

**Management Advisory Report: Percentage of  
Rejected Electronically Filed Returns**

**October 1999**

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**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.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

October 29, 1999

MEMORANDUM FOR COMMISSIONER ROSSOTTI

*Pamela J. Gardiner*

FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Management Advisory Report – Percentage of Rejected  
Electronically Filed Returns

As requested by senior Internal Revenue Service (IRS) management, this management advisory report provides answers to two congressional questions posed to IRS executives during a 1997 hearing covering the IRS' Revenue Protection Program. The House Ways and Means Committee Chairman, Bill Archer, asked what percentage of electronically filed returns were rejected by the IRS, and how many of these rejected electronic returns were subsequently filed as paper returns. The IRS executives could not answer the questions, and the Assistant Commissioner (Criminal Investigation) subsequently asked for our (the former IRS Inspection Service) assistance.

The National Director (Tax Refund Fraud) responded that the information provided addressed the two congressional questions posed to the IRS executives. Management's comments have been incorporated into the report where appropriate, and the full text of their comments is included as an appendix.

Please contact me at (202) 622-6510 if you have questions, or your staff may call Walter E. Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 455-2475.

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## **Executive Summary**

This management advisory report provides information developed to assist Internal Revenue Service (IRS) management in responding to past congressional questions about the IRS' Revenue Protection Program.<sup>1</sup>

In a May 8, 1997, House Ways and Means Committee hearing, Chairman Bill Archer asked IRS executives what percentage of electronic returns (*e-file*) the IRS "rejected" (declined to accept for processing),<sup>2</sup> and how many of the rejected *e-file* returns were subsequently filed as paper returns. The Assistant Commissioner (Criminal Investigation) responded that IRS systems did not count the number of returns rejected and did not provide for tracking whether rejected *e-file* returns were later submitted on paper; therefore, the IRS could not answer the questions.

Subsequently, the Assistant Commissioner (Criminal Investigation) requested that the IRS Inspection Service (now Treasury Inspector General for Tax Administration (TIGTA)), attempt to develop the information requested by Chairman Archer. The Chief Operations Officer endorsed this request, which was renewed in 1998.

## **Results**

We developed the following information which answers the congressional questions:

### **Analysis of Rejected Electronically Filed Returns**

<b>Tax Year</b>	<b>Percent Rejected</b>	<b>Number of Returns Rejected &amp; Subsequently Filed on Paper</b>
1996	9.5%	290,737
1997	10.2%	300,955

*Sources: Data extracted by TIGTA personnel from IRS computer records, and e-file data compiled by TIGTA personnel from the IRS' Andover, Austin, Cincinnati, Memphis, and Ogden Service Centers.*

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<sup>1</sup> The Revenue Protection Program was designed to improve the IRS' detection and prevention of refund fraud in paper and *e-file* returns.

<sup>2</sup> Rejected *e-file* returns may contain information which otherwise could cause the tax system to issue inflated, fraudulent, or erroneous refunds.

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We believe IRS management should develop capabilities and a methodology similar to the one we used on this project. The results of this project provided valuable additional information beyond that originally requested. Also, this capability would enable IRS analysts to address other difficult-to-measure Revenue Protection issues.

Management's Response: The National Director (Tax Refund Fraud) responded that the information provided addressed the two congressional questions posed to IRS executives. Management's complete response to the draft report is included as Appendix IV.

## **Objective and Scope**

Our objective was to provide, if possible, the Assistant Commissioner (Criminal Investigation) with information which would enable him to answer two congressional questions about returns that the Internal Revenue Service (IRS) rejected from electronic filing (*e-file*).

We developed the requested information at the Andover Service Center and the National Office. After receiving and installing the necessary computer hardware, successfully locating and obtaining usable data from around the country in late 1998, and familiarizing auditors with software capable of handling large data files, we performed the major parts of the analysis in February and March 1999.

IRS *e-file* computer systems are not designed to provide the type of management information necessary to answer the congressional questions. To accomplish our objective, we:

- Obtained and analyzed relevant portions of over 237 million records of individual taxpayers who filed returns (*e-file* or paper) for Tax Years (TY) 1996 and 1997.
- Obtained, combined, and analyzed separate computer files containing a total of over 49 million taxpayer *e-file* records for TYs 1996 and 1997 from the Andover, Austin, Cincinnati, Memphis, and Ogden Service Centers.
- Developed customized programs and analyses to manipulate and match data and tabulate the results.

Appendix I provides more information on our detailed objective, scope, and methodology. Appendix II lists the major contributors to this report.

*IRS e-file computer systems are not designed to provide the type of information necessary to address congressional questions relating to rejected electronic returns.*

*We analyzed over 237 million individual taxpayer records and over 49 million taxpayer e-file records to provide quantifiable answers to congressional questions.*

*Analysis of the millions of records obtained required the development of customized programs and database query statements.*

## Background

Before accepting *e-file* returns for processing, the IRS subjects them to computerized checks designed to keep out *e-file* returns having certain questionable characteristics. These characteristics include items that might cause the federal tax system to issue inflated, fraudulent, or erroneous refunds. *E-file* returns not accepted by the IRS in this way are termed “rejected.”

