



*Actions Are Needed to Ensure Proper Use
of Individual Taxpayer Identification
Numbers and to Verify or Limit
Refundable Credit Claims*

March 31, 2009

Reference Number: 2009-40-057

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:

2(a) = Law Enforcement Criteria

2(e) = Law Enforcement Procedure(s)

2(f) = Risk Circumvention of Agency Regulation or Statute (whichever is applicable)

3(d) = Identifying Information - Other Identifying Information of an Individual or Individuals

5 = Information concerning a pending law enforcement proceeding



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 31, 2009

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

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

SUBJECT: Final Audit Report – Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims (Audit # 200840020)

This report represents the results of our review to determine whether the Internal Revenue Service (IRS) has proper controls in place to detect and deter improper use of Individual Taxpayer Identification Numbers (ITIN) when processing tax returns. This audit was conducted as part of our Fiscal Year 2008 Annual Audit Plan.

Impact on the Taxpayer

The IRS issues ITINs to help individuals comply with the United States (U.S.) tax laws and provide a means to efficiently process and account for tax returns. The issuance of ITINs was intended to address concerns by the IRS and the Department of the Treasury that, without a unique number, taxpayers could not be identified effectively. There has been a significant increase in the use of ITINs since the IRS began issuing them in Tax Year (TY) 1996. There was a 246 percent increase from 530,000 in TY 2001 to more than 1.8 million in TY 2007. Improvements to the ITIN Program are needed to ensure that the Program is meeting its intent and that refundable claims are verified.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

Synopsis

Any person required to file a tax return is required to include an identifying number, referred to as a taxpayer identification number. For the majority of filers, the taxpayer identification number is the individual's Social Security Number (SSN). Non-U.S. citizens who do not have an employment authorization must prove a valid nonwork reason for requesting an SSN in order to receive one.¹ Consequently, many individuals are unable to obtain an SSN. Individuals who are unable to obtain an SSN but have a tax return filing requirement can be either resident or nonresident aliens. The ITIN is available to these individuals.

The ITIN is available to individuals who are required to have a taxpayer identification number for tax purposes, but do not have and are not eligible to obtain an SSN.

The IRS has initiated a number of actions in an attempt to improve the processing of tax returns from individuals who are unable to obtain an SSN. Despite these efforts, improvements to the ITIN Program are still needed.

- *Individuals are assigned multiple ITINs, which results in the issuance of erroneous refunds.* A recent IRS study² identified that 4 percent of individuals applying for ITINs already had an ITIN assigned to them and that 30 percent of these individuals were assigned another one. The study further estimated that approximately \$60 million per year in erroneous refunds were issued for ITIN cases. Some of these resulted from the same individual filing multiple tax returns under the different identification numbers.
- *ITINs are improperly used for employment.* Employers are reporting wage income under an ITIN. The law establishing the ITIN specifically states that it is not an SSN or an account number for use in employment for wages.³ Our review of TY 2006 Wage and Tax Statements (Form W-2) identified 292,992 employers that filed 790,701 Forms W-2 with ITINs reporting wages totaling more than \$9.5 billion. The number of noncompliant employers increased 15 percent from 253,742 in TY 2004 to 292,992 in TY 2006. Although the IRS has data available to identify these individuals and employers, no significant actions are taken to address the noncompliance.

¹ Generally for obtaining Government benefits (Federal, State, or local) to which the individual is entitled.

² IRS Lean Six Sigma study entitled, *Individual Taxpayer Identification Number, Control Tollgate*, dated February 21, 2008. The data contained in the study were collected in October and November 2007 and were not statistically valid for the entire applicant pool, but rather were used as a basis point specifically for the Tax Examiner prescreening process.

³ Treas. Reg. § 301.6109.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

- *Incomplete or inaccurate information is being input into IRS systems from tax returns filed with ITINs.*⁴ This occurs when a tax return is filed with an ITIN and an attached Form W-2 contains an SSN that does not belong to the individual filing the tax return. The IRS does not transcribe information from Forms W-2 for paper-filed tax returns. In addition, a feature included in tax preparation software packages automatically populates the identification number on the electronic Form W-2 [for electronically filed (*e-filed*) tax returns] with the identification number reported on the tax return, i.e., the ITIN. This occurs even though there is an SSN on the Form W-2 which does not belong to the individual filing the return.

2(e), 2(f)

• [REDACTED]

The amount of the CTC and/or the ACTC allowed to ITIN filers increased from \$152 million in TY 2000 to almost \$2.4 billion in TY 2007. In TY 2007, more than 1.2 million (66 percent) ITIN filers received ACTCs of almost \$1.8 billion. The ACTC is a refundable credit available to individuals with no tax liability. [REDACTED]

[REDACTED]

2(e), 2(f)

- *Legislation should be considered to require an SSN in order to be eligible for the ACTC, consistent with the requirements for the Earned Income Tax Credit.* Prior to 1996, ITIN filers were entitled to claim the Earned Income Tax Credit. However, concerns were raised by the Government Accountability Office, IRS, and Congress regarding noncompliance with Earned Income Tax Credit requirements. The Government Accountability Office reported that awarding the Earned Income Tax Credit to illegal aliens⁵ was at cross purposes with Federal Government policies that prohibit illegal aliens from working in the U.S.⁶ The law was subsequently changed to deny the Earned Income Tax Credit to individuals who file a tax return without an SSN valid for work.⁷ The change in the law was made prior to the establishment of the ACTC. While the law also prohibits aliens residing without authorization in the U.S. from receiving most Federal public benefits, IRS management's view is that the law does not provide sufficient legal authority for the IRS to disallow the ACTC to ITIN filers. Nonetheless, as it now stands, the payment of Federal funds through this tax benefit appears to provide an additional incentive for aliens to enter, reside, and work in the U.S. without authorization, which contradicts Federal law and policy to remove such incentives.

