



*Evaluation of the Computation of Economic  
Stimulus Payments*

**September 4, 2008**

**Reference Number: 2008-40-174**

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.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 4, 2008

**MEMORANDUM FOR** DEPUTY COMMISSIONER FOR OPERATIONS SUPPORT  
DEPUTY COMMISSIONER FOR SERVICES AND  
ENFORCEMENT

A handwritten signature in black ink, appearing to read "Michael R. Phillips".

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

**SUBJECT:** Final Audit Report – Evaluation of the Computation of Economic  
Stimulus Payments (Audit # 200840030.02)

This report presents the results of our review to assess the accuracy of the Internal Revenue Service's (IRS) computation of the economic stimulus payment and the adequacy of controls to prevent ineligible individuals from receiving a payment. The scope of this review was limited to an assessment of controls established and economic stimulus payments generated by the IRS as of June 13, 2008. This review is the second in a series of reviews designed to provide Congress with an ongoing status of the IRS' implementation of the Economic Stimulus Act of 2008.<sup>1</sup>

*Impact on the Taxpayer*

Signed on February 13, 2008, the Economic Stimulus Act of 2008 was passed to energize the national economy. The most significant part of the Act is the economic stimulus payment to individuals. Our analysis of 129.1 million economic stimulus payments generated as of June 13, 2008, determined that the IRS correctly calculated 128.5 million stimulus payments (99.6 percent) totaling \$89.2 billion. In addition, IRS programs ensured that payments were not issued to individuals who were not entitled to receive an economic stimulus payment.

*Synopsis*

As required in the Economic Stimulus Act of 2008, specific filing and income requirements must be met for an individual to qualify for an economic stimulus payment. For example, an

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<sup>1</sup> Pub. L. 110-185, 122 Stat. 613.



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individual must have an income tax liability or at least \$3,000 in qualifying income,<sup>2</sup> must file a Tax Year 2007 return with a valid Social Security Number, and cannot be claimed on another person's tax return. The economic stimulus payment also phases out as an individual's income increases.

In preparation for computing the amount that individuals would receive for an economic stimulus payment, the IRS was required to take a number of actions. These include:

- Coordinating with the Department of the Treasury to ensure correct interpretation of the law.
- Obtaining and reviewing the specific language included in the law to identify requirements that must be met to qualify for an economic stimulus payment.
- Developing computer programming to identify characteristics included on a tax return that result in an individual not qualifying for an economic stimulus payment.
- Developing computer programming to identify characteristics included on a tax return to be used to calculate the economic stimulus payment.

***Significant computer programming was required to enable the IRS to compute economic stimulus payments based on characteristics included on tax returns.***

The IRS correctly calculated 99.6 percent of the 129.1 million economic stimulus payments we reviewed. In addition, IRS programs ensured that payments were not issued to individuals who were not entitled to receive an economic stimulus payment. These include individuals who 1) did not have a valid Social Security Number; 2) did not meet qualifying income, gross income, and net tax liability requirements; 3) had income that exceeded requirements; and 4) indicated that they can be claimed by someone else on a tax return.

Although the accuracy rate for economic stimulus payments was very high, we identified 539,550 returns (0.4 percent) for which our calculation of the payment and the IRS' calculation did not agree. Most of the differences we identified resulted from business decisions made by the IRS in concurrence with the Department of the Treasury, taxpayer errors, and/or tax software errors.

During the course of this review, we monitored a number of other issues related to economic stimulus payments. The issues were monitored to identify the cause and actions taken by the IRS to address the concerns, which included duplicate paper tax returns filed only to claim the economic stimulus payment, Understanding Your Economic Stimulus Payment (Notice 1378)

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<sup>2</sup> Wages; tips; net self-employment earnings; nontaxable combat pay; and some Social Security, Veterans Affairs disability, and Railroad Retirement benefits are types of qualifying income.



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sent to the wrong individuals, direct deposits sent to the wrong bank accounts, and missing Refund Anticipation Loan<sup>3</sup> indicators.

The next phase of our assessment will evaluate IRS efforts to ensure that 1) all individuals entitled to an economic stimulus payment receive one, and 2) the IRS complies with the provision of the law that prevents issuance of economic stimulus payments after December 31, 2008. Our assessment will also evaluate IRS efforts to implement provisions included in the Heroes Earnings Assistance and Relief Act of 2008,<sup>4</sup> which the President signed into law on June 17, 2008. The Act amends the Economic Stimulus Act of 2008 so that thousands of military personnel will receive an economic stimulus payment regardless of whether they, their spouses, or their children have valid Social Security Numbers.

