

**The Internal Revenue Service's Individual
Taxpayer Identification Number Creates
Significant Challenges for Tax Administration**

January 2004

Reference Number: 2004-30-023

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.

Redaction Legend:

2d = Law Enforcement Technique(s)

2e = Law Enforcement Procedure(s)



INSPECTOR GENERAL
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ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

January 8, 2004

MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT

Gordon C. Milbourn III

FROM: Gordon C. Milbourn III
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - The Internal Revenue Service's Individual
Taxpayer Identification Number Creates Significant Challenges
for Tax Administration (Audit # 200230050)

This report presents the results of our analysis of United States (U.S.) Individual Income Tax Returns (Form 1040) filed with an Internal Revenue Service (IRS) Individual Taxpayer Identification Number (ITIN) by resident aliens¹ for Tax Year (TY) 2001 and, where applicable, TY 2000.² This evaluation included identifying attributes of these Forms 1040, such as income, deductions, credits and refunds, and the related tax administration issues that affect compliance with tax laws and regulations.

Forms 1040 filed with ITINs represent significant challenges for tax administration and affect other areas of Federal Government concern and tax policy. An analysis of the tax return attributes for TY 2001 resident aliens who were not authorized to work in the U.S. showed that approximately 530,000 Forms 1040 were filed with ITINs as the primary number.

¹ 26 U.S.C. § 7701 (2003) defines a *resident alien* as a resident of the U.S. for any calendar year if that individual was lawfully admitted for permanent residence. A resident alien is also a foreign person in the U.S. who meets the "substantial presence" test, which is based on the number of days that person resides in the U.S.

² TYs 2001 and 2000 were the most recent years available at the time of this review. Our data are based on the primary filer's identification number as an ITIN.

These returns reported adjusted gross income (AGI)³ of \$10.7 billion, which was reduced by \$7.5 billion for the standard and itemized deductions and exemptions. The amount of taxes due was \$495 million.

The taxes due were reduced by tax credits and payments, leaving a reported total tax liability of \$184 million. This tax liability represented 1.7 percent of the \$10.7 billion in AGI. After the tax liability was computed, the claimed amount of refunds totaled \$522 million.

In all likelihood, the number of Forms 1040 with ITINs will increase. The approximately 530,000 returns is a 99 percent increase in the number of Form 1040 returns filed with an ITIN over a 3-year period. Moreover, the number of ITINs issued to resident aliens, their spouses, and dependents increased from approximately 693,000 in Calendar Year (CY) 2001 to 925,000 in CY 2002.

Forms 1040 filed with an ITIN represent two major challenges for tax administration. First, unauthorized resident aliens⁴ with questionable identification benefit 2d, 2e----- 2d, 2e----- In TY 2000, 353,000 tax returns included an estimated 309,000⁵ paper filed returns with 2 different identification numbers: an ITIN on the Form 1040 and a Social Security Number (SSN) on 1 or more of the attached Wage and Tax Statements (Form W-2). 2d, 2e-----

----- 2d, 2e--- These returns raise concerns about identity theft,⁶ perjury,⁷ and fraud.⁸ Second, unauthorized resident aliens benefit 2d, 2e----- 2d, 2e----- For TY 2000, we estimated that 82,000 unauthorized resident aliens (1 in 4 return filers) did not report income from wages and nonemployee compensation of \$324 million,⁹ an average of almost \$4,000 per return.

Other Federal Government agencies and tax policy issues also are affected by ITIN usage because unauthorized resident aliens benefit from the tax law¹⁰ that generally prohibits disclosing tax return information. First, the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 provided that information concerning immigration

³ 26 U.S.C. § 62 (2003) provides that AGI is income from all taxable sources reduced by certain deductions, such as business expenses, retirement savings, and alimony payments.

⁴ See Appendix VII for an explanation of the term *unauthorized resident alien*.

⁵ The margin of error for this figure and all subsequent figures, except electronically filed returns, is in Appendix V.

⁶ Identity Theft and Assumption Deterrence Act of 1998, Pub. L. No. 105-318, 112 Stat. 3007 (1998).

⁷ 26 U.S.C. § 6065 (2003).

⁸ 26 U.S.C. § 7206 (2003).

⁹ Projection based on a statistically valid sample of TY 2000 Forms 1040 with an ITIN for resident aliens claiming wages and nonemployee compensation and comparing this amount to the IRS Information Returns Program (IRP) files. The IRP processes information returns submitted either on magnetic media or electronically from businesses; financial institutions; and Federal, state, and local governments.

¹⁰ 26 U.S.C. § 6103 (2003).

status should be reported to the Bureau of Immigration and Customs Enforcement (BICE).¹¹ In our opinion, the IRS is able to identify some unauthorized resident aliens by using ITIN records. However, the tax law generally prohibits the IRS from sharing this tax return information with other Federal Government agencies. Thus, there is a conflict between the tax law and immigration law.

The second area of Federal Government concern is identity theft through misuse of the SSN. Federal Government agencies have reported that hundreds of thousands of unauthorized resident aliens have used fraudulent documents to obtain employment. We found unauthorized resident aliens had used approximately 265,000 SSNs¹² that the Social Security Administration (SSA) had assigned to other individuals. Under current law, the IRS is prohibited from sharing this information with the SSA.

From a tax policy perspective, unauthorized resident aliens benefit from the tax law since they are treated virtually the same as U.S. citizens and lawful resident aliens. An unauthorized resident alien is entitled to the same deductions and credits, except for the Earned Income Tax Credit (EITC). Therefore, unauthorized resident aliens are eligible for the Additional Child Tax Credit (ACTC), which is one of only two major credits that can result in a Federal Government payment above the tax liability. In TY 2001, \$160.5 million was given to approximately 203,000 unauthorized resident aliens, with about 190,000 of these filers having no tax liability and receiving \$151 million.

Like the ACTC, the EITC was available to unauthorized resident aliens when it became law in 1975. In 1996, the law was changed in part to deny the EITC to unauthorized workers. A legislative purpose of the ACTC is similar to the purpose of the EITC. Prior to the EITC law change, the General Accounting Office reported that awarding the EITC to illegal aliens was at cross-purposes with Federal Government policies that prohibit illegal aliens from working in the U.S. Similar to the purpose of the EITC, the Senate stated that tax law changes to the Child Tax Credit (CTC) and ACTC were intended for "low income working families to promote work."¹³

Furthermore, while unauthorized resident aliens are treated virtually the same as U.S. citizens and legal resident aliens, they are not taxed like aliens who do not reside in the U.S. but have U.S. source income. If the unauthorized resident aliens were taxed the same as nonresident aliens, they could not take the standard deduction. Unauthorized resident aliens claimed the standard deduction on 92.3 percent of the returns filed, reducing their AGI by \$3.2 billion. Also, if unauthorized resident aliens were taxed the same as nonresident aliens, they could not claim the lower tax rate associated with the

¹¹ Pub. L. No. 104-208, 110 Stat. 3009 (1996). This law refers to the U.S. Immigration and Naturalization Service (INS). The Department of Homeland Security's BICE assumed the INS' enforcement responsibilities 2003. This Bureau is now known as the U.S. Immigration and Customs Enforcement.

¹² Projection based on a statistically valid sample of paper filed TY 2000 Forms 1040 filed with an ITIN as the primary number for resident aliens with Forms W-2 attached, and comparing the SSN on the Form W-2 to IRS records provided by the SSA to determine to whom the SSA assigned the SSN.

¹³ Restoring Earnings To Lift Individuals and Empower Families Act of 2001, H.R. 1836, as agreed to by the Senate. This bill was submitted to the House of Representatives and eventually became the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

head of household filing status. Unauthorized resident aliens claimed this status on about 160,000 (30.2 percent) of the approximately 530,000 tax returns filed during TY 2001.

Finally, unauthorized resident aliens using an ITIN as their identification number prepared over 6,700 tax returns for U.S. citizens. The IRS' reliance on unauthorized resident aliens for tax return preparation may have an adverse impact on public confidence and satisfaction with the tax system.

On July 8, 2003, we issued a memorandum to the IRS (see Appendix VIII) that stated unauthorized resident aliens would be eligible for the accelerated CTC and ACTC disbursements under the newly passed¹⁴ and proposed legislation.¹⁵ We estimated that these disbursements could be \$150 million. We recommended that the IRS Commissioner advise the Department of the Treasury concerning the potential conflict with immigration law, delay sending the disbursements until questionable identifications could be resolved, and propose legislation to limit the ACTC, similar to the EITC, for unauthorized resident aliens. The IRS provided a reasoned response to the memorandum (see Appendix IX). The Department of the Treasury was advised of our concern about the credits and the process of considering legislation to limit the ACTC was initiated. The IRS stated that it was not authorized to delay the disbursements because unauthorized resident aliens are entitled to the credit by the current law.

The IRS recognizes the need to address the ITIN tax administration challenges. The IRS chartered an ITIN Task Force, accepted most of its recommendations, and established an ITIN Project Office that is implementing the accepted recommendations. In addition, the IRS established an ITIN position in the National Taxpayer Advocate (NTA) Service and is initiating procedures to assist taxpayers who might have been victims of identity theft.

We recommended that the Commissioner, Wage and Investment (W&I) Division issue instructions to 2d, 2e-----that have questionable identification issues, 2d, 2e------(Recommendations 1 and 2), and communicate this problem to persons providing assistance with return preparation and filing (Recommendations 3, 4, and 5). 2d, 2e-----
2d, 2e-- the Commissioner, W&I Division, should 2d, 2e-----unreported income and improve assistance to victims of identity theft (Recommendations 6, 7, and 8). The Deputy Commissioner for Services and Enforcement should determine whether any actions are warranted against persons preparing or assisting with the preparation of tax returns with questionable identification (Recommendations 9 and 13), coordinate with the Bureau of Citizenship and Immigration Services (BCIS)¹⁶ and the SSA to assess the benefits to these agencies of seeking legislation to broaden the IRS' authority to share information (Recommendation 10), seek legislation to generally require persons who

¹⁴ Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752.

¹⁵ Relief for Working Families Tax Act of 2003, H.R. 1308, as amended, and pending in Conference Committee.

¹⁶ The Department of Homeland Security's BCIS assumed the INS' customer service responsibilities in 2003. This Bureau is now known as the U.S. Citizenship and Immigration Services.

are compensated for assisting with preparing or filing tax returns be a U.S. citizen or a resident alien authorized to work in the U.S. (Recommendation 11), and define and tax unauthorized resident aliens more like nonresident aliens (Recommendation 12).

Management's Response: IRS management expressed agreement with 5 of the 13 recommendations. They agreed with Recommendation 5 and will work with software developers to modify computer programs used by Electronic Return Preparers (ERP). They also agreed with Recommendation 8 and will explore using Federal Trade Commission data to reduce the tax administration effects of identity theft. In addition, management agreed with Recommendations 10, 11, and 12 by initiating the process through which the legislative proposals would be considered. These proposals included broadening the use of IRS data by other Federal agencies, preventing unauthorized resident aliens from working in the tax return preparation industry, and changing the taxation of income reported by unauthorized resident aliens. Management provided corrective actions for each of these issues. Moreover, management is taking additional actions on ITIN issues not included in the scope of the review, such as the changes recently announced for the ITIN application process.

Management partially agreed with Recommendations 3 and 4 involving tax return preparation assistance provided by paid preparers, ERPs, and volunteer groups. Management is taking corrective action on Recommendation 3 and already has programs that address Recommendation 4. However, management indicated that paid preparers and volunteers are not required to verify the identification information provided by a taxpayer.

Management expressed disagreement with six recommendations. They did not agree with Recommendations 1 and 2d, 2e-----
2d, 2e----- Management advised that they have seen no evidence that ITIN holders are more or less accurate in calculating their tax liabilities than any other taxpayer group. Management also advised that the economic and noneconomic costs (e.g., taxpayer burden) of implementing a new policy would outweigh the potential benefits to tax administration.

Management did not agree at this time with Recommendations 6 and 7, 2d,2
2d, 2e-----to address underreported income and identity theft. Management advised that implementing this system was currently not feasible 2d, 2e-----and that a cost-benefit analysis would be needed. Management also advised that they would continue to study whether the system might become feasible in the future.

Also, management disagreed with Recommendations 9 and 13. These recommendations concerned the suitability of administrative or legal actions involving tax preparation situations, such as individuals who prepare or assist with preparing or filing tax returns with questionable identification and paid preparers identifying themselves with ITINs. However, management followed the intent of the recommendations by receiving IRS Office of Chief Counsel's advice. Its Chief Counsel indicated that no actions were warranted.

Recommendations 1, 2, 6, 7, 10, and 12 included outcome measures. Since management did not agree with Recommendations 1, 2, 6 and 7, they did not agree with the outcome measures associated with them. Furthermore, management stated that it was not appropriate to comment on the outcome measures for Recommendations 10 and 12 involving tax policy.

Management’s complete response to the draft report is included as Appendix X.

Office of Audit Comment: Management’s corrective action for Recommendation 10 was to initiate the process through which the legislative proposals would be considered by sharing our report with the Assistant Secretary for Tax Policy at the Department of the Treasury and other Federal agencies. We encourage the IRS to further its coordination, and take a more proactive role by offering to these agencies in-depth guidance on the type of information the IRS receives, its privacy concerns, and the potential impact of legislation on tax administration. This approach could assist Federal agencies in determining whether legislation would help them achieve their missions, understanding the IRS’ interests, and, therefore, deciding whether to coordinate with the Assistant Secretary.

Management’s corrective action for Recommendation 11 was to initiate the process for considering this legislative proposal by sharing our report with the Assistant Secretary for Tax Policy and the NTA. However, management did not specifically address the recommendation for the IRS to supplement the NTA’s existing proposal for legislation regulating paid preparers.

Likewise, management’s corrective action for Recommendation 12 was to initiate the legislative process by sharing our report with the Assistant Secretary for Tax Policy. However, we are unclear whether the IRS agrees or disagrees from a tax administration viewpoint since the IRS did not address these tax administration issues to the extent permitted by its policy on providing comments on legislation.

It appears that the basis of the IRS’ disagreement with a part of Recommendations 3 and 4 was that paid preparers or volunteers should not verify taxpayer identification information. However, we made no recommendation to take this action. The intent of these recommendations was not to have a verification performed but simply to have two different identification numbers identified. We believe these actions are unrelated. As a result, this issue remains a concern.

We are unclear concerning management’s rationale for not implementing Recommendations 1 and 2, 2d, 2e----- The intent of the recommendations was not to question the ability to correctly calculate tax 2d, 2e-----, but rather to establish the identity of the filer. The recommendations for paper filed and electronically filed returns follow the IRS’ current application of the Internal Revenue Code provision 2d, 2e----- 2d, 2e-----¹⁷ The recommendation for paper filed returns follows the methodology currently used on 2d, 2e----- Consequently, the recommendations do

¹⁷ 2d, 2e-----

not constitute a new policy. By not taking action, the IRS will continue to hold U.S. citizens and resident aliens authorized to work in the U.S. to a different standard than that to which unauthorized resident aliens are held.

Similarly, different standards will continue to be applied because management disagreed at this time with Recommendations 6 and 7 regarding unreported income and identity theft. However, while management's interest in the future feasibility of these recommendations appears to be a corrective action, they did not identify the responsible officials, set completion dates, or describe how any actions taken would be monitored. We believe acting on underreported income is particularly important when the percentage of people in America who think that it is acceptable to cheat on their Federal income tax increased from 11 to 17 percent from 1999 to 2003.¹⁸ In our opinion, the benefits of providing equal treatment to all taxpayers and of enabling assistance to as many as 265,000 potential victims of identity theft would outweigh the relatively modest processing cost of an estimated \$435,000.¹⁹

Management disagreed with Recommendations 9 and 13. However, management's response showed that they followed our intent by receiving the Office of Chief Counsel's advice. While the response for Recommendation 9 addressed penalties against tax return preparers, it did not address sanctions against ERPs, as described in the report. Furthermore, the basis of management's response appears to be similar to their basis for Recommendations 3 and 4, which addressed verification of identification information. As we noted, our interest was in detecting the use of two different identification numbers. Consequently, we cannot be certain that management fully addressed this issue and, as a result, it remains a concern.

Management's response to Recommendation 13 indicated that resident aliens who are not authorized to work in the U.S. are permitted to use ITINs to meet the IRS' identification requirement for individuals who work, within the tax system, as paid preparers. Furthermore, this issue aligns with the Federal Government's focus on citizenship issues: unauthorized resident aliens have access to sensitive identification and financial information from potentially unsuspecting U.S. citizens. In our opinion, these factors provide management with knowledge of an employment issue that is inseparable from tax administration because of its potential impact on the public's confidence in the tax system. So, while no laws may have been violated, we believe that the risk of continuing this practice outweighs its benefit to tax administration.

While we still believe our recommendations are worthwhile, we do not intend to elevate our disagreement concerning them to the Department of the Treasury for resolution.

¹⁸ 2003 IRS Oversight Board Annual Survey on Taxpayer Attitudes, September 2003.

¹⁹ Estimate based on the most recent cost figures available, as included in the IRS' FY 2000 cost estimate guidelines. Our estimate would increase for FY 2004 due to inflation. This figure does not include programming costs.

Due to the nature of some material in this report, we have placed on the public Treasury Inspector General for Tax Administration (TIGTA) Internet web site a redacted version of the report. If you identify a need to release this report to anyone outside of the IRS, please refer them to the redacted version on the TIGTA Internet web site.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Philip Shropshire, Acting Assistant Inspector General for Audit (Small Business and Corporate Programs), at (215) 516-2341.

