TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft

April 24, 2015

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2 = Risk Circumvention of Agency Regulation or Statute

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EFFORTS ARE RESULTING IN THE IMPROVED IDENTIFICATION OF FRAUDULENT TAX RETURNS INVOLVING IDENTITY THEFT

Highlights

Final Report issued on April 24, 2015

Highlights of Reference Number: 2015-40-026 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Identity theft continues to be a serious and evolving issue which has a significant impact on tax administration. Undetected tax refund fraud results in significant unintended Federal outlays and erodes taxpayer confidence in the Federal tax system.

WHY TIGTA DID THE AUDIT

This review is a follow-up to a September 2013 TIGTA audit report, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Reference Number 2013-40-122). The overall objective of this review was to determine the effectiveness of the IRS's ongoing efforts to detect and prevent identity theft at the time tax returns are processed.

WHAT TIGTA FOUND

TIGTA found that efforts continue to result in increased detection and prevention of identity theft tax returns. Nonetheless, the extent of the IRS's ability to stem this problem is still limited because it does not have access to third-party income and withholding information until well after tax return filing begins. The IRS continues to propose legislation to accelerate and expand its access to data that would further improve its detection efforts.

TIGTA's analysis of Tax Year 2012 tax returns identified 787,343 undetected potentially fraudulent tax returns with tax refunds totaling more than $2.1 billion that have the same characteristics as IRS-confirmed identity theft tax returns. In addition, TIGTA's analysis continues to identify multiple tax returns with the same addresses and/or bank accounts which were not identified by the IRS's cluster-filtering tool. This includes *****2********** **********2**********.

Further, efforts are needed to expand the detection of identity theft tax returns reporting ********2******. TIGTA's three-year analysis determined that **********2********** **********2********** **********2********** **********2**********.

Lastly, Individual Taxpayer Identification Numbers continue to be used to file potentially fraudulent tax returns. TIGTA identified more than 140,000 Tax Year 2012 tax returns filed by individuals using an Individual Taxpayer Identification Number that have the same characteristics as IRS-confirmed identity theft tax returns. These tax returns resulted in the issuance of approximately $375 million in potentially fraudulent tax refunds.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, continue to evaluate clustering filters to ensure that they properly identify tax returns with multiple uses of addresses and/or bank accounts; include ***2*** **********2**********in identity theft filter identification processes; expand identity theft filters to address the ****2******* **2***patterns that may indicate that a tax return is related to identity theft; and outline specific actions and time frames for implementation of a process to deactivate Individual Taxpayer Identification Numbers assigned prior to January 1, 2013, including Individual Taxpayer Identification Numbers assigned to individuals who are now deceased.

The IRS agreed with our recommendations. The IRS plans to continue to evaluate identity theft-related fraud trends and review fraud filter performance to improve its clustering process. These efforts would include analysis of potentially fraudulent refunds using ****2*** ****2****and those claiming ****2********** *****2******. The IRS also plans to develop an action plan to deactivate Individual Taxpayer Identification Numbers.

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

April 24, 2015

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft (Audit # 201440001)

This report presents the results of our review to determine the effectiveness of the Internal Revenue Service's (IRS) ongoing efforts to detect and prevent identity theft at the time tax returns are processed. This audit was included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Fraudulent Claims and Improper Payments.

The IRS notes in its response to the draft report that the projected losses of $26 billion over five years associated with undetected identity theft in our prior report[1] is not being realized. It should be noted that the amount we forecasted in the prior report was $21 billion. Furthermore, this estimate reflected the potential amount of fraudulent refunds that could be stopped if appropriate corrective action was taken. Our subsequent assessments have shown that this is indeed the case. The IRS is making improvements to better detect identity theft based on our previous recommendations. For example, the IRS reports that as of October 9, 2014, its cluster filtering tool identified 517,316 tax returns and prevented the issuance of approximately $3.1 billion in fraudulent tax refunds. This tool was developed in response to our continued identification of large volumes of undetected potentially fraudulent tax returns with tax refunds issued to the same address or deposited into the same bank account.

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

[1] Treasury Inspector General for Tax Administration, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (Jul. 2012).

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Russell P. Martin, Acting Assistant Inspector General for Audit (Returns Processing and Account Services).

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Abbreviations

e-file(d)	Electronically file(d)
IRS	Internal Revenue Service
ITIN	Individual Taxpayer Identification Number
NDNH	National Directory of New Hires
PY	Processing Year
SSA	Social Security Administration
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year

Background

Identity theft for the purpose of tax fraud occurs when an individual uses another person's name and Taxpayer Identification Number[1] (generally a Social Security Number (SSN)) to file a fraudulent tax return to obtain a fraudulent tax refund. Many individuals who are victims of this type of identity theft may be unaware that their identity has been used to file fraudulent tax returns. The individuals victimized are typically those who are not required to file a tax return.

However, for those individuals who are required to file a tax return, the identity theft goes unknown until the legitimate filer attempts to file a tax return resulting in a duplicate filing. This causes the Internal Revenue Service (IRS) to hold the legitimate return and places the burden on the taxpayer to prove his or her identity.

Prior Treasury Inspector General for Tax Administration (TIGTA) reports have identified billions of dollars in potentially fraudulent tax refunds resulting from identity theft

In July 2012,[2] TIGTA reported that while the number of fraudulent tax refunds the IRS detects and prevents is substantial, the IRS does not know the full scope of the fraud. For example, our analysis of Tax Year (TY) 2010 tax returns identified approximately 1.5 million undetected tax returns with potentially fraudulent tax refunds totaling in excess of $5.2 billion that had the characteristics of identity theft confirmed by the IRS. In September 2013,[3] we reported that in response to our July 2012 report, the IRS continued to expand its efforts to identify and prevent fraudulent tax refunds from being issued because of identity theft. Our analysis of TY 2011 tax returns identified approximately 1.1 million undetected tax returns filed using SSNs that have the same characteristics as IRS-confirmed identity theft tax returns. Potentially fraudulent tax refunds issued totaled approximately $3.6 billion.

In addition, we expanded our TY 2011 analysis to include tax returns for which the primary Taxpayer Identification Number on the return was an Individual Taxpayer Identification Number (ITIN). We identified more than 141,000 TY 2011 tax returns filed with an ITIN that have the same characteristics as IRS-confirmed identity theft tax returns involving an ITIN. Potentially fraudulent tax refunds issued for these undetected tax returns totaled approximately $385 million.