### *Response*

We made no recommendations in this report. IRS management agreed that the accuracy rate for the economic stimulus payments was very high. Management's complete response to the draft report is included as Appendix IV.

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

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<sup>3</sup> A Refund Anticipation Loan is a short-term loan based on the taxpayer's expected income tax refund and is a contract between the taxpayer and a lender.

<sup>4</sup> Pub. L. 110-245, 122 Stat 1624.



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*Abbreviations*

IRS	Internal Revenue Service
RAL	Refund Anticipation Loan



## *Background*

The Economic Stimulus Act of 2008,<sup>1</sup> signed on February 13, 2008, was passed to energize the national economy. The most significant part of the Act is the economic stimulus payment to individuals, which is a credit for Tax Year 2008.

The payments are being estimated using information reported on Tax Year 2007 tax returns and issued in 2008<sup>2</sup> so individuals can benefit from the payments as soon as possible. Individuals who qualify for a larger economic stimulus payment as a result of changes between their Tax Years 2007 and 2008 returns will receive the additional payment

***As of June 13, 2008, the Department of the Treasury had issued about 76.5 million economic stimulus payments totaling approximately \$63.9 billion.***

when they file their Tax Year 2008 returns (generally between January and April 2009). Individuals who receive more than they would have if the payment had been calculated using information from their Tax Year 2008 returns will not be asked to pay back the excess. The economic stimulus payment will not increase the amount of tax an individual owes or reduce an individual's refund for Tax Year 2008. The Department of the Treasury issued the first economic stimulus payments via direct deposit on April 28, 2008.

Included in the language of the Act are specific filing and income requirements that an individual must meet to qualify for an economic stimulus payment. For example, an individual must have

***To receive an economic stimulus payment, individuals must have a valid Social Security Number and not be claimed on another person's tax return.***

an income tax liability or at least \$3,000 in qualifying income,<sup>3</sup> must file a Tax Year 2007 return with a valid Social Security Number, and cannot be claimed on another person's tax return. The economic stimulus payment also phases out as an individual's income increases. The amount of the payment will be reduced by 5 percent of every \$1,000 that an individual's adjusted gross income<sup>4</sup> is greater than \$75,000 (\$150,000 for married couples). In addition, residents of the five United States Possessions

who file a U.S. Individual Income Tax Return (Form 1040 series) should not receive an economic stimulus payment from the Department of the Treasury. These individuals will receive

<sup>1</sup> Pub. L. 110-185, 122 Stat. 613.

<sup>2</sup> Unless otherwise noted, all dates in this report are calendar year.

<sup>3</sup> Wages; tips; net self-employment earnings; nontaxable combat pay; and some Social Security, Veterans Affairs disability, and Railroad Retirement benefits are types of qualifying income.

<sup>4</sup> Adjusted gross income is total income minus adjustments.



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their payments from their provisional Governments under a separate provision of the Economic Stimulus Act of 2008.

In preparation for computing the amount that individuals would receive for an economic stimulus payment, the Internal Revenue Service (IRS) was required to take certain actions, including:

- Coordinating with the Department of the Treasury to ensure correct interpretation of the law.
- Obtaining and reviewing the specific language included in the law to identify requirements that must be met to qualify for an economic stimulus payment.
- Developing computer programming to identify characteristics included on a tax return that result in an individual not qualifying for an economic stimulus payment.
- Developing computer programming to identify characteristics included on a tax return to be used to calculate the economic stimulus payment.

Most individuals who included their bank account information on their tax returns had their economic stimulus payment directly deposited into their bank accounts. However, the IRS noted that a paper check would be sent to an individual who:

- Did not include bank account information on the tax return.
- Used a Refund Anticipation Loan (RAL).<sup>5</sup>
- Had the return preparation fees paid out of his or her tax refund (commonly called a Refund Anticipation Check).

The IRS' policy is to issue paper economic stimulus checks to these individuals to ensure that the payments are received by the individual instead of the financial institution or tax preparer who provided a RAL or a Refund Anticipation Check.