**The Internal Revenue Service’s Individual Taxpayer Identification Number Creates
Significant Challenges for Tax Administration**

Table of Contents

Background	Page 1
Attributes of Forms 1040 Filed by Resident Aliens	Page 3
Forms 1040 Filed With an Individual Taxpayer Identification Number Represent a Challenge for Tax Administration	Page 7
<u>Recommendations 1 and 2:</u>	Page 16
<u>Recommendation 3:</u>	Page 18
<u>Recommendation 4:</u>	Page 19
<u>Recommendations 5 through 7:</u>	Page 20
<u>Recommendation 8:</u>	Page 21
<u>Recommendation 9:</u>	Page 22
Other Federal Government Agencies and Tax Policy Are Affected by Individual Taxpayer Identification Number Usage	Page 22
<u>Recommendation 10:</u>	Page 32
<u>Recommendations 11 and 12:</u>	Page 33
<u>Recommendation 13:</u>	Page 34
Appendix I – Detailed Objective, Scope, and Methodology	Page 35
Appendix II – Major Contributors to This Report.....	Page 37
Appendix III – Report Distribution List.....	Page 38
Appendix IV – Outcome Measures.....	Page 39
Appendix V – Attributes of Forms 1040 Filed With an Individual Taxpayer Identification Number in Tax Years 2000 and 2001	Page 42
Appendix VI – Credits Claimed on Forms 1040 Filed With an Individual Taxpayer Identification Number in Tax Years 1998-2001	Page 43
Appendix VII – Explanation of the Term “Unauthorized Resident Alien”	Page 44
Appendix VIII – Memorandum: Accelerating Scheduled Increases in the Child Tax Credit and the Additional Child Tax Credit to Unauthorized Resident Aliens Should Be Reconsidered.....	Page 48

**The Internal Revenue Service's Individual Taxpayer Identification Number Creates
Significant Challenges for Tax Administration**

Appendix IX – Management's Response to MemorandumPage 58
Appendix X – Management's Response to the Draft ReportPage 60

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Background

To efficiently and effectively process tax returns, the Internal Revenue Service (IRS) uses Taxpayer Identification Numbers (TIN). The TIN is a required entry on tax returns to facilitate tax administration. For individuals, the required TIN is the Social Security Number (SSN).

The Internal Revenue Code (I.R.C.) also provides that any person required to file a return, statement, or other document shall include an identifying number for securing proper identification of that person. The SSN shall be used as the identifying number for such individual for this purpose, except as otherwise specified under regulations.¹ A United States (U.S.) Individual Income Tax Return (Form 1040) is the primary tax return filed by individuals.

In general, the Social Security Administration (SSA) limits its assignment of SSNs to individuals who are U.S. citizens and alien individuals legally admitted to the U.S. for permanent residence or under other immigration categories authorizing U.S. employment. Consequently, individuals who do not meet these criteria cannot obtain SSNs.

In past years, alien individuals who could not obtain SSNs, and who had income that was taxable by the U.S., would file tax returns without identifying numbers. To help these taxpayers comply with the identification requirements of the I.R.C., Treasury Regulations² were issued in 1996 to provide for an Internal Revenue Service (IRS) Individual Taxpayer Identification Number (ITIN). The purpose of the ITIN was to provide alien individuals, whether or not they reside in the U.S., an identifying number for use in connection with U.S. tax return filing requirements.

Also, the Treasury Regulation provides that the IRS assign ITINs to resident aliens who cannot obtain an SSN. The ITIN is intended for tax purposes only and creates no inference regarding an alien individual's right to be legally employed in the U.S. and that individual's immigration

¹ 26 U.S.C. § 6109 (2003).

² Treas. Reg. § 301.6109.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

status³ (i.e., the ITIN does not authorize a foreign individual to work or live in the U.S.).

This audit serves as an in-depth analysis of data that were developed in response to a request for information from the Honorable Charles E. Grassley, then Ranking Member of the Senate's Committee on Finance.⁴ The request concerned the IRS programs for identifying illegal aliens⁵ and for sharing this information with the Bureau of Immigration and Customs Enforcement (BICE)⁶ and the SSA. This audit also serves as a follow-up to our previous report on ITINs.⁷

We performed our audit work between October 2002 and March 2003 at the Headquarters of the Wage and Investment (W&I) Division in Atlanta, Georgia; the Headquarters of the Small Business/Self-Employed (SB/SE) Division in New Carrollton, Maryland; and the IRS National Headquarters in Washington, D.C. The audit was performed in accordance with *Government Auditing Standards*.

³ Treas. Reg. § 301.6109-1. 26 U.S.C. § 7701 (2003) defines a *resident alien* as a resident of the U.S. for any calendar year if that individual was lawfully admitted for permanent residence. A resident alien is also a foreign person in the U.S. who meets the "substantial presence" test, which is based on the number of days that person resides in the U.S. A *nonresident alien* is neither a citizen of the U.S. nor a resident of the U.S.

⁴ Senator Grassley is now the Chairman of the Senate's Committee on Finance.

⁵ The use of the term *illegal alien* would convey the same meaning as the term *unauthorized resident alien*, as used later in this report. See Appendix VII for an explanation of the term *unauthorized resident alien*.

⁶ The request refers to the U.S. Immigration and Naturalization Service (INS). The Department of Homeland Security assumed the INS' responsibilities in 2003. Its BICE is responsible for law enforcement. Its Bureau of Citizenship and Immigration Services (BCIS) is responsible for customer service. The BICE is now known as the U.S. Immigration and Customs Enforcement, and the BCIS is known as the U.S. Citizenship and Immigration Services. These functions will be referred to throughout this report when the source of the reported information cited is the former INS.

⁷ *The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations* (Reference Number 094505, dated September 1999).

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Attributes of Forms 1040 Filed by Resident Aliens

Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

We performed extensive analysis of Forms 1040 that had an ITIN as the identifying number to provide decision makers and stakeholders with information. This evaluation included identifying attributes of these Forms 1040, such as income, deductions, credits and refunds, and the related tax administration issues that affect compliance with tax laws and regulations.

To perform the analysis, we reviewed tax return documents based on a statistical sample for Tax Year (TY) 2000. We then projected the sample results. From our sample analysis, we observed three attributes of the ITIN tax returns filed on a Form 1040.⁸ Numbers have been rounded for presentation purposes.

First, the ITIN does not authorize an individual to work in the U.S., yet the presence of the Wage and Tax Statement (Form W-2) in the filer's name indicates wages from employment. For TY 2000, we determined that approximately 353,000 Forms 1040 with an ITIN were filed by resident aliens who were not authorized to work in the U.S., yet the tax returns showed wages. The analysis also showed that 278,000 of these filers received refunds of \$262 million.

Second, we estimate that the 353,000 returns included 309,000⁹ paper filed returns with 265,000¹⁰ SSNs that the SSA did not assign to the individual who used it as the identification number on the Form W-2. These returns also included an estimated 89,000 SSNs that the SSA never issued. We concluded that these resident aliens used incorrect SSNs because, most likely, they could not legally

⁸ An analysis of the IRS' actions to resolve any tax returns with a balance due was beyond the scope of this review.

⁹ The margin of error is +/- 12,385 tax returns.

¹⁰ The margin of error is +/- 17,732 SSNs. Projection based on a statistically valid sample of paper filed TY 2000 Forms 1040 filed with an ITIN as the primary number for resident aliens with Forms W-2 attached, and comparing the SSN on the Form W-2 to IRS records provided by the SSA to determine to whom the SSA assigned the SSN.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

obtain an SSN. Therefore, these resident aliens were apparently employed without authorization.¹¹

Finally, unauthorized resident aliens did not report on their TY 2000 Forms 1040 income from wages and nonemployee compensation of an estimated \$324 million.¹² These filers represent almost one of every four individuals who filed a Form 1040 with an ITIN.

For TY 2001, we computer analyzed the IRS tax return information for the resident aliens filing 530,000 Forms 1040. These tax returns:¹³

- ?? Reported adjusted gross income (AGI)¹⁴ of \$10.7 billion, which was reduced by \$7.5 billion for deductions. These deductions included the standard deduction, itemized deductions, and exemptions for the filers, the filers' spouses, and their dependents.
- ?? Claimed tax due before credits of \$495 million and then reduced tax due with credits of \$149 million.¹⁵ The credits included the Child Tax Credit (CTC), Dependent Care Credit, Education Credit, Foreign Tax Credit, and Credit for the Elderly.
- ?? Claimed refunds of \$522 million.
- ?? Reported no tax liability on 285,000 (54 percent) of the 530,000 tax returns filed.
- ?? Received Federal Government payments totaling \$160.5 million for the Additional Child Tax Credit (ACTC), \$151 million of which was paid to 190,000 individuals who had no tax liability. In

¹¹ See Appendix VII for an explanation of the term *unauthorized resident alien*.

¹² The margin of error is +/- \$122 million. The wide precision is caused by the number of returns in the sample with this attribute.

¹³ See Appendices V and VI for details concerning these attributes.

¹⁴ 26 U.S.C. § 62 (2003) provides that AGI is income from all taxable sources reduced by certain deductions, such as business expenses, retirement savings, and alimony payments.

¹⁵ See Appendix VI for additional information on each credit.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

addition, \$1.5 million was paid for the Earned Income Tax Credit (EITC).¹⁶

?? After all deductions and credits, reported a total tax liability of \$184 million, or 1.7 percent of the \$10.7 billion in AGI.

We identified an estimated 84,000 electronically filed returns reporting wages and having ITINs on both Forms 1040 and W-2. However, since the ITIN cannot be used for work purposes, it is unlikely that the employer provided a Form W-2 with the ITIN as the identifying number.¹⁷

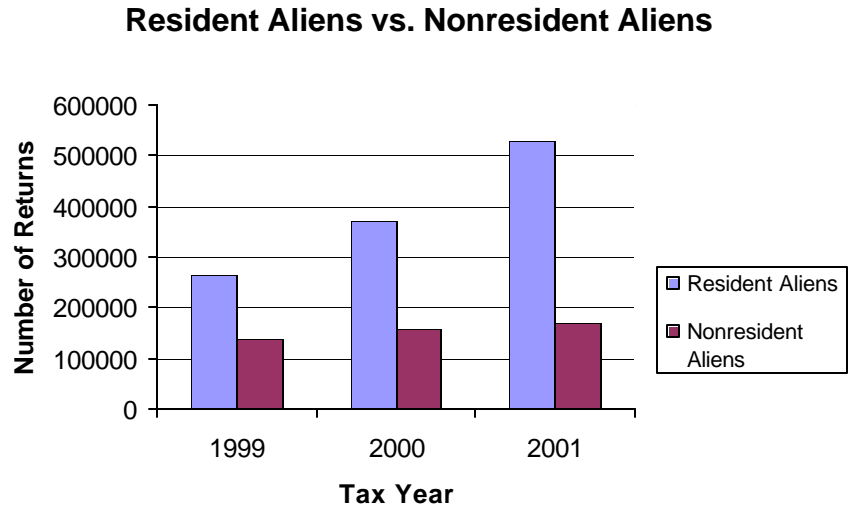
In all likelihood, the number of Forms 1040 with ITINs will increase. Resident aliens filing Forms 1040 identified with an ITIN have increased from approximately 266,000 in TY 1999 to approximately 530,000 in TY 2001, as shown in Figure 1.

¹⁶ The EITC is a refundable tax credit for eligible individuals and families who work and have earned income under a specified dollar amount. The individual must have an SSN that allows that individual to work. SSNs are required for that individual, the individual's spouse (if filing a joint return), and qualifying child.

¹⁷ The margin of error is +/- 2,144 tax returns.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Figure 1: Income Tax Returns Filed by Resident Aliens and Nonresident Aliens



Source: IRS ITIN Usage Report, 1999-2001, and Treasury Inspector General for Tax Administration (TIGTA) analysis for TY 2001.

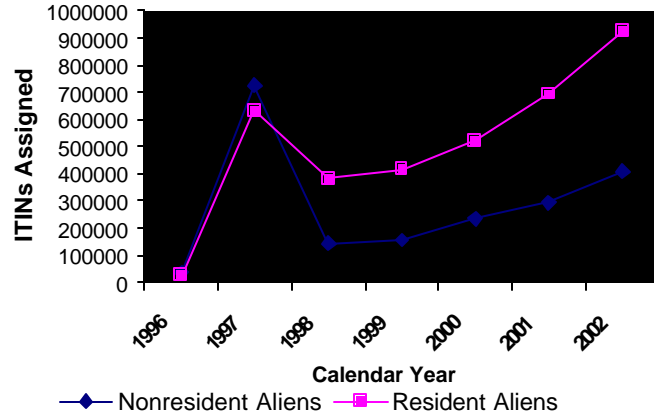
In fact, the number of Forms 1040 with an ITIN processed for TY 2001 represents a 99 percent increase over a 3-year period. During these same years, the number of all Forms 1040 processed increased by only 2.8 percent.

This rapid growth will continue if the number of recently issued ITINs can be used as an indication of future filing trends. As shown in Figure 2, resident aliens account for a significant majority of individuals to whom ITINs were issued. The IRS issued almost 6 million ITINs to resident and nonresident aliens in Calendar Years (CY) 1996 through 2002. Resident aliens accounted for 60 percent, and nonresident aliens accounted for a little over 33 percent of the ITINs issued.¹⁸

¹⁸ The IRS categorized the remaining 7 percent of the ITINs issued as "Other." An analysis of this category was beyond the scope of this review.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Figure 2: ITINs Assigned by the IRS



Source: TIGTA analysis of the IRS Database for ITINs.

Moreover, the number of ITINs issued to resident aliens, their spouses, and dependents increased from 693,000 in CY 2001 to 925,000 in CY 2002, a 1-year increase of 33 percent. The IRS Commissioner stated that the IRS Taxpayer Assistance Centers (TAC)¹⁹ in the Western and Southwestern parts of the U.S. help between 100 and 150 noncitizens seeking ITINs per day.

Forms 1040 Filed With an Individual Taxpayer Identification Number Represent a Challenge for Tax Administration

Forms 1040 filed with ITINs represent a challenge for tax administration. Two tax administration concerns arose from these returns:

- ?? Unauthorized resident aliens with questionable identification benefit 2d, 2e-----
- 2d, 2e-----

¹⁹ The TACs primarily serve taxpayers who choose to seek help from the IRS in person. The IRS employees who work in the TACs provide services such as assisting in interpreting tax laws and regulations, preparing some tax returns, and resolving inquiries on taxpayer accounts.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

?? Unauthorized resident aliens, who did not report in TY 2000 an estimated \$324 million in income, would benefit 2d, 2e-----
----- --

**Unauthorized resident aliens with questionable identification benefit 2d, 2e-----
2d, 2e-----**

2d, 2e-----
2d, 2e----- even though they filed Forms 1040 with incorrect or altered identification information on their Forms W-2. Persons preparing tax returns for compensation (paid preparers) and, occasionally, IRS employees and federally funded volunteers supported by the IRS,²¹ assisted with 81 percent of these returns in TY 2000 and 75 percent in TY 2001. The situation is different for paper filed and electronically filed returns.

Paper filed Forms 1040

2d, 2e-----

2d, 2e--- This situation occurs when Forms 1040 are identified with an ITIN, but one or more of the attached Forms W-2 is identified with an SSN. We estimate 2d, 2e---
2d, 2e-----309,000 TY 2000 Forms 1040 with questionable identification.

2d, 2e-----

²⁰ The IRS identifies unreported income through its Automated Underreporter (AUR) document matching program. The AUR program compares income reported on tax returns to income reported by third-party sources, such as the Forms W-2 submitted through the SSA to the IRS by employers.

²¹ These volunteers are associated with the Volunteer Income Tax Assistance and the Tax Counseling for the Elderly programs.

^{2d}, 2e-----

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

2d, 2e----- the IRS ITIN Task Force recommended in September 2002 that an automated system be developed2d, 2e-----
2d, 2e-----
2d, 2e-----²³ However, the IRS did not take this action pending further study of the issue.

In August 2002, the IRS Commissioner advised the Department of the Treasury 2d, 2e-----

2d, 2e----- The IRS did not take action because it believed there would be a significant cost to developing and implementing the required procedures.²⁴

2d, 2e-----

Potential violations of tax statutes and the identity theft statute – 2d, 2e-----

2d, 2e-----there is concern whether potential violations of tax laws may have been committed which affect tax administration. In general, the tax law provides that the tax return information be true.

There are three provisions concerning the information on the tax return. First, the I.R.C. states, “that any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under the penalties of perjury.”²⁵ Individuals convicted of perjury may be subject to fines and imprisonment.²⁶

²³ *Internal Revenue Service Individual Taxpayer Identification Number (ITIN) National Task Force Final Report* (September 2002).

²⁴ *The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations* (Reference Number 094505, dated September 1999).

²⁵ 26 U.S.C. § 6065 (2003).

²⁶ 18 U.S.C. § 1621 (2003).

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Second, the I.R.C. states that, “any person who willfully aids or assists in the preparation or presentation of a return, which is fraudulent or is false as to any material matter shall be guilty of a felony and subject to fines and imprisonment.”²⁷

Finally, “any person who willfully delivers or discloses to the Secretary any list, return, account, statement, or other document, known by him to be fraudulent or to be false as to any material matter shall be guilty of a felony, and subject to fines and imprisonment.”²⁸

In the case of the ITIN returns, there is further concern whether there were potential violations of the identity theft statute. We estimate that the 309,000 TY 2000 Forms 1040 included 265,000 SSNs that did not belong to the individuals who filed the tax returns or to their spouses. Seventy-nine percent of these 309,000 tax returns received a refund. The SSA had assigned these SSNs to other individuals. This indicates the possibility that the SSNs were fraudulently used.