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[1] See Appendix IV for a glossary of terms.
[2] TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (Jul. 2012).
[3] TIGTA, Ref. No. 2013-40-122, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Sept. 2013).

The IRS's analysis measures its effectiveness in defending against identity theft

The IRS's Office of Compliance Analytics and Return Integrity and Compliance Services function initiated a research project in Calendar Year 2012 to assess the IRS's efforts to defend against identity theft and to identify areas requiring additional effort. This analysis identified that in the 2013 Filing Season, the IRS's efforts prevented between $22 billion and $24 billion in identity theft tax refunds from being issued. However, the IRS also reported that identity thieves were successful in receiving approximately $5.75 billion in fraudulent tax refunds.

The IRS's methodology is different than ours in two primary respects. The IRS's estimate of revenue loss resulting from identity theft includes tax returns in which a third-party document was received reporting a **********2********** ***2****. In addition, the IRS's estimate includes tax returns that have been reported by the victims or detected by other means and confirmed to have involved identity theft which resulted in an improper refund. Our analysis was performed to identify and quantify tax returns with characteristics of confirmed identity theft that the **********2********** **********2**********.

The IRS plans to continue to conduct this type of analysis to improve its identity theft detection efforts. For example, results from this analysis will be used to evaluate emerging patterns of identity theft, identify previously unknown patterns of identity theft, and identify new strategies for prevention. The IRS recognizes that new identity theft patterns are constantly evolving and, as such, it needs to continue to adapt its detection and prevention processes. We plan to assess the IRS's measures and its efforts to use its assessment to further improve detection of identity theft in a future review.

This review was performed as a follow-up review to the September 2013 TIGTA audit on identity theft and was performed with information obtained from the IRS Wage and Investment Division Accounts Management, Return Integrity and Compliance Services, and Submission Processing functions in Atlanta, Georgia, during the period June through November 2014. 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.

Results of Review

Efforts Continue to Result in Increased Detection and Prevention of Identity Theft Tax Returns

The IRS continues to make significant improvements in its identification of identity theft tax returns at the time the returns are processed and before fraudulent tax refunds are released. For example, the IRS reports that in the 2013 Filing Season, it detected approximately $24.3 billion in identity theft refund fraud. Figure 1 provides a comparison of identity theft tax returns filed and refund dollars prevented from being issued in the 2012 and 2013 Filing Seasons.

Figure 1: Revenue Protected by IRS Identity Theft Detection Processes

Filing Season	Tax Returns (Millions)	Identity Theft Tax Refunds Stopped (Billions)
2012	3.7	$21.6
2013	4.1	$24.3

Source: The IRS Return Integrity and Compliance Services function analysis of identity theft.

Figure 2 provides a summary of the actions the IRS is taking to continue to improve its detection of identity theft tax returns.

Figure 2: Actions Taken to Improve Detection of Identity Theft Tax Returns

Action Taken	Results
Expanding filters used to detect identity theft refund fraud at the time tax returns are processed.	• Processing Year (PY) 2012 – 11 filters were used to detect approximately 325,000 tax returns preventing the issuance of approximately $2.2 billion in fraudulent tax refunds. • PY 2013 – 80 filters were used to detect approximately 720,000 tax returns preventing the issuance of approximately $3.3 billion in fraudulent tax refunds. • PY 2014 – As of September 30, 2014, 114 filters were used to detect 832,412 tax returns preventing the issuance of approximately $5.5 billion in fraudulent tax refunds.

Action Taken	Results
Expanding the locking of tax account locks which result in the rejection of an electronically filed (e-filed) tax return (the IRS will not accept the tax return for processing) and prevent paper-filed tax returns from posting to the Master File if the SSN associated with the locked tax account is used to file a tax return.	• Between January 2011 and September 2014, the IRS locked approximately 26.3 million taxpayer accounts of deceased individuals. • PY 2012 – The IRS rejected 16,341 e-filed tax returns and stopped 588 paper-filed tax returns from posting to the Master File. • PY 2013 – The IRS rejected 442,743 e-filed tax returns and stopped 2,255 paper-filed tax returns from posting to the Master File. • PY 2014 – As of September 30, 2014, the IRS has rejected 338,807 e-filed tax returns and stopped 15,915 paper-filed tax returns from posting to the Master File.
Developing leads from its Identity Theft Clearinghouse. The Clearinghouse provides IRS Criminal Investigation with a central location to review and process identity theft leads to open investigations and provide information to improve identity theft filters.	• PY 2012 – The Clearinghouse received 2,341 identity theft leads that have resulted in the development of 322 investigations. • PY 2013 – The Clearinghouse received 1,894 identity theft leads that have resulted in the development of 211 investigations. • PY 2014 – As of September 30, 2014, the Clearinghouse has received more than 3,394 identity theft leads that have resulted in the development of 93 investigations.
Matching Social Security benefit and withholding reported on tax returns to information reported to the IRS by the Social Security Administration (SSA) when tax returns are processed.	• In response to a recommendation made in our July 2012 report, the IRS began matching Social Security benefit income and withholding reported on tax returns to information reported on the Forms SSA-1099, *Social Security Benefit Statement*, the IRS receives from the SSA when tax returns are processed. • This process has resulted in a reduction in the volume of undetected fraudulent identity theft tax returns claiming false SSA income and withholding: Tax Year / Return Total / Refunds Claimed 2010 / 93,142 / $231,692,282 2011 / 12,993 / $62,856,556 2012 / 3,064 / $8,151,222

Action Taken	Results
Establishment of the Law Enforcement Assistance Program. This program assists law enforcement in obtaining tax return information vital to their efforts in investigating and prosecuting cases of tax fraud identity theft. The program is available to law enforcement in all 50 States, the District of Columbia, Guam, the Northern Marianas Islands, Puerto Rico, and the U.S. Virgin Islands.	Processing of law enforcement requests for tax return information on identity theft cases: Fiscal Year / Law Enforcement Agencies / Waivers Processed 2012 / 49 / 811 2013 / 326 / 2,875 2014 / 550 / 3,090

Source: TIGTA's analysis of improvements.

