

**Improvements Are Needed to Ensure
Tax Returns Are Correctly Prepared at
Taxpayer Assistance Centers**

December 2003

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INSPECTOR GENERAL
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ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 10, 2003

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

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

SUBJECT: Final Audit Report - Improvements Are Needed to Ensure Tax Returns Are Correctly Prepared at Taxpayer Assistance Centers (Audit # 200340021)

This report presents the results of our review of tax returns prepared at the Internal Revenue Service (IRS) Taxpayer Assistance Centers (TAC). The overall objective of this review was to determine if tax returns prepared were correct¹ based on the facts provided by the taxpayers. Our assessment also included determining whether IRS employees at the TACs properly screened taxpayers to ensure qualifications for tax preparation assistance were met prior to preparing the tax returns.

Taxpayers are provided with the ability to seek assistance from the IRS in person at its TACs. The primary emphasis of the TACs is to provide face-to-face assistance to taxpayers in meeting their filing and payment responsibilities, including educating taxpayers, providing self-help, interpreting tax laws and regulations, securing forms, resolving notices, and providing need-based complimentary tax return preparation.

Complimentary tax return preparation is provided to those taxpayers whose returns meet certain requirements and limitations (i.e., the type of tax return, the type and amount of income being reported, and deductions claimed).² IRS employees located at the TACs prepare the tax returns using an electronic tax preparation software package. Current year tax returns are electronically filed at no cost to the taxpayer, providing the taxpayer with a faster refund than if a paper tax return was filed.

For Tax Year (TY) 2002, IRS employees at the TACs prepared 289,312 tax returns that involved refunds and tax liabilities totaling approximately \$330 million and \$6 million,

¹ Correct determination is based on whether IRS employees preparing the tax returns properly evaluated eligibility for credits and/or deductions claimed on the prepared tax returns.

² A detailed list of requirements is provided later in the report.

respectively. In addition, IRS employees at the TACs prepared 3,930 tax returns on which the taxpayers had no refund or liability (break-even).

From February through April 2003, Treasury Inspector General for Tax Administration auditors made 34 anonymous visits to 26 TACs nationwide in an attempt to have a tax return prepared. These visits resulted in 23 prepared tax returns. Results show taxpayers do not always receive proper and accurate customer service assistance during tax return preparation. Specifically, in 21 (72 percent) of the 29 visits,³ IRS employees at the TACs did not inform auditors of tax return preparation requirements prior to preparing or scheduling an appointment to prepare the tax return. In addition, none of the IRS employees at the TACs who prepared the 23 tax returns first advised the auditors of the specific forms they were trained to prepare.⁴

Further results show that tax returns are not always correctly prepared. IRS employees incorrectly prepared 19 (83 percent) of the 23 tax returns prepared during our visits. If 17 of the 19 incorrectly prepared tax returns had been filed, the IRS would have incorrectly refunded approximately \$32,000. If the remaining 2 incorrectly prepared tax returns had been filed, the IRS would have inappropriately withheld \$2,400 in tax refunds.

During the course of the review, we communicated our concerns to IRS management. In response, IRS management immediately initiated corrective actions, including requiring IRS employees providing tax preparation assistance to ask questions, based on existing tax instructions and publications, to obtain relevant facts needed to determine that the credits and deductions claimed on a tax return are correct. However, additional actions are needed to ensure taxpayers receive proper and accurate customer service when requesting assistance with tax return preparation.

We recommended that the Commissioner, Wage and Investment (W&I) Division, ensure that IRS employees at the TACs 1) follow the existing screening procedures before providing taxpayers with tax preparation assistance or scheduling an appointment, and 2) use the existing tax law instructions and publications to determine taxpayer eligibility for credits and deductions claimed on the tax return. In addition, the Commissioner, W&I Division, should ensure that a quality review methodology for tax return preparation assistance is in place for the upcoming filing season.⁵

Management's Response: IRS management appreciated our recognition of the corrective actions they took during the course of the review. The IRS' long-term approach to improving quality in the TACs is the implementation of Embedded Quality. This approach focuses on standardized measures, employee monitoring, and feedback at the group level.

³ This percentage is based on 29 visits because, at 1 TAC, an auditor had 2 tax returns prepared, but the TAC was required to screen the auditor only once upon entering the TAC. During four visits, auditors did not go through the screening process because they were denied service.

⁴ All scenarios used by auditors involved tax law topics within the scope of employee training.

⁵ The filing season is the period from January through mid-April when most individual income tax returns are filed.

IRS management agreed with our recommendations and is taking corrective action. The IRS will issue a memorandum reminding all Field Assistance function⁶ employees to adhere to tax return preparation and screening procedures in the Internal Revenue Manual (IRM). Until Embedded Quality is fully implemented in all the TACs, the IRS will also develop a quality review plan to identify actions needed to ensure TAC employees are adhering to return preparation procedures in the IRM. This plan will include requirements for managerial reviews of TAC employees who prepare tax returns and steps the Quality Review staff will take to review tax return preparation in the TACs.

Management's complete response to the draft report is included as Appendix VII.

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 Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

⁶ The Field Assistance function is a business unit within the W&I Division's Customer Assistance, Relationships, and Education function.

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Background

One of the Congress' principal objectives in enacting the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98)¹ was to mandate that the IRS do a better job of meeting the needs of its customers. As part of the RRA 98, the Congress directed the IRS to achieve a better balance between its post-filing enforcement efforts and pre-filing taxpayer assistance through education and service.