The Identity Theft and Assumption Deterrence Act of 1998²⁹ provides that a criminal offense is committed if an individual knowingly uses, without lawful authority, a means of identification of another individual with the intent to commit any unlawful activity that constitutes a violation of Federal law. This would include using another individual's personal identifying information, such as an SSN, and providing that SSN to obtain a tax refund.

The IRS Criminal Investigation (CI) function is authorized to investigate the submission of potential fraudulent or false documents in connection with a return and fraudulent claims for a refund. The CI function can also investigate potential identity theft when one of these tax violations is already present. The facts and circumstances of the potential tax and identity theft violations, as they pertain to Forms 1040 identified with an ITIN, may not fall within the guidelines for initiating an investigation.

²⁷ 26 U.S.C. § 7206 (2003).

²⁸ 26 U.S.C. § 7207 (2003).

²⁹ Pub. L. No. 105-318, 112 Stat. 3007 (1998).

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Assisting the victims of identity theft – Law enforcement officials have characterized identity theft as the fastest growing type of crime in the U.S.³⁰ Identity theft headed the Federal Trade Commission's (FTC) list of the top 10 consumer fraud complaints for 2001 and 2002.³¹ The FTC stated that, in CY 2001, approximately 1,700 victims reported "fraudulent claims for tax returns in their name." In CY 2002, almost 3,100 victims reported tax return-related fraud. Some of these instances may have involved Federal tax.³²

When the use of a false SSN results in the IRS making an unwarranted contact with a taxpayer, the IRS Commissioner stated, "Not only will the innocent taxpayer undergo the burden of resolving this issue with the IRS, their social security earnings and FICA withholding must be corrected."³³ The IRS is addressing the victims of identity theft through its National Taxpayer Advocate (NTA) Service and initiating procedures to assist taxpayers in response to reports of identity theft.

We recognize these efforts. However, the IRS does not take advantage of all available methods to reduce the consequences of identity theft that might affect taxpayers. When it processes Forms 1040, the IRS does not
2d, 2e-----
2d, 2e-----Nor has the IRS determined whether the FTC's data could be used to assist taxpayers.

³⁰ *Identity Theft - Greater Awareness and Use of Existing Data Are Needed* (GAO-02-766, dated June 2002).

³¹ FTC, Identity Theft Complaint Data – Figures and Trends on Identity Theft, January 2001 through December 2001; FTC, National and State Trends in Fraud and Identity Theft, January – December 2002. The FTC is responsible for the Federal Government's centralized complaint and consumer education service for victims of identity theft. The FTC does not keep statistics showing the number of reported identity thefts affecting Forms 1040.

³² FTC reports for 2001 and 2002.

³³ FICA stands for the Federal Insurance Contributions Act. FICA payroll withholding finances benefits for retired workers and their dependents, as well as for disabled workers and their dependents. The FICA tax is also known as the Social Security tax.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Electronically filed Forms 1040

2d, 2e-----the IRS has a method to identify electronically filed Forms 1040 with two different identification numbers. 2d, 2e-----
2d, 2e-----

2d, 2e----- However, this process is ineffective for two reasons.

First, 2d, 2e-----

The IRS no longer assists taxpayers with this type of 2d, 2e-----return. Instead, the IRS employees were instructed to direct taxpayers to a volunteer program for assistance 2d, 2e----- In effect, the IRS transferred to volunteer organizations any risk of providing return preparation assistance 2d, 2e-----

Second, 2d, 2e----- electronically filed tax returns on which the Form W-2 identification number was apparently changed from the number appearing on the original Form W-2. The IRS processed an estimated 84,000 TY 2001 Forms 1040 filed with an ITIN that reported wages³⁴ and refunded \$121 million; it rejected only 119 of these returns.

In all likelihood, the Form W-2 identification numbers were changed between the time the Forms W-2 were issued by the employer and the time the tax returns were electronically filed with the IRS. As a result, using ITINs on Forms W-2 submitted with electronically filed tax returns may raise

³⁴ The margin of error is +/- 2,144 tax returns.

The Internal Revenue Service’s Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

concerns over potential violations of tax statutes similar to concerns that may arise when two different identification numbers are used on paper filed tax returns.

2d, 2e-----

Why Form W-2 identification is changed – Not surprisingly, electronic filers usually were assisted by IRS-authorized Electronic Return Providers (ERP)³⁵ and, on occasion, by the IRS’ own employees and volunteers, as shown in Table 1.

Table 1: Electronic Filing Assistance Provided on TY 2001 Forms 1040 With an ITIN

Tax Return Prepared by	Number of Tax Returns	Percentage of Tax Returns
IRS-Authorized Electronic Return Originators	79,125	94.6%
IRS	1,558	1.9%
IRS-Supported Volunteer Tax Assistance Programs	636	0.8%
Total Assisted	81,319	97.3%
Taxpayer Prepared	2,308	2.8%
Total Processed by the IRS	83,627	100%

Source: The IRS Electronic Tax Administration Research and Analysis System.³⁶ Percentages do not total to 100 percent due to rounding.

These Forms W-2 were filed with incorrect identification numbers for several reasons. The IRS advised the ERPs not

³⁵ There are four categories of Electronic Return Providers (ERP), each of which has a separate role in the electronic return preparation and filing process. One type, the Electronic Return Originator, is discussed later in this report.

³⁶ This system provides information on tax returns filed electronically. This information is used solely for research purposes, such as identifying error trends and how errors were resolved.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

to alter Form W-2 information and to confirm the identity and identification number of the taxpayer. The IRS also indicated that it would not accept a tax return for electronic processing when the identification number on Form W-2 does not match the identification number on Form 1040. However, to file electronically, the Form W-2 identification number must be changed or the IRS will not accept the return for processing.

In addition, IRS employees and volunteers did not follow instructions to prepare only paper returns. The IRS stated that preparing electronic tax returns would involve changing the identification number on the Form W-2.

Computer programs used by the ERPs may automatically change the Form W-2 number. We tested four computer programs used to prepare electronic tax returns, including one used by IRS employees and volunteers. The preparer enters the identification number under which the Form 1040 will be filed. This identification number is automatically updated to the Form W-2 information. So, when an ITIN is used for the Form 1040, the computer program will automatically insert the ITIN as the Form W-2 identification number.

Similar to paper filed returns, taxpayers and preparers may be subject to perjury and fraud statutes when information is changed. In addition, the ERPs may be subject to income tax return preparer penalties. These penalties can be considered when an ERP makes changes to a tax return, other than a transposition error, misplaced entry, spelling error, or arithmetic correction. The IRS can also sanction an ERP for violating the requirements of the electronic filing program. These sanctions include a written reprimand, suspension, or expulsion from the program, depending upon the seriousness of the infraction.

We expect this issue to become more prominent in the future. The IRS electronically processed over 86,700³⁷ TY 2001 Forms 1040 with an ITIN, almost doubling the estimated 44,000 electronic returns with ITINs processed in TY 2000. The IRS Restructuring and Reform

³⁷ All electronically filed tax returns, including the 84,000 reporting wages.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Act of 1998 (RRA 98)³⁸ established a goal that 80 percent of all tax returns should be filed electronically by 2007.

Unauthorized resident aliens who did not report in TY 2000 an estimated \$324 million in income benefit
2d, 2e-----

2d, 2e-----

2d, 2e-- For TY 2000, we estimate that 82,000³⁹ returns filed by unauthorized resident aliens did not report income from wages and nonemployee compensation of \$324 million,⁴⁰ an average of almost \$4,000 per tax return.

These 82,000 underreporters represent 23 percent of all unauthorized resident aliens who filed tax returns. Therefore, almost one of every four filers did not report all their income as required by law. Over one-half of these underreporters claimed no tax liability on their tax returns.

One of the IRS' strategic goals is to provide service to all taxpayers by increasing the fairness of compliance and increasing overall compliance. To help achieve this goal, the IRS identifies unreported income through its Automated Underreporter (AUR) document matching program and by examining tax returns. However, neither method is fully effective for finding and taxing income not reported by unauthorized resident aliens.

2d, 2e-----

³⁸ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

³⁹ The margin of error is +/- 15,866 tax returns.

⁴⁰ Projection based on a statistically valid sample of TY 2000 Forms 1040 with an ITIN for resident aliens claiming wages and nonemployee compensation 2d, 2e-----

2d, 2e-----The IRP proces ses information returns submitted either on magnetic media or electronically from businesses; financial institutions; and Federal, state, and local governments.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

2d, 2e-----

The IRS can also identify unreported income through examinations. However, of the 353,000 TY 2000 Forms 1040 filed with an ITIN and reporting wages, 2d, 2e--

Examinations of returns submitted by these filers may become even less frequent because the IRS is redirecting its resources to higher-income taxpayers.

The IRS recognizes the need to address the ITIN tax administration challenges. The IRS chartered an ITIN Task Force, accepted most of its recommendations, and established an ITIN Project Office that is implementing the accepted recommendations. In addition, the IRS established an ITIN position in the NTA Service and is initiating procedures to assist taxpayers who might have been victims of identity theft. Our recommendations to supplement these actions follow.

Recommendations

The Commissioner, W&I Division, should:

1. Identify paper filed Forms 1040 with an ITIN having a related Form W-2 with an SSN, 2d, 2e-----

2. Identify electronically filed tax returns where both the Form 1040 and related electronic Form W-2 are filed with an ITIN, 2d, 2e-----
2d, 2e----- Since the IRS' electronic control already rejects tax returns when

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

identification numbers do not match, no electronically filed return with an ITIN should be accepted.

Management's Response: Management did not agree that 2d, 2e-----
2d, 2e---would improve tax administration. 2d, 2e-----
2d, 2e-----
Management has seen no evidence that ITIN holders are more or less accurate in calculating their tax liabilities than any other taxpayer group. 2d, 2e-----

2d, 2e-----

Office of Audit Comment: We are unclear concerning the IRS' rationale for not implementing these recommendations. The intent was not to question the ability to correctly calculate tax 2d, 2e-----, but rather to establish the identity of the filer. The recommendations for paper filed and electronically filed returns follow the IRS' current application of the I.R.C. provision 2d, 2e-----
2d, 2e-----⁴² and the recommendation for paper filed returns follows the methodology currently used on 2d, 2e----- - Consequently, the recommendations do not constitute a new policy. In fact, the IRS Commissioner advised the Chairman of the U.S. Senate Committee on Finance that the IRS routinely uses its

⁴¹ The filing season is the period from January through mid-April when most individual income tax returns are filed.

^{2d}, 2e-----

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

authority 2d, 2e-----

2d, 2e-----³ In
FY 2000, the IRS used this authority over 1.2 million
times⁴⁴ 2d, 2e-----
2d, 2e----- Therefore, the issue is not a
matter of accurately calculating tax liability but rather the
consistency of the identification numbers on the tax returns,
schedules, or statements.

We disagree with the decision to 2d, 2e-----
electronic returns for ITIN filers when the Forms W-2 show
ITINs. As a result, 2d, 2e-----
2d, 2e--even though the Form W-2 identification numbers
were probably changed between the time they were issued
by the employer and the time the returns were filed.

By not taking action on paper filed and electronically filed
returns, the IRS will continue to hold U.S. citizens and
resident aliens authorized to work in the U.S. to a different
standard than that to which unauthorized resident aliens are
held.

Additionally, management's response seems to address an
overall ITIN filer tax compliance issue that these
recommendations do not address, but which is addressed by
Recommendation 6. While management states 2d, 2e-----
2d, 2e-----with
underreporting tax liability, the report shows that one in four
of these TY 2000 filers had underreported their income.

3. Conduct outreach to advise paid preparers and ERPs that
the ITIN is not a legal identification number for
employment and that their customers may be using
fraudulent or erroneous SSNs on Forms W-2. In
addition, they should be advised that the electronic
Form W-2 information must show the identification
number that appears on the Form W-2 as issued by the
employer.

^{2d}, 2e-----

⁴⁴ Does not include identification mismatches related to the EITC.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Management's Response: Management agreed, in part, with this recommendation. The Office of Taxpayer Education and Communication, SB/SE Division, will conduct outreach and provide advice to paid preparers and ERPs through the SB/SE Division Payroll and Practitioner's Forum, the IRS Stakeholder Headliners, and the IRS e-News for Tax Practitioners. The Director, Electronic Tax Administration, will conduct outreach to alert paid preparers and ERPs to the allowable use and application of ITINs and the importance of not altering Form W-2 information. However, management stated that paid preparers and ERPs are not required to verify the identification information provided by a taxpayer.

Office of Audit Comment: The intent of the recommendation is not to verify identification information, but simply to identify two inconsistent identification numbers used on Forms 1040 and Forms W-2. We believe the issue of verifying identification information is separate from the issue of identifying two different identification numbers. We made no recommendation concerning this issue and did not include it in the scope of the audit.

4. Ensure that IRS employees and volunteer programs do not assist with the preparation or filing of tax returns with questionable identification.

Management's Response: Management agreed with this recommendation to the extent that IRS programs already address it. Training was provided to volunteers regarding identification verification, and the existing training advises volunteers to refuse return preparation if there are concerns regarding the validity of documents. The IRS Field Assistance sites stopped preparing returns with mismatched TINs during the 2003 Filing Season. However, management stated that return preparers are not required to verify identification information provided by a taxpayer.

Office of Audit Comment: Similar to our comments for Recommendation 3, the purpose of this recommendation is not to put volunteers in the position of performing identification information verification. As we reported, the IRS does not permit its own employees to assist with these returns. 2d, 2e-----

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

2d, 2e-----

2d, 2e----- The fact that there are two different identification numbers should preclude the volunteers from assisting in return preparation, just as it precludes IRS employees from assisting in return preparation

- 5. Advise developers of electronic filing computer programs to modify these programs to prevent the automatic update of Form W-2 identification information when an ITIN is used on Form 1040.

Management's Response: The IRS will work with the software developers to ensure that their *e-file* programs validate that the information populated on the Form 1040 agrees with the information contained on the Form W-2. This will prevent the automatic update of Forms W-2 when an ITIN is used on Form 1040.

2d, 2e-----
2d, 2e----- the Commissioner, W&I Division, should:

- 6. 2d, 2e----- unreported income from third -party records 2d, 2e-- -----
2d, 2e-----
- 7. Identify potential victims of identity theft and minimize the possibility of unwarranted IRS contacts 2d, 2e---
2d, 2e-----

Management's Response: Management did not agree with the recommendations at this time, stating that a cost-benefit analysis of implementing 2d, 2e----- would need to be undertaken. 2d, 2e-----
2d, 2e-----

2d, 2e-- Management stated that while these actions are currently not feasible, they will continue to study whether the actions might become feasible in the future.

Office of Audit Comment: While management's interest in the future feasibility of these recommendations appears to

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

be a corrective action, management did not identify the responsible officials, set completion dates, or describe how any actions taken would be monitored. We determined that the corrective action would involve 2d, 2e----- 2d, 2e---- an estimated 444,000 of the 89 million paper filed TY 2001 Forms 1040, or about one-half of 1 percent. The processing cost would be approximately \$435,000.⁴⁵ In FY 2003, the IRS had a budget approaching \$10 billion. By not 2d, 2e----- the IRS continues to hold U.S. citizens to a higher standard than that to which it holds unauthorized resident aliens.

As we stated in the report, one in four TY 2000 Forms 1040 filed with an ITIN by resident aliens had underreported income 2d, 2e----- In contrast, available statistics show that one in nine tax returns 2d, 2e----- for potentially discrepant income or deductions. While these results may not be directly comparable to those in the report, the results suggest that the noncompliance rate of Forms 1040 with an ITIN could be higher than that for all Forms 1040.

Furthermore, we believe taking action is of heightened importance when the percentage of people in America who think that it is acceptable to cheat on their Federal income tax returns increased from 11 to 17 percent between 1999 and 2003.⁴⁶ In our opinion, providing equal treatment to all taxpayers and enabling the IRS to assist as many as 265,000 potential victims of identity theft would outweigh the costs.

8. Determine whether the FTC's data on identity theft can be used to assist taxpayers who might be victims of this violation.

Management's Response: The ITIN Program Office will contact the FTC to determine whether the data contained in

⁴⁵ Estimate based on the most recent cost figures available, as included in the IRS' FY 2000 cost estimate guidelines. Our estimate would increase for FY 2004 due to inflation. This figure does not include programming costs.

⁴⁶ 2003 IRS Oversight Board Annual Survey on Taxpayer Attitudes, September 2003.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

its database can be used by the IRS to assist victims of identity theft.

The Deputy Commissioner for Services and Enforcement should:

9. Determine whether any actions are warranted against taxpayers, ERPs, IRS employees, and volunteers who prepare or assist with preparing or filing of tax returns with questionable identification.

Management's Response: The IRS Office of Chief Counsel advised that a person who prepares or assists with the preparation or filing of a tax return is not subject to a preparer penalty merely because the taxpayer's identification on the return is questionable. The IRS stated that return preparers are not required to verify the identification information provided by a taxpayer, and the recognition of such questionable identification may be beyond their expertise.

Office of Audit Comment: Management's response showed that they followed the intent of the recommendation by obtaining the IRS Office of Chief Counsel's advice. However, while the response addressed penalties against tax return preparers, it did not address sanctions against ERPs, as described in the report. Furthermore, the basis of management's response appears to be similar to their basis for Recommendations 3 and 4, which addressed verification of identification information. As we noted, our interest was in detecting the use of two different identification numbers. Consequently, we cannot be certain that management fully addressed this issue. Moreover, we believe that the preparer community could recognize the use of two inconsistent identification numbers if the IRS includes this information as part of its action on Recommendation 3. As a result of these factors, this issue remains a concern.