⁴ An SSN is needed for work purposes, but if an individual is not eligible for an SSN, an SSN may be used that does not belong to this individual.

⁵ The Government Accountability Office defined an "illegal alien" as a foreign person who is in the U.S. without a lawful immigration status.

⁶ *Earned Income Credit – Targeting to the Working Poor* (GAO/GGD-95-122BR, dated March 1995).

⁷ Personal Responsibility and Work Opportunity Reconciliation Act of 1996, P.L. 104-193 § 401(c).



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

Recommendations

We recommended that the Commissioner, Wage and Investment Division:

- Develop a process to identify individuals who are improperly using ITINs for work purposes and develop outreach efforts with the Social Security Administration to address the improper use.
- Coordinate with electronic tax software preparation companies to initiate actions to limit the automatic population feature of the taxpayer identification numbers on Forms W-2 for Forms W-2 associated with *e-filed* ITIN tax returns.
- Develop a process to ensure that accurate tax information is input into IRS systems from both paper and *e-filed* tax returns filed with an ITIN.
- Develop a process to ensure the residency requirement for the CTC and ACTC is met on ITIN returns claiming the credits.

Legislative Recommendation

Legislation is needed to clarify whether or not refundable tax credits such as the ACTC may be paid to filers without a valid SSN and, if these credits may not be paid, to provide IRS math error authority⁸ to disallow associated claims for the credits. Disallowance of the ACTC to filers without a valid SSN would reduce Federal outlays by \$8.9 billion over 5 years.

Response

IRS management agreed with two recommendations and disagreed with three recommendations. The IRS agreed to continue to work with electronic tax software preparation companies and remind them of the problem of automatic population of the ITIN in the SSN field. The IRS also agreed to explore with the Department of the Treasury legislative changes to address the payment of refundable credits to taxpayers who file without an SSN.

Management does not plan to work with the SSA to develop outreach efforts to address the improper use of the ITIN for employment. They believe their involvement would be a duplication of the SSA's efforts. Management did not agree to ensure that accurate tax information is input into IRS systems from both paper and *e-filed* tax returns with an ITIN. Furthermore, management did not agree to develop a process to ensure the residency requirement for the CTC and ACTC is met on ITIN returns claiming the credits. The IRS states that, without

⁸ Math error authority provides the IRS with the ability to systemically identify errors and disallow associated claims for refunds associated with the erroneous claims.



**Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims**

2(a),2(e),2(f) a legislative change, it does not have the legal authority during tax return processing to verify and disallow the CTC or ACTC based on [REDACTED]. The current process for verification of eligibility is an examination, where the taxpayer would need to provide [REDACTED] [REDACTED] [REDACTED] 2(a),2(e),2(f)

2(e),2(f) IRS management agreed with the outcome measure regarding *e-filed* returns with Forms W-2 containing ITINs, but disagreed with the outcome measure regarding ACTC payments because the outcome measure is based on two contingencies: 1) interpretation of the Internal Revenue Code and 2) the enactment of legislation to specifically disallow the ACTC to filers without an SSN. Should such legislation be enacted, IRS management will reconsider the outcome measure. Management's complete response to the draft report is included as Appendix VII.

Office of Audit Comment

IRS management disagreed with our recommendation to develop a process to identify individuals who are improperly using ITINs for work purposes because they believe that it would duplicate SSA efforts and that the SSA is the correct agency to address the issue. However, because the ITIN is a number issued by the IRS, we believe it is the IRS' responsibility to educate individuals and employers of its limitations, especially in the instances that the IRS knows it is being used for employment. Since our recommendation was for the IRS to work with the SSA on this issue, it should not result in duplicate efforts.

We are concerned with the IRS' disagreement to our recommendation to ensure that accurate tax information is input into IRS systems from both paper and *e-filed* tax returns with an ITIN. Without correct wage reporting information, there is no wage matching to make sure the amount reported as withheld is correct. Management did not provide us information supporting their statement that transcribing the information from Forms W-2 would be cost prohibitive.

2(a),2(e),2(f) While IRS management states that it disagrees with the recommendation to develop a process to ensure the [REDACTED] [REDACTED] [REDACTED] with ITINs being claimed for the CTC and/or ACTC, management also states on page 4 of the response that its "SP [Submission Processing] and Reporting Compliance organizations are partnering in a pilot to explore options to better identify false claims for examination." This appears as if it is intended to address our recommendation, so the basis for disagreement is not clear.