In response to the Congressional mandate, the IRS reorganized its functional areas and revised its mission statement to refocus its emphasis on helping taxpayers understand and meet their tax responsibilities.

As part of the IRS' restructuring efforts, the IRS Field Assistance (FA)² function was created. Its mission is to minimize the burden to customers in satisfying their tax obligations by providing the right services at the right location at the right time. To accomplish its mission, the FA function has over 400 Taxpayer Assistance Centers (TAC) organized into 7 geographical areas located throughout the United States (U.S.).

The primary emphasis of the TACs is to provide face-to-face assistance to taxpayers in meeting their filing and payment responsibilities. This includes educating taxpayers, providing self-help, interpreting tax laws and regulations, securing forms, resolving notices, and providing complimentary need-based tax return preparation.

TACs provide certain taxpayers with free tax return preparation assistance

The IRS provides certain taxpayers face-to-face assistance when preparing their tax returns. Complimentary tax return preparation is provided at the TACs to those taxpayers

¹ 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.).

² The FA function is a business unit within the Wage and Investment Division's Customer Assistance, Relationships, and Education function.

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whose returns meet certain requirements based on the type of tax return they are filing along with their income.³

When taxpayers visit a TAC to obtain assistance or have their tax returns prepared, IRS employees prescreen them to ensure that their tax returns meet the TAC qualifications for complimentary tax return preparation. After the prescreening, they are either provided tax preparation assistance or offered an appointment to come back to the TAC for assistance. They may also be advised of the location of a Volunteer Income Tax Assistance (VITA)⁴ site for tax preparation assistance.

IRS employees prepare the tax returns using an electronic tax preparation software package. Each current year tax return is electronically filed (*e-filed*) at no cost to the taxpayer. This provides the taxpayer with a faster refund than if a paper tax return was filed.

According to the IRS, the TACs served approximately 9.1 million taxpayers during Calendar Year (CY) 2002. Approximately 877,800⁵ of these taxpayers visited a TAC to either have their returns prepared and filed or to request assistance preparing their tax returns. From January through June 2003, approximately 5.5 million taxpayers visited TACs; 526,000 visited them either to have their returns prepared and filed or to request assistance in preparing their tax returns. Figure 1 shows the number of tax returns, total

³ Tax return preparation is limited to specific U.S. Individual Income Tax Returns (Forms 1040, 1040A, 1040EZ, and 1040X), Child and Dependent Care Expenses (Form 2441), Education Credits (Hope and Lifetime Learning Credits) (Form 8863), Additional Child Tax Credit (Form 8812), Qualified Adoption Expenses (Form 8839), and specific schedules (i.e., Schedules A, B (interest only), Earned Income Tax Credit (EITC), R, C-EZ, and SE (in conjunction with C-EZ only)).

Taxpayers must provide picture identification, have all necessary tax documents including Social Security cards, and may not have income that exceeds \$33,000 for Tax Year (TY) 2001 and \$35,000 for TY 2002.

⁴ VITA sites provide free basic income tax return preparation assistance to individuals with low to moderate incomes, individuals with disabilities, non-English-speaking taxpayers, and the elderly.

⁵ This number includes both taxpayers who had their returns prepared by an IRS employee and those who just requested assistance in preparing the current and prior year's tax returns. (The IRS provided this figure. We did not verify the accuracy of the number.)

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refunds, and total tax liabilities for Tax Years (TY) 2001 and 2002 tax returns prepared in the TACs.

**Figure 1: TYs 2001 and 2002
Tax Return Preparation Assistance at the TACs⁶**

Tax Year	Number of Tax Returns			Total Dollars (Millions)	
	With Refunds	Break-even ⁷	With Tax Due	Refunded	Due
2001	334,479	3,548	33,775	\$419	\$21
2002	277,023	3,930	12,289	\$330	\$6
Totals	611,502	7,478	46,064	\$749	\$27

Source: IRS management information system (Return Transaction File) containing all tax returns prepared at the TACs.

Auditors played the role of taxpayers

To evaluate the procedures followed in the TACs when preparing taxpayer tax returns, Treasury Inspector General for Tax Administration (TIGTA) auditors played the role of taxpayers and completed the steps taxpayers might take if they visit a TAC to have their tax returns prepared. From February through April 2003, TIGTA auditors performed 34 anonymous visits to 26 TACs located in 7 states (see Appendix IV for the specific states visited).

During these anonymous visits, TIGTA auditors presented scenarios and were successful in having IRS employees at the TACs prepare 23 tax returns. The tax returns involved only those tax law issues within the scope of services IRS employees at the TACs were trained to evaluate while preparing the tax returns.

Each scenario was designed to cover a wide range of tax law topics⁸ to provide an overall assessment of whether taxpayers are having correct tax returns prepared when they visit the TACs. Figure 2 provides a summary of the

⁶ These numbers represent TYs 2001 and 2002 tax returns prepared and filed in the TACs and cannot be compared to the number of taxpayers that visited the TACs during CYs 2001 and 2002.

⁷ Tax returns with no refund or tax due.

⁸ Tax law topics evaluated by IRS employees included Filing Status, Dependents, EITC, Child Tax Credit, Additional Child Tax Credit, and Rate Reduction Credit.

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auditors' attempts to have tax returns prepared during the 34 visits.

Figure 2: Results of Auditor Visits to 34 TACs

	Tax Returns Prepared	Service Denied⁹	No Tax Return Prepared¹⁰	Appointments Scheduled
TAC Visits	23	4	1	6
Percentages¹¹	68%	12%	3%	18%

Source: Anonymous visits performed by TIGTA auditors.