Other Federal Government Agencies and Tax Policy Are Affected by Individual Taxpayer Identification Number Usage

Other Federal Government agencies and tax policy issues are affected by ITIN usage. The two concerns that arose from the analysis of these returns are:

- ?? Other Federal Government agencies are affected because unauthorized resident aliens benefit from the tax law that generally prohibits the disclosure of tax information to other Federal Government agencies.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

?? From a tax policy perspective, unauthorized resident aliens benefit from the tax law when they are treated the same as U.S. citizens.

Other Federal Government agencies are affected because unauthorized resident aliens benefit from the tax law that generally prohibits the IRS from sharing with other Federal Government agencies tax return information submitted by taxpayers

There are at least two Federal Government agencies that could benefit from the information that the IRS receives on Forms 1040 that use ITINs. The IRS does not share this information with the other agencies.

Available statistics indicate that unauthorized resident aliens are increasing in number, despite efforts to prevent unlawful entry. The Bureau of Citizenship and Immigration Services (BCIS) estimated that the total unauthorized resident alien population had doubled in the past decade, from 3.5 million in 1990 to 7 million in 2000. On average, this population grew by 350,000 annually.⁴⁷

The IRS does have information on some of the unauthorized resident aliens. However, the tax law generally prohibits the IRS from sharing tax return information submitted by taxpayers with other Federal Government agencies unless there is a specific legislated exception.⁴⁸ Because the IRS is unable to share this information, it cannot assist with addressing unauthorized immigration or unauthorized work. In turn, this creates the need to administer tax laws to an increasing number of unauthorized resident aliens.

The IRS cannot share information with the BICE

The Illegal Immigration Reform and Immigrant Responsibility Act of 1996 (IIRIRA)⁴⁹ provided that information concerning immigration status should be reported to the BICE notwithstanding any other law. The General Accounting Office (GAO) testified before the Congress that the BICE needed to coordinate with other

⁴⁷ *Estimates of the Unauthorized Immigrant Population Residing in the United States: 1990 to 2000* (2003).

⁴⁸ 26 U.S.C. § 6103 (2003).

⁴⁹ Pub. L. No. 104-208, 110 Stat. 3009 (1996).

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Federal Government agencies to effectively implement its strategies for controlling illegal immigration.⁵⁰

In our opinion, the IRS is able to identify some unauthorized resident aliens by using its ITIN records but by law is unable to share this information with other Federal Government agencies. The I.R.C. provides that this information is confidential, and it does not include a provision for disclosing this information.

In 1999, we first reported on the apparent conflict between immigration and tax laws.⁵¹ We recommended that the ITIN program disclosure policy be brought into conformance with the immigration law. The IRS advised us that the disclosure law would need to be changed to specifically permit the IRS to follow the IIRIRA. While the disclosure law was amended, it provides only for certain disclosures involving terrorism.⁵² Therefore, the IRS is unable to assist the BICE with information about potential unauthorized resident aliens. In light of the events of September 11, 2001, and the importance of homeland security, the apparent conflict between immigration and tax law remains a concern.

Unauthorized resident aliens are preparing tax returns for U.S. citizens

Paid preparers are required to show on the tax return their SSN or Preparer Tax Identification Number (PTIN). An ITIN recipient is not authorized to obtain a PTIN.

For TY 2001, 290 ITINs were shown as the preparer's identification number on 8,179 tax returns. Of these returns, 6,747 (82 percent) were filed by taxpayers with SSNs who, therefore, likely were U.S. citizens or foreign individuals

⁵⁰ *Immigration Enforcement - Challenges to Implementing the INS Interior Enforcement Strategy* (GAO-02-861T, dated June 2002).

⁵¹ *The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations* (Reference Number 094505, dated September 1999).

⁵² Victims of Terrorism Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427 (2002). This law amended 26 U.S.C. § 6103 to provide for disclosure until December 31, 2003, of certain IRS information in the event of a terrorist incident, threat, or activity.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

legally residing in the U.S. Most of these tax returns were prepared by 42 individuals, as shown in Table 2.

Table 2: Unauthorized Resident Aliens Prepared TY 2001 Forms 1040 for Taxpayers Filing with SSNs

Number of Tax Returns Prepared: Strata	Number of Preparers	Number of Tax Returns	% of Total Tax Returns
10 or more	42	6,459	96%
Less than 10	190	288	4%
Totals	232	6,747	100%

Source: TIGTA analysis of the IRS Returns Transaction File (RTF).⁵³

Consequently, unauthorized resident aliens would have access to sensitive data such as SSNs and financial records, which could be used inappropriately. Yet, the IRS cannot share this information with other Federal Government agencies or the affected taxpayers.

The IRS NTA reported to the Congress that there are no national standards that a person is required to satisfy before presenting himself or herself as a Federal tax preparer and selling tax preparation services to the public. To address this issue, the NTA recommended that the Congress enact a registration, examination, certification, and enforcement program for persons who prepare Federal tax returns.⁵⁴

Although there are no overall standards for the preparer industry, the IRS has standards for Electronic Returns Originators (ERO).⁵⁵ Each ERO's responsible officials must be U.S. citizens or legal resident aliens and are subject to a screening process as a condition of approval of their application. However, individuals who work for those

⁵³ The RTF contains all edited, transcribed, and error-corrected data from the Form 1040 series of tax returns and related forms for the current processing year and 2 prior years.

⁵⁴ *National Taxpayer Advocate FY 2002 Annual Report to Congress.* The NTA Service is an independent organization within the IRS that helps taxpayers resolve problems with the IRS and recommends changes that will prevent the problems.

⁵⁵ An ERO begins the process of transmitting a completed tax return to the IRS. The ERO is one of the four categories of ERPs.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

EROs are not required to meet the same requirements. Preparers with ITINs were affiliated with 15 businesses that were approved by the IRS as EROs.

The IRS relies on EROs to confirm identities and identification numbers shown on tax returns. The IRS has stated that confirmation of identification numbers is “the cornerstone of any fraud prevention program.” The IRS asks the EROs to look for suspicious or altered Forms W-2 and fraudulent returns where an individual uses someone else’s name or SSN. The IRS’ reliance on unauthorized resident aliens to be watchdogs over fraud could cause the IRS embarrassment and may have an adverse impact on public confidence and satisfaction with the tax system.

The IRS cannot share information with the SSA

The second area of Federal Government concern is with SSN identity theft. Government agencies reported that hundreds of thousands of unauthorized resident aliens have used fraudulent documents, including Social Security cards, to obtain employment.⁵⁶

The Inspector General of the SSA testified before the Congress that identity theft was already a significant problem facing law enforcement, the financial industry, and the American public before September 11, 2001. The Inspector General stated that improperly obtained SSNs were a factor in the terrorists’ ability to assimilate themselves into American society while they planned their attacks. The events of September 11, 2001, heightened the urgency for protecting the integrity of SSNs.⁵⁷

The Social Security Act⁵⁸ provides that whoever, with the intent to deceive, falsely represents a number to be his or her SSN when, in fact, that number was not assigned to that person, shall be guilty of a felony and subject to a fine,

⁵⁶ *Immigration Enforcement - Challenges to Implementing the INS Interior Enforcement Strategy* (GAO-02-861T, dated June 2002).

⁵⁷ Statement of the Honorable James G. Huse, Jr., Inspector General, SSA, Testimony Before the Subcommittee on Social Security of the House Committee on Ways and Means and the Subcommittee on Oversight and Investigations of the House Committee on Financial Services, November 8, 2001.

⁵⁸ 42 U.S.C. § 408 (2003).

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

imprisonment, or both. This includes using a false SSN to obtain employment.

The I.R.C. generally prohibits the IRS from disclosing this information to the SSA. Consequently, the SSA would not be provided with the opportunity to initiate investigations based on the IRS information, and unauthorized resident aliens would not be affected by the consequences of potentially violating the Social Security statute.

Unauthorized resident aliens submitted to the IRS an estimated 309,000 paper filed tax returns with an estimated 354,000⁵⁹ SSNs on Forms W-2. These Forms W-2 included 265,000 SSNs that are assigned by the SSA to other individuals.

As a possible indicator of a growing problem with identity theft, the FTC stated that, in CY 2001, approximately 7,800 victims reported that the identity thief used the victim's personal information to obtain employment.⁶⁰ In CY 2002, approximately 15,000 victims reported employment-related fraud.⁶¹

From a tax policy perspective, unauthorized resident aliens benefit from the tax law when they are treated the same as U.S. citizens

The I.R.C. defines for tax purposes the terms *nonresident alien* and *resident alien*. A nonresident alien is neither a citizen of the U.S. nor a resident of the U.S. A resident alien is a resident of the U.S. for any calendar year if that individual was lawfully admitted for permanent residence. A resident alien is also a foreign individual in the U.S. who meets the "substantial presence" test, which is based on the number of days that individual resides in the U.S.⁶² Therefore, for tax purposes, an unauthorized alien residing in the U.S. is a resident alien.

As a result, unauthorized resident aliens are taxed the same as U.S. citizens and lawful resident aliens. An unauthorized

⁵⁹ The margin of error is +/- 21,348 SSNs.

⁶⁰ *Identity Theft Complaint Data - Figures and Trends on Identity Theft, January 2001 through December 2001.*

⁶¹ *National and State Trends in Fraud and Identity Theft, January - December 2002.*

⁶² 26 U.S.C. § 7701.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

resident alien is entitled to the same deductions and credits to reduce income tax, except for the EITC.

So, the question becomes whether the taxation of unauthorized resident aliens should be more closely aligned to that of nonresident aliens. Specifically, the ACTC provides a tax policy conflict since other Federal Government statutes prohibit treating unauthorized resident aliens the same as U.S. citizens and lawful resident aliens.

The ACTC law provides for Federal Government payments to unauthorized resident aliens who had no income tax liability

One of the credits that unauthorized resident aliens are entitled to is the ACTC. Over 203,000 unauthorized resident aliens received \$160.5 million in ACTC credits in TY 2001. Of these filers, 190,000 had no tax liability and received \$151 million in Federal Government payments for the ACTC.

The ACTC is one of only two major credits that can result in a Federal Government payment above the tax liability; the other credit is the EITC, which unauthorized resident aliens are prohibited from receiving.⁶³ Despite the difference in tax treatment, there are similarities between the ACTC and EITC.

Like the ACTC, the EITC was available to unauthorized resident aliens when it became law in 1975.⁶⁴ Subsequently, the Congress and IRS expressed concerns about noncompliance with EITC requirements, including fraud.⁶⁵ The law was changed in 1996, in part to deny the EITC to unauthorized workers; the tax return must be identified by

⁶³ While unauthorized resident aliens are not permitted to receive the EITC, they can attempt to obtain the credit by claiming it on the line provided for this purpose on Form 1040. In TY 2001, 17,797 filers claimed \$31.1 million. However, the IRS allowed only 843 filers credits of \$1.5 million. Determining the reason that these claims were paid was beyond the scope of this review.

⁶⁴ Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (1975).

⁶⁵ *Earned Income Credit - Data on Noncompliance and Illegal Alien Recipients* (GAO/GGD-95-27, dated October 1994). The term *Earned Income Credit* is interchangeable with the term *Earned Income Tax Credit* that is used throughout this report.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

an SSN issued to an individual by the SSA for work purposes.⁶⁶

One of the legislative purposes for the ACTC is similar to the purpose for the EITC. Prior to the EITC law change, the GAO reported that awarding the EITC to illegal aliens⁶⁷ was at cross-purposes with Federal Government policies that prohibit illegal aliens from working in the U.S.⁶⁸ Similar to the purpose of EITC, the Senate stated that tax law changes to the CTC and ACTC were intended for “low income working families to promote work.”⁶⁹ Like the EITC, providing the ACTC to resident aliens who are not authorized to work is inconsistent with the immigration law that prohibits employing unauthorized resident aliens.

Moreover, we identified an early indication of a similar filing pattern between the ACTC and EITC. Between 1975 and 1993, the maximum amount of the EITC increased from \$200 to \$2,364. As the amount of the EITC increased:

?? The number of Internal Revenue Service Numbers (IRSN), the predecessor to the ITIN, increased significantly. The IRS assigned approximately 1,800 IRSNs in 1975, which increased to 175,000 assigned in 1993.

?? The amount of the EITC claimed on returns assigned an IRSN increased from a projected \$141,000 in 1986 to a projected \$197 million in 1993.

Recent tax return filings show that the ACTC may be following a similar pattern. The ACTC first became available in TY 1998. Taxpayers needed three or more qualifying children to receive the credit. In TY 2001, the number of qualifying children was changed to one or more.

⁶⁶ Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 110 Stat. 2105 (1996).

⁶⁷ The GAO defined an *illegal alien* as a foreign person who is in the U.S. without a lawful immigration status.

⁶⁸ *Earned Income Credit - Targeting to the Working Poor* (GAO/GGD-95-122BR, dated March 1995).

⁶⁹ Restoring Earnings To Lift Individuals and Empower Families Act of 2001, H.R. 1836, as agreed to by the Senate. This bill was submitted to the House of Representatives and eventually became the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

While this reduction may have accounted for some of the increase in the ACTC, it may have also made obtaining an ITIN more appealing.

?? The IRS assigned 123,000 ITINs to resident aliens in CY 1998, the first year that the ACTC could be claimed. This rose to 339,000 ITINs in CY 2001 and 538,000 in CY 2002.

?? In TY 2000, the last year that 3 children were required to claim the ACTC, over 62,000 ITIN filers received an estimated \$62 million in ACTC. In TY 2001, when the number of qualifying children was reduced, 203,000 ITIN filers received \$160.5 million in ACTC.

On July 8, 2003, we issued a memorandum to the IRS (see Appendix VIII) that stated unauthorized resident aliens would be eligible for both the accelerated CTC disbursements under the newly passed Jobs and Growth Tax Relief Reconciliation Act of 2003,⁷⁰ and ACTC disbursements under the proposed Relief for Working Families Tax Act of 2003.⁷¹ We estimated that the accelerated disbursements could be \$150 million.

We recommended that the IRS Commissioner advise the Department of the Treasury about the apparent conflict with the immigration law, delay sending the accelerated disbursements until questionable identifications could be resolved, and propose legislation to place limitations on the ACTC, similar to the EITC, for unauthorized resident aliens.

In response to the memorandum, the IRS advised the Department of the Treasury of our concern about the credits and started the process of considering legislation to limit the ACTC. The IRS stated that it was not authorized to delay the disbursements because unauthorized resident aliens are entitled to the credit by law. The response is included as Appendix IX.

⁷⁰ Pub. L. No. 108-27, 117 Stat. 752.

⁷¹ H.R. 1308, as amended, and pending in Conference Committee.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

While virtually the same tax treatment is provided to all residents, the same treatment is not provided to all aliens

While unauthorized resident aliens are taxed like other residents, they are not taxed like aliens who do not reside in the U.S. but have U.S. source income. Thus, as a matter of tax law, unauthorized resident aliens are treated virtually the same as U.S. citizens and lawful resident aliens.

Nonresident aliens cannot receive certain benefits from the tax law that would reduce their tax bills. For example, for TY 2001:

- ?? Nonresident aliens cannot claim the standard deduction. Instead, they must itemize deductions. This may lower the amount of deductions from income and increase the tax liability. In contrast, unauthorized resident aliens claimed the standard deduction in 489,000 (92.3 percent) of the 530,000 tax returns filed, decreasing reported AGI by \$3.2 billion.
- ?? Nonresident aliens cannot claim the Education Credit. In contrast, 10,000 unauthorized resident aliens claimed \$7.4 million in credits to decrease their tax liabilities.
- ?? Unmarried nonresident aliens cannot claim the lower tax rate of the head of household filing status. In contrast, resident aliens claimed this status in 160,000 (30.2 percent) of the 530,000 tax returns filed.
- ?? Nonresident aliens could not receive a rate reduction credit. For TY 2001, unauthorized resident aliens received \$53 million⁷² in advance payments for the rate reduction credit. Those that did not receive an advance payment claimed \$63 million in credits to reduce their tax liabilities when they filed their TY 2001 tax returns.

The Federal Government has recognized that unauthorized resident aliens are not always entitled to benefit from the same laws as U.S. citizens. For example, the Social Security Act provides that they are not entitled to receive benefits from Old-Age, Survivors, and Disability Insurance benefits.⁷³

⁷² The margin of error is +/- \$7,724,530.

⁷³ 42 U.S.C. § 202 (2003).

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Similarly, the State of Wisconsin recognized that individuals who have not been granted immigrant status by the BCIS should be taxed differently from other state taxpayers. Wisconsin requires that these individuals be taxed like nonresidents of Wisconsin. Consequently, they are not eligible for the Working Families Tax Credit or the Homestead Credit.

When unauthorized resident aliens receive the ACTC like U.S. citizens and lawful resident aliens, the legislative purposes for assisting lawful working taxpayers may be compromised. The current tax laws and policy are favoring individuals who already may not have complied with immigration, Social Security, and identity theft laws.

Recommendations

The Deputy Commissioner for Services and Enforcement should:

10. Coordinate with the BCIS and the SSA to assess the benefits to these agencies of seeking legislation to broaden the IRS' authority to share information with them regarding unauthorized resident aliens and seek legislation as warranted.

Management's Response: Management's overall response to the content of the report stated, "Despite the distinctly undesirable behaviors actually or potentially associated with ITINs, the Service remains legally responsible for enforcement of the nation's Federal tax laws with respect to ITIN holders..." and that it has "statutory responsibilities and limitations to which the Service is subject that prevent or limit the Service from taking actions that might be desirable as matters of public policy."

Management's specific response to the recommendation stated that if the BCIS and SSA can demonstrate a need for the IRS' information that clearly outweighs taxpayer privacy interests and concerns about the effect such sharing has on tax administration, they should coordinate with the Office of the Assistant Secretary for Tax Policy at the Department of the Treasury to seek a legislative proposal to change I.R.C. § 6103. Management indicated they will

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

share a copy of this report with the Office of the Assistant Secretary for Tax Policy, the BCIS, and the SSA.