We agree with IRS management that our outcome measure related to ACTC payments is contingent upon interpretation or enactment of legislation, as we note in Appendix IV on page 25.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Because this report contains a legislative recommendation, we have discussed the recommendation with the Department of the Treasury Office of Tax Policy and will provide a copy of the report to the Assistant Secretary of the Treasury for Tax Policy.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Table of Contents

Background	Page 1
Results of Review	Page 5
The Internal Revenue Service Receives Millions of Forms W-2 With Invalid Identification Numbers	Page 5
Improvements Can Be Made to the Individual Taxpayer Identification Number Program	Page 6
<u>Recommendation 1</u> :	Page 10
<u>Recommendations 2 and 3</u> :	Page 13
<u>Recommendation 4</u> :	Page 18
<u>Recommendation 5</u> :	Page 19
Appendices	
Appendix I – Detailed Objective, Scope, and Methodology	Page 20
Appendix II – Major Contributors to This Report	Page 23
Appendix III – Report Distribution List	Page 24
Appendix IV – Outcome Measures	Page 25
Appendix V – Methods for Employers to Verify Work Eligibility	Page 27
Appendix VI – Rules for Claiming the Child Tax Credit and the Additional Child Tax Credit	Page 29
Appendix VII – Management’s Response to the Draft Report	Page 30



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Abbreviations

ACTC	Additional Child Tax Credit
CTC	Child Tax Credit
DHS	Department of Homeland Security
<i>e-file; e-filed</i>	Electronic file; electronically filed
IRS	Internal Revenue Service
ITIN	Individual Taxpayer Identification Number
SSA	Social Security Administration
SSN	Social Security Number
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year
U.S.	United States



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Background

Employers have a legal obligation to ensure that they are not hiring individuals unauthorized to work in the United States (U.S.). Employers have to complete the following actions to comply with legal requirements regarding verifying eligibility to work and administration of tax laws:

- **Work Eligibility** – The employer is required to complete an Employment Eligibility Verification (Form I-9). Both the Department of Homeland Security (DHS) and the Social Security Administration (SSA) provide various methods for employers to verify work eligibility. See Appendix V for a description of methods provided for verification.
- **New Hire Reporting** – The employer is required to report newly hired employees to a designated State new hire registry.
- **Income Tax Withholding** – An Employee’s Withholding Allowance Certificate (Form W-4) must be completed.
- **Name and Social Security Number (SSN)** – The employer is required to record each new employee’s SSN when completing the Wage and Tax Statement (Form W-2). Although the employer should ask to view the employee’s social security card, there is no requirement that the card be viewed and, therefore, no requirement to ensure the authenticity of the SSN.



The Individual Taxpayer Identification Number (ITIN) was created to provide individuals who are not eligible to obtain an SSN with an identification number for tax purposes

The Internal Revenue Service (IRS) issues ITINs to help individuals comply with the U.S. tax laws and provide a means to efficiently process and account for tax returns. Only individuals who have a valid filing requirement or who are filing a tax return to claim a refund of over-withheld tax are eligible to receive an ITIN. The ITINs are issued regardless of an individual’s immigration status. The issuance of an ITIN does **not**:

- Change an individual’s immigration status.
- Entitle the individual to social security benefits.
- Entitle the individual to work in the U.S.
- Entitle the individual to the Earned Income Tax Credit.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Individuals who are unable to obtain an SSN but have a tax return filing requirement can be either resident or nonresident aliens. The ITIN is available to individuals who are required to have a taxpayer identification number for tax purposes, but do not have and are not eligible to obtain an SSN. The distinction between a resident and nonresident alien is important because each is taxed differently. Resident aliens must follow the same tax laws as U.S. citizens. Specifically, income from all sources, both within and outside the U.S., is taxed and the same tax forms used by U.S. citizens are required to be filed. Nonresident aliens must file a tax return only if they are engaged in a trade or business in the U.S. or if they have any other U.S. sources of income on which the tax was not fully paid by the amount withheld. Nonresident aliens file using a U.S. Nonresident Alien Income Tax Return (Form 1040NR).

The ITINs are not valid identification outside the tax system. To obtain an ITIN, an alien individual, a spouse, or qualifying dependent must complete an Application for IRS Individual Taxpayer Identification Number (Form W-7). Most individuals must attach a Federal income tax return to the application to ensure the ITINs are being used for their intended tax administration

***Individuals applying for an ITIN
must submit documentary
evidence to establish their
identity and foreign status.***

purpose. In addition, the individual applying for an ITIN must submit proof of identity. An original, certified, or notarized copy of an unexpired passport is the only document that is accepted for both identity and foreign status. If the individual does not have a passport, the individual must provide a combination of at least two or more current and unexpired documents to prove identity and foreign status. Medical and school records can be

provided for dependents under age 14 (under age 18 if a student) and can be used to establish foreign status only if they are foreign documents. For school and medical records that do not have expiration dates, the issuing date must be within the last 12 months. All supporting documents must show the individual's name and support the claim of foreign status. At least one document must show the individual's photograph.¹

There has been a significant increase in the use of ITINs since the IRS began issuing them in Tax Year (TY) 1996. Figure 1 shows a 246 percent increase in the number of individual income tax returns filed using ITINs and reporting wages from TY 2001 to TY 2007.

