiveness of the IRS processes to ensure the accurate and timely repayment of the First-Time Homebuyer Credit (FTHBC). As reflected in the report, the FTHBC posed administration challenges in that it was amended by three subsequent legislative provisions which changed the nature of the credit from a \$7,500 interest-free loan intended to assist qualifying individuals with the purchase of a home, to an \$8,000 credit that, generally, does not require repayment. The legislation does, however, include recapture provisions which will accelerate repayment of the \$7,500 if the taxpayer(s) dispose of the home, or it ceases to be the primary residence prior to the end of the fifteen-year repayment period. The \$8,000 credit is subject to repayment if a disposition occurs, or the home ceases to be the primary residence within three years from the date of purchase. The scope of the FTHBC was unprecedented in that it required the development of a comprehensive and balanced strategy to administer the credit amid the many unique situations that could trigger the recapture provisions, and to provide information to affected taxpayers to assist them in complying with their tax reporting obligations.

In developing our administrative plan, we considered sources of data available that would assist us in identifying taxpayers who might be subject to the recapture provisions. We considered internal data, such as updated address information when taxpayers file tax returns with a different address than was used the previous year and data provided on information returns from third-party reporters. We also considered and, eventually, decided on using county property records obtained from a third-party vendor because it was believed those records would provide the timeliest information to be used in identifying potential dispositions. Our education outreach efforts included, in part, the revision of forms and publications that addressed the provisions of the credit;



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posting information on our web site, IRS.gov; public service announcements; and, outreach efforts to taxpayers and the professional preparer communities. We also initiated a program that proactively focused educational activities on those taxpayers whom we identified as claiming the credit by sending them informational notices to inform them of the repayment and recapture provisions of the FTHBC. Through the notice program, we reached out to 5.2 million affected taxpayers and, despite some data and programming errors in this initial effort, achieved a 99 percent accuracy rate in providing correct information to the affected individuals.

Based on feedback obtained from the IRS Advisory Council, the tax return preparer and software development communities, and other various sources, we will be altering our strategy by discontinuing the use of Computer Paragraph (CP) Notices CP03a, *Repaying your First-Time Homebuyer Credit* and CP03b, *Courtesy message about your First-Time Homebuyer Credit*. We have determined a more cost-effective approach will be to provide a web-based utility on IRS.gov that will assist taxpayers in determining if they have a repayment or recapture requirement. This tool will be available to the public for the upcoming 2012 Filing Season.

For future implementation, a second part of our strategy is to review the returns of those taxpayers identified as having a disposition, who neglected to report the disposition on their return. We are completing our evaluation of the use of the third party vendor data and will consider the use of available internal data to address this group of taxpayers.

Our comments to your recommendations are attached. If you have any questions, please contact me, or a member of your staff may contact Robin L. Canady, Director, Strategy and Finance, at (404) 338-8801.

Attachment



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Attachment

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1

Ensure notice issuance programming accurately identifies individuals who should receive a Notice CP03a or CP03b and ensure information contained in these notices is accurate.

CORRECTIVE ACTION

We are discontinuing the use of Computer Paragraph (CP) Notices CP03a, *Repaying your First-Time Homebuyer Credit* and CP03b, *Courtesy message about your First-Time Homebuyer Credit*, and replacing them with a web-based tool that will be available to taxpayers for the 2012 Filing Season. We are publicizing the availability of the tool to the tax software and return preparer communities, and will conduct additional outreach to inform taxpayers for the Filing Season.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

Correct the purchase dates for the 2,535 tax accounts we identified as still having an incorrect purchase date recorded on their Homebuyer Credit Entity Section on the IRS's computer system.

CORRECTIVE ACTION

We agree with this recommendation, however, our preliminary reviews indicate that a high percentage of these accounts appear to be correct. Purchase dates have been updated from the original return values by subsequent examination or adjustment activity on the tax return. These accounts have been referred to our Accounts Management function, which is analyzing the accounts and making necessary corrections.

IMPLEMENTATION DATE

December 15, 2011

RESPONSIBLE OFFICIAL

Director, Accounts Management, Wage and Investment Division



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CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management control.

RECOMMENDATION 3

The Commissioner, Wage and Investment Division, should discontinue using third-party vendor data to identify individuals who may have disposed of their principal residence unless the reliability can be significantly improved. The IRS should develop a methodology that uses the IRS's tax return data and information to identify individuals who have an indication of a disposition of their principal residence.

CORRECTIVE ACTION

We agree with this recommendation. We will complete our evaluation of the use of the third-party vendor data and re-evaluate the use of our own internal data which was considered when our recapture strategy was first developed.

IMPLEMENTATION DATE

September 15, 2012

RESPONSIBLE OFFICIAL

Director, Earned Income Tax Credit, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

The IRS will monitor this corrective action as part of our internal management control.