In addition to the above actions, the IRS developed and implemented a clustering filter tool for use during the 2013 Filing Season. This tool was developed in response to TIGTA's continued identification of large volumes of undetected potentially fraudulent tax returns with tax refunds issued to the same address or deposited into the same bank account. The clustering filter tool groups tax returns based on characteristics that include the address, zip code, and/or bank routing numbers. For the tax returns identified, the IRS applies a set of business rules in an attempt to ensure that legitimate taxpayers are not included.

Tax returns identified are held from processing until the IRS can verify the taxpayer's identity. The IRS attempts to contact the individual who filed the tax return and requests information that will assist the IRS in ensuring that the individual filing the tax return is the legitimate taxpayer. Once a taxpayer's identity has been confirmed, the tax return is released for processing and the tax refund is issued. For those tax returns that the IRS is unable to confirm the individual's identity, it removes the tax return from processing which prevents the issuance of a fraudulent tax refund. As of October 9, 2014, the IRS reports that, using this tool, it identified 517,316 tax returns and prevented the issuance of approximately $3.1 billion in fraudulent tax refunds.

The IRS continues to propose legislation to accelerate income and withholding information and expanded access to wage employment data

Notwithstanding improvements in its detection efforts, the IRS still does not have timely access to third-party income and withholding information. Most of the third-party income and withholding information is not received by the IRS until well after tax return filing begins. For example, the deadline for filing most information returns with the IRS is March 31, yet taxpayers can begin filing their tax returns as early as mid-January each year. For the 2014 Filing Season, the IRS received approximately 90.8 million tax returns as of March 28, 2014. Legislation would be needed to accelerate the filing of the information returns.

In its Fiscal Year 2015 Revenue Proposal, the IRS again proposed legislation to accelerate the deadline for filing third-party income and withholding information returns and eliminate the

extended due date for e-filed information returns. The information returns would then be required to be filed with the IRS (or the SSA), in the case of Forms W-2, *Wage and Tax Statement*, by January 31. In addition, a Senate Bill introduced on July 31, 2014, proposed to enhance the ability of the IRS to identify and prevent fraudulent tax refund claims that are made through identity theft.[4] This bill also proposed that businesses be required to report employee compensation to the Government by January 31 each year.

In addition, the IRS continues to request expanded access to the National Directory of New Hires (NDNH). As we have previously reported,[5] expanded access to the NDNH would further improve the IRS's ability to identify tax returns with false income documents at the time tax returns are processed. The NDNH is a national database of wage and employment information. The NDNH database contains the following information:

- **New Hire File:** The New Hire File contains information on all newly hired employees reported by employers to each State Directory of New Hires. Federal agencies report directly to the NDNH.
- **Quarterly Wage File:** The Quarterly Wage File contains quarterly wage information on individual employees from the records of State workforce agencies and Federal agencies.
- **Unemployment Insurance File:** The Unemployment Insurance File contains unemployment insurance information on individuals who have received or applied for unemployment benefits as reported by State workforce agencies.

The Social Security Act, 42 U.S.C. Section 653 (i) (3), grants authority to the Secretary of the Treasury to use the Department of Health and Human Service's NDNH to verify an individual's claim of employment with regard to the Earned Income Tax Credit. The Act states:

> *The Secretary of the Treasury shall have access to the information in the National Directory of New Hires for purposes of administering section 32 of the Internal Revenue Code of 1986, or the advance payment of the earned income tax credit under section 3507 of such Code, and verifying a claim with respect to employment in a tax return.*

Although the IRS is granted the authority to use the NDNH to verify Earned Income Tax Credit claims, it does not have the authority to use these data to identify individuals who steal identities and submit tax returns with false income and withholding documents to the IRS for the sole purpose of receiving a fraudulent tax refund.

[4] S. 2736, *Tax Refund Theft Prevention Act of 2014*, 113th Congress (2013-2014), July 31, 2014.
[5] TIGTA, Ref. No. 2010-40-129, *Expanded Access to Wage and Withholding Information Can Improve Identification of Fraudulent Tax Returns* (Sept. 2010).

Analysis Identified Continued Reduction in Undetected Potentially Fraudulent Tax Returns

Our review of TY 2012 tax returns identified continued reductions in the volume of undetected tax returns with characteristics of IRS-confirmed identity theft cases. We identified 787,343 TY 2012 undetected potentially fraudulent tax returns with tax refunds totaling more than $2.1 billion.[6] Figure 3 summarizes our three-year analysis, including the types of ***2****2****reported.

Figure 3: Comparisons by Tax Year of Type of ********2******* on the Undetected Potentially Fraudulent Tax Returns***

Type of False Income Reported		TY 2010	TY 2011	TY 2012
2	Tax Returns	1,128,531	802,672	607,481
	Tax Refunds	$3,495,621,793	$2,354,349,943	$1,511,910,501
********2********* ******2***	Tax Returns	93,142	12,993	3,064
	Tax Refunds	$231,692,282	$62,856,556	$8,151,222
*******2******* *******2******* ********2****** ********2****** ******2****** ******2****	Tax Returns	154,729	204,522	175,191
	Tax Refunds	$531,293,018	$698,118,714	$611,279,472
*******2*****	Tax Returns	115,813	66,811	1,607
	Tax Refunds	$962,411,091	$497,081,019	$6,056,787
Total	**Tax Returns**	**1,492,215**	**1,086,998**	**787,343**
	Tax Refunds	**$5,221,018,184**	**$3,612,406,232**	**$2,137,397,982**

Source: TIGTA's analysis of TYs 2010, 2011, and 2012 tax returns.

The characteristics we used to identify these potentially fraudulent tax returns are based on IRS-confirmed identity theft tax returns and are the same characteristics we have used since we

[6] Although these tax returns met the characteristics of IRS-confirmed identity theft cases involving the use of an SSN, some potentially fraudulent tax returns we identified could also be the result of nonreporting of income and withholding by the employer or an individual using his or her own SSN to file a fraudulent tax return.

began this assessment of TY 2010 tax returns. Identity thieves and the characteristics they use to submit fraudulent tax returns continue to evolve. As such, the characteristics we use for our analysis are not all-inclusive. We have used our analyses for comparison to assess the IRS's efforts to improve its detection of identity theft tax returns. Figure 4 provides a summary of the characteristics of the SSNs used on the undetected tax returns we identified.