¹ Photographs are not required for dependents under age 14 or under age 18 if a student.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

Figure 1: Growth of Tax Returns Filed Using ITINs and Reporting Wages

	2001	2007	% Change
Total Individual Income Tax Returns	530,000	1,835,000	246%
Paper-Filed Returns	444,000	950,000	114%
Electronically Filed (E-Filed) Returns	86,000	885,000	929%

Sources: Data for TY 2001 were obtained from a prior Treasury Inspector General for Tax Administration (TIGTA) report.² Data for TY 2007 were obtained from analysis of the IRS Returns Transaction File.³ Data was rounded to the nearest thousand.

The number of resident aliens assigned ITINs has increased considerably as compared to the number of ITINs assigned to nonresident aliens

Foreign individuals are considered a resident alien if they meet one of two tests for the calendar year—the *green card test* or the *substantial presence test*.⁴ An individual meets the *green card test* if at any time during the calendar year he or she was a lawful permanent resident of the U.S. according to the immigration laws (and this status has not been rescinded or abandoned). These individuals are able to obtain SSNs, but depending on their immigration status, the SSN may be a nonwork SSN. An individual meets the *substantial presence test* if he or she was physically present in the U.S. for at least 31 days during the current year, and 183 days during the 3-year period that includes the current year and the 2 years immediately before (with some limited exceptions). These individuals may or may not be able to obtain an SSN, depending on their immigration status (some individuals meet both tests). Foreign individuals are considered a nonresident alien for any period they are neither a U.S. citizen nor a U.S. resident alien.⁵

Resident aliens accounted for 93 percent of the total number of ITINS issued.

The number of resident aliens assigned ITINs has increased considerably when compared with the number of ITINs assigned to nonresident aliens. In fact, resident aliens have become the primary users of the ITIN. In 1996, a total of 24,277 resident aliens were assigned ITINs, accounting for 40 percent of all ITINs issued. By 2006, a total of 1,456,214 resident aliens were assigned ITINs, which accounted for 93 percent of all ITINs issued. See Figure 2.

² *The Internal Revenue Service’s Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration* (Reference Number 2004-30-023, dated January 2004).

³ The Returns Transaction File contains all edited, transcribed, and error-corrected data from the U.S. Individual Income Tax Returns (Form 1040 series) and related forms for the current processing year and 2 prior years.

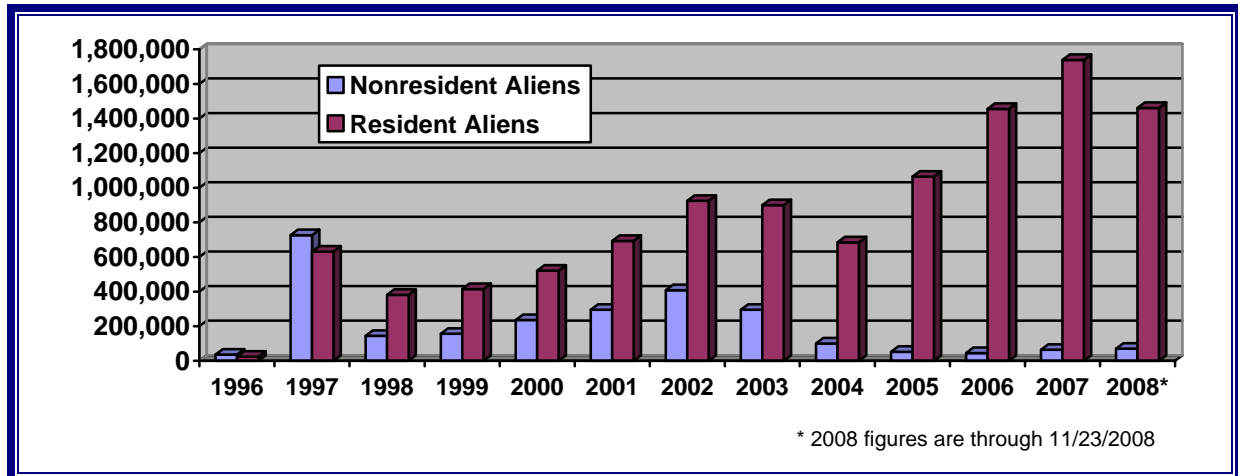
⁴ 26 U.S.C. § 7701.

⁵ It is important to note that the definition of “U.S. Resident Alien” differs for immigration laws versus the tax laws. Throughout this report, we are referring to the tax law definition.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

Figure 2: Comparison of ITINs Issued to Resident Versus Nonresident Aliens TY 1996 Through TY 2008⁶



Source: TIGTA analysis of the IRS ITIN Database.⁷

This review was performed at the IRS Campus⁸ in Austin, Texas. It included discussions with personnel in the ITIN Program Office, ITIN Operations Unit, Submission Processing function, Accounts Management function, Office of Electronic Tax Administration, Six Sigma office, and the Automated Underreporter function in the Wage and Investment Division. In addition, we met with personnel in the Small Business/Self-Employed Division, the Office of Modernization and Information Technology Services, the SSA Office of the Inspector General, the DHS, and the State of California Franchise Tax Board. The review was performed during the period January through December 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁶ Figures presented are not inclusive of the entire ITIN population. There is a small percentage of additional categories not reflected. However, these categories make up only 5 percent of the total ITIN population and by 2008 accounted for only 3 percent of the ITINs issued that year.

⁷ The ITIN Database (also known as the ITIN Real-Time System) is a modernized application processing system used to control and track Forms W-7 and Acceptance Agent Applications. It also provides management information.