This review was conducted in the IRS Customer Assistance, Relationships, and Education function in the Wage and Investment (W&I) Division between February and July 2003. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Tax Returns May Be Prepared for Taxpayers That Do Not Qualify for Tax Preparation Assistance

IRS employees at the TACs do not always prescreen taxpayers to ensure that their tax returns meet the requirements and limitations, such as the type of tax return, type and amount of income being reported, and deductions claimed. In addition, IRS employees at the TACs who help prepare tax returns do not always first ensure that the tax returns qualify for complimentary tax return preparation and are within the scope of the IRS employees' tax preparation training. Specifically:

?? For 21 (72 percent) of the 29 visits,¹² IRS employees at the TACs did not prescreen or advise auditors of tax

⁹ IRS employees incorrectly informed auditors that tax return preparation assistance was not offered at the TACs and referred auditors to a VITA site for assistance.

¹⁰ The auditor was unable to ensure anonymity and did not request that a return be prepared.

¹¹ Percentage does not add up to 100 percent due to rounding.

¹² This percentage is based on 29 visits because, at 1 TAC, an auditor had 2 tax returns prepared, but the TAC was required to prescreen the auditor only once upon entering the TAC. During four visits, auditors did not go through the screening process because they were denied service.

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return preparation requirements prior to preparing or scheduling appointments to prepare the tax returns.

?? For all 23 of the tax returns prepared, IRS employees at the TACs did not determine if the issues on the tax returns would require forms or schedules that could not be prepared because they were outside the scope of their training.¹³

We recognize that there may be instances where it is more appropriate to accommodate taxpayers than to deny assistance to those whose returns might not qualify. However, IRS employees at the TACs did not always follow existing procedures to ensure qualifications for tax preparation assistance were met prior to preparing the tax return. For example, a review of all tax returns prepared in the TACs showed that IRS employees at the TACs prepared 14,815 TY 2001 and 6,102 TY 2002 tax returns for taxpayers with income that exceeded the income limitations in IRS internal guidelines.

For the TY 2002 tax returns prepared for taxpayers whose income exceeded the income limitations, the limits were exceeded by an average of \$158,450, from \$35,002 to \$219,308. See Figure 3 for the specific breakdown by income level for tax returns prepared and *e-filed*¹⁴ by IRS employees at the TACs for taxpayers with incomes that exceeded IRS guidelines. Appendix V provides a complete breakdown by state.

¹³ All scenarios used by auditors involved tax law topics within the scope of employee training.

¹⁴ Our results were limited to *e-filed* tax returns because we could not identify the paper tax returns prepared in the TACs. The IRS assigns an identification number to *e-filed* tax returns to indicate they were prepared in a TAC; it does not do so for paper filed tax returns.

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**Figure 3: TYs 2001 and 2002 Tax Returns That Exceed Income
Limitations Prepared at the TACs¹⁵**

Income Level (Dollars)	Number of TY 2001 Tax Returns > \$33,000	Income Level (Dollars)	Number of TY 2002 Tax Returns > \$35,000
33,000-39,999	8,272	35,000-39,999	2,919
40,000-59,999	4,765	40,000-59,999	2,297
60,000-79,999	1,191	60,000-79,999	616
80,000-99,999	370	80,000-99,999	168
Over 100,000	211	Over 100,000	98
Over 200,000	6	Over 200,000	4
Total	14,815	Total	6,102

Source: IRS management information system (Return Transaction File) containing all tax returns prepared at the TACs.

IRS guidelines require IRS employees at the TACs to:

- ?? Assist taxpayers that visit TACs for tax return preparation assistance on a first-come, first-served basis.
- ?? Designate an employee to control the flow of traffic and prescreen taxpayers to ensure they meet the requirements for tax preparation assistance. The number of taxpayers requesting tax return preparation assistance may, at times, exceed the number of tax returns that can be prepared during 1 workday. Therefore, if it appears that taxpayers cannot be assisted on the day of their visit, IRS employees will offer appointments within the next 5 business days.
- ?? Limit the types of tax return preparation assistance to only those forms and schedules for which the IRS employees have received training.
- ?? Limit assistance to only those taxpayers within the allowable income level. Income level is tied to the amount allowed to claim the Earned Income Tax Credit

¹⁵ The preparation of these tax returns represents only 4 percent and 2 percent of all TYs 2001 and 2002 tax returns, respectively, prepared in the TACs.

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(EITC).¹⁶ The TACs may make exceptions to the tax return preparation limitations to accommodate individuals on a case-by-case basis. However, in most cases involving tax return preparation outside of the limitations, the IRS employee should refer the taxpayer to alternative sources for assistance.

Preparing tax returns for taxpayers who do not qualify can adversely affect the IRS' ability to provide qualifying taxpayers with assistance when they are denied service because IRS employees are preparing tax returns for taxpayers with incomes that exceed limitations or income and deductions that require using forms and schedules on which they have not been trained. If guidelines are not followed, IRS employees could make errors on the tax returns, creating additional burden to the taxpayers through the misapplication of tax laws and regulations.

Recommendation

We recommend that the Commissioner, W&I Division:

1. Reinforce procedures and monitor the assistance provided at the TACs to ensure existing screening procedures are being followed before employees provide taxpayers with tax preparation assistance or schedule an appointment.