Figure 4: Characteristics of the Individuals Whose SSNs Were Used on Undetected Potentially Fraudulent Tax Returns

Characteristic	Tax Returns	Tax Refunds Issued
Children (under age 14)	1,814	$1,475,878
Citizens of U.S. Possessions	12,593	$58,242,049
Deceased Individuals	12,338	$22,239,751
Elderly Individuals (age 70 and over)	9,831	$14,304,433
**********2********** ******2**********[7]	559,181	$1,716,557,532
Prisoners	3,642	$7,439,615
Students (ages 16 to 22)	187,944	$317,138,724
Total	**787,343**	**$2,137,397,982**

Source: TIGTA's analysis of TY 2012 tax returns.

IRS management indicated that their review of the 787,343 tax returns we identified found that 366,136 would be identified as a likely fraudulent tax return involving identity theft. For another 348,669 tax returns, management indicated that based on their new "historical" exclusion processes developed in May 2013, the returns would still likely be excluded from review. For example, one of the exclusions removes tax returns when **********2********* **********2*****. For the remaining 72,538, the IRS did not review the tax returns for identity theft characteristics **********2********** **********2**********.

The historical exclusion process was not in place during the time the TY 2012 tax returns that we analyzed were processed. We have opened a separate audit to review the use of the exclusion criteria. Our review will include an assessment of the IRS's documentation and support for the development of the specific criteria to remove tax returns as having a low likelihood of identity theft fraud.

[7] This category contains tax returns filed with income claimed for which **********2********** that would indicate the legitimate taxpayers did not have a*********2**********.

When taxpayers file their tax returns after a fraudulent tax return has been filed, they often experience significant burden and delays

For those individuals who are required to file a tax return, it is not until the legitimate taxpayer files a tax return which results in a duplicate tax return filing under the same name and SSN that many individuals realize they are a victim of identity theft. When an identity thief files a fraudulent tax return before the legitimate taxpayer, the IRS does not yet know that the victim's identity will be used more than once. Once the legitimate individual files his or her tax return, the tax return is identified as a duplicate tax return and the refund is held until the IRS can confirm the taxpayer's identity. For TY 2012, we identified more than 158,000 SSNs that were used on multiple tax returns. We estimate that approximately $162 million in potentially fraudulent tax refunds were paid to identity thieves who filed tax returns before the legitimate taxpayers filed theirs.[8] This is in addition to the $2.1 billion in tax refunds noted previously from the undetected potentially fraudulent tax returns.

Improvements to the Clustering Filter Tool Are Needed to Better Identify Potentially Fraudulent Tax Returns With Common Characteristics

Our analysis of the TY 2012 potentially fraudulent undetected tax returns continues to identify multiple tax returns with the same addresses and/or bank accounts. Although the volumes associated with multiple tax return use of addresses and bank accounts have declined, we found that the cluster-filtering tool was not correctly identifying these types of tax returns. Figures 5 and 6 provide examples of the commonalities we identified.

[8] This estimate is based on the duplicate use of 43,051 primary SSNs where the tax refund was reversed.

Figure 5: Top 10 Addresses Used on Undetected Potentially Fraudulent Tax Returns

Address	Tax Returns	Tax Refunds Issued
Undetected Tax Returns Filed Using a Non-ITIN SSN		
Address 1 in Kilkenny, Ireland	580	$218,974
Address 2 in Kaunas, Lithuania	525	$156,274
Address 3 in Miami, Florida	417	$221,806
Address 4 in Dalgopol, Bulgaria	260	$124,944
Address 5 in Aksakovo, Bulgaria	160	$76,941
Address 6 in San Luis, Arizona	105	$347,629
Address 7 in Chicago, Illinois	96	$282,590
Address 8 in Miami, Florida	81	$40,500
Address 9 in Belle Glade, Florida	80	$55,043
Address 10 in Gabrovo, Bulgaria	80	$45,270
Total	**2,384**	**$1,569,971**

Source: TIGTA's analysis of TY 2012 tax returns.

Figure 6: Analysis of Multiple Deposits to the Same Bank Account

Direct Deposits Per Bank Account (one bank account per row)	Tax Refunds Deposited to the Account
Undetected Tax Returns Filed Using an SSN	
151	$602,175
135	$670,136
133	$798,839
120	$79,488
107	$374,919
Total	**$2,525,557**
Direct Deposits Per Bank Account (one bank account per row)	**Tax Refunds Deposited to the Account**
Undetected Tax Returns Filed Using an ITIN	
120	$340,966
105	$262,547
104	$296,672
91	$276,168
78	$192,378
Total	**$1,368,731**

Source: TIGTA's analysis of TY 2012 tax returns.

When we brought our concern about the undetected tax returns with commonalities in the addresses and bank accounts to IRS management's attention, they indicated that the filters created to identify clusters of tax returns with common characteristics for TY 2012 were not as effective as they could have been. The IRS indicated that improvements were made to the clustering filters used to identify potentially fraudulent TY 2013 tax returns.

**********2**********

Our review also identified that the IRS's **********2********** **********2********** ******2***. For example, we identified 3,898 tax returns filed for TY 2012 that had **2*** ****2**** and characteristics of IRS-confirmed identity theft tax returns, with some involving multiple uses of the same address and/or direct deposit account number. These tax returns had potentially fraudulent tax refunds totaling approximately $3.5 million. IRS management

indicated that tax returns with **********2********** **********2**********. However, IRS management noted that they are in the process of developing a strategy and models for identity theft tax returns filed ********2********* that have a high fraud potential.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Continue to evaluate clustering filters to ensure that they properly identify tax returns with multiple uses of addresses and/or bank accounts.

> ***Management's Response:*** The IRS agreed with this recommendation. An ongoing process is in place that provides for the evaluation of identity theft-related refund fraud trends and the review of fraud filter performance. As a result, improved clustering filters were activated for the 2015 Filing Season to consider fraud potential when multiple returns are filed using the same address and/or refunds are requested for the same bank account.

Recommendation 2: Include tax returns with ****2***** in identity theft filter identification processes.

> ***Management's Response:*** The IRS agreed with this recommendation. The process for evaluating fraud filter performance has been expanded to include an analysis of potentially **********2**********. The IRS will consider adjustments to the fraud detection filters, as supported by the data.