During a May 8, 1997, House Ways and Means Committee hearing on Revenue Protection, the IRS Deputy Commissioner and the Assistant Commissioner (Criminal Investigation) were questioned by Chairman Bill Archer as to the percentage of *e-file* returns the IRS had rejected and whether these rejected *e-file* returns had been later filed as paper returns.

*IRS’ e-file computer systems do not capture data on rejected returns in a way that allows the number of taxpayers involved to be counted.*

The Assistant Commissioner (Criminal Investigation) testified that the percentage of *e-file* taxpayer returns that the IRS rejects could not be determined because IRS *e-file* computer systems do not keep track of “rejects” by taxpayer. Instead, the IRS counts “rejects” by occurrence, no matter which taxpayer was involved. For example, *e-file* returns for the same taxpayer may be resubmitted electronically many times (and rejected many times), at several or *all* of the five *e-file* service centers. IRS *e-file* computer systems count each of the rejected occurrences, even though the same taxpayer’s return is being resubmitted.

The Assistant Commissioner (Criminal Investigation) also advised Chairman Archer that because IRS computer systems do not track rejected *e-file* returns for later IRS activity, they could not determine if rejected *e-file* returns were subsequently filed as paper returns.

As a result of the IRS’ inability to respond to the above detailed congressional questions, the Assistant Commissioner (Criminal Investigation) asked the IRS Inspection Service (now Treasury Inspector General for Tax Administration (TIGTA)), for assistance. This request was endorsed by the Chief Operations Officer, who considered the project important enough to offer to

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fund the purchase of a special computer for the IRS Inspection Service (now TIGTA) personnel to use for the project.

### Results

*Review results were limited to TYs 1996 and 1997, the years for which the IRS maintained complete computerized e-file return data.*

The answers to the two questions asked of IRS executives relating to rejected *e-file* returns are summarized in the following table:

#### Analysis of Rejected Electronically Filed Returns

Tax Year	Percent Rejected	Number of Returns Rejected & Subsequently Filed on Paper
1996	9.5%	290,737
1997	10.2%	300,955

*Sources: Data extracted by TIGTA personnel from IRS computer records, and e-file data compiled by TIGTA personnel from the IRS' Andover, Austin, Cincinnati, Memphis, and Ogden Service Centers.*

#### Additional Information About Rejected Electronic Returns

*The methodology and capabilities used by Audit staff could be employed by the IRS to address additional Revenue Protection Program issues.*

While the primary thrust of this report is answering the two congressional questions posed to the IRS, we also point out that the methodology and capabilities used to answer these questions could be developed and used by the IRS to address other Revenue Protection Program issues.

For example, the following table provides further Revenue Protection information revealed during this project relating to rejected *e-file* returns:



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### Supplemental Information Relating To Rejected Electronically Filed Returns

Tax Year	Taxpayer <i>e-file</i> Returns Rejected	Rejected <i>e-file</i> Returns Resubmitted Electronically for Acceptance	Rejected <i>e-file</i> Returns Resubmitted on Paper	Rejected <i>e-file</i> Returns – Not Resubmitted (Paper or Electronic)
1996	1,974,349	1,599,437	290,737	84,175
1997	2,378,541	1,960,658	300,955	116,928

Sources: Data extracted by TIGTA personnel from IRS computerized files, and e-file data compiled by TIGTA personnel from the IRS' Andover, Austin, Cincinnati, Memphis, and Ogden Service Centers.

The data supporting the above information have been shared with Criminal Investigation personnel.

Management's Response: The National Director (Tax Refund Fraud) responded that the information provided addressed the two congressional questions posed to IRS executives.

### Conclusion

Our review provided quantifiable answers to the congressional questions about the IRS' Revenue Protection Program. The IRS rejected 9.5 percent of the *e-file* returns for TY 1996, and 10.2 percent for 1997. Additionally, we found that 290,737 taxpayers whose *e-file* returns were rejected for 1996 subsequently filed a paper return. The number filed on paper increased to 300,955 for TY 1997. We also noted that the methodology used to develop this information could be used to answer other Revenue Protection questions and problems.

### Detailed Objective, Scope, and Methodology

Our objective was to provide, if possible, the Assistant Commissioner (Criminal Investigation) with information which would enable him to answer two congressional questions about returns that the Internal Revenue Service (IRS) had rejected from electronic filing (*e-file*).

In order to accomplish our objective, we:

- I. Obtained and analyzed relevant portions of the over 237 million individual tax returns which IRS computer records showed had been filed for Tax Years (TY) 1996 and 1997 (both *e-file* and paper). To do this we:
  - A. Designed specific criteria for accessing and compiling data from these records.
  - B. Coordinated with personnel from the Treasury Inspector General for Tax Administration's (TIGTA) Data Analysis Section to perfect the computer extract format.
- II. Obtained, combined, and analyzed computer files containing over 49 million taxpayer *e-file* records for TYs 1996 and 1997 from the Andover, Austin, Cincinnati, Memphis, and Ogden Service Centers. To do this we:
  - A. Contacted personnel at the Office of Electronic Tax Administration and determined that sufficient computerized *e-file* information was maintained by each of the five service centers that accept *e-file* returns for TYs 1996 and 1997.
  - B. Coordinated with Information Systems and Electronic Filing staffs at each of the five service centers that accept *e-file* returns to obtain copies of computerized files containing *e-file* records.
  - C. Performed extensive validity checks to ensure the integrity and accuracy of data included in each set of data. For example, we compared the counts of the computerized files containing *e-file* records sent by the five Service Centers to the counts of the information received and downloaded onto the TIGTA computer.
  - D. Maintained a log of all cartridges containing the extracted information sent from the Martinsburg Computing Center to ensure all cartridges were received at the Andover Service Center tape library.

