



Treasury Inspector General for Tax Administration Office of Audit

AN ESTIMATED \$1.6 BILLION IN FRAUDULENT REFUNDS WAS ISSUED DURING THE 2006 AND 2007 FILING SEASONS

Issued on September 22, 2008

Highlights

Highlights of Report Number: 2008-10-172 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

The Criminal Investigation (CI) Division Questionable Refund Program is a nationwide, multi-functional program designed to detect and stop fraudulent claims for refunds on income tax returns. TIGTA estimated that the number of potentially fraudulent returns that would have been identified without threshold restrictions rose by an alarming 70 percent between Processing Years (PY) 2006 and 2007. Due to resource limitations, the Internal Revenue Service (IRS) worked only 48.7 percent of these returns, potentially allowing \$742 million in fraudulent refunds to be issued. If this trend continues over the next few years, the IRS might issue an even greater number of fraudulent refunds, possibly resulting in a significant annual revenue loss to the Federal Government. As a result, additional burden is placed on honest taxpayers whose tax dollars are being used to support this criminal activity.

WHY TIGTA DID THE AUDIT

The objectives of this audit were to determine the effectiveness of the IRS' processes to identify and stop questionable refunds during PY 2007 and to evaluate the effect the failure of the Electronic Fraud Detection System had on PY 2006. This audit was conducted as part of our response to a request made by the House Committee on Ways and Means.

WHAT TIGTA FOUND

TIGTA estimated that the IRS failed to stop approximately \$894 million in fraudulent refunds during PY 2006, when the Electronic Fraud Detection System was not operational. The IRS had previously advised the Senate Appropriations Committee Staff that it did not plan to recover the fraudulent refunds paid during PY 2006 because it believed the total was only about \$200 million (this estimate was based on data available at that time).

The exponential growth in fraud in PY 2007 presented a challenge for the IRS, which did not have the resources to handle this volume. As a result, the CI Division focused on identifying those returns with higher dollar values and higher data-mining scores, which precluded more than 500,000 potentially fraudulent returns from entering the Fraud Detection Centers' screening process. Had these returns been included, TIGTA estimated that the Fraud Detection Centers would have identified an additional potential \$742 million in fraudulent refunds.

Although TIGTA determined that tax returns were being verified as fraudulent and transferred to the Accounts Management Organization and the Examination functions in a timely manner, several processing errors allowed millions of dollars of fraudulent refunds to be issued and increased taxpayer burden.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Deputy Commissioner for Services and Enforcement 1) develop a more urgent approach on the legislative change exempting the IRS from having to issue statutory notices of deficiency on returns determined to be fraudulent, and 2) develop a long-term, strategic approach to balancing available resources with the growth in refund fraud and other compliance priorities. In addition, TIGTA made several additional recommendations related to improving procedures for identifying and working potentially fraudulent returns.

In their response to the report, IRS officials stated that they agreed with five of our nine recommendations and plan to take corrective actions. The IRS has developed a 5-year plan and formed an Executive Steering Committee to provide strategic guidance for the refund fraud program. IRS officials disagreed with one recommendation and provided responses to—but neither agreed nor disagreed—with the remaining three recommendations.

TIGTA continues to believe that several of the corrective actions to our recommendations will not fully address the reported concerns. These recommendations need to be reconsidered as part of the Pre-Refund Program Office's long-term strategy.

READ THE FULL REPORT

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

<http://www.treas.gov/tigta/auditreports/2008reports/200810172fr.pdf>

Email Address: inquiries@tigta.treas.gov
Web Site: <http://www.tigta.gov>

Phone Number: 202-622-6500