Management's Response: The IRS will issue a memorandum to remind all FA function employees to adhere to return preparation screening procedures in the Internal Revenue Manual (IRM). The employee performing the screening will determine if the customer meets the return preparation limitations and has all necessary documents such as Social Security cards. If the customer meets the criteria, he or she will be scheduled for the next available return preparation appointment.

¹⁶ The EITC is a refundable credit established to offset the impact of Social Security taxes on low-income families and encourage them to seek employment rather than welfare.

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Taxpayers May Have Tax Returns Incorrectly Prepared at Taxpayer Assistance Centers

IRS employees incorrectly prepared 19 (83 percent) of the 23 tax returns based on the facts the TIGTA auditors provided them while making anonymous visits to the TACs. Thirteen of the tax returns were for TY 2001 and 10 were for TY 2002. Figure 4 provides a summary of the accuracy rates for the 23 tax returns prepared.

Figure 4: Results of 23 Tax Returns Prepared

	Correct ¹⁷	Incorrect ¹⁸
Tax Returns Prepared	4	19
Percentage	17%	83%

Source: Anonymous visits performed by TIGTA auditors.

If 17 (89 percent) of the 19 incorrectly prepared tax returns had been filed, the IRS would have incorrectly refunded approximately \$32,000, including EITC totaling \$15,800 and Child Tax Credit (CTC)¹⁹ totaling \$6,164. If the remaining 2 (11 percent) incorrectly prepared tax returns had been filed, the IRS would have inappropriately withheld \$2,400 in tax refunds. Appendix VI provides a breakdown by the TACs visited and the overstatement or understatement for the 19 incorrectly prepared tax returns.

After the TAC visits, we analyzed the tax returns prepared and identified the following factors that contributed to the incorrect preparation of tax returns.

IRS employees modified the facts provided by the TIGTA auditors

For all 23 tax returns, TIGTA auditors either verbally or in writing presented scenarios to the IRS employees preparing the tax returns. All scenarios required the IRS employees to determine whether the auditors qualified for the EITC. For 6 (32 percent) of the 19 incorrectly prepared tax returns, IRS

¹⁷ Correct refers to tax returns on which the IRS employee correctly allowed only the credits and deductions the auditors were entitled to receive.

¹⁸ Incorrect refers to tax returns on which the IRS employee incorrectly allowed credits or deductions to which the auditors were not entitled. We also counted as incorrect those returns on which the auditors did not receive credits or deductions to which they were entitled.

¹⁹ The CTC is a refundable credit taxpayers may take to reduce the amount of tax up to \$600 for each qualifying child.

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employees did not correctly use the facts presented by the auditors. These actions would have allowed the auditors to receive EITC for which they were not eligible.

For example, TIGTA auditors presented to the IRS employees how many months qualifying children had lived with them. The number of months presented did not qualify them for the EITC. However, IRS employees modified the number of months to a sufficient number needed to be eligible for the EITC.

If filed, the 6 tax returns would have resulted in EITC overclaims totaling approximately \$13,500. For one correctly prepared tax return, an IRS employee tried to use the tax preparation software to allow the auditor the credit. However, the tax preparation software would not allow the credit.

We referred these cases to the TIGTA Office of Investigations for review to determine the intent behind the employees' modifications of the facts presented by the auditors. Those investigations did not find intentional misconduct on the part of the employees. For example, some of the employees claimed inadequate training and/or a misunderstanding of the facts presented by the auditors as the reasons for their actions.

IRS employees did not use the Paid Preparer's EITC Checklist (Form 8867) to ensure taxpayers met the requirements for claiming the EITC

For all 23 (100 percent) of the prepared tax returns, IRS employees did not use the Form 8867 when determining EITC eligibility. IRS operating guidelines require IRS employees to use the Form 8867 and exhibit due diligence when preparing tax returns to ensure taxpayers meet the requirements for claiming the EITC. In addition, using the Form 8867 helps to educate taxpayers on the requirements to claim the EITC.

Of the 665,044 TYs 2001 and 2002 tax returns prepared in the TACs, a total of 155,208 (24 percent) involved an EITC claim. The EITC claims associated with these tax returns totaled approximately \$296 million.

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Both the IRS and the Congress recognize the EITC as a highly visible and well-known source of noncompliance. By not ensuring taxpayer eligibility, IRS employees increase the risk of taxpayers receiving erroneous payments and potentially subjecting these taxpayers to EITC examinations. As part of its Examination program, the IRS has identified 8,273 TY 2001 tax returns²⁰ prepared in the TACs as having questionable EITC claims. As of August 2003, 287 of these tax returns had been selected for examination

IRS employees did not use tax instructions and publications to determine taxpayer eligibility to receive credits and deductions

The scenarios used by TIGTA auditors for the 23 tax returns prepared were designed to require IRS employees to make an eligibility determination for a wide range of tax law topics.²¹ Figure 5 shows the accuracy of IRS employees' determinations in relation to these tax law topics.

Figure 5: Accuracy of Tax Returns by Tax Law Topic

Tax Law Topics	Eligibility Assessment	
	Correct	Incorrect
Filing Status	9	14
Dependents	13	10
EITC	15	8
CTC	13	10
Additional Child Tax Credit	17	6
Rate Reduction Credit ²²	11	2

Source: Anonymous visits performed by TIGTA auditors.

During the fall of CY 2002, IRS employees were trained on the use of tax instructions and publications to assist taxpayers with tax law questions to ensure the accuracy of

²⁰ We limited our analysis to TY 2001 tax returns because this was the tax year for which the most recent IRS data were available.