⁸ The campuses are the data processing arm of the IRS. They process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

Results of Review

The Internal Revenue Service Receives Millions of Forms W-2 With Invalid Identification Numbers

Despite the actions employers are required to take to verify an individual’s eligibility to work, the IRS continues to receive millions of Forms W-2 with a name and/or identifying number that does not match SSA records. Figure 3 identifies the number of Forms W-2 on which the name and/or identifying number shown did not match SSA records.

Figure 3: Forms W-2 With Invalid Identification Numbers TY 2003 through TY 2006

Table with 5 columns: Category, 2003, 2004, 2005, 2006. Rows include Forms W-2 Received, Forms W-2 With Invalid Information, and Percent Invalid.

Source: TIGTA analysis of Forms W-2 on the IRS Information Returns Master File. Numbers were rounded to the nearest thousand.

The IRS is responsible for tax collection and enforcement in the U.S. and is required to accept Forms W-2 with invalid identification numbers as the tax law does not distinguish between legal or illegal income. If the income is taxable, the person receiving the income is required to file a Federal tax return. Specifically, the Internal Revenue Code requires all individuals to file a Federal tax return if they have income subject to U.S. tax and the income equals or exceeds the exemption amount. These obligations extend to both U.S. citizens and foreign individuals.



9 The Information Returns Master File contains tax information reported from third parties for the current and prior 5 tax years.

10 The exemption amount here refers to a combination of personal exemptions and the standard deduction and is based on a combination of filing status, age, and blindness. This information is summarized for U.S. citizens and resident aliens in the first section (Filing Information) of Your Federal Income Tax (Publication 17). Nonresident aliens are more limited in their choices of filing status and claims for personal exemptions and are generally not allowed the standard deduction. As a result, they would have a lower exemption amount with regards to the requirement to file a tax return. More information is available in the U.S. Tax Guide for Aliens (Publication 519). For TY 2006, the exemption referred to in this section of the Internal Revenue Code ranges from \$3,300 to as much as \$18,900.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

Further, any person required to file a tax return is required to include an identifying number, referred to as a taxpayer identification number. For the majority of filers, the taxpayer identification number is the individual's SSN.¹¹ To obtain an SSN, an individual must submit to the SSA an Application for a Social Security Card (Form SS-5) and prove his or her age, identity, and U.S. citizenship or current lawful, work-authorized immigration status. Various documents need to be provided to substantiate age, identity, citizenship, and immigration status. Individuals over the age of 12 who have never received an SSN must apply in person.

Non-U.S. citizens who do not have an employment authorization must prove a valid nonwork reason for requesting an SSN in order to receive one.¹² Consequently, many individuals are unable to obtain an SSN. This presents a problem for tax administration because the Internal Revenue Code requires foreign investors and individuals working without authorization in the U.S. to file a tax return and pay any Federal income taxes owed. As explained by the IRS Commissioner in Congressional testimony on February 16, 2006, "Our [the IRS'] job is to make sure that everyone who earns income within our borders pays the proper amount of taxes, even if they may not be working here legally."

Improvements Can Be Made to the Individual Taxpayer Identification Number Program

The IRS has initiated a number of actions in an attempt to improve the processing of tax returns from individuals who are unable to obtain an SSN. These actions include:

- Creating and issuing ITINs beginning in July 1996.
- Establishing the ITIN Program Office in early Calendar Year 2004. The mission of the office is to ensure ITINs are issued timely to qualifying individuals and used only for tax administration purposes.
- Developing and issuing *Understanding Your IRS Individual Taxpayer Identification Number* (Publication 1915) to assist the public in understanding the requirements to obtain an ITIN as well as the specific purpose for which the ITIN is to be used.
- Requiring applicants to attach a completed tax return to the application for an ITIN.
- Updating procedures to no longer issue ITINs on a card like a social security card. This change was to minimize or eliminate confusion between ITINs and SSNs that might arise based on similar appearances.

¹¹ 26 C.F.R. 301.6109-1.

¹² Generally for obtaining Government benefits (Federal, State, or local) to which the individual is entitled.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

- Reducing the number of acceptable documents required to be provided during the application process. This change was to provide individuals applying for an ITIN with better, more consistent, and faster service.

Despite these efforts, improvements to the ITIN Program are still needed. We identified the following issues with the ITIN Program:

1. Individuals are assigned multiple ITINs.
2. The ITINs are being improperly used for employment.
3. Incomplete or inaccurate information is being input to IRS systems from tax returns filed with ITINs.
4. Billions of dollars in tax credits are provided to ITIN filers without verification of eligibility.

These problems stem from the fact that the IRS' primary focus is on ensuring individuals can obtain an ITIN, without ensuring that individuals fully comply with ITIN Program requirements and guidelines.

Individuals are assigned multiple ITINs, which results in the issuance of erroneous refunds

Assigning multiple ITINs to the same individual defeats the purpose of the ITIN. Prior to the establishment of the ITIN, tax returns filed by individuals who were not eligible for SSNs were assigned temporary IRS numbers in order to process their tax returns. The temporary IRS numbers were associated with the tax return and not the individual filing the return. Subsequent tax returns filed by the same individual were assigned different numbers. Consequently, the same individual would have numerous IRS numbers assigned to their tax returns without a common identifying number being assigned to the individual. Without a permanent taxpayer identification number assigned to each specific individual, the individual could not be identified efficiently and reliably.