Office of Audit Comment: While management recognized that there are “distinctly undesirable behaviors actually or potentially associated with ITINs,” it has limited its coordination to sharing the report with the Assistant Secretary for Tax Policy and other Federal agencies. We encourage the IRS to take a more proactive role with these agencies by providing more in-depth guidance on the type of information the IRS receives, its privacy concerns, and the potential impact of legislation on tax administration. This approach could assist Federal agencies in determining whether legislation would help them achieve their missions, understanding the IRS’ interests, and, therefore, deciding whether to coordinate with the Assistant Secretary for Tax Policy. In addition, although not included in our recommendation, we also encourage the IRS to share a copy of the report with the BICE.

11. Supplement the NTA’s recommendation for a certification program for tax preparers by proposing that, in general, (1) preparers must be U.S. citizens or resident aliens authorized to work in the U.S. and (2) individuals who assist with electronically filed tax returns for U.S. residents, and who are affiliated with an ERO, must be U.S. citizens or resident aliens authorized to work in the U.S.

Management’s Response: A copy of this report will be shared with the NTA and the Office of the Assistant Secretary for Tax Policy, which is responsible for proposing legislative changes.

Office of Audit Comment: We are unclear from the response whether the IRS plans to supplement the NTA’s recommendation for a certification program for tax preparers. While the IRS will share a copy of the report with the NTA and the Office of the Assistant Secretary for Tax Policy, management did not specifically address the recommendation for the IRS to supplement the NTA’s existing proposal for legislation regulating paid preparers.

12. Seek legislation to define and tax individuals who file tax returns reporting income from employment, but who

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

are not authorized to be employed in the U.S., more like nonresident aliens.

Management's Response: A copy of this report will be shared with the Office of the Assistant Secretary for Tax Policy, which is responsible for proposing legislative changes.

Office of Audit Comment: We are unclear whether the IRS agrees or disagrees from a tax administration viewpoint since the IRS did not address these tax administration issues to the extent permitted by its policy on providing comments on legislation.

13. Determine whether tax return preparers who use ITINs as identification have violated any laws that the IRS is authorized to investigate and, if so, determine whether these violations warrant any action.

Management's Response: The IRS Office of Chief Counsel has indicated that inasmuch as the IRS requires a paid return preparer to furnish an identifying number, the tax return preparers who are not eligible for an SSN are not in violation of 26 U.S.C. § 6109(a)(4) or any revenue laws if they enter their ITIN. An individual who is not eligible for an SSN generally is expected to use an ITIN whenever such person is required to furnish an identifying number for tax administration purposes.

Office of Audit Comment: Management's response indicated that resident aliens who are not authorized to work in the U.S. are permitted to use ITINs to meet the IRS' identification requirement for individuals who work, within the tax system, as paid preparers. Furthermore, this issue aligns with the Federal Government's focus on citizenship issues: unauthorized resident aliens have access to sensitive identification and financial information from potentially unsuspecting U.S. citizens.

In our opinion, these factors provide management with knowledge of an employment issue that is inseparable from tax administration because of its potential impact on the public's confidence in the tax system. So, while no laws may have been violated, we believe that the risk of continuing this practice outweighs its benefit to tax administration.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to analyze United States (U.S.) Individual Income Tax Returns (Form 1040) filed with an Internal Revenue Service (IRS) Individual Taxpayer Identification Number (ITIN) by resident aliens for Tax Year (TY) 2001 and, where applicable, TY 2000. This evaluation included identifying attributes of these Forms 1040, such as income, deductions, credits and refunds, and the related tax administration issues that affect compliance with tax laws and regulations.¹ To accomplish the objective, we:

- I. Determined the filing attributes for Forms 1040.
 - A. Obtained a statistically valid sample of Forms 1040 for TY 2000 for review.
 1. Identified from the Returns Transaction File (RTF)² Forms 1040 meeting our criteria: filed for TY 2000, identified by an ITIN as the primary identification number, and filed by a resident alien.
 2. Selected from the universe of 353,373 tax returns a statistically valid sample of 353 tax returns for review using a confidence level of 95 percent, a precision level of +/- 2.5 percent, and an expected rate of occurrence not less than 95 percent. We obtained guidance on our sampling methodology from the IRS Office of Statistics of Income.
 3. Obtained the original Forms 1040 and information from the IRS Master File³ and Integrated Data Retrieval System.⁴
 - B. Quantified selected data from the TY 2000 tax returns involving identification numbers, dependents, income, deductions, credits, and refunds.
 1. Determined whether the identification numbers reported on the Forms 1040 and the attached Wage and Tax Statements (Form W-2) were both assigned to the same individual. We researched the IRS' records provided by the Social Security Administration to determine the identity of the individual for both identification numbers.
 2. Determined who prepared the Forms 1040.

¹ An analysis of the IRS' actions to resolve any tax returns with a balance due was beyond the scope of this review.

² The RTF contains all edited, transcribed, and error-corrected data from the Form 1040 series returns and related forms for the current processing year and 2 prior years.

³ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

⁴ The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

3. Identified potential unreported income by reviewing records from the IRS Information Returns Program (IRP) and comparing this information to the tax return submitted by the taxpayer.⁵
 4. Evaluated refunds by determining the amount of Rate Reduction Credit received in advance for TY 2001.
- C. Obtained an extract from the RTF for TY 2001 for Forms 1040 identified by an ITIN as the primary identification number and filed by a resident alien. We analyzed the data contained on the RTF, which included credits, deductions, income, and return preparation.
 - D. Determined the number of electronically filed TY 2001 Forms 1040 identified with an ITIN and reporting wages that were (1) processed by the IRS and (2) rejected by the IRS because the Taxpayer Identification Number (TIN) on the Form 1040 did not match the TIN on the Form(s) W-2. We analyzed data from the IRS Electronic Tax Administration Research and Analysis System.⁶
 - E. Evaluated the frequency of the examination of the filers' books and records by reviewing records from the IRS Audit Information Management System (AIMS).⁷
- II. Compared the Form 1040 to the U.S. Nonresident Alien Income Tax Return (Form 1040NR) to identify differences in benefits such as credits and deductions.
 - III. Analyzed the IRS ITIN Application Database for 1996 through 2002 to determine if each applicant was a resident or nonresident alien.

⁵ The IRP processes information returns submitted either on magnetic media or electronically from businesses; financial institutions; and Federal, state, and local governments.

⁶ This system provides information on tax returns filed electronically. This information is used solely for research purposes, such as identifying error trends and how errors were resolved.

⁷ The AIMS is designed to give the IRS Compliance function information about tax returns in inventory and closed.

**The Internal Revenue Service's Individual Taxpayer Identification Number Creates
Significant Challenges for Tax Administration**

Appendix II

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**The Internal Revenue Service's Individual Taxpayer Identification Number Creates
Significant Challenges for Tax Administration**

Appendix III

Report Distribution List

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Office of the Commissioner – Attn: Chief of Staff C
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Commissioner, Wage and Investment Division SE:W
Chief, Criminal Investigation CI
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Director, Customer Assistance, Relationships, and Education, Wage and Investment Division
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Director, Electronic Tax Administration OS:CIO:I:ET
Director, Taxpayer Education and Communication, Small Business/Self-Employed Division
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Director, Communications and Liaison, Small Business/Self-Employed Division SE:S:M:CL
Director, Stakeholder Partnerships, Education, and Communication, Wage and Investment
Division SE:W:CAR:SPEC
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Audit Liaisons:
 Commissioner, Large and Mid-Size Business Division SE:LM
 Commissioner, Small Business/Self-Employed Division SE:S
 Commissioner, Wage and Investment Division SE:W

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. We have separated the outcome measures at risk based on Tax Administration and Tax Policy issues. These benefits will be incorporated into our Semiannual Report to the Congress.

We obtained guidance on our sampling methodology and projections from the Internal Revenue Service (IRS) Office of Statistics of Income. Unless otherwise annotated, all computations are based on a 5-year period, computed as follows: Year 1 = estimates and actual data for Tax Year (TY) 2000, and Years 2 through 5 = actual data for TY 2001 which was used to compute the outcomes for this 4-year period.

Type and Value of Outcome Measure:¹

Tax Administration Issues

?? Revenue Protection – Potential; approximately 530,000 unauthorized resident aliens received approximately \$2.4 billion in refunds 2d, 2e------(see page 3).

[TY 2000 \$262 million x 1 year] + [TY 2001 \$522 million x 4 years] = \$2.4 billion

?? Increased Revenue – Potential; approximately 82,000 unauthorized resident aliens did not report income of \$324 million from all sources. Using an effective tax rate of 1.7 percent, the tax effect would be approximately \$27.5 million (see page 7).

[TY 2000 \$324 million x 1.7 percent in tax due = \$5.5 million] x 5 years = \$27.5 million

?? Cost Savings (Funds Put to Better Use) – Potential; unauthorized resident aliens working in the United States (U.S.) without authorization received the refundable Earned Income Tax Credit of approximately \$7.3 million (see page 3).

[TY 2000 \$1.2 million x 1 year] + [TY 2001 \$1.52 million x 4 years] = \$7.3 million

?? Taxpayer Burden – Potential; over 265,000 taxpayers may have been the victims of identity theft by unauthorized resident aliens in TY 2000 (see page 7).

Tax Policy Issues

?? Revenue Protection – Potential; unauthorized resident aliens received an accelerated payment of the Child Tax Credit of approximately \$150 million in TY 2003 (see page 23).

¹ Figures in this appendix and Appendix V may not match due to rounding.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

?? Revenue Protection – Potential; unauthorized resident aliens claimed the standard deduction of \$3.2 billion. Using an effective tax rate of 1.7 percent, there would be a tax effect of \$272 million (see page 23).

[TY 2001 \$3.2 billion x 1.7 percent in tax due = \$54.4 million] x 5 years = \$272 million

?? Revenue Protection – Potential; unauthorized resident aliens received the Child Tax Credit of \$597.3 million (see page 3).

[TY 2000 \$90 million x 1 year] + [TY 2001 \$126.83 million x 4 years] = \$597.3 million

?? Revenue Protection – Potential; unauthorized resident aliens received the Education Credit of \$33.5 million (see page 23).

[TY 2000 \$4.1 million x 1 year] + [TY 2001 \$7.35 million x 4 years] = \$33.5 million

?? Revenue Protection – Potential; unauthorized resident aliens received the Credit for the Elderly of approximately \$204,000 (see page 3).

[TY 2000 \$32,000 x 1 year] + [TY 2001 \$43,000 x 4 years] = \$204,000

?? Cost Savings (Funds Put to Better Use) – Potential; unauthorized resident aliens working in the U.S. without authorization received the refundable Additional Child Tax Credit of approximately \$704 million (see page 23).

[TY 2000 \$62 million x 1 year] + [TY 2001 \$160.53 million x 4 years] = \$704.1 million

?? Taxpayer Privacy and Security – Potential; 8,200 returns and financial information were available to unauthorized resident aliens who prepared tax returns in TY 2001 (see page 23).

Methodology Used to Measure the Reported Benefits:

We obtained tax return data from the TYs 2000 and 2001 IRS Returns Transaction Files (RTF).² In addition, we selected a statistically valid sample of 353 TY 2000 Forms 1040 filed with an Individual Taxpayer Identification Number (ITIN) as the primary identification number from a universe of 353,373 tax returns. Our sample was selected using a confidence level of 95 percent, a precision level of +/- 2.5 percent, and an expected rate of occurrence not less than 95 percent. We analyzed the attributes of the tax returns and the associated documents (i.e., Wage and Tax Statement [Form W-2]). Our analysis included quantifying income, deductions, tax credits, refunds, etc. We also obtained actual data for TY 2001 for returns filed by resident aliens with

² The RTF contains all edited, transcribed, and error-corrected data from the U.S. Individual Income Tax Return (Form 1040) series returns and related forms for the current processing year and 2 prior years.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

an ITIN. In addition, we obtained information from the IRS Master File³ and Integrated Data Retrieval System.⁴

³ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

⁴ The IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

**The Internal Revenue Service's Individual Taxpayer Identification Number Creates
Significant Challenges for Tax Administration**

Appendix V

**Attributes of Forms 1040 Filed With an Individual Taxpayer Identification
Number in Tax Years 2000 and 2001¹**

Category	Tax Year (TY) 2000	TY 2000 Estimated Margin of Error +/-	TY 2001 Actual	Percentage Change
United States Individual Income Tax Returns (Form 1040)	353,000	Actual	530,000	50%
Salaries and Wages Claimed	\$7,200,000,000	\$474,000,000	\$10,200,000,000	42%
Forms 1040 With a Tax Liability	162,000	19,000	245,000	51%
Refunds Paid	\$262,000,000	Actual	\$522,000,000	99%
Rate Reduction Credit Allowed ²	\$53,000,000	\$7,700,000	\$63,000,000	19%
Child Tax Credit Allowed	\$90,000,000	Actual	\$127,000,000	41%
Additional Child Tax Credit Paid	\$62,000,000	\$16,000,000	\$161,000,000	160%
Earned Income Tax Credit Paid	\$1,200,000	Actual	\$1,500,000	25%
Education Credit Allowed	\$4,100,000	Actual	\$7,400,000	80%
Foreign Tax Credit Allowed	\$1,300,000	Actual	\$5,800,000	346%
Child and Dependent Care Credit Allowed	\$4,900,000	Actual	\$6,400,000	31%
Credit for the Elderly and Disabled Allowed	\$32,000	Actual	\$43,000	34%
Returns Prepared by Paid Preparers	282,000	15,000	³ 396,000	40%
Returns Prepared by Taxpayers	66,000	14,000	128,000	94%
Returns Prepared by IRS/Volunteers	5,000	⁴ 5,000	5,000	0%
Paper Filed Forms 1040	309,000	12,000	444,000	44%
Electronically Filed Forms 1040	44,000	12,000	86,000	95%
Social Security Numbers (SSN) Misused and Not Assigned to the Individual on the Wage and Tax Statement (Form W-2)	354,000	21,000	Not Available	
SSNs Misused and Assigned to Someone Else	265,000	18,000	Not Available	
Unreported Earned Income	\$324,000,000	\$122,000,000	Not Available	

¹ All figures are rounded to nearest thousands.

² The figure for TY 2000 is the estimated amount of advance payments received for TY 2001, and the TY 2001 figure is the amount claimed on TY 2001 tax returns by those who did not receive an advance payment of this credit.

³ The sum of Returns Prepared by Paid Preparers, Taxpayers, and IRS/Volunteers does not equal 530,000 due to rounding.

⁴ The wide precision is caused by the number of returns in the sample with this attribute.

**The Internal Revenue Service's Individual Taxpayer Identification Number Creates
Significant Challenges for Tax Administration**

Appendix VI

**Credits Claimed on Forms 1040 Filed With an Individual Taxpayer Identification
Number in Tax Years 1998-2001¹**

Tax Year	Forms 1040² filed by Resident Aliens	Child Tax Credit Allowed	Child Tax Credit Claims	Additional Child Tax Credit Paid	Additional Child Tax Credit Claims	Child Care Credit Allowed	Child Care Credit Claims	Foreign Tax Credit Allowed	Foreign Tax Credit Claims
1998	213,995	\$34,959	69,672			\$3,163	5,312	\$6,567	196
1999	271,912	\$62,036	97,965			\$3,521	5,955	\$6,269	251
2000	353,373	\$89,974	134,097	\$61,952	62,434	\$4,937	8,290	\$1,269	289
2001	529,977	\$126,839	194,686	\$160,534	203,156	\$6,396	11,209	\$5,817	302
Totals	1,369,257	\$313,808	496,420	\$222,486	265,590	\$18,017	30,766	\$19,922	1,038

Tax Year	Earned Income Tax Credit Paid	Earned Income Tax Credit Claims	Education Credit Allowed	Education Credit Claims	Credit for the Elderly Allowed	Credit for the Elderly Claims
1998	\$2,572	1,286	\$853	1,451	\$16	67
1999	\$1,995	1,035	\$2,035	3,278	\$23	101
2000	\$1,184	662	\$4,060	5,833	\$32	129
2001	\$1,520	843	\$7,354	9,995	\$43	193
Totals	\$7,271	3,826	\$14,302	20,557	\$114	490

¹ Dollars in thousands.

² United States Individual Income Tax Return (Form 1040).

³ This information was not developed.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Appendix VII

Explanation of the Term “Unauthorized Resident Alien”

This audit report uses the term *unauthorized resident alien* based on the evidence we found during this and a prior analysis of the Internal Revenue Service (IRS) Individual Taxpayer Identification Number (ITIN) process. Our conclusion is that, generally, the individuals who file a United States (U.S.) Individual Income Tax Return (Form 1040) with an ITIN as the identification number and receive wages that are identified with a Social Security Number (SSN) on the attached Wage and Tax Statements (Form W-2) are unauthorized resident aliens. This conclusion is based on the following evidence and assumptions.

Foreign individuals who received ITINs were residing in the U.S. without apparent authorization by the U.S. Department of Homeland Security (DHS)

The Treasury Regulation providing for the ITIN states that, “Any individual who is not eligible to obtain a social security number and is required to furnish a taxpayer identifying number must apply for an IRS individual taxpayer identification number on Form W-7, Application for IRS Individual Taxpayer Identification Number....”¹ The Form W-7 states, “Do not submit this form if you have, or are eligible to obtain, a U.S. social security number (SSN).” The Form W-7 requires the applicant to provide identity information and support his or her claim of foreign status (i.e., with passport or visa information).