²¹ Tax law topics evaluated by IRS employees included Filing Status, Dependents, EITC, CTC, Additional Child Tax Credit, and Rate Reduction Credit.

²² The Rate Reduction Credit applies only to the 13 TY 2001 tax returns the TIGTA auditors had prepared.

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responses provided. This “publication method” requires IRS employees to obtain the appropriate publication, discuss specific information related to the topic, ask appropriate questions to obtain facts, and respond to the taxpayer’s issue or question. However, IRS management informed us that employees were not required to use this method when providing tax preparation assistance.

During the course of the review, we communicated the above results to IRS management. The IRS took immediate corrective actions that required all IRS employees to use existing tax instructions and publications to ensure taxpayers were eligible to receive credits and deductions allowed on the tax returns.

Each of the scenarios presented facts that required the IRS employee at the TAC to make a determination regarding the EITC and CTC. To qualify for these credits, a taxpayer must meet specific eligibility requirements, including items relating to relationship, residency, etc. If IRS employees do not use all resources available to them, they may not be able to correctly apply the applicable laws and regulations to ensure taxpayers are not receiving credits they are not entitled to receive. Figure 6 provides the volume of TYs 2001 and 2002 tax returns prepared at the TACs along with the substantial amount claimed for the EITC and CTC.

**Figure 6: TYs 2001 and 2002 Tax Returns
Prepared at the TACs With the EITC and CTC**

Tax Return Type ²³	TY 2001		TY 2002	
	Total Tax Returns	Credits Claimed (Millions)	Total Tax Returns	Credits Claimed (Millions)
EITC	84,988	\$160	70,220	\$136
CTC	52,692	\$31	36,240	\$20

Source: IRS management information system (Return Transaction File) containing all tax returns prepared at the TACs.

In addition, when employees do not ensure that they correctly apply tax laws and regulations, taxpayers may be at risk of not receiving the credits to which they are entitled.

²³ These tax returns are limited to taxpayers that claimed dependents on the tax returns and received the EITC or CTC.

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For example, an analysis of all TYs 2001 and 2002 tax returns prepared at the TACs showed 30,741 tax returns and 105,746 tax returns²⁴ on which the taxpayer claimed a dependent but did not receive the EITC and CTC, respectively.

In July 2003, we informed the IRS there was a risk that approximately 48,538 TY 2002 taxpayers may have been entitled to receive the \$400 advanced CTC payment but may not have received it as planned. In addition, there were 36,240 taxpayers scheduled to receive approximately \$14.5 million in advanced CTC payments to which they may not be entitled. This happened because IRS employees at the TACs did not properly determine taxpayer eligibility for the credit when preparing tax returns and because there was a systemic error in a tax preparation software package. Based on our results, we recommended the IRS take steps to ensure only eligible taxpayers receive the planned \$400 advanced CTC payment.

IRS employees used tax preparation software that had systemic errors to prepare returns for TYs 2001 and 2002

For 2 (11 percent) of the 19 incorrectly prepared tax returns, systemic errors in the tax preparation software used when preparing these tax returns would have prevented TIGTA auditors from receiving \$2,400 in refunds to which they were entitled. The software for TYs 2001 and 2002 had the following systemic errors:

- ?? For TY 2001, the software would not allow the EITC or CTC for taxpayers that claimed their brothers, sisters, nieces, or nephews as qualifying children or dependents, even though the taxpayers were entitled to receive these credits.
- ?? For TY 2002, the software would not allow the CTC for taxpayers that claimed their brothers, sisters, nieces, or nephews as dependents. The software would incorrectly allow the CTC for taxpayers that claimed as dependents foster children that lived in the home less than

²⁴ We limited our analysis to only those taxpayers that met the income qualifications for tax preparation assistance in the TACs.

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12 months, even though taxpayers were not entitled to receive the credit.

We could not determine how many taxpayers this might affect because of the way the IRS transcribes data. Management has been alerted to the problems we identified with the electronic tax preparation software. We are not making a specific recommendation to address this problem. We plan to conduct a separate review to evaluate the IRS' process for ensuring tax preparation software used by employees to prepare tax returns is accurate.

The IRS FA function does not have a tax preparation assistance quality review process

Tax returns prepared by IRS employees at the TACs are not subjected to a quality review process to ensure the correctness of the tax returns prepared. Instead, the IRS relies on a validation process²⁵ at submission processing sites²⁶ to identify errors on tax returns prepared in the TACs. However, this process does not validate a taxpayer's eligibility to receive credits and deductions allowed by IRS employees on the tax return. That type of validation generally takes place only if the tax return is selected for examination.

The IRS recognizes the need to implement an effective quality review system for its TACs. However, during Fiscal Year (FY) 2003, the FA function focused on a plan to improve the accuracy of the answers IRS employees at the TACs provide to taxpayers' tax law questions. The IRS informed us that in FY 2004 it plans to implement a methodology to use Embedded Quality to measure customer service, including tax preparation assistance, provided in the TACs. The Embedded Quality approach focuses on standardized measurements, employee monitoring, and employee feedback at the group level. The IRS believes this type of quality review will allow TAC managers to provide feedback to their employees.

²⁵ Primary reasons returns are rejected by the IRS are math errors or an incorrect taxpayer name, Social Security Number, or birthday.

²⁶ Submission processing sites process tax returns, payments, and refunds; send taxpayer notices; and reconcile taxpayer accounts.