Expanded Efforts Are Needed to Better Detect Identity Theft Tax Returns Reporting ********2**********

While the IRS has improved the detection of potentially fraudulent tax returns reporting **2*** **********2********** **********2******continues to be a challenge. As detailed in Figure 3, this is an area in which the IRS has made the least amount of progress in its detection of potentially fraudulent tax returns, as identified in our analysis. For example, 175,191 (22 percent) of the 787,343 potentially fraudulent tax returns we identified as undetected involve individuals who claim only ***2*** on the tax return. In many instances, there is *********2********** **********2**********.

Our concern is that as detection efforts improve, fraudsters may shift their attempts to file fraudulent tax returns with **********2********** **********2**********. To identify opportunities in which the IRS could improve its identity theft filters to better identify the undetected tax returns claiming ***2*** **2**, we further analyzed the 175,191 tax returns. We compared filing patterns from these tax

returns to the total population of tax returns reporting ****2**** that the IRS could use to identify potentially fraudulent tax returns. Figure 7 shows a comparison of filing patterns of ******2******* reported on the potential identity theft tax returns we identified to the total population of tax returns reporting ******2********.

Figure 7: Filing Pattern Comparison – Undetected Potentially Fraudulent Tax Returns to All TY 2012 Tax Returns **********2*********

Characteristic	Tax Returns Reporting ******2*****[9]	Undetected Potentially Fraudulent Tax Returns
Tax returns with refund based primarily on ****2*******.	41%	<0.1%
Tax returns with refund based primarily on**********2****** ****2*********.	26%	99.4%
Tax returns reporting round numbers as *****2*****.	11%	24%
**********2********** **********2**********.	26%	49%

Source: TIGTA's analysis of TY 2012 tax returns.

For TY 2012, the IRS developed two identity theft filters in an attempt to identify fraudulently filed*********2******. One filter identified tax returns with a ********2**********, while the other filter identified tax returns with********2**********. However, the majority of the *******2******* potentially fraudulent tax returns we identified did not involve claims of **********2**********. While tax returns with **********2**********may be identified through the clustering filters, the filters do not address characteristics such as ***2*** **********2********** ****2*******. The IRS should consider expanding the characteristics used to detect ********2********* identity theft.

Recommendation

Recommendation 3: The Commissioner, Wage and Investment Division, should ***2*** **********2********** *******2**********.

[9] **********2********** **********2********** **********2**********.

Management's Response: The IRS agreed with this recommendation. The IRS will evaluate confirmed identity theft returns captured by the Taxpayer Protection Program during the 2015 Filing Season to identify trends and patterns associated with those containing ****2****. The fraud filters will be updated accordingly based on the results of its review.

Actions Continue to Be Delayed That Could Reduce Individual Taxpayer Identification Numbers Used to File Potentially Fraudulent Tax Returns

Despite our continued identification that many ITINs are being used to file tax returns for which there is no support for the income and withholding being reported, the IRS continues to delay and/or change its actions and criteria for deactivating ITINs assigned to individuals with no filing requirements. For example, our review identified 140,286 tax returns[10] filed for TY 2012 that had characteristics of IRS-confirmed identity theft tax returns filed by individuals using an ITIN with approximately $375 million in potentially fraudulent tax refunds.[11] There were 140,598 Taxpayer Identification Numbers used on the Forms W-2 associated with the 140,286 tax returns. Each of these tax returns had false income and withholding reported on the tax return. These results are similar to our previous analysis of TY 2011 returns in which we identified more than 141,000 tax returns filed with an ITIN that had the same characteristics as IRS-confirmed identity theft tax returns involving an ITIN. Potentially fraudulent tax refunds issued for these undetected tax returns totaled approximately $385 million. Figure 8 identifies specific characteristics of the Taxpayer Identification Numbers under which the income and withholding were reported on the tax returns we identified.

[10] The tax returns we identified were filed using an ITIN but often used an SSN related to another individual to report the false income and withholding on the tax return.

[11] Although these tax returns had the characteristics of the IRS-confirmed identity theft cases involving the use of an ITIN, some of the potentially fraudulent tax returns we identified could also be the result of misreporting of income and withholding by the employer or an individual obtaining an ITIN for the sole purpose of using the ITIN to file a fraudulent tax return.

Figure 8: Characteristics of the Taxpayer Identification Numbers Used to Report Income on the Undetected Potentially Fraudulent Tax Returns

Characteristic	Taxpayer Identification Numbers Used on Forms W-2
Children (under age 14)	6,003
Citizens of U.S. Possessions	525
Deceased Individuals	4,000
Elderly Individuals (age 70 and over)	2,677
IRS-Issued Identification Numbers[12]	100,734
Prisoners	66
Students (ages 16 to 22)	10,289
Individuals Not in Above Categories[13]	16,304
Total	**140,598**

Source: TIGTA's analysis of TY 2012 tax returns.

In response to our results, IRS management indicated that specific identity theft filters for tax returns filed using an ITIN are subjected to the same filters as non-ITIN-filed tax returns. IRS management believes these filters provide sufficient identity theft detection coverage.

TIGTA's analysis continues to show the majority of the ITINs used were assigned five years or longer

Implementing processes to deactivate ITINs will assist the IRS in reducing the likelihood that the ITIN could be used to file a fraudulent tax return. Such a process would support the IRS's policy that an ITIN is intended for tax purposes only and creates no inference regarding an alien individual's right to be legally employed in the United States or that individual's immigration status, *i.e.*, the ITIN does not authorize a foreign individual to work or live in the United States.

Figure 9 provides a breakdown related to the assignment year of the ITINs used on the potentially fraudulent tax returns we identified. It shows those ITINs assigned more than five years ago and those assigned within the last five years.

[12] This category consisted primarily of ITINs used on the Forms W-2, but there were also 339 Internal Revenue Service Numbers included in our population.
[13] The Taxpayer Identification Numbers in this category did not have identifiable characteristics that would indicate the taxpayer may not have a filing requirement.

Figure 9: Analysis of ITIN Assignment Year for the ITINs Used to File Undetected Potentially Fraudulent Tax Returns

ITIN Assignment Tax Year	Tax Returns	Tax Refunds Issued
ITINs More Than Five Years Old	88,500	$224,035,500
ITINs Five Years Old or Less	51,786	$150,856,148
Total	**140,286**	**$374,891,648**

Source: TIGTA's analysis of TY 2012 tax returns and the IRS's Real-Time System.