To address the problem of multiple identifying numbers being assigned to the same individual, the Code of Federal Regulations was changed in 1996 to provide for the issuance and use of ITINs.¹³ The regulations were intended to address the concern by the IRS and the Department of the Treasury that, without a unique number, taxpayers could not be identified effectively.

¹³ Treas. Reg. § 301.6109.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

A recent IRS study¹⁴ identified that 4 percent of individuals applying for ITINs were from individuals that already had an ITIN assigned to them and that 30 percent of these individuals were assigned multiple ITINs. The study further estimated that approximately \$60 million per year in erroneous refunds were issued for ITIN cases routed to the Accounts Management function. Some of the erroneous refunds resulted from the same individual filing multiple tax returns under the different identification numbers and receiving a tax refund for each. The IRS study reported that the process used to ensure multiple ITINs are not assigned to the same individual was inefficient. The inefficiencies included:

An IRS study identified that some ITIN applicants already had an ITIN.

- Checks for duplicate status were not made until after the application for an ITIN was manually entered into the ITIN Database.
- Previously rejected applications were not considered when processing a subsequent application. IRS guidelines required this check, but this was waived to improve the productivity of processing the ITIN applications.

To address these issues, the study recommended the development of new procedures to include a check for a duplicate status before entering the ITIN application data and a process to flag potential duplicates for further research. The IRS cites that the new procedures have reduced the percentage of individuals being assigned another ITIN to 6 percent. The IRS is attempting to reduce this percentage further by streamlining local prescreening instructions for all Tax Examiners. We have an ongoing audit that will include an assessment of the efficiency and effectiveness of IRS processing of Forms W-7.¹⁵

ITINs are improperly used for employment

Employers are reporting wage income under an ITIN. The law establishing the ITIN specifically states that the ITIN is not an SSN or an account number for use in employment for wages.¹⁶ IRS guidelines reiterate this position by specifying that an ITIN is to be used for Federal income tax purposes only and is not valid for work purposes. However, our review of TY 2006 Forms W-2 identified 292,992 employers that filed 790,455 Forms W-2 with ITINs reporting wages totaling more than \$9.5 billion. The number of noncompliant employers increased 15 percent from 253,742 in TY 2004 to 292,992 in TY 2006. See Figure 4 for comparative statistics.

¹⁴ IRS Lean Six Sigma study entitled, *Individual Taxpayer Identification Number, Control Tollgate*, dated February 21, 2008. The data contained in the study were collected in October and November 2007 and were not statistically valid for the entire applicant pool, but rather were used as a basis point specifically for the Tax Examiner prescreening process.

¹⁵ Processing Applications for Individual Taxpayer Identification Numbers (Audit # 200940006).

¹⁶ Treas. Reg. § 301.6109.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Figure 4: Forms W-2 Filed With ITINs

TY	Total Forms W-2 Researched	Forms W-2 With ITIN Payee	ITIN Forms W-2 Reporting Wages	Total Wages Reported on ITIN Forms W-2	Employers Reporting Wages on ITIN Forms W-2
2004	231,145,713	912,697	911,861	\$9,827,525,648	253,742
2005	238,030,192	672,329	672,015	\$7,769,425,043	223,855
2006	243,282,891	790,701	790,455	\$9,564,288,500	292,992
Total	712,458,796	2,375,727	2,374,331	\$27,161,239,191	770,589

Source: TIGTA analysis of Forms W-2 on the IRS Information Returns Master File.

Although the IRS has data available to identify employers reporting wages and individuals improperly working under an ITIN, no significant actions are taken to address the noncompliance. The IRS' position is that a *liberal due diligence standard for employers serves an important role in tax administration*.¹⁷ This is despite prohibitions cited both within the law that established the ITIN and IRS guidelines. The former IRS Commissioner stated in Congressional testimony on February 16, 2006, "We must make sure that any change in the current system encourages the type of behavior that we desire from both employees and employers. Imposing procedures on employers that are too stringent or requiring too much documentation from employees may have the effect of driving certain economic activities 'underground.' At least now we are collecting some taxes in these areas, and we are working to collect even more." The IRS continues to maintain this position.

The SSA has a program that each year sends a letter (Employee No-Match Letter) to individuals the SSA identifies as having Forms W-2 with a name and/or identifying number that does not match SSA records. Individuals with an ITIN on their Forms W-2 also receive an Employee No-Match Letter. The letter requests that the individual check the reported information and provide the SSA and his/her employer with corrected information. Furthermore, the SSA had also been sending a similar letter to employers (Employer No-Match Letters). In August 2007, a Federal court issued an order temporarily blocking the government from implementing a DHS rule, *Safe Harbor Procedures for Employers Who Receive a No-Match Letter*. The order also blocked the SSA from sending letters to notify employers of the rule. While this matter is pending, the SSA has also stopped sending the Employer No-Match Letters.

¹⁷ If an employer makes or repeats a request for an accurate SSN, it has performed due diligence and has reasonable cause to believe the SSN is correct. As a result, under I.R.C. § 6724, a penalty assessed against an employer under I.R.C. § 6721 will be abated.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

We believe the IRS should consider additional actions to advise employees and employers in the instances that ITINs are being improperly used for employment. Because the SSA already has a notice process, the best method may be to provide information to the SSA so that the no-match letters for these individuals (and their employers if these letters are resumed) provide more specific information on the reason for the no-match and the limitations of an ITIN.