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We believe that one of the major management challenges the IRS faces is to provide quality customer service to each and every taxpayer. Taxpayers that seek help in preparing their tax returns rely upon the professional assistance of IRS employees. However, without an effective tax preparation assistance quality review process, the IRS cannot be assured that its employees are preparing correct tax returns based on facts provided by taxpayers.

Recommendations

We recommend that the Commissioner, W&I Division:

2. Reinforce existing procedures that require IRS employees to use existing tax law instructions and publications when assisting taxpayers.

Management's Response: The IRS will issue a memorandum reminding all FA function employees to adhere to return preparation procedures in the IRM which require that each TAC employee use the applicable worksheets prompted by the return preparation software and the publication method or job aids to determine eligibility for deductions and credits.

3. Ensure a quality review methodology for tax return preparation assistance is in place before the 2004 Filing Season²⁷ begins in January 2004.

Management's Response: Until Embedded Quality is fully implemented in all the TACs, the IRS will develop a quality review plan to identify actions needed to ensure TAC employees are adhering to return preparation procedures in the IRM. This plan will include requirements for managerial reviews of TAC employees who prepare tax returns and steps the Quality Review staff will take to review tax return preparation in the TACs.

²⁷ The filing season is the period from January through mid-April when most individual income tax returns are filed.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of the review was to determine if tax returns prepared at the Internal Revenue Service (IRS) Taxpayer Assistance Centers (TAC) were correct based on the facts provided by the taxpayers. We determined if tax returns prepared in the TACs were correct by determining if IRS employees evaluated each requesting taxpayer's eligibility to claim credits and deductions on the tax return. In addition, we assessed whether IRS employees at the TACs properly screened taxpayers to ensure qualifications for tax return preparation¹ were met prior to the IRS employees' preparation of the tax returns.

To achieve this objective, we performed the following tests:

- I. Determined if IRS employees prepared correct tax returns based on facts provided by Treasury Inspector General for Tax Administration (TIGTA) auditors at the 26 TACs visited. Audit coverage included the TACs in states with high and low accuracy rates reported in the January through June 2002 Semiannual Walk-In report.² Where possible, TIGTA auditors visited the TACs located in or around major cities located in the selected states. Auditors developed scenarios and had IRS employees prepare tax returns based on training and the scope of topics prescribed in the Fiscal Year 2003 Field Assistance function Operating Procedures.
- II. Determined if IRS employees at the TACs used tax instructions and publications (i.e., the "publication method") and asked appropriate probing questions while preparing tax returns.
- III. Determined if IRS employees at the TACs properly screened taxpayers for tax preparation assistance requirements and tax law topics that were within the scope of topics prescribed in the Field Assistance function Operating Procedures.
- IV. Analyzed IRS data to determine the number of taxpayers who visited the TACs and the number of taxpayers who had their tax returns prepared by IRS employees at the TACs. We did not validate the IRS data.

¹ Tax return preparation is limited to specific United States Individual Income Tax Returns (Forms 1040, 1040A, 1040EZ, and 1040X), Child and Dependent Care Expenses (Form 2441), Education Credits (Hope and Lifetime Learning Credits) (Form 8863), Additional Child Tax Credit (Form 8812), Qualified Adoption Expenses (Form 8839), and specific schedules (i.e., Schedules A, B (interest only), Earned Income Tax Credit, R, C-EZ, and SE (in conjunction with C-EZ only)). Taxpayers must provide picture identification, have all necessary tax documents including Social Security cards, and may not have income that exceeds \$33,000 for Tax Year 2001 and \$35,000 for Tax Year 2002.

² *Trends in Customer Service in the Taxpayer Assistance Centers Show Procedural and Training Causes for Inaccurate Answers to Tax law Questions* (Reference Number 2003-40-023, dated November 2002).

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- V. Analyzed Tax Years 2001 and 2002 tax preparation software used by IRS employees at the TACs to prepare tax returns to determine if the programs prepared the tax returns correctly.

**Improvements Are Needed to Ensure Tax Returns
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Appendix II

Major Contributors to This Report

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)

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**Improvements Are Needed to Ensure Tax Returns
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Wage and Investment Division SE:W
Chief, Customer Liaison, Small Business/Self-Employed Division SE:S:COM
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division
SE:W:CAR
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Director, Communications and Liaison, Small Business/Self-Employed Division SE:S:MS:CL
Director, Field Assistance, Wage and Investment Division SE:W:CAR:FA
Director, Stakeholder Partnerships, Education, and Communication, Wage and Investment
Division SE:W:CAR:SPEC
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Management Controls OS:CFO:AR:M
Audit Liaison: GAO/TIGTA Liaison, Wage and Investment Division SE:W:S:PA

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Appendix IV

**States Visited for Tax Preparation Assistance
February through April 2003**



We visited seven states: California, Florida, Illinois, Massachusetts, New Hampshire, South Carolina, and Texas.