Our prior reports raised concerns that the IRS had not established a process to deactivate those ITINs assigned to individuals without a tax filing requirement. For example:

- In July 2012, TIGTA reported that the IRS had not established processes to identify and deactivate the ITINs. We recommended that the IRS develop a process to identify and deactivate the ITINs assigned to individuals who no longer have a tax filing requirement. In response, the IRS stated that the ITINs issued after January 1, 2013, will expire after five years. Individuals who still need an ITIN after the five-year expiration will have to reapply. The IRS also noted that it would continue to explore options for deactivating the ITINs assigned to individuals prior to January 1, 2013, who no longer have a tax filing requirement.
- In September 2013, we provided the IRS with a breakdown related to the assignment year of the ITINs used on the 141,000 potentially fraudulent tax returns we identified. It showed those ITINs assigned more than five years ago and those assigned within the last five years. Figure 10 provides an analysis performed for TY 2011 showing a breakdown related to the assignment year of the ITINs used on the potentially fraudulent tax returns we identified.

Figure 10: Analysis of ITIN Assignment Year for the ITINs Used to File Undetected Potentially Fraudulent Tax Returns

ITIN Assignment Tax Year	Tax Returns	Tax Refunds Issued
ITINs More Than 5 Years Old	84,821	$216,932,792
ITINs 5 Years Old or Less	56,241	$167,605,923
Total	**141,062**	**$384,538,715**

Source: TIGTA's analysis of TY 2011 tax returns and the IRS's Real-Time System.

To reduce the potential for tax filing fraud, we recommended that the IRS implement a process to deactivate the ITINs assigned to individuals prior to January 1, 2013, who no longer have a tax filing requirement. The IRS agreed with this recommendation, stating that an implementation team is addressing the deactivation process for the ITINs issued prior to 2013 and is developing an enterprise-wide process to accomplish that objective.

In June 2014, the IRS announced a new policy stating that the ITINs will expire if not used on a tax return for *any year* during a period of five consecutive years rather than the original policy that an ITIN would expire after five years. We plan to address the IRS's implementation of this new policy and the effects on reducing fraud during a subsequent review. When discussing the results of our analysis of TY 2012 tax returns, the IRS advised us of its plans to implement a process to deactivate the ITINs for deceased taxpayers when identified on final individual tax returns. Doing so should help the IRS continue to reduce the number of potentially fraudulent tax returns filed using an ITIN.

Recommendation

Recommendation 4: The Commissioner, Wage and Investment Division, to reduce the potential for tax filing fraud, should outline specific actions and time frames for the implementation of a process to deactivate the ITINs assigned to individuals prior to January 1, 2013. This should include those processes to identify and deactivate the ITINs assigned to individuals who are now deceased.

> ***Management's Response:*** The IRS agreed with this recommendation. The IRS is developing an action plan and projecting time frames to effect the implementation of the ITIN deactivation. The IRS has procedures to identify and lock the accounts of individuals when the IRS is informed of their deceased status, including individuals to whom ITINs have been assigned. For any ITIN account where third-party information is not available to disclose the individual's decedent status, the account will still be subject to the five-year deactivation process.

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine the effectiveness of the IRS's ongoing efforts to detect and prevent identity theft at the time tax returns are processed. To accomplish this objective, we:

I. Assessed the adequacy of the IRS's implementation of corrective actions in response to our September 2013 audit report.[1]

A. Identified approximately 787,000 potentially fraudulent tax returns filed with an SSN by identity thieves for TY 2012 using criteria used in prior TIGTA audit reports[2] **********2********** **********2********** *********2**********. In addition to our cases with an SSN, we identified more than 140,000 records filed with an ITIN.

1. Analyzed Data Center Warehouse files and TIGTA Office of Investigations' Strategic Data Services extracted data to identify potential identity theft tax returns filed for TY 2012. We identified populations, *e.g.*, elderly, children, deceased, *etc*., vulnerable to identity theft who have filed for a refund for TY 2012.

2. Stratified identified populations by applicable fields such as wages, tax refunds, number of ITINs, multiple tax returns using the same address, and multiple direct deposits into the same bank account.

3. Analyzed the population of TY 2012 identity theft tax returns for similar income combinations used to file more than one tax return. We considered the following fields: **********2********** ****2******.

B. Compared the TY 2012 population of potential identity theft tax returns to the population identified during the prior audits. For each strata identified, we compared the number of potentially fraudulent tax returns identified to the number identified in the prior audits.

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[1] TIGTA, Ref. No. 2013-40-122, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Sept. 2013).

[2] TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (Jul. 2012) and TIGTA, Ref. No. 2013-40-122, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Sept. 2013).

II. Determined if individuals committed identity theft by altering the characteristics in an effort to circumvent processes the IRS is implementing to detect identity theft tax returns.

III. Assessed the status of the IRS's efforts to use expedited wage and withholding data and determined that the IRS believes access to third-party data and an acceleration in receiving income and withholding information is essential to fighting identity theft; however, it needs congressional approval for both.

IV. Identified control breakdowns that continue to result in the issuance of fraudulent tax refunds resulting from identity theft that were identified in the potential identity theft cases.

A. Evaluated the tax returns suspected of identity theft and determined why these tax returns were not captured by the identity theft filters.

B. Used the characteristics of the approximately 787,000 tax returns identified as suspected identity theft tax returns to assess the adequacy of the IRS's implementation of corrective actions and whether inadequate implementation continues to result in fraudulent tax refund issuance, *i.e.*, lack of a process to use **********2**********, information and multiple tax refunds continuing to be sent to the same address/bank account.

C. Assessed the IRS's clustering categories based on tax returns identified in Step I.A. to determine if the IRS is effectively using clustering techniques.

D. Determined the status of the IRS obtaining, or preparing to obtain, access to third-party income and withholding information (notably the NDNH).

V. Assessed the status of the IRS's proactive initiatives to identify and prevent fraudulent tax refunds resulting from identity theft.

A. Determined the status of the IRS's implementation of identity theft filters used to identify fraudulent tax returns at the time of tax return processing.