During our prior audit of the ITIN process,² we identified Forms W-7 that were approved by the IRS and showed applicants provided U.S. addresses and claimed to be U.S. resident aliens filing U.S. tax returns. These Forms W-7 did not have passport information or U.S. visa information. The absence of this information indicates the applicant may not have gained lawful entry into the U.S. In fact, Forms W-7 had statements such as, “... NO LEGAL STATUS WITH INS”³ and “Entered without a visa” for an indefinite stay in the U.S.

In a related opinion,⁴ the IRS Office of the Assistant Commissioner (International) stated, “the Form W-7 is to be used only by individuals who are not eligible to obtain an SSN, and that citizens of the United States thus will not file a Form W-7.” The IRS Office of Chief Counsel determined that, “the group of persons with United States federal tax obligations who are not eligible to obtain an SSN is limited to non-citizens who either do not reside in the United States or who reside here illegally.”

¹ Treas. Reg. § 301.6109. All references to “Treasury Regulation” in this appendix mean Treas. Reg. § 301.6109.

² *The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations* (Reference Number 094505, dated September 1999).

³ INS refers to the former U.S. Immigration and Naturalization Service. The DHS assumed the INS' responsibilities in 2003.

⁴ Memorandum for Chief Operations Officer, re: *Draft Internal Audit Report – Review of the Individual Taxpayer Identification Number (ITIN) Program*, Internal Audit Project # 960084 (May 27, 1999). This opinion was limited to issues involving individuals under the Privacy Act of 1974, 5 U.S.C. § 552a (2000).

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

The DHS is responsible for citizenship, asylum, lawful permanent residency, employment authorization, refugee status, intercountry adoptions, replacement immigration documents, family and employment-related immigration, and foreign student authorization. Foreign individuals who received ITINs and declared themselves as residing in the U.S. were apparently not authorized by the DHS to reside in the U.S.

Forms 1040 were filed by resident aliens

The Internal Revenue Code provides that an alien individual shall be treated for tax purposes as a resident of the U.S. with respect to any calendar year if such individual is a lawful permanent resident of the U.S. at any time during that calendar year, meets the substantial presence test, or makes a first-year election.⁵ An individual is a nonresident alien if that individual is neither a citizen of the U.S. nor a resident of the U.S.

An individual who does not reside in the U.S., but who must report income, is required to file a U.S. Nonresident Alien Income Tax Return (Form 1040NR). A resident alien individual is required to file a Form 1040. All of the individuals included in our review filed Forms 1040 identified by ITINs. By filing Forms 1040 with an ITIN, these individuals are declaring themselves as resident aliens rather than nonresident aliens.

Resident aliens were employed

The ITIN is intended for tax purposes only and creates no inference regarding an alien individual's right to be legally employed in the U.S. (i.e., the ITIN does not authorize a foreign individual to work in the U.S.). We estimate that \$7.2 billion⁶ was claimed in wages and salaries in Tax Year (TY) 2000 on Forms 1040 identified by an ITIN. In TY 2001, this amount increased to \$10.2 billion. The claimed wages and salaries indicated that these resident aliens were employed.

Resident aliens provided SSNs to their employers to obtain employment

The ITIN is not valid for work purposes. So, employers are responsible for obtaining from new hires their names and SSNs from their Social Security cards. Employers are also responsible for preparing Forms W-2 and submitting them to the Social Security Administration (SSA). We estimate that the 309,000⁷ TY 2000 Forms 1040 that resident aliens filed on paper had 354,000 SSNs on the attached Forms W-2, indicating that the resident aliens provided to their employers Social Security cards or SSNs for the purpose of obtaining employment.

⁵ 26 U.S.C § 7701 (2003). The "substantial presence" test is based on the number of days that an individual resided in the U.S. The "first-year election" is an option for aliens meeting certain criteria to be treated as U.S. residents.

⁶ The margin of error is +/- \$474,000,000.

⁷ The margin of error is +/- 12,385 tax returns.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Resident aliens would not have been able to obtain Social Security cards valid for employment in the U.S.

The SSA issues three types of Social Security cards. The SSA issues Social Security cards to U.S. citizens or individuals lawfully admitted to the U.S. with permanent work authorization obtained from the DHS. The second type of card has the legend, "Not Valid for Employment." The SSA issues this type of card to individuals from other countries lawfully admitted to the U.S. without work authorization from the DHS and who need a number because of a Federal Government law requiring an SSN to get a benefit or service. The third type of card bears the legend, "Valid for Work only with [DHS] Authorization." The SSA issues these cards to individuals who are lawfully admitted to the U.S. on a temporary basis and with DHS authorization to work. We concluded that the SSA should not issue a Social Security card (and therefore an SSN) to an individual who is not authorized by the DHS for admission into the U.S.

The Treasury Regulation states that, "Any individual who is duly assigned a social security number or who is entitled to a social security number will not be issued an IRS individual taxpayer identification number." Since the IRS assigns ITINs to resident aliens, we concluded that these resident aliens were not entitled to an SSN as assigned by the SSA when they applied for an ITIN. We also concluded that if resident aliens were authorized by the DHS to reside in the U.S., and if that authorization permitted those individuals to work in the U.S., then those individuals would be eligible for a Social Security card valid for working purposes, and the IRS would not have assigned an ITIN.

Resident aliens obtained employment using false SSNs

The Social Security law states that, "whoever...with intent to deceive, falsely represents a number to be the social security account number assigned by the Commissioner of Social Security to him or to another person, when in fact such number is not the social security account number assigned by the Commissioner of Social Security to him or to such other person...shall be guilty of a felony...." We estimate that all of the 354,000 SSNs⁸ on Forms W-2 submitted by resident aliens on the 309,000 TY 2000 paper filed Forms 1040 with an ITIN were assigned by the SSA to an individual other than the filer (265,000)⁹ or not assigned by the SSA (89,000).

Furthermore, a joint publication by the IRS and the SSA addresses the use of SSNs by individuals with ITINs. The publication summarized an employer's responsibilities for withholding and reporting of employment taxes on wages paid to "illegal aliens." Under the title "Illegal Use of Social Security Numbers (SSN)," the publication states that, "Since ITINs are for tax purposes only and are by no means a legal identification number for employment, individuals are utilizing erroneous or stolen SSNs when applying for employment."¹⁰

We concluded that the SSNs shown on the Forms W-2 had not been assigned to the resident aliens and were therefore false. We further concluded that these false SSNs were used to obtain

⁸ The margin of error is +/- 21,348 SSNs.

⁹ The margin of error is +/- 17,732 SSNs.

¹⁰ *SSA/IRS Reporter, A Newsletter for Employers*, Summer 2003.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

employment. Additionally, we concluded that if the resident aliens were lawfully admitted to the U.S. and were lawfully permitted to work in the U.S., the resident aliens would have provided to their employers SSNs assigned to them by the SSA.

Audit Conclusion

The Forms 1040 included in our review were filed by resident aliens who were living in the U.S. without apparent authorization by the DHS. Therefore, these individuals could not legally acquire Social Security cards that were valid for obtaining employment. Since they could not acquire the necessary Social Security cards, the resident aliens needed, and probably provided to their employers, SSNs that had not been assigned to them by the SSA. It is our opinion that individuals who are legally entitled to employment in the U.S. would also be legally entitled to obtain Social Security cards valid for employment. Consequently, we concluded that the Forms 1040 included in our review were filed by *unauthorized resident aliens*: foreign individuals who were working in the U.S. without authorization from the DHS and without a Social Security card valid for employment.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates
Significant Challenges for Tax Administration

Appendix VIII

Memorandum: Accelerating Scheduled Increases in the Child Tax Credit and the
Additional Child Tax Credit to Unauthorized Resident Aliens Should Be
Reconsidered



INSPECTOR GENERAL
for TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 8, 2003

Response Date
July 18, 2003

MEMORANDUM FOR COMMISSIONER EVERSON

Gordon C. Milbourn

FROM: Gordon C. Milbourn III
Assistant Inspector General for Audit (Small Business
and Corporate Programs)

SUBJECT: Accelerating Scheduled Increases in the Child Tax Credit
and the Additional Child Tax Credit to Unauthorized
Resident Aliens Should Be Reconsidered

The purpose of this memorandum is to advise you of a significant issue concerning tax returns filed with the Internal Revenue Service (IRS) Individual Taxpayer Identification Number (ITIN), in relation to certain provisions in the Jobs Growth Tax Relief Reconciliation Act of 2003 (JGTRRA)¹ and the proposed Relief for Working Families Tax Act of 2003 (RWFTA).² Specifically, unauthorized resident aliens filing U.S. Individual Income Tax Returns (Form 1040) identified with an ITIN would qualify for accelerated disbursements of the Child Tax Credit (CTC) and the Additional Child Tax Credit (ACTC).

A resident alien is a resident of the United States (U.S.) for any calendar year if that individual was lawfully admitted for permanent residence. A resident alien is also a foreign person in the U.S. who meets the "substantial presence" test, which is based on the number of days that person resides in the U.S.³

Our concern is two-fold. First, the ITIN does not authorize a resident alien to work,⁴ yet these persons filed tax returns with a Wage and Tax Statement (Form W-2). The presence of the Form W-2 issued in the filer's name indicates that employment was secured. Therefore, these resident aliens were apparently employed without authorization. Consequently, we believe the IRS is at risk of conflicting with the Immigration Reform and Control Act of 1986,⁵ which was designed to prevent unauthorized resident aliens from working in the U.S.

¹ Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752 (2003).

² Relief for Working Families Tax Act of 2003, H.R.1308, as amended, and pending in Conference Committee.

³ 26 U.S.C. § 7701 (2003).

⁴ Treas. Reg. § 301.6109.

⁵ Immigration Reform and Control Act of 1986, Pub. L. No. 99-603, 100 Stat. 3359 (1986).

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

2

2d, 2e

For Tax Year (TY) 2001, 195,000 unauthorized resident aliens received CTCs of \$127 million, and 203,000 received ACTCs of \$161 million. We estimate that the accelerated disbursements generated by the JGTRRA and the proposed RWFTA could total \$150 million.⁶ The *Results* section of this memorandum includes additional information about the CTC and the ACTC.

We identified this issue during our *Review of the Internal Revenue Service Individual Taxpayer Identification Number and U.S. Individual Income Tax Return Filing* (Audit #200230050). We discussed this issue with the Director, Field Assistance, Wage & Investment Division. Our forthcoming report will provide information on this and other ITIN-related issues.

Results

The CTC provided eligible taxpayers with a credit of up to \$600 per child in TY 2002. This amount was scheduled to increase to \$1,000 by TY 2010. However, the JGTRRA accelerated this increase. The IRS plans to begin these payments on July 25, 2003. The JGTRRA also affects the ACTC, since taxpayers who cannot claim the maximum amount of CTC could be eligible for an accelerated ACTC payment.

Moreover, pending legislation could further increase the accelerated ACTC payment. The amount of the ACTC was limited in TY 2002 to 10 percent of the taxpayer's earned income over \$10,000.⁷ The ACTC percentage was scheduled to increase to 15 percent in TY 2005. The RWFTA, as passed by the Senate, would accelerate this increase and may permit an automatic payment in CY 2003.

Unauthorized resident aliens would be eligible for the accelerated CTC and ACTC disbursements under the current law and proposed legislation. Table 1 below shows an example of how the ACTC might be affected.

Table 1. Comparison of the Child Tax Credit and the Additional Child Tax Credit for Tax Year 2002 Forms 1040, Current Law, and Proposed Legislation

Income, Liability, Credits, and Payments	TY 2002 Form 1040 as Filed	Current Law Providing for the Accelerated CTC and its Effect on the ACTC	Proposed Legislation Providing for the Accelerated ACTC

⁶ TY 2001 was the most recent year available at the time of this review. For the purposes of this estimate, we assumed that TY 2002 filing statistics would be similar to TY 2001 filing statistics, and that the tax returns filed by unauthorized resident aliens would be similar to those filed by all taxpayers.

⁷ The ACTC includes other limitations. For example, the ACTC is limited to the amount of Social Security tax paid during the year.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

3

Income	\$16,560	\$16,560	\$16,560
Tax Liability Before Credits	\$368	\$368	\$368
Child Tax Credit	\$600	\$1,000	\$1,000
Tax Liability After Child Tax Credit	\$0	\$0	\$0
Additional Child Tax Credit	\$232	\$621	\$632
Difference Between TY 2002 ACTC and Current Law	-----	\$389	-----
Difference between TY 2002 ACTC and Proposed Legislation	-----	-----	\$400

Source: The column entitled "Current Law Providing for the Accelerated CTC and its Effect on the ACTC" is the IRS' analysis of the accelerated Child Tax Credit (one child). The column entitled "Proposed Legislation Providing for the Accelerated ACTC" is the Treasury Inspector General for Tax Administration's extrapolation of the IRS' computation, adding the proposed accelerated 15 percent rate for the Additional Child Tax Credit.

Different situations have occurred with paper-filed tax returns and electronically filed tax returns. First, some paper-filed returns appear to have been submitted to the IRS with inconsistent identification information, since the Form 1040 showed an ITIN and the filer's Form W-2 showed an SSN. This SSN often belonged to another person, indicating potential identity theft. When there is a mismatch between TINs on the Form 1040 and the Form W-2, the IRS' Office of Chief Counsel determined that the tax return is not in processible form and that the IRS is able to freeze the amount of the refund claim pending the resolution of the mismatch (see Appendix I).

Second, some electronically filed returns may have a Form W-2 with a TIN that appears to have been changed. An ITIN was shown on the electronic Form W-2 as filed with the IRS. However, since the ITIN cannot be used for work purposes, it is unlikely that the employer provided a Form W-2 with an ITIN as the TIN.

Further, we are concerned about the CTC and the ACTC and their similarity to the Earned Income Tax Credit (EITC). The CTC and the ACTC have a legislative rationale similar to the EITC. The General Accounting Office (GAO) reported that awarding the EITC to illegal aliens⁸ was at cross-purposes with federal policies that prohibit illegal aliens from working in the U.S.⁹ The Senate stated that the changes in the CTC and the ACTC were intended for "low income working families to promote work."¹⁰ In our view, like the EITC, providing the CTC and the ACTC to resident aliens who are not authorized to work is inconsistent with the immigration law that prohibits employing unauthorized aliens.

⁸ The General Accounting Office (GAO) defined an "illegal alien" as a foreign person who is in the U.S. without a lawful immigration status. This definition appears to convey the same meaning as the terminology "unauthorized resident alien" used in this memorandum.

⁹ GAO, *Earned Income Credit—Targeting to the Working Poor*, (GAO/GGD-95-122BR, March 1995). The term *Earned Income Credit* is synonymous with the term *Earned Income Tax Credit*.

¹⁰ Restoring Earnings To Lift Individuals and Empower Families Act of 2001, H.R. 1836, as agreed to by the Senate. This bill was submitted to the House of Representatives, and eventually became the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. No. 107-16, 115 Stat. 38 (2001). The EGTRRA does not include the statement by the Senate.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

4

Also, the ACTC is a refundable credit funded by appropriated money,¹¹ similar to the EITC. However, resident aliens without SSNs authorizing them to work are prohibited from claiming the EITC. This was not always the case. These resident aliens were permitted to claim the EITC when it became law in 1975.¹² Subsequently, the Congress and the IRS expressed concerns about noncompliance with EITC requirements, including fraud.¹³ The law was changed in 1996, in part to deny the EITC to individuals not authorized to be employed in the U.S.¹⁴

The IRS has reported that the EITC continues to experience compliance problems, and the GAO has listed the administration of the credit as a "high risk area for the federal government."¹⁵ To help reduce these problems, the IRS plans to test a procedure whereby certain taxpayers who have previously claimed the EITC will need to "pre-certify" their eligibility to claim the EITC on their TY 2004 return. For example, the IRS will require additional information on the taxpayers' relationship to and/or the residency status of the qualifying children listed on their returns. Claimants who choose not to pre-certify can submit documentation with their return, but the EITC-portion of their refund will be delayed until that documentation is processed.

We also identified an early indication of a similar filing pattern between the ACTC and the EITC. Between 1975 and 1993, the maximum amount of the EITC increased from \$200 to \$2,364. As the amount of the EITC increased:

- The number of Internal Revenue Service Numbers (IRSN), the predecessor to the ITIN, increased significantly. The IRS assigned approximately 1,800 IRSNs in 1975, which increased to 175,000 assigned in 1993.
- The amount of the EITC, claimed by persons assigned an IRSN, increased from a projected \$141,000 in 1986 to a projected \$197 million in 1993.

Recent tax return filings show that the ACTC may be following a similar pattern. The ACTC first became available in TY 1998. Taxpayers needed three or more qualifying children to receive the credit. In TY 2001, the number of qualifying children was reduced to one or more. While this reduction may have accounted for some of the increase in the ACTC, it also may have made obtaining an ITIN more appealing.

- The IRS assigned 123,000 ITINs to resident aliens in CY 1998, the first year that the ACTC could be claimed. This rose to 339,000 in CY 2001 and 538,000 in CY 2002.

¹¹ Budget of the United States Government, Fiscal Year 2003, p. 839.

¹² Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (1975).

¹³ GAO, *Earned Income Credit—Data on Noncompliance and Illegal Alien Recipients* (GAO/IGD-95-27, October 1994).

¹⁴ Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, 110 Stat. 2105 (1996).

¹⁵ The scope of our review did not include testing for CTC and ACTC non-compliance, including fraud.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

5

- In TY 2000, the last year that three children were required to claim the ACTC, over 62,000 resident aliens received an estimated \$62 million in ACTC credits. In TY 2001, when the number of qualifying children was reduced to one, 203,000 resident aliens received \$161 million.