**Improvements Are Needed to Ensure Tax Returns
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Appendix V

**Tax Years 2001 and 2002 Tax Returns Prepared at
Taxpayer Assistance Centers for Taxpayers With Income
That Exceeded Requirements¹**

States	Tax Returns Prepared for Taxpayers With Income > \$33,000	Total Tax Year 2001 Tax Returns Prepared	Tax Returns Prepared for Taxpayers With Income > \$35,000	Total Tax Year 2002 Tax Returns ² Prepared
ALABAMA	141	4,850	58	4,525
ALASKA	21	1,288	2	677
ARIZONA	73	1,553	11	560
ARKANSAS	73	1,954	20	1,433
CALIFORNIA	1,641	19,715	687	11,846
COLORADO	7	403	4	362
CONNECTICUT	717	21,797	296	17,626
DELAWARE	0	0	0	0
FLORIDA	224	7,032	52	5,247
GEORGIA	265	10,512	60	9,188
HAWAII	49	851	11	516
IDAHO	65	901	28	687
ILLINOIS	473	12,457	293	14,088
INDIANA	485	13,140	188	8,862
IOWA	67	1,344	75	1,235
KANSAS	345	4,320	120	2,531
KENTUCKY	105	5,466	44	5,151
LOUISIANA	285	6,561	60	4,647
MAINE	237	5,814	96	4,821
MARYLAND	1,076	17,337	530	12,917
MASSACHUSETTS	178	5,368	71	3,925
MICHIGAN	203	6,719	46	4,529
MINNESOTA	56	727	19	345
MISSISSIPPI	76	3,467	30	2,910
MISSOURI	725	9,648	257	11,279

¹ The income limit requirement for tax return preparation in the Taxpayer Assistance Centers was \$33,000 for Tax Year 2001 and \$35,000 for Tax Year 2002.

² January through June 2003.

**Improvements Are Needed to Ensure Tax Returns
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States	Tax Returns Prepared for Taxpayers With Income > \$33,000	Total Tax Year 2001 Tax Returns Prepared	Tax Returns Prepared for Taxpayers With Income > \$35,000	Total Tax Year 2002 Tax Returns ² Prepared
MONTANA	140	3,978	52	2,383
NEBRASKA	81	3,277	33	3,419
NEVADA	112	2,055	21	1,125
NEW HAMPSHIRE	120	2,055	46	1,929
NEW JERSEY	271	7,585	121	7,763
NEW MEXICO	56	1,529	14	584
NEW YORK	1,155	35,600	439	27,499
NORTH CAROLINA	304	6,700	141	7,522
NORTH DAKOTA	27	890	68	1,443
OHIO	430	19,186	154	17,385
OKLAHOMA	54	2,669	41	2,338
OREGON	145	4,685	63	3,165
PENNSYLVANIA	481	12,885	215	13,166
RHODE ISLAND	69	5,378	20	4,482
SOUTH CAROLINA	86	2,819	33	3,246
SOUTH DEKOTA	124	1,792	71	1,613
TENNESSEE	318	8,512	140	6,252
TEXAS	1,028	17,024	324	11,352
UTAH	129	1,490	40	1,070
VERMONT	35	1,225	7	1,055
VIRGINIA	426	12,390	271	15,307
WASHINGTON	547	10,133	146	5,723
WASHINGTON, D.C.	68	2,094	25	2,050
WEST VIRGINIA	109	1,631	67	4,738
WISCONSIN	76	2,616	16	1,423
WYOMING	176	1,776	43	1,193
NO STATE NAMED ³	661	7,794	433	5,863
Totals⁴	14,815	342,992	6,102	284,995

Source: Internal Revenue Service management information system (Return Transaction File) containing all tax returns prepared at the Taxpayer Assistance Centers.

³ For these tax returns, Internal Revenue Service records did not identify the taxpayer address.

⁴ These totals are limited to e-filed tax returns and do not include 37,057 paper tax returns prepared at the TACs.

**Improvements Are Needed to Ensure Tax Returns
Are Correctly Prepared at Taxpayer Assistance Centers**

Appendix VI

Results of Tax Returns Incorrectly Prepared at the Taxpayer Assistance Centers

Taxpayer Assistance Centers Visited	Internal Revenue Service Refund	Correct¹ Refund	Refunds Understated	Refunds Overstated
Long Beach, CA	\$4,241	\$5,441	\$1,200	
Los Angeles, CA	\$4,241	\$5,441	\$1,200	
Santa Ana, CA	\$3,914	\$2,691		\$1,223
Fort Myers, FL	\$1,295	\$980		\$315
Fort Myers, FL	\$1,227	\$192		\$1,035
St. Petersburg, FL	\$2,818	\$2,547		\$271
St. Petersburg, FL	\$1,518	\$192		\$1,326
Tampa, FL	\$2,495	\$980		\$1,515
Tampa, FL	\$627	\$(559) ²		\$627
Tampa, FL	\$4,241	\$3,070		\$1,171
Chicago, IL	\$5,441	\$2,547		\$2,894
Ford City, IL	\$5,441	\$2,547		\$2,894
Manchester, MA	\$1,827	\$(559)		\$1,827
Worcester, MA	\$4,121	\$(559)		\$4,121
Myrtle Beach, SC	\$5,037	\$2,180		\$2,857
Myrtle Beach, SC	\$3,806	\$312		\$3,494
Columbia, SC	\$3,806	\$(559)		\$3,806
Columbia, SC	\$3,103	\$860		\$2,243
Desoto, TX	\$627	\$(559)		\$627
Totals:			\$2,400	\$32,246

Source: Anonymous visits performed by Treasury Inspector General for Tax Administration (TIGTA) auditors.

¹ Correct amount of refund based on TIGTA auditors' preparation of the tax returns using the facts in the scenarios.

² If these tax returns had been prepared correctly, taxpayers would have owed taxes totaling \$559 instead of receiving refunds. If examined, these taxpayers would have to repay the refunded amount and the \$559 tax liability, plus interest.