B. Determined the status of the IRS's efforts to continue to expand the locking of tax accounts, including those of deceased taxpayers and individuals without a tax filing requirement.

1. Evaluated the IRS's efforts to place locks on deceased taxpayer accounts by determining if deceased taxpayer SSNs identified in Step I.A. received a fraudulent refund because a lock was not placed on the deceased taxpayer's account.

2. Evaluated the IRS's efforts to place locks on all accounts with no filing requirements, such as the elderly and children.

C. Determined the status of the IRS's efforts to combat identity theft through procedures implemented to strengthen the ITIN program requirements.

Data validation methodology

During this review, we relied on data extracted from the IRS's Individual Returns Transaction File for PY 2013, the Individual Master File for TY 2012, the National Account Profile database, the Form W-2 File for TY 2012, the Modernized Tax Return Database, the Direct Deposit Database, and the Real-Time System database located on the TIGTA Data Center Warehouse. We also relied on a data extract from the IRS's Information Returns Master File database for TY 2012 that was provided by the TIGTA Office of Investigations' Strategic Data Services. Before relying on our data, we ensured that each file contained the specific data elements we requested. In addition, we selected random samples of each extract and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System. Based on the results of our testing, we believe that the data used in our review were reliable.

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 that the following internal controls were relevant to our audit objective: the internal controls prescribed by the IRS's Internal Revenue Manual sections that the IRS Accounts Management and Submission Processing functions use to process identity theft tax returns. We evaluated those internal controls by interviewing management and reviewing policies and procedures. We also conducted tests of the IRS's procedures to prevent identity theft tax returns from being processed.

Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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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:PEI

Appendix IV

Glossary of Terms

Term	Definition
Accounts Management	The Accounts Management organization is responsible for taxpayer relations by answering tax law/account inquiries and adjusting tax accounts. In addition, it is responsible for providing taxpayers with information on the status of their returns/refunds, and for resolving the majority of issues and questions to settle their accounts.
Calendar Year	The 12-consecutive-month period ending on December 31.
Data Center Warehouse	A collection of IRS databases containing various types of taxpayer account information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.
Federal Trade Commission	The primary Federal agency responsible for receiving identity theft complaints.
Filing Season	The period from January through mid-April when most individual income tax returns are filed.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Form W-2 File	An extract from the Data Center Warehouse of Form W-2, *Wage and Tax Statement*, information filed by employers from the Information Returns Master File database.
Individual Master File	An IRS database that maintains transactions or records of individual tax accounts.
Individual Returns Transaction File	An IRS database containing transcribed tax returns for individuals that includes most forms and schedules.
Individual Taxpayer Identification Number	The IRS created this Taxpayer Identification Number for individuals who do not have and are not eligible to obtain an SSN.
Information Returns Master File	An IRS database that contains third-party information documents for taxpayers, such as Forms W-2 and Forms SSA-1099, *Social Security Benefit Statement*.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.

Term	Definition
Internal Revenue Manual	Provides procedural guidance for IRS operations.
Internal Revenue Service Number	A temporarily assigned number used as an internal identifying number until a permanent Taxpayer Identification Number is supplied.
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.
Modernized Tax Return Database	The legal repository for original e-filed tax returns received by the IRS through the Modernized e-File system.
National Account Profile Database	A compilation of selected entity data from various Master Files that also includes data from the SSA.
Processing Year	The calendar year in which the tax return or document is processed by the IRS.
Real-Time System	The IRS system that houses ITIN application information.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
Taxpayer Identification Number	A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, it can be an Employer Identification Number, an SSN, or an ITIN.

Appendix V

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

FEB 24 2015

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Debra Holland Debra S. Holland
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Efforts Are Resulting in the Improved Identification of Fraudulent Tax Returns Involving Identity Theft (Audit # 201440001)

Thank you for the opportunity to review and provide comments on the subject draft report. Identity Theft (IDT) refund fraud is one of the most significant and pervasive threats confronting the United States tax system and the taxpaying public it serves. As the report shows, the IRS has made significant progress in recent years in our ability to detect and stop IDT-related refund fraud. The 2013 filing season, during which Tax Year 2012 returns were received and processed, was a period when many of our initial improvements to detection tools and processes were implemented. For the 2013 filing season, existing fraud filters were updated and refined, based on observations of their performance in prior years, and a substantial number of new filters were added to address the ever-evolving nature of IDT fraud. The performance of the fraud filters is continuously evaluated during and after each filing season, and they are modified, as necessary, to recognize and address emerging trends in IDT-related refund fraud schemes. Our detection abilities have also been supplemented by leveraging information obtained from expanded partnerships with financial institutions and law enforcement agencies investigating and addressing IDT activities.

As a result of our actions, the number of fraudulent returns filed by identity thieves that are detected and stopped by the IRS has increased over the years. While some fraudulent returns can evade detection until such time as the legitimate taxpayers attempt to file their returns, we note that the number of incidents where identity theft is first detected by the IRS, rather than the victimized taxpayers, has increased. Consequently, we believe that the statements included in the "Background" and "Results of Review" sections of the report, which describe the act of identity theft as being unknown until the legitimate filer attempts to file a return, are overly broad generalizations. Improvements in our ability to detect fraudulent returns as they are filed and processed have led to commensurate improvements in our ability to inform potential victims and provide assistance to them prior to their filing.

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For Tax Year 2013 return processing, we implemented a systemic change in our processing and recordation systems that permits a discovered IDT return to be completely removed from the legitimate taxpayer account. This further serves to reduce burden on the victims by preventing a duplicate filing condition from occurring.

We analyzed the 787,343 returns the Treasury Inspector General for Tax Administration (TIGTA) identified as undetected potentially fraudulent tax returns. Our analysis found that 54 percent should not be considered as undetected fraud. Of that population, 72,538 returns claimed refunds below the tolerance level used to determine if treatment would be an efficient use of limited resources. Another 348,669 returns were found to have met exclusion criteria built into the evaluative process. Exclusions to the various filter rules are applied, based on analysis of historical results, to reduce the probability that returns of legitimate taxpayers will be captured and identified as potential IDT. We agree that the remaining 366,136 returns are potentially fraudulent IDT filings. Those returns have been further analyzed and the findings incorporated into adjustments made to improve the filter accuracy.