Recommendations

The IRS Commissioner should:

1. Advise the Department of the Treasury that the accelerated CTC and ACTC may conflict with the immigration law and may affect tax administration.
2. Determine if the IRS is authorized to delay sending the advance disbursements to unauthorized resident aliens. If the IRS has this authorization, delay the disbursement until the identities of the taxpayers can be resolved.
3. Propose legislation to place limitations on the ACTC, similar to the EITC, for unauthorized resident aliens.

Please provide your written response to this memorandum by the date shown above. Please include the proposed corrective action, the completion date of the proposed corrective action, the responsible management official, and the plan and methodology for tracking and ensuring the proposed corrective action. If you disagree with any of the facts presented in the memorandum, or if you would like to meet and discuss these issues, please contact me at (202) 622-6510, or your staff may contact Richard J. Dagliolo, Director (Submission Processing), at (631) 654-6028.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Appendix I

Office of Chief Counsel Advice

UILC: 6109.00-00
SCANO-120953-02
Release Date: 8/16/2002

June 13, 2002

Refer Reply To: CC:PA:APJP:1
INTERNAL REVENUE SERVICE NATIONAL OFFICE SERVICE CENTER
ADVICE
MEMORANDUM FOR RONALD P. RIVELLI
CHIEF, PARTNERSHIPS, TRUSTS AND INTERNATIONAL
SECTION
OP:FS:S:P:P
Attn: Nicholas Palumbo

FROM: James C. Gibbons
Branch Chief

Administrative Provisions & Judicial Practice CC:PA:APJP:1
[1] This Chief Counsel Advice responds to your inquiry of April 12, 2002. Specifically, you ask how the Service should process a Form 1040 that claims a refund and shows the taxpayer's correct ITIN, but includes a Form W-2 with an incorrect SSN.

In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

ISSUES

- 1) Whether a Form 1040 that claims a refund and shows the taxpayer's correct ITIN on the form, but includes a Form W-2 with an incorrect SSN, constitutes a valid return for purposes of the statute of limitations on assessment under section 6501 of the Code?
- 2) If the return constitutes a valid return, whether the return constitutes a valid claim for refund for purposes of section 6402 of the Internal Revenue Code?
- 3) If the return constitutes a valid return and a valid claim for refund, whether the return is in processible form for purposes of section 6611 of the Code?

CONCLUSIONS

- 1) A Form 1040 that claims a refund and shows the taxpayer's correct ITIN on the form, but includes a Form W-2 with an incorrect SSN, constitutes a valid return for purposes of the statute of limitations on assessment under section 6501 of the Code.
- 2) The return constitutes a valid claim for refund for purposes of section 6402.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

2

3) The return is not in processible form for purposes of section 6611. As a result, the Service may freeze the amount of the refund claim and will not be subject to overpayment interest on the amount of the overpayment until the return is in processible form.

FACTS

[2] The Service receives completed returns consisting of a Form 1040, "U.S. Individual Income Tax Return," which claims a tax refund and lists the correct individual taxpayer identification number (ITIN) of the taxpayer filing the return, with an attached Form W-2, "Wage and Tax Statement," that lists an erroneous social security number (SSN) not belonging to the taxpayer. This situation sometimes arises when a taxpayer has a valid ITIN but provides an erroneous SSN to a potential employer in order to secure a job within the U.S. Presently, the Service processes these returns using the valid ITIN and issues the refund to the taxpayer.

LAW AND ANALYSIS

Issue 1

[3] Section 6011 of the Code provides that any person made liable for any tax imposed by this title, or with respect to the collection thereof, shall make a return or statement according to the forms and the regulations prescribed by the Secretary. Every person required to make a return or statement shall include therein the information required by such forms and regulations.

[4] Section 1.6011-1(b) of the Income Tax Regulations provides that each taxpayer should carefully prepare his return and set forth fully and clearly the information required to be included therein. Returns which have not been so prepared will not be accepted as meeting this requirement of the Code.

[5] Although Congress has granted the Commissioner broad authority to determine what information should be submitted with a tax return, the issue of what constitutes a valid tax return is frequently litigated. Courts have stated the criteria for a valid return: "First, there must be sufficient data to calculate tax liability; second, the document must purport to be a return; third, there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and fourth, the taxpayer must execute the return under penalties of perjury." *Beard v. Commissioner*, 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986). This formulation, known as the "substantial compliance" standard, has been derived from a line of Supreme Court cases. *See Zellerbach Paper Co. v. Helvering*, 293 U.S. 172, 180 (1934); *Florsheim Bros. Drygoods Co. v. United States*, 280 U.S. 453 (1930). If an income tax return meets the "substantial compliance" standard, the return is a valid return for purposes of the statute of limitations on assessment.

[6] There is no bright line test to determine whether a Form 1040 with an attached Form W-2 that contains incorrect information is a valid return. Courts

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

3

typically apply the "substantial compliance" standard to the specific facts of each case. In *Blount v. Commissioner*, the court found that a Form 1040 that was filed without a Form W-2 met the "substantial compliance" standard and did not invalidate the return or prevent the calculation of tax liability. See *Blount v. Commissioner*, 86 T.C. 383 (1986), acq. in result, 1986-2 C.B. 1. If a Form W-2 that does not belong to the taxpayer is filed with a Form 1040, the Service should disregard the Form W-2 because it contains all incorrect information with regard to the taxpayer. However, under *Blount*, the Form 1040 is still a valid return. If a Form 1040 that has an attached Form W-2 with all incorrect information is a valid return, a Form 1040 that has an attached Form W-2 with partially incorrect information is a valid return as well. We conclude, under the *Blount* decision, that a completed Form 1040 with an attached Form W-2 that lists an incorrect SSN, meets the "substantial compliance" standard and does not invalidate the return for purposes of the statute of limitations on assessment under section 6501 of the Code.

Issue 2

[7] Section 6402(a) of the Code provides that in the case of any overpayment, the Secretary, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall, subject to certain offsets, refund any balance to such person.

[8] Section 301.6402-2(a) of the Regulations on Procedure and Administration provides that credits or refunds of overpayments may not be allowed or made after the expiration of the statutory period of limitation properly applicable unless, before the expiration of such period, a claim therefore has been filed by the taxpayer.

[9] Section 301.6402-2(b) of the regulations provides, as a general rule, that all claims for credit or refund must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to apprise the Commissioner of the exact basis thereof.

[10] Section 301.6402-3 of the regulations provides special rules for refund claims of income tax. Section 301.6402-3(a)(5) provides that a properly executed individual original income tax return shall constitute a claim for refund or credit for the amount of the overpayment disclosed by such return. To constitute a sufficient claim for refund, the income tax return must set forth the amount determined as an overpayment and should advise the Service whether such amount shall be refunded to the taxpayer or shall be applied as a credit against the taxpayer's estimated income tax for the succeeding taxable year.

[11] The purpose of the general rule of section 301.6402-2(b) of the regulations, which requires taxpayers to set forth in detail each ground upon which a refund is claimed, is to adequately notify the Service of the grounds on which the

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

4

taxpayer's claim is based, allowing the Service to properly investigate the claim. *Angelus Milling Co. v. Commissioner*, 325 U.S. 239 (1945). Section 301.6402-3(a)(5) provides a simplified procedure to notify the Service of the grounds for the claim where the taxpayer makes his or her refund claim on the original or amended income tax return for the taxable year. In such a case, the taxpayer must simply set forth the amount of the overpayment and request that it be refunded or credited. If the return meets the *Beard* "substantial compliance" standard, and the requirements of section 301.6402-3(a)(5), it will generally meet the requirements of section 301.6402-2(b). See generally *Fearis v. United States*, 548 F.Supp. 408 (N.D. Tex. 1982); *United States v. Ryan*, 64 F.3d 1516 (11th Cir. 1995); *Sumrall v. United States*, 98-2 USTC P50,689 (D. Colo. 1998).

[12] In this situation, the Form 1040 meets the *Beard* "substantial compliance" standard, sets forth the amount of the overpayment, and advises the Service that the overpayment shall be refunded to the taxpayer. Although the attached Form W-2 lists an incorrect SSN, the Service is adequately notified of the grounds for the taxpayer's claim. Therefore, the Form 1040 constitutes a valid claim for refund. However, if the Service cannot resolve the mismatch between the Form 1040 ITIN and the Form W-2 SSN, it cannot determine that the taxpayer made an overpayment which requires the issuance of a refund under section 6402(a). As such, the Service is not required to issue the refund under section 6402. If the Service does not issue the refund, the taxpayer may file a suit for refund under section 6532(a)(1) of the Code once the Service renders a decision on the claim provided the applicable period of limitations has not expired. If the Service does not render a decision, the taxpayer may file a suit for refund beginning 6 months after the date the claim for refund is filed.

Issue 3

[13] Section 6611(a) of the Code provides that interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the overpayment rate established under section 6621.

[14] Section 6611(b)(3) of the Code provides that in the case of a return filed after the last date prescribed for filing the return (determined without regard to extensions), no interest shall be allowed or paid for any day before the date on which the return is filed.

[15] Section 6611(e)(1) of the Code provides that if any overpayment of tax is refunded within 45 days after the last day prescribed for filing the return of such tax (determined without regard to any extension of time for filing the return) or, in the case of a return filed after such last date, is refunded within 45 days after the date the return is filed, no interest shall be allowed under section 6611(a) on such overpayment.

[16] Section 6611(g) of the Code provides that for purposes of sections 6611(b)(3) and 6611(e), a return shall not be treated as filed until it is filed in processible form. A return is in processible form if: (1) it is filed on a permitted

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

5

form; and (2) it contains the taxpayer's name, address, identifying number, the required signature, and sufficient required information (whether on the return or on required attachments) to permit the mathematical verification of tax liability shown on the return.

[17] According to the court in *The Columbia Gas System, Inc. v. United States*, "[m]athematical verifiability requires sufficient information to permit IRS to recalculate and corroborate the mathematics and data reported by the taxpayer. Thus, under section 6611, a taxpayer must submit, in good faith, all the required forms with the required signatures and enough underlying data for IRS to verify the tax liability shown on the return. The information must be sufficient to enable IRS to calculate the tax liability without undue burden." *The Columbia Gas System, Inc. v. United States*, 70 F.3d 1244, 1246 (Fed. Cir. 1995).

[18] A Form 1040 with a Form W-2 that lists an incorrect SSN does not meet the mathematical verification test because the Form W-2 does not provide sufficient information to allow the Service to corroborate the mathematics and data reported by the taxpayer. The Service requires the correct TIN to be listed on the Form W-2 and Form 1040 in order to verify that the amounts paid by the employer on behalf of the taxpayer are amounts which are properly attributable to the taxpayer. Without the correct TIN listed on the Form W-2, the Service cannot ascertain with certainty that the attached Form W-2 belongs to the taxpayer filing the Form 1040. As a result, the return is not a processible return for purposes of section 6611(g), and overpayment interest will not begin to accrue until the return is in processible form. Therefore, the Service can freeze the refund amount claimed on the Form 1040 pending the resolution of the mismatching ITIN and SSN or the determination that an overpayment exists without subjecting itself to a liability for overpayment interest.

[19] In order to obtain a processible return, the Service should notify the taxpayer that a Form W-2c "Corrected Wage and Tax Statement," or a Form 4852, "Substitute for Form W-2, Wage and Tax Statement, or Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, Etc.," listing the correct ITIN must be filed. Once the Service receives the Form W-2c or the Form 4852 that lists the correct ITIN, and which matches the ITIN listed on the Form 1040, the return will be in processible form for purposes of section 6611(g). If the Service issues the refund within 45 days from the date the return is in processible form, the Service will not owe overpayment interest on the refund amount. If the Service issues the refund after 45 days from the date the return is in processible form, the Service will owe overpayment interest on the refund amount from the date the return is in processible form. I.R.C. § 6611(e).

[20] Please call if you have any further questions.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

Appendix IX

Management's Response to Memorandum



DEPUTY COMMISSIONER

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

July 18, 2003

MEMORANDUM FOR GORDON C. MILBOURN III
ASSISTANT INSPECTOR GENERAL FOR AUDIT (SMALL
BUSINESS AND CORPORATE PROGRAMS)

FROM: *for* Bob Wenzel *Bob Wenzel*
Deputy Commissioner for Services and Enforcement

SUBJECT: Accelerating Scheduled Increases in the Child Tax Credit and
the Additional Child Tax Credit to Unauthorized Resident Aliens
Should Be Reconsidered

I am responding to your memorandum dated July 8, 2003, advising the IRS that you are concerned that unauthorized resident aliens filing an individual income tax return with an ITIN will qualify for the advance payment of the increase in the child tax credit. You also are concerned that providing the child tax credit and additional child tax credit to resident aliens who are not authorized to work is inconsistent with the immigration law that prohibits employing unauthorized aliens.

The Jobs Growth and Tax Relief Reconciliation Act of 2003 (JGTRRA) increased the child credit for 2003 by \$400. The JGTRRA also required the IRS, using tax year 2002 data, to refund the increase in the child tax credit to eligible taxpayers as rapidly as possible.

To compute, account for, control, and produce advance refund checks, complex computer programs and systems had to be modified, tested, integrated with existing programs, and put into production. By giving this work top priority, we completed these actions and placed programs into production on July 5. As a result, checks will be mailed to taxpayers who filed by April 15 on July 25, August 1 and August 8. An estimated 25 million checks will be mailed within this three-week time period.

For checks and notices to be printed and mailed for the three-week period, IRS' data is submitted to the notice vendor and FMS on July 15, July 22, and July 29. At this time, we cannot implement a change so that unauthorized resident aliens would not receive an advance payment check without delaying the mailing of all 25 million checks. In addition, the IRS Office of Chief Counsel has advised us that we do not have the authority to delay the disbursement of the advance child tax credit merely because the taxpayer is an unauthorized resident alien.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

2

Our comments on your specific recommendations follow:

Recommendation 1

Advise the Department of the Treasury that the accelerated Child Tax Credit and Additional Child Tax Credit may conflict with the immigration law and may affect tax administration.

Proposed Corrective Action

The electronic version of your memorandum was shared with the Office of the Assistant Secretary for Tax Policy.

Completion Date

Completed on July 10, 2003

Recommendation 2

Determine if the IRS is authorized to delay sending the advance disbursements to unauthorized resident aliens. If the IRS has this authorization, delay the disbursement until the identities of the taxpayers can be resolved.

Proposed Corrective Action

The IRS Office of Chief Counsel has advised that unauthorized resident aliens are entitled to the child tax credit under section 24 of the Internal Revenue Code. Therefore, IRS does not have the authority to delay the disbursement of the advance child tax credit merely because the taxpayer is an unauthorized resident alien.

Recommendation 3

Propose legislation to place limitations on the Additional Child Tax Credit, similar to EITC, for unauthorized resident aliens.

Proposed Corrective Action

The electronic version of your memorandum was shared with the Office of the Assistant Secretary for Tax Policy, which is responsible for proposing legislative changes.

Completion Date

Completed on July 10, 2003

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

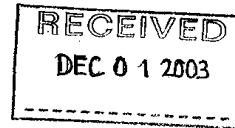
Appendix X

Management's Response to the Draft Report



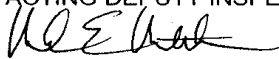
DEPUTY COMMISSIONER

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



December 1, 2003

MEMORANDUM FOR GORDON C. MILBOURN III
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: 
Mark E. Matthews
Deputy Commissioner for Services and Enforcement

SUBJECT: Draft Report – The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration (Audit # 200230050)

Thank you for the opportunity to respond to the captioned draft report. Your report thoroughly and usefully highlights issues arising from the Internal Revenue Service's use of Individual Taxpayer Identification Numbers (ITINs), ranging from tax administration to national security. We recognize the difficult issues raised by the ITIN program and the challenge of properly and thoroughly attending to them. The Service itself has also engaged in an extended process of assessment with regard to the ITIN program, as well as in critical analysis of the relative merits and drawbacks of any actions we could pursue to address the challenges posed by the program, in light of the Service's mandated mission to administer and enforce the revenue laws of the United States.

Our review leads us to conclude that, based on the proportion of ITINs that have been used for tax purposes relative to the overall number of ITINs that have been issued, a substantial majority of ITIN holders is compliant with Federal tax laws. Such compliance is reflected not only in the appearance of ITINs in tax filings but in the repetition and frequency of tax filings by ITIN holders. As you have identified, however, there are aspects of the program that can be strengthened.

Your report assisted us in framing issues and considering further actions to improve the ITIN program. We have decided to make fundamental improvements to the ITIN program immediately, and believe these enhancements represent an appropriate balance to resolve ITIN program deficiencies without unduly burdening either taxpayers or the tax system this

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

2

year. We will evaluate these changes during the filing season and consider additional enhancements to the program in the future.

BACKGROUND

The Service created ITINs solely for tax administration purposes. Principally, these purposes are to enable the Service to identify and track the reporting and payment of tax obligations by, and the entitlement to refund or other payments to, individuals who otherwise lack Taxpayer Identification Numbers (TINs). As you know, most individual taxpayers utilize Social Security Numbers (SSNs) as TINs.

The Service has concluded that most resident aliens who hold ITINs and who report and pay tax from wage income are not legally employed in the United States. This is because such a taxpayer would have a valid SSN if the holder were legally employed in the United States, making procurement of an ITIN unnecessary and duplicative. The Service has no legal authority with respect to the enforcement of immigration and social security administration laws. Moreover, the Service is broadly restricted under Section 6103 of the Internal Revenue Code from sharing taxpayer information, including the possibility that the applicant is not working legally in the United States, with third parties, including other executive agencies, except in very limited circumstances.