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- III. Validated the data in the Masterfile extract and in the *e-file* records against the data in the primary IRS on-line computer system.
  - A. For the Masterfile, out of the universe of 117 million, we sampled 44 individual tax account records, selected by interval and random sampling, and checked selected fields of the Masterfile records against IRS records.
  - B. For the *e-file* database, out of the universe of 24 million, we sampled 5 *e-file* tax account records, selected by interval sampling, and checked selected fields of the *e-file* records against IRS records.
- IV. Developed and executed customized programs and computer instructions, in an advanced database management language, Microsoft Sequential Query Language (SQL), to manipulate, match, and analyze information contained in both sets of data. To do this we:
  - A. Trained auditors how to design and use the advanced database management language (Microsoft SQL) to devise customized computer instructions.
  - B. Executed the customized (SQL) computer instructions to identify and then count or compute:
    - 1. The number of *unique* taxpayers filing electronically (thus avoiding counting duplicate attempts to file electronically, either in the same location or anywhere in the country).
    - 2. The number of unique taxpayers whose *e-file* returns the IRS had rejected (again, avoiding counting duplicate attempts to file electronically either in the same location or anywhere in the country).
    - 3. The percentage of rejected *e-file* returns (by unique taxpayers) versus total *e-file* transmitted returns (by unique taxpayers).
    - 4. The number of rejected *e-file* returns (by unique taxpayers) that were resubmitted electronically and accepted.
    - 5. The number of rejected *e-file* returns (by unique taxpayers) successfully resubmitted and accepted as paper tax returns.
    - 6. The number of rejected *e-file* returns (by unique taxpayers) not resubmitted either electronically or on paper.
- V. Tested the intermediate (COBOL) programs to ensure total record counts were complete, and the output matched and accounted for all records received from the *e-file* service centers. We verified:
  - A. Total records received.
  - B. Identification of reject codes detailed on file.

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- C. Reject code occurrences.
  - D. Records input.
  - E. Total unique Social Security Numbers (SSN).
  - F. Total records containing a reject code of “A,” “D,” “R” or “blank.”
  - G. Initial transmission resulting in acceptance, rejection, duplication, or other.
  - H. Total records containing an invalid primary SSN.
  - I. Total reject codes on file.
  - J. Total rejected returns where the reject code field is blank.
  - K. Total primary SSNs whereby the rejected return contained in excess of 15 reject codes.
  - L. Total reject codes in excess of 15 or primary SSNs where the rejected return contained in excess of 15 reject codes.
- VI. Tested the auditor-written SQL statements by having two independent auditors not assigned to the project perform the following validations. To do this we:
- A. Traced and verified information contained in SQL methodologies.
  - B. Reviewed the logic of the queries performed.
  - C. Re-ran the queries to verify the results matched those shown in the report.

**Major Contributors to This Report**

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Management's Response to the Draft Report



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

September 24, 1999

OFFICE OF TREASURY  
INSPECTOR GENERAL  
RECEIVED

1999 SEP 27 A 8 13

FOR TAX ADMINISTRATION

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR  
TAX ADMINISTRATION

FROM: *Acting for* Charles O. Rossotti *Bob Rossotti*  
Commissioner of Internal Revenue

SUBJECT: Draft Treasury Inspector General for Tax Administration (TIGTA)  
Management Advisory Report: Percentage of Rejected  
Electronically Filed Returns (Ref. #19980089)

Thank you for the opportunity to respond to your draft report dated September 3, 1999. The Internal Revenue Service's (IRS) Revenue Protection Program is extremely important to the IRS. We appreciate your efforts in support of our objectives to improve the program, while responding to the attendant congressional inquiries.

The current Revenue Protection Program provides valuable statistics for improving the program and measuring levels of success within the currently known universe of fraud. It also provides direction toward developing and managing emerging areas of fraud. You recommended a methodology to analyze rejected e-file returns. Based on the information you provided, we cannot make a quantitative determination of the potential improvement these methodologies might make in the Revenue Protection Program. Our current processes focus on subjecting the resubmission of rejected e-file returns to the same fraud detection criteria as originally submitted returns, whether it is done on paper or through e-file.

Questions regarding this response should be directed to Gary D. Bell, National Director (Tax Refund Fraud), OP:CI:ORF, at (202) 622-7140, or Bill Turner of his staff at (202) 622-7795.

cc: Assistant Commissioner (Electronic Tax Administration) OP:ETA