This review was performed at the IRS National Headquarters in the Wage and Investment Division and the Modernization and Information Technology Services organization in Washington, D.C., during the period April through July 2008. 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 finding and conclusions based on our audit objective. The scope of this review was limited to an assessment of the controls in place and economic stimulus payments generated by the IRS as of June 13, 2008. However, we present the most current data available from the IRS or the Department of the Treasury when

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<sup>5</sup> A Refund Anticipation Loan is a short-term loan based on the taxpayer's expected income tax refund and is a contract between the taxpayer and a lender.





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possible. We will continue to assess the IRS' actions as it progresses with issuance of economic stimulus payments. 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

### The Accuracy Rate for Economic Stimulus Payments Was Very High

Based on our analysis of 129.1 million economic stimulus payments generated as of June 13, 2008, the IRS correctly calculated 128.5 million stimulus payments (totaling \$89.2 billion), which is a 99.6 percent accuracy rate. In addition, IRS programs ensured that payments were not issued to individuals who were not entitled to receive an economic stimulus payment. These include individuals who 1) did not have a valid Social Security Number; 2) did not meet qualifying income, gross income, and net tax liability requirements; 3) had income that exceeded requirements; and 4) indicated that they can be claimed by someone else on a tax return.

**Controls prevented ineligible individuals from receiving an economic stimulus payment.**

Although the accuracy rate for economic stimulus payments was very high, we identified 539,550 returns (0.4 percent) for which our calculation of the payment and the IRS' calculation did not agree. These differences include:

- 375,931 returns for which individuals did not receive \$142.4 million in Additional Child Tax Credits they were entitled to. Taxpayer and/or tax preparation software errors resulted in these individuals not receiving the child portion of the economic stimulus payment. These errors relate to not checking the Child Tax Credit qualifying child box on their tax returns as required.<sup>6</sup> The IRS initially responded that it could not allow the child portion of the economic stimulus payment in these instances because eligibility for the Child Tax Credit cannot be determined from information on the tax return. The IRS subsequently announced that it will issue the additional child portion of the economic stimulus payment to these individuals in July 2008.

The IRS is currently issuing “recovery” payments to 218,533 individuals. We will be assessing the differences between our figures and those of the IRS as part of the next phase of our review. The difference primarily results from the IRS sending payments to only those individuals who had listed children but had not checked the Child Tax Credit qualifying box for any child listed. The IRS will not send a recovery payment to a taxpayer who had

<sup>6</sup> The IRS determined that some tax preparation software used by tax preparers did not check the Child Tax Credit qualifying child box on the return when 1) the child qualified for the Credit, but 2) the taxpayer could not claim it because his or her income was above the Child Tax Credit phaseout range. We considered these taxpayer errors because the taxpayers signed the returns.



checked the Child Tax Credit qualifying box for one child but not for another child listed. Our identification included any child who 1) was listed without the Child Tax Credit qualifying box checked, 2) met the relationship, and 3) was under age 17.

- 129,488 economic stimulus payments totaling approximately \$68 million that should not have been paid but were paid because programming did not include qualified self-employment losses in the determination of eligibility. The IRS, with the Department of the Treasury's concurrence, is computing self-employment income by applying a multiplier against the deduction for self-employment tax reported on the tax return instead of applying the multiplier against the actual self-employment income or loss reported on various tax schedules. The IRS and the Department of the Treasury indicated that they were aware that this methodology did not address losses on Form 1040 Profit or Loss From Business (Schedule C) and Profit or Loss From Farming (Schedule F). The Department of the Treasury chose to use the self-employment tax deduction method because, given the time available, programming the calculation of the economic stimulus payment for every possible self-employment scenario would have been too complex. The Department of the Treasury indicated that the method it is using would result in a correct payment for most individuals.

However, we raised the same concern in our review of the 2003 Child Tax Credit advance payment.<sup>7</sup> The IRS used the same method to estimate self-employment income in its calculation of the Child Tax Credit advance payment resulting from enactment of the Jobs and Growth Tax Relief Reconciliation Act of 2003.<sup>8</sup> In that review, we estimated that 91,000 taxpayers received approximately \$39 million in Child Tax Credit advance payments that they were not entitled to because the IRS did not include losses reported on the Schedules C and F.

