



Treasury Inspector General for Tax Administration Office of Audit

THERE ARE BILLIONS OF DOLLARS IN UNDETECTED TAX REFUND FRAUD RESULTING FROM IDENTITY THEFT

Issued on July 19, 2012

Highlights

Highlights of Report Number: 2012-42-080 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Undetected tax refund fraud results in significant unintended Federal outlays and erodes the confidence in our Nation's tax system. Our analysis of tax returns using characteristics of IRS-confirmed identity theft identified approximately 1.5 million undetected tax returns with potentially fraudulent tax refunds totaling in excess of \$5.2 billion. TIGTA estimates the IRS could issue \$21 billion in potentially fraudulent tax refunds resulting from identity theft over the next five years.

WHY TIGTA DID THE AUDIT

This audit was initiated at the request of the Chairman of the Senate Finance Committee, Subcommittee on Fiscal Responsibility and Economic Growth. The overall objective of this review was to evaluate the effectiveness of the IRS's efforts to identify and prevent fraudulent tax refunds resulting from identity theft.

WHAT TIGTA FOUND

The impact of identity theft on tax administration is significantly greater than the amount the IRS detects and prevents. Using the characteristics of confirmed identity theft, TIGTA identified potentially fraudulent tax refunds in excess of \$5.2 billion that were issued by the IRS.

The IRS has expanded its efforts to detect and prevent identity theft. However, delayed access to third-party income and withholding information makes it difficult for the IRS to detect fraudulent tax refunds at the time tax returns are processed. Third parties are not required to submit income and withholding documents to the IRS until March 31, yet taxpayers can begin filing tax returns in mid-January.

While the IRS does not have access to all third-party information documents at the time tax returns are filed, some third-party information is available. However, the IRS has not developed processes to obtain and use this third-party information.

Lastly, the use of direct deposits, including debit cards, to claim fraudulent tax refunds also contributes to the increased risk that the IRS will not detect identity theft.

WHAT TIGTA RECOMMENDED

TIGTA made seven recommendations for the IRS Commissioner, Wage and Investment Division, to develop or improve processes that will increase the IRS's ability to detect and prevent the issuance of fraudulent tax refunds resulting from identity theft. In addition, TIGTA recommended legislation to expand the IRS's access to and authority to use the National Directory of New Hires database for the purposes of identifying identity theft.

The IRS agreed with TIGTA's recommendations and has taken or plans to take corrective actions. However, in view of its ongoing efforts to improve the detection of identity theft, the IRS did not agree with TIGTA's estimate of \$21 billion in potentially fraudulent refunds as a result of identity theft over the next five years. TIGTA agrees that the IRS's ongoing efforts will help reduce fraudulent refunds. As such, TIGTA's estimate of \$21 billion includes an annual reduction factor to reflect the dollar amount that the IRS estimated it protected by implementing new filters.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2012reports/201242080fr.pdf>