We agree with the TIGTA's recommendation for continued evaluation of the data clustering algorithms used in concert with the fraud detection filters; however, we do not fully agree with the presentation of the addresses shown in Figure 5: Top 10 Addresses Used on Undetected Potentially Fraudulent Tax Returns. Our analysis of returns filed from the addresses listed found that four of the five domestic addresses do appear to be questionable; however the remaining domestic address was the primary address of a centralized mail box store, with sub-box numbers recorded as part of the second name field in the data record. Similarly for the five ***2***, the second name field contained either additional address detail or the name and address of the tax return preparation firms. Many of the returns filed from ******2******* were **********2********** **********2**********. Typically, exchange students who have been authorized to work while in the United States file ******2****** to request a refund of income tax withheld from their wages. **********2********** **********2**********.

We also agree that the use of the same bank account when requesting an electronic deposit of the refund is an indicator of potential fraud. In addition to using the bank account as a data point for clustering analysis during fraud filtering, we have also implemented a new control, effective for the 2015 filing season, that will not permit more than three deposits to be sent electronically to the same bank account. If an IDT return is able to avoid detection by the fraud filters, the new control will stop the electronic transfer and issue the refund on a paper check for the fourth and subsequent refunds to the taxpayer's address of record. While this is a secondary control that will not stop a potentially fraudulent refund that has avoided detection by other processes, it will eliminate a substantial amount of opportunity for the identity thief and improve the ability to recover refunds through returned checks.

The IRS acknowledges the work the TIGTA has done previously in reporting on the use of Individual Taxpayer Identification Numbers (ITINs) for the commission of IDT refund fraud. It is important to note, however, that ITINs are assigned for tax administration purposes, to individuals who are otherwise ineligible for assignment of a Social Security Number (SSN). The ITINs are used by both non-resident and resident aliens who have United States tax reporting and payment obligations. Resident aliens who apply for, or have applied for and received, an ITIN may be undocumented workers who are not legally employed in the United States. The Tax Code does not distinguish between legitimate and illegitimate employment. All income derived from all sources whatsoever, unless otherwise exempted, is reportable and taxable. This includes the earnings of undocumented workers regardless of potential violations of labor or immigration law. In many cases, employers aid and abet the undocumented workers, willingly or unwillingly, by failing to verify the identity or work status of the individuals. Consequently, it is not uncommon for wage and withholding documents of ITIN holders either not to be filed by the employers or to be filed under an SSN belonging to another individual, and to have the appearance of an IDT scenario.

In 2012, the IRS implemented procedures to provide for the expiration of ITINs issued after 2013. In determining the actions needed to deactivate those issued prior to 2013, administrative challenges were encountered that required a modified approach to ensure the program continued to meet its objective of ensuring effective tax administration for the population of taxpayers ineligible for SSNs, while removing from use those ITINs that could potentially be used to commit refund fraud. As noted in the report, changes to the original expiration plan were announced in June 2014. We are developing the action plan that will lead to implementation of an ITIN deactivation process by 2017. We are also working to refine processes for identifying ITINs used for fraudulent purposes and deactivating them.

Finally, while Outcome Measures are not included in this report, we note that the projected $26 billion in losses over five years associated with undetected identity theft, which is often cited by third parties and the news media, are not being realized. The $5.2 billion in undetected identity theft losses determined for Tax Year 2010 fell to $3.6 billion when Tax Year 2011 returns were analyzed. The analysis of Tax Year 2012, addressed in this report, estimates losses of $2.1 billion; however, as we have noted, our analysis of the exception returns identified by the TIGTA indicates that 54 percent of the returns comprising that estimate should not be considered as undetected identity theft returns because the returns either met specific exclusion criteria or the refund amounts were below the tolerance amount for treatment by limited resources. Based on our preliminary analysis of Tax Year 2013 returns and our preparations for the current filing season, we believe the actual five-year outcome results will be significantly less than the originally projected amount.

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Attached is our response to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Jodi L. Patterson, Director, Return Integrity and Compliance Services, Wage and Investment Division, at (404) 338-8961.

Attachment

Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1
Continue to evaluate clustering filters to ensure that they properly identify tax returns with multiple uses of addresses and/or bank accounts.

CORRECTIVE ACTION
An ongoing process is in place that provides for the evaluation of identity theft-related refund fraud trends and the review of fraud filter performance. As a result, improved clustering filters were activated for the 2015 filing season to consider fraud potential when multiple returns are filed using the same address and/or refunds are requested for the same bank account.

IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Return Integrity and Compliance Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2
Include tax returns with ********2********** in identity theft filter identification processes.

CORRECTIVE ACTION
The process for evaluating fraud filter performance has been expanded to include an analysis of potentially fraudulent returns using ******2********. We will consider adjustments to the fraud detection filters, as supported by the data.

IMPLEMENTATION DATE
February 15, 2016

RESPONSIBLE OFFICIAL
Director, Return Integrity and Compliance Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

2

Recommendation

RECOMMENDATION 3
The Commissioner, Wage and Investment Division, should **********2********** **********2**********.

CORRECTIVE ACTION
We will evaluate confirmed identity theft returns captured by the Taxpayer Protection Program during the 2015 filing season, to identify trends and patterns associated with those containing **********2**********2**********. The fraud filters will be updated accordingly, based on the results of our review.

IMPLEMENTATION DATE
February 15, 2016

RESPONSIBLE OFFICIAL
Director, Return Integrity and Compliance Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

Recommendation

RECOMMENDATION 4
The Commissioner, Wage and Investment Division, to reduce the potential for tax filing fraud, should outline specific actions and time frames for the implementation of a process to deactivate the ITINs assigned to individuals prior to January 1, 2013. This should include those processes to identify and deactivate the ITINs assigned to individuals who are now deceased.

CORRECTIVE ACTION
We are developing an action plan and projecting time frames to effect the implementation of the Individual Taxpayer Identification Number (ITIN) deactivation. The IRS has procedures to identify and lock the accounts of individuals when we are informed of their deceased status, including individuals to whom ITINs have been assigned. For any ITIN account, where third-party information is not available to disclose the individual's decedent status, the account will still be subject to the five-year deactivation process.

IMPLEMENTATION DATE
June 15, 2015

3

RESPONSIBLE OFFICIAL
Director, Submission Processing, Customer Account Sevices, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.