- 33,658 returns for which taxpayers did not receive \$19.4 million they were entitled to because of the Department of the Treasury decision to use the self-employment tax deduction reported on the tax return to estimate self-employment income. The method used did not include all qualified self-employment income when determining eligibility to receive a payment. These errors affect clergy and other individuals whose income is not subject to the self-employment tax. We plan to review the IRS' programming of the economic stimulus payments for Tax Year 2008 to ensure that these individuals will receive the payments they are entitled to when they file their 2008 returns.
- 149 economic stimulus payments totaling approximately \$62,700 that should not have been paid because of the Department of the Treasury decision to use the self-employment tax deduction reported on the tax return to estimate self-employment income. The multiplier used to estimate self-employment income overestimated the individuals' self-employment

<sup>7</sup> *The Child Tax Credit Advance Payment Was Effectively Planned and Implemented, but a Programming Discrepancy Caused Some Overpayments* (Report Number 2004-40-042, dated January 2004).

<sup>8</sup> Pub. L. No. 108-27, 117 Stat. 752.



income. Unlike the returns discussed above, these individuals claimed a self-employment deduction on their tax return and did not have self-employment losses.

- 324 economic stimulus payments totaling approximately \$10,019 that should not have been paid because the IRS used taxpayer return figures when computing the payment. Our payment calculation used the IRS' computer figures on the tax returns to compute the economic stimulus payment, whereas the IRS used the taxpayers' figures. As the IRS processes individual tax returns, its computer programs correct information or computations on a tax return as needed, resulting in a difference between what the taxpayer reported and what the IRS computer system shows. If the difference is below a set amount, the IRS will default to the taxpayer's figures for purposes of figuring the income tax liability.

During the course of this review, we monitored a number of other issues related to economic stimulus payments. The issues were monitored to identify the cause and actions taken by the IRS to address the concerns. These included:

- ***Duplicate paper tax returns were filed only to claim the economic stimulus payment.*** As of June 21, 2008, the IRS had identified 277,868 duplicate-filed tax returns. These are stimulus-only returns for which another tax return was filed using the same Social Security Number. In an effort to assist these taxpayers, the IRS established a unit in its Andover, Massachusetts, Campus<sup>9</sup> to expedite the processing of the cases and minimize delays in issuing the economic stimulus payments. As of June 21, 2008, the IRS had resolved 80,952 cases (29 percent). The majority of the duplicate-filing conditions resulted from taxpayers inadvertently filing two tax returns. Only three returns have been determined to possibly involve identity theft.
- ***Understanding Your Economic Stimulus Payment (Notice 1378) was sent to the wrong individuals.*** The IRS determined that between 18,000 and 22,000 Notices 1378 were issued to the wrong individuals. This was the result of an error by the vendor contracted to print and mail these notices. The vendor immediately increased its quality review controls to help prevent the problem from recurring.
- ***Direct deposits were sent to the wrong accounts.*** The IRS identified a programming error that resulted in approximately 1,500 direct deposits being deposited into the wrong individuals' financial institution accounts. These payments totaled approximately \$1.4 million. The IRS has since corrected the error and is in the process of issuing payments to the entitled individuals. The IRS is working with the financial institutions to recover the incorrect deposits.

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<sup>9</sup> The data processing arm of the IRS. The Campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayers accounts.



- ***A tax preparer did not correctly add the RAL indicator, which could have resulted in incorrect direct deposit of economic stimulus payments to the RAL accounts instead of to the taxpayers' accounts.*** IRS officials stated on May 28, 2008, that they had been notified by a tax preparation firm that approximately 450,000 tax returns had been submitted to the IRS without the RAL indicator. The IRS, aided by the firm, was able to identify these accounts before the economic stimulus payments were issued. Payments for these accounts are being correctly issued via paper check, which is consistent with the IRS' decision to issue paper checks on accounts that have a RAL. The media incorrectly reported that these payments were being deposited into RAL accounts.

The next phase of our assessment will evaluate IRS efforts to ensure that 1) all individuals entitled to an economic stimulus payment receive one, and 2) the IRS complies with the provision of the law that prevents the issuance of economic stimulus payments after December 31, 2008. Our assessment will also evaluate IRS efforts to implement provisions included in the Heroes Earnings Assistance and Relief Tax Act of 2008,<sup>10</sup> which the President signed into law on June 17, 2008. This Act amends the Economic Stimulus Act of 2008 so that thousands of military personnel will receive an economic stimulus payment regardless of whether they, their spouses, or their children have valid Social Security Numbers. The Joint Committee on Taxation estimates that this provision will cost \$14 million in Fiscal Year 2009.