Recommendation

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Develop a process to identify individuals who are improperly using ITINs for work purposes, as well as those employers accepting the ITIN for wage reporting, and develop outreach efforts with the SSA to address the improper use of the ITIN.

Management's Response: Management disagreed with this recommendation because the SSA has a program in place called the Employee No-Match Letter that requests correct information from individuals. The SSA has also been sending similar letters to employers, but this was suspended pending resolution of a court case. Regardless of the current status of the Employer No-Match Letters, management believes the SSA is the correct agency to work with the taxpayers and their employers regarding this issue. IRS involvement would be a duplication of the SSA efforts.

Office of Audit Comment: Because the ITIN is a number issued by the IRS, we believe it is the IRS' responsibility to educate individuals and employers of its limitations, especially in the instances that the IRS knows it is being used for employment. Since our recommendation was for the IRS to work with the SSA on this issue, it should not result in duplicate efforts.

Incomplete or inaccurate information is being input to IRS systems from tax returns filed with ITINs¹⁸

Incomplete or inaccurate information is being input into IRS systems when a tax return is filed with an ITIN and an attached Form W-2 contains an SSN which does not belong to the individual filing the tax return. Specifically, the IRS does not transcribe information from Forms W-2 for paper-filed tax returns. In addition, some tax preparation software packages automatically populate the identification number on the electronic Form W-2 (for *e-filed* tax returns) with the identification number reported on the tax return, i.e., the ITIN. This occurs even though there is an SSN on the Form W-2 which does not belong to the individual filing the return. This automatic population feature diminishes the potential benefits of receiving information from these *e-filed* returns.

¹⁸ An SSN is needed for work purposes, but if an individual is not eligible for an SSN, an SSN may be used that does not belong to this individual.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Without an effective process to capture complete and accurate information from both paper and *e-filed* tax returns with an ITIN, the IRS will not have the data needed to make informed business decisions as to the impact on tax administration resulting from these mismatches. Improving its process to identify tax returns that are filed with an ITIN and have an attached Form W-2 with an SSN that does not belong to the return filer would facilitate the IRS' ability to determine the nature and extent of the mismatches and minimize taxpayer burden related to the downstream effects of associating reported income with the wrong wage earner.

No actions have been taken to capture Form W-2 information attached to paper returns filed by individuals with ITINs. In September 2002, an IRS task force recommended that an automated system be developed that would identify tax returns filed with an ITIN when the attached Forms W-2 listed an SSN that did not belong to that individual.¹⁹ The IRS did not take this action, citing that it wanted to study the issue further. To date, there still has been no progress in developing a process to track ITIN-filed paper tax returns with a Form W-2 SSN not belonging to the individual filing the tax return.

To determine the number of ITIN-filed tax returns with a Form W-2 SSN that did not belong to the individual, we identified a population of 1,621,846 TY 2006 ITIN-filed tax returns with reported wages more than \$39.4 billion.²⁰ We reviewed a random sample of 230 tax returns (86 *e-filed* and 144 paper filed) that had a total of 363 associated Forms W-2 wages totaling more than \$11.8 million. Our review of the 144 paper returns showed that 203 (91 percent) of the 224 attached Forms W-2 contained an SSN that did not belong to the individual filing the paper tax return. These mismatches are not captured by the IRS because Form W-2 information is not transcribed from paper tax returns during processing. We raised this issue in a prior review, but the IRS' position was that information is not transcribed from paper returns because of the cost to develop and implement the required procedures.²¹

The auto-populate feature in tax preparation software packages diminishes the potential benefits cited in support of the IRS changing its *e-file* system. Prior to the 2007 Filing Season,²² the IRS would reject *e-filed* tax returns with an ITIN when the Forms W-2 contained an SSN not belonging to the individual *e-filing* the tax return. The IRS reported that this led to some *E-file* Providers²³ replacing the SSN on the Forms W-2 with the ITIN to prevent the tax return from being rejected. In an attempt to capture data about the nature and extent of *e-filed*

¹⁹ *Internal Revenue Service Individual Taxpayer Identification Number (ITIN) National Task Force Final Report*, dated September 11, 2002.

²⁰ This consists of 961,410 (59 percent) paper returns with reported wages of nearly \$21.9 billion (56 percent), and 660,436 (41 percent) *e-filed* returns with reported wages of more than \$17.5 billion (44 percent).

²¹ *The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration* (Reference Number 2004-30-023, dated January 2004).

²² The period from January through mid-April when most individual income tax returns are filed.

²³ An *E-file* Provider is a business authorized by the IRS to participate in IRS *e-file*. The business may be a sole proprietorship, partnership, corporation, or other entity. Authorized IRS *E-file* Providers facilitate the filing of electronic tax returns from taxpayers to the IRS.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

tax returns filed with an ITIN and a Form W-2 containing an SSN that did not belong to the individual filing the tax return, the IRS changed its *e-file* system to accept these tax returns for processing.