In addition, the Service believes that most ITIN holders whose wages are reflected on valid Forms W-2 furnished to the Service are using stolen or fabricated SSNs, because employers are prohibited from employing individuals who lack an SSN and employers use the SSN provided by such employees in reporting Form W-2 information. Although the theft or fabrication of an SSN is illegal, the Service is precluded under Section 6103 from sharing that information with third parties, except in very limited circumstances provided under Section 6103. As noted above, the Service has no legal authority with respect to the enforcement of immigration and social security administration laws.

The Service also believes that a substantial number of the ITINs that have been issued have subsequently not been used for tax reporting and payment. It is widely believed that some ITINs are procured for the purpose of creating an identity other than for tax purposes, such as for the procurement of a drivers license. Because of this possibility, the Service has actively worked to make states aware of the limitations of ITINs and their unsuitability for determining identity, such as for the purpose of granting a drivers license.

The Service is also fully sensitive to the possible dangers that can arise from the misuse of ITINs for the purpose of creating an identity, including the possible threat to national security.

Despite the distinctly undesirable behaviors actually or potentially associated with ITINs, the Service remains legally responsible for enforcement of the nation's

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

3

Federal tax laws with respect to ITIN holders, including the responsibility to assess and impose tax on ITIN holders irrespective of the circumstances of their employment or the possibility that ITIN applicants may be solely or collaterally seeking the procurement of an ITIN to establish an identity for non-tax purposes,

RESPONSES TO ITIN CHALLENGES

The factors identified above inform the Service's possible responses to the challenges that ITINs present to tax administration. In addition, the Service believes it is necessary to weigh the potential benefits of any changes against their costs to the tax system, including both direct economic costs and the indirect costs that arise from discouraging participation in the tax system. Certain responses, though desirable, may only be achieved through legislation. Accordingly, we will forward your report to the Office of the Assistant Secretary for Tax Policy at the Department of the Treasury, the Bureau of Citizenship and Immigration Services at the Department of Homeland Security, and the Social Security Administration.

We have determined to implement a number of changes to the current procedures to better regulate the issuance of ITINs. These will assist in ensuring that ITINs are used for the purpose for which they were created, tax administration, and will include changes based on the recommendations of your report as well as changes and potential future changes based on our own internal review of the ITIN program.

First, consistent with the recommendations of the ITIN task force, we will require that all future ITIN applicants show that procurement of an ITIN serves a valid tax administration purpose. This will primarily take form as a requirement that the ITIN application, Form W-7, be co-filed with a tax return. We will no longer accept applications from applicants stating that they need an ITIN to file a return without proof that the applicant needs the number to file a return.

Of all ITINs issued, approximately 15% of applicants have applied for an ITIN for a purpose other than filing an income tax return, such as to take advantage of a tax treaty or for other specified purposes. There will be no changes to the process for such applicants. Thus, as before, applicants who are not required to pay income tax will continue to be able to apply for an ITIN at any time throughout the year, subject to existing requirements for furnishing documentary support for their need for an ITIN.

Next, we will discontinue our practice of issuing ITINs in the form of cards. Instead, applicants will be notified of their ITIN in a letter issued by the Service. This will eliminate any confusion between ITIN cards and Social Security cards.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

4

Finally, we are considering the merits of a taxpayer identification number (TIN) validation system for use by employers. TIN validation would allow employers to verify the name/TIN combination provided by a prospective or current employee against the Service's records. Such a system is technologically feasible, would provide benefits to tax administration, and would address certain concerns raised in your report with respect to unauthorized resident aliens. However, disclosure of the existence of a mismatch to an employer would be inconsistent with the statute ensuring confidentiality of taxpayer information, Section 6103 of the Code. Legislation currently under consideration in the Senate would provide the explicit authority necessary to overcome the general prohibition, allowing the Service to disclose mismatches to employers. The provision is Section 413 of the Tax Administration Good Government Act, S. 882. We believe that TIN validation could be an important tool in discouraging and resolving mismatches. Absent specific authority, though, we are unable to implement a TIN validation system for use by employers.

As more fully discussed below in our response to Recommendation 1, further consideration of the proposal to [REDACTED] [REDACTED] has led us to conclude that pursuing such an option would not improve tax administration. The

2d, 2e
[REDACTED]

ADDITIONAL IRS ACTIONS

The Service wishes to emphasize that its responses to the recommendations set forth in your draft report reflect its current considered and best judgment in light of the myriad factors enumerated above. Additional considerations that bear on those responses include: the Service's need to allocate resources among various projects, including ITIN administration, that warrant possible increased scrutiny or possible additional action; the current and near-term capacity of the Service to address both its service and enforcement responsibilities, including with respect to ITINs; the likely potential tax administration results of any new ITIN initiative that may be launched; and statutory responsibilities and limitations to which the Service is subject that prevent or limit the Service from taking actions that might be desirable as matters of public policy.

The Service also understands that it will need to continue to evaluate on an ongoing basis its response to the challenges posed by ITINs. Consequently, some of the conclusions the Service has reached regarding your

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

5

recommendations will need to be reconsidered by the Service as time passes and conditions both outside and within the Service change.

Lastly, the Service wishes to bring to your attention that it is evaluating recommendations in addition to those set forth in your report and it may well decide to take additional actions, or make changes, with respect to its ITIN administration that it believes will improve such administration or better address the challenges that ITINs present to tax administration.

Legislative changes would, of course, dictate that the Service reevaluate its administration of ITINs in order to ensure that the Service complied with its statutory obligations.

SPECIFIC RECOMMENDATIONS

The Service's responses to your specific recommendations follow.

RECOMMENDATION 1

Identify paper-filed Forms 1040 with an ITIN having a related Form W-2 with an SSN, 2d, 2e

2d, 2e

CORRECTIVE ACTION

For the reasons identified above and below, we have concluded that implementation of this recommendation would not improve tax administration.

The considerations identified above have led the Service to conclude that it is not desirable or appropriate to resident ITIN holders who have a related W-2 with an SSN. The Service has reached its conclusion for a number of reasons.

2d, 2e

Second, 2d, 2e the Service has seen no evidence that ITIN holders are more or less accurate in calculating their tax liabilities than any other taxpayer group. 2d, 2e

2d, 2e

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

6

2d, 2e
2d, 2e While it may well be demonstrable that mismatches between SSNs reflected on Forms W-2 and ITINs reflected on Forms 1040 exceed, on a proportional basis, mismatches between SSNs reflected on Forms W-2 and SSNs reflected on Forms 1040 among other taxpayer groups, the Service is not aware of 2d, 2e

2d, 2e

2d, 2e

Notwithstanding the apparent violations of other laws, the Service believes that the costs attendant 2d, 2e – disruption of the filing season with resource demands on Service staff during the filing season, along with burdens placed on taxpayers – outweigh the likely marginal benefits of

2d, 2e

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

Identify electronically filed tax returns where both the Form 1040 and related electronic Form W-2 are filed with an ITIN, 2d, 2e

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

7

2d, 2e

Since the IRS' electronic control already rejects tax returns when identification numbers do not match, no electronically filed return with an ITIN should be accepted.

CORRECTIVE ACTION

For the reasons identified in our response to Recommendation 1, we do not agree with this recommendation. See our response to Recommendation 1.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 3

Conduct outreach to advise paid preparers and Electronic Return Providers (ERPs) the ITIN is not a legal identification number for employment and their customers may be using fraudulent or erroneous SSNs on Forms W-2. In addition, they should be advised that the electronic Form W-2 information must show the identification number that appears on the Form W-2 as issued by the employer.

CORRECTIVE ACTION

We agree, in part, with this recommendation. Return preparers and ERPs are not required to verify the identification information provided by a taxpayer. In addition, the person who prepares or assists with the preparation or filing of a tax return is not subject to a preparer penalty merely because the taxpayer's identification is questionable. Nevertheless, we will take the following actions to advise that the ITIN is not a legal identification number for employment and that the electronic Form W-2 must show the identification number that appears on the Form W-2 as issued by the employer.

1. SB/SE, Taxpayer Education and Communication (TEC) will conduct outreach and provide advice to paid preparers and ERPs as follows:

- a. SB/SE Payroll & Practitioner Forum – Discussions including background information, instructions, and expectations will be held with the National Practitioner Organizations through bi-monthly meetings with representatives from each participating organization.
- b. IRS Stakeholder Headliners – E-mails focusing on specific topics for distribution to organizations and their members. SB/SE will develop the

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

8

Headliner and send it to all participating organizations through the Office of National Public Liaison.

c. IRS e-News for Tax Practitioners – An electronic mail service designed to provide localized, targeted and immediate information for tax professionals specifically for geographic areas.

2. Stakeholder Partnerships, Education and Communication (SPEC) will collaborate with the ITIN Program Office regarding the education and communication strategy. SPEC will work with TEC Communications & Liaison Staffs to develop communication content plans. SPEC will conduct educational campaigns targeted at the paid preparer community, for which they are responsible, by the end of fiscal year 2004. The target group for SPEC includes Electronic Return Originators (ERO) and other paid preparers. These campaigns will alert paid preparers to the allowable use and application of ITINs and the importance of not altering W-2 information.

3. The Director, Electronic Tax Administration will conduct outreach alerting paid preparers of the allowable use and application of ITINs and the importance of not altering W-2 information. These outreach efforts will be accomplished as follows:

a. QuickAlerts – An online service that disseminates mass *e-file* messages, within seconds, to all "*subscribed*" individual and business *e-file* Software Developers, Transmitters and Authorized IRS *e-file* Providers.

b. IRS e-News for Tax Practitioners – An electronic mail service designed to provide localized, targeted and immediate information for tax professionals specifically for geographic areas.

c. Tax Forums – A three day forum designed to help educate and serve the tax practitioner community with the latest information on a variety of IRS programs, practices and policies.

IMPLEMENTATION DATES

1. – January 5, 2004
2. – January 5, 2004
3. – January 5, 2004 3a. and 3b.
January 7, 2005 for 3c.

RESPONSIBLE OFFICIALS

Director, Taxpayer Education and Communication, SB/SE Division
Director, Stakeholder Partnerships, Education and Communications, W&I
Division
Director, Electronic Tax Administration, MITS

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

9

CORRECTIVE ACTION MONITORING PLAN

1. For each of the outreach vehicles above SB/SE TEC will do as follows:
 - a. Payroll & Practitioner Forum – Work with NPL on the development of the meeting agenda and invitation and assist in identifying any follow-up items regarding the ITIN issues. Feedback will be monitored and provided to the ITIN Program Office and will follow-up during the January 2004 SB/SE Forum.
 - b. IRS Stakeholder Headliners – Feedback will be solicited on the usefulness and effectiveness of the ITIN “Headliner” during the January 2004 SB/SE Forum. Further follow-up will occur during the February 2004 NPL Meeting and the March 2004 SB/SE Forum.
 - c. IRS e-News for Tax Practitioners – Once the message is drafted and forwarded to C&L, SB/SE will follow-up with the e-News coordinator to confirm distribution.
2. SPEC will work with the ITIN Program Office to develop the outreach and education strategy and appropriate metrics. The outreach and education plan will be completed by January 5, 2004, and an assessment of progress against goals will be completed by July 1, 2004.
3. ETA will follow-up with our paid preparers on the allowable use of ITINs during our annual tax forums and speaking engagements.

RECOMMENDATION 4

Ensure that IRS employees and volunteer programs do not assist with the preparation or filing of tax returns with questionable identification.

CORRECTIVE ACTION

We agree with this recommendation, to the extent that IRS programs already address this. IRS provides training to volunteers. The existing training provides guidance to volunteers regarding identification verification and advises volunteers to refuse return preparation if there are concerns regarding the validity of documents. In addition, IRS Field Assistance sites stopped preparing returns with mismatched TINs during the 2003 filing season. Return preparers are not required, however, to verify the identification information provided by a taxpayer.

IMPLEMENTATION DATE

Completed.

RESPONSIBLE OFFICIAL

N/A

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

10

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 5

Advise developers of electronic filing computer programs to modify these programs to prevent the automatic update of Form W-2 identification information when an ITIN is used on Form 1040.

CORRECTIVE ACTION

We agree with this recommendation. We will work with the software developers to ensure that their e-file programs validate that the information populated on the Form 1040 agrees with the information contained on the Form W-2. This will prevent the automatic update of Form W-2 when an ITIN is used on Form 1040.

IMPLEMENTATION DATE

January 7, 2005

RESPONSIBLE OFFICIAL

Director, Electronic Tax Administration, MITS

CORRECTIVE ACTION MONITORING PLAN

The Director, Electronic Tax Administration will follow-up with the software developers during our annual conference to ensure this change is made in the e-file products.

RECOMMENDATION 6

unreported income from third-party records 2d, 2e

2d, 2e

CORRECTIVE ACTION

We do not agree with this recommendation at this time. We will have to undertake a cost-benefit analysis of implementing

Thus,

while it is currently not feasible, we will continue to study whether it might become feasible in the future.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

11

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 7

Identify potential victims of identity theft and minimize the possibility of unwarranted IRS contacts [REDACTED]

CORRECTIVE ACTION

We do not agree with this recommendation at this time. We will have to undertake a cost-benefit analysis of implementing [REDACTED]

[REDACTED] Thus, while it is currently not feasible, we will continue to study whether it might become feasible in the future.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 8

Determine whether the FTC's data on identity theft can be used to assist taxpayers who might be victims of this violation.

CORRECTIVE ACTION

We agree with this recommendation. The ITIN Program Office will contact the FTC to determine whether the data contained in its database can be used by the IRS to assist victims of identity theft.

IMPLEMENTATION DATE

Determine utility of data by April 30, 2004.

RESPONSIBLE OFFICIALS

Director, ITIN Program, W&I Division

CORRECTIVE ACTION MONITORING PLAN

This action will be monitored as part of our internal management control system. The Director, ITIN, will update the Commissioner, W&I, on a monthly basis.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

12

RECOMMENDATION 9

Determine whether any actions are warranted against taxpayers, ERPs, IRS employees, and volunteers who prepare or assist with the preparing or filing of tax returns with questionable identification.

CORRECTIVE ACTION

We do not agree with this recommendation. The IRS Office of Chief Counsel has advised that a person who prepares or assists with the preparation or filing of a tax return is not subject to a preparer penalty merely because the taxpayer's identification on the return is questionable. Return preparers are not required to verify the identification information provided by a taxpayer, and the recognition of such questionable identification may be beyond their expertise.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 10

Coordinate with the BCIS and the SSA to assess the benefits to these agencies of seeking legislation to broaden the IRS' authority to share information with them regarding unauthorized resident aliens and seek legislation as warranted.

CORRECTIVE ACTION

BCIS and SSA are knowledgeable of the type of information collected by the IRS. A legislative change to Section 6103 of the Code is needed before IRS can share tax information with these agencies. The Treasury Department's position on legislative changes to Section 6103 is that "additional exceptions to the confidentiality of taxpayer information under section 6103 should be granted in rare circumstances and only where the requesting agency can demonstrate, using established criteria, a need for the information that clearly outweighs taxpayer privacy interests and concerns about the effect on voluntary tax compliance." (See the Department of the Treasury's October 2000 Report to the Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions.) Thus, if these agencies can demonstrate a need for the information that clearly outweighs taxpayer privacy interests and concerns about the effect such sharing has on tax administration, they should coordinate with the Office of the Assistant Secretary for Tax Policy at Treasury on a legislative proposal to change Section 6103. We will share a copy of your final report with Tax Policy, BCIS, and SSA.

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

13

IMPLEMENTATION DATE

January 15, 2004

RESPONSIBLE OFFICIAL

Director, ITIN Program, W&I Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 11

Supplement the National Taxpayer Advocate's (NTA) recommendation for a certification program for tax preparers by proposing that, in general, (1) preparers must be U.S. citizens or resident aliens authorized to work in the U.S., and (2) individuals who assist with electronically filed tax returns for U.S. residents, and who are affiliated with an ERO, must be U.S. citizens or resident aliens authorized to work in the U.S.

CORRECTIVE ACTION

A copy of your final report will be shared with the National Taxpayer Advocate, and with the Office of the Assistant Secretary for Tax Policy, which is responsible for proposing legislative changes.

IMPLEMENTATION DATE

January 15, 2004

RESPONSIBLE OFFICIAL

Director, ITIN Program, W&I Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 12

Seek legislation to define and tax individuals who file tax returns reporting income from employment, but who are not authorized to be employed in the U.S., more closely to nonresident aliens.

CORRECTIVE ACTION

A copy of your final report will be shared with the Office of the Assistant Secretary for Tax Policy, which is responsible for proposing legislative changes.

IMPLEMENTATION DATE

January 15, 2004

The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration

14

RESPONSIBLE OFFICIAL

Director, ITIN Program, W&I Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 13

Determine whether tax return preparers who use ITINs as identification have violated any laws that the IRS is authorized to investigate and, if so, determine whether these violations warrant any action.

CORRECTIVE ACTION

The IRS Office of Chief Counsel has advised that inasmuch as the Service requires a paid return preparer to furnish an identifying number, the tax return preparers who are not eligible for a SSN are not in violation of 26 U.S.C. § 6109(a)(4) or any revenue laws if they enter their ITIN. The purpose for the ITIN program is to facilitate tax administration. An individual who is not eligible for a SSN generally is expected to use an ITIN whenever such person is required to furnish an identifying number for tax administration purposes.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

As we do not concur with recommendations 1, 2, 6, and 7, we also do not concur with the benefits to tax administration associated with those recommendations. Furthermore, it is not appropriate for us to comment on the benefits to tax administration associated with the recommendations regarding tax policy, which will be referred to the Office of the Assistant Secretary for Tax Policy at the Department of the Treasury.

If you have any questions concerning this matter, please contact me or have a member of your staff contact Jerald H. Heschel, Director, ITIN Program, at (404) 338-9004.