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<sup>10</sup> Pub. L. 110-245, 122 Stat 1624.



## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The overall objective of this review was to assess the accuracy of the IRS' computation of the economic stimulus payment and the adequacy of controls to prevent ineligible individuals from receiving a payment. The scope of this review was limited to an assessment of controls established and economic stimulus payments generated by the IRS as of June 13, 2008. To accomplish our objective, we:

- I. Determined whether the economic stimulus payments calculated by the IRS were accurate.
- II. Determined whether controls were in place to prevent ineligible individuals from receiving an economic stimulus payment. For example, we assessed the IRS' controls to identify ineligible individuals who received an economic stimulus payment as a result of a duplicate-filing condition.
- III. Assessed the IRS' process to ensure that eligible individuals received their economic stimulus payment in a timely manner.



## **Appendix II**

### *Major Contributors to This Report*

Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Russell Martin, Director

Deann Baiza, Audit Manager

John Hawkins, Lead Auditor

Sharla Robinson, Lead Auditor

Kathleen Hughes, Senior Auditor

John Mansfield, Senior Auditor

Steven Stephens, Senior Auditor

Jennie Choo, Auditor

Jane Lee, Auditor

James Allen, Computer Specialist

Kevin O’Gallagher, Computer Specialist



## **Appendix III**

### *Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Commissioner, Wage and Investment Division SE:W  
Chief Information Officer OS:CIO  
Director, Compliance, Wage and Investment Division SE:W:CP  
Director, Customer Account Services, Wage and Investment Division SE:W:CAS  
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  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaison: Senior Operations Advisor, Wage and Investment Division SE:W:S





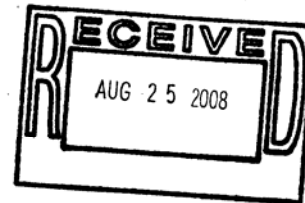
Appendix IV

Management's Response to the Draft Report



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224



August 21, 2008

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Linda E. Stiff *Linda E. Stiff*  
Deputy Commissioner for Services and Enforcement

SUBJECT: Draft Audit Report – Evaluation of the Computation of Economic Stimulus Payments (Audit # 200840030.02)

We have reviewed the subject draft report which acknowledges that the accuracy rate for the economic stimulus payments was very high. This is a noteworthy accomplishment given the programming challenges necessary to ensure that specific filing and income requirements were met prior to issuance of economic stimulus payments. This success is further illustrated by the fact that the IRS was able to complete these programming requirements in record time and issue the first payments by direct deposit within 70 days (55 workdays) from the February 13, 2008 enactment of the Economic Stimulus Act of 2008.

We note that your analysis of 129.1 million stimulus payments confirms that 128.5 million were calculated correctly, which is a 99.6 percent accuracy rate. Of the remaining 539,550 (0.4 percent), you agree that the discrepancies are either due to taxpayer and/or tax preparation software error, or a business decision made by the Department of Treasury in conjunction with the IRS. For example, of the 539,550 returns, 375,931 were a result of the taxpayers or specific tax preparation software not checking the Child Tax Credit qualifying box on the tax return as required. Once the IRS recognized this error, a systemic solution was developed to ensure these taxpayers received the credit to which they were entitled.

Of the remaining 163,619 returns, the IRS used the self-employment tax deduction to compute earnings from self-employment. This methodology was used because of the limitations in transcribed items from returns and the added complexity of the programming that would have been required. This was a conscious business decision to generate the payments within the timeframes required. In doing so, the IRS recognized that the methodology while not exact would nevertheless result in a correct economic stimulus payment for the vast majority of the individuals involved.



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Your report also acknowledges the effort of the IRS to assist those not normally required to file a return. As you indicated, the IRS established a special unit in Andover, Massachusetts to expedite the processing of cases with a duplicate return. This was done to minimize the delay for these individuals in receiving their economic stimulus payment.

I would like to thank the audit team for their valuable assistance and input. As you move forward with your evaluation of the implementation of the economic stimulus payments, we look forward to continued cooperative efforts to further improve this process. If you have any questions, or if you would like to discuss this response in more detail, please contact Julie Rushin, Director, Strategy and Finance, Wage and Investment Division, at (404) 338-8800.