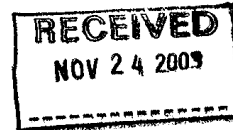
**Improvements Are Needed to Ensure Tax Returns
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Appendix VII

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308



NOV 24 2003

MEMORANDUM FOR PAMELA J. GARDINER
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Henry O. Lamar, Jr. *Henry O. Lamar, Jr.*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Improvements Are Needed to
Ensure Tax Returns Are Correctly Prepared at Taxpayer
Assistance Centers (Audit #200340021)

I reviewed your draft report that presents the results of your review of tax return preparation in our Taxpayer Assistance Centers (TAC). I appreciate your recognition of the corrective actions we took during the course of your review. We required all employees to use existing tax instructions and publications to ensure taxpayers were eligible to receive the tax credits and deductions allowed on the return. We will continue to remind our employees of these requirements. We will also remind all employees to adhere to our screening procedures to ensure taxpayers meet our return preparation criteria.

In regards to your finding that 2 of the 19 incorrectly prepared tax returns were due to systemic errors in the tax preparation software, the software that IRS purchases is an "off the shelf product" that is not customized for IRS use. All software providers follow the file specifications provided by IRS (as listed in Publication 1346). As errors are detected, the file specifications are corrected, and the software providers send out updates to their customers to correct the issue that was discovered. Regarding the Child Tax Credit and Earned Income Tax Credit issues mentioned, the errors were detected, and the software providers (including the software provider used by the IRS) sent updates to correct the issues.

As stated in prior responses to TIGTA reports, our long-term approach to improving quality in all aspects of our TACs is the implementation of Embedded Quality (EQ). EQ is a way of doing business that builds commitment and capability among individuals to continually improve customer service, employee satisfaction, and business results. The EQ approach focuses on standardized measures, employee monitoring, and feedback methods at the group level.

Improvements Are Needed to Ensure Tax Returns Are Correctly Prepared at Taxpayer Assistance Centers

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EQ includes several attributes for monitoring returns prepared by TAC employees. Some of the attributes include: (1) verifying that the employee determined if the customer met the return preparation criteria; (2) ensuring the employee asked probing questions and used the publication method as appropriate to determine whether a customer qualified for deductions and credits such as the child tax credit; and (3) whether the customer qualified to claim children as dependents.

We began piloting EQ in late October 2003, and the pilot will run through early December 2003. Full implementation of EQ is scheduled for April 2004. Until we fully implement EQ, we will develop a quality review process for return preparation that will be in place for the 2004 filing season.

Our corrective actions are detailed in the attachment. If you need additional information, please contact me at (404) 338-7060, or Ellen M. Cimaglia, Director, Field Assistance, Wage and Investment, Customer Assistance, Relationships and Education, at (404) 338-7141.

Attachment

Improvements Are Needed to Ensure Tax Returns Are Correctly Prepared at Taxpayer Assistance Centers

ATTACHMENT

RECOMMENDATION 1

Reinforce procedures and monitor the assistance provided at the TACs to ensure existing screening procedures are being followed before employees provide taxpayers with tax preparation assistance or schedule an appointment.

CORRECTIVE ACTION

We will issue a memorandum to all Field Assistance employees reminding them to adhere to our return preparation screening procedures in the IRM. These IRM procedures require that all TACs screen customers who need return preparation assistance. The employee performing the screening will determine if the customer meets the return preparation limitations and has all necessary documents such as social security cards. If the customer meets the criteria, they will be scheduled for the next available return preparation appointment.

IMPLEMENTATION DATE

Proposed: December 31, 2003

RESPONSIBLE OFFICIAL

Director, Field Assistance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor adherence to our return preparation screening procedures during operational and managerial reviews of employees responsible for screening customers.

RECOMMENDATION 2

Reinforce existing procedures that require IRS employees to use existing tax law instructions and publications when assisting taxpayers.

CORRECTIVE ACTION

We will issue a memorandum to all Field Assistance employees reminding them to adhere to our return preparation procedures in the IRM. These IRM procedures state that each TAC will use the applicable worksheets prompted by the return preparation software, [REDACTED] and the Publication Method or job aids to determine eligibility for deductions and credits including Dependents, EITC, Child and Dependent Care Credit, Child Tax Credit, Additional Child Tax Credit and Filing Status. The Publication Method is a technique to "walk" a taxpayer

Improvements Are Needed to Ensure Tax Returns Are Correctly Prepared at Taxpayer Assistance Centers

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through a publication. The technique covers all appropriate probing questions to determine eligibility for credits and deductions.

PROPOSED IMPLEMENTATION DATE

Proposed: December 31, 2003

RESPONSIBLE OFFICIAL

Director, Field Assistance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor adherence to these requirements during operational and managerial reviews of employees who prepare tax returns for customers.

RECOMMENDATION 3

Ensure a quality review methodology for tax return preparation assistance is in place before the 2004 Filing Season begins in January 2004.

CORRECTIVE ACTION

Until we fully implement Embedded Quality in all TACs, we will develop a quality review plan to identify actions needed to ensure TAC employees are adhering to our return preparation procedures in the IRM. This plan will include requirements for managerial reviews of TAC employees who prepare tax returns and steps our Headquarters Quality review staff will take to review tax return preparation in the TACs.

PROPOSED IMPLEMENTATION DATE

Proposed: December 31, 2003

RESPONSIBLE OFFICIAL

Director, Field Assistance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor adherence to our return preparation procedures during managerial and operational reviews of our TACs.