In September 2006, the IRS concluded that a proposed change to begin accepting *e-filed* tax returns with mismatches is consistent with the “tenets of sound stewardship over tax administration.” In addition, accepting these tax returns via *e-file* “provides a mechanism to improve service to America’s taxpayers by removing obstacles which cause undue burden and discourage participation in the tax system.” The IRS detailed the following benefits that could be achieved from capturing information from ITIN filers:

- Provides the IRS with an improved paper trail which could in turn be used to prevent the negative downstream impact of unassigned SSN use within tax administration when the SSN legitimately belongs to another individual.
- Allows the IRS to validate the appropriateness of a notice through reconciliation of potentially unreported wages to an ITIN holder. This would reduce burden to a taxpayer whose SSN has been used inappropriately.
- Enables the IRS to obtain metrics to tailor outreach efforts to particular market segments to potentially augment enforcement efforts.

A number of benefits to improve tax administration were listed in support of accepting e-filed tax returns with SSN mismatches. However, the benefits have not been realized.

The Senate Finance Committee was concerned about the IRS’ decision to expand *e-filing* to these individuals. The Senate Finance Committee questioned the rationale behind the IRS’ decision to make it easier to *e-file* a tax return that contains a stolen or false SSN. The IRS responded that it changed its policy to allow *e-filing* to make the process consistent with paper returns. Further, according to the IRS:

A related benefit associated with this change includes the fact that when tax returns are e-filed, the IRS captures the Form W-2 data, a process that does not happen when tax returns are filed on paper. Capturing the Form W-2 data enables the IRS to track the tax returns where wage income is reported irrespective of whether the taxpayer identification number on the Form W-2 matches the taxpayer identification on the tax return. Without this information, if the name and SSN used on the W-2 matches the name and SSN of an identity theft victim, the true owner of the SSN would likely be contacted by the IRS to determine why he or she had not report[ed] the W-2 income on their tax return. In these situations, the case is closed by [the] IRS when the true owner of the SSN provides evidence that he or she was a victim [of] identity theft.

Our initial review of the 86 *e-filed* tax returns included in the sample previously described, showed that 77 (90 percent) had 115 associated Forms W-2 with ITINs. To confirm the



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

“auto-populate” problem, we reviewed the employers’ copies of the Form W-2 records reported to the IRS for these 77 *e-filed* tax returns. We identified 51 tax returns (66 percent) with 74 associated Forms W-2 with SSNs that were changed to ITINs. Specifically, the electronically captured version of the Forms W-2 incorrectly listed the ITIN despite an SSN being listed on the actual Forms W-2.²⁴ We estimate that 359,523 of the 660,436 TY 2006 ITIN *e-filed* tax returns contained inaccurate Forms W-2 information.

To date, potential benefits cited by the IRS have not been realized as no efforts have been taken to develop an effective process to accurately capture the data from ITIN-filed tax returns and to use it to improve tax administration.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 2: Coordinate with electronic tax software preparation companies to initiate actions to limit the automatic population feature of the taxpayer identification numbers on Forms W-2 for Forms W-2 associated with *e-filed* ITIN tax returns.

Managements Response: Management agreed with this recommendation and has already implemented this procedure. For TY 2007, the *e-file* program was revised to discourage the filing of Forms W-2 containing ITINs. The *e-file* preparation software containing the automatic feature that populated the ITIN from the return to the Form W-2 field had to be disabled so that the ITINs would not be captured as the identification number on the Forms W-2. The software should direct the user to input the taxpayer identification number from the Form W-2 exactly as it was issued by the employer. This information is contained in Electronic Return File Specifications and Record Layouts for Individual Tax Returns (Publication 1346), and we will continue to remind the software companies of this issue.

Recommendation 3: Develop a process to ensure that accurate tax information is input into IRS systems from both paper and *e-filed* tax returns filed with an ITIN.

Management’s Response: Management disagreed with this recommendation. Management stated that *e-file* software should already direct the user to input the taxpayer identification number from the Form W-2 exactly as it was issued by the employer to ensure that accurate information is input into IRS systems. With regard to paper returns, it is currently cost prohibitive to transcribe Form W-2 data during processing.

Office of Audit Comment: Without correct wage reporting information, there is no wage matching to make sure the amount reported as withheld is correct. Management

²⁴ See Appendix IV for the sampling methodology.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

did not provide us information supporting their statement that transcribing the information from Forms W-2 would be cost prohibitive.

Billions of dollars in tax credits are provided to ITIN filers without verification of eligibility

ITIN filers are receiving billions of dollars in Child Tax Credits (CTC) and Additional Child Tax Credits (ACTC) intended for working families, although these individuals are not authorized to work in the U.S. Figure 5 shows that the amount of CTC and/or ACTC allowed to ITIN filers increased from \$152 million in TY 2000 to almost \$2.4 billion in TY 2007. Further analysis of the TY 2007 ITIN returns showed that more than 1.2 million (66 percent) received ACTC of almost \$1.8 billion. *The individuals receiving the ACTC had no tax liability.*

Figure 5 - Comparative Statistics of ITIN Taxpayers Allowed the CTC and ACTC for TYs 2000, 2001, and 2004 through 2007²⁵

Tax Year	Total Tax Returns Filed	Total Returns Allowed CTC	Total Amount of CTC Allowed	Total Returns Allowed ACTC	Total Amount of ACTC Allowed
2000	353,000	134,000	\$90,000,000	62,000	\$62,000,000
2001	530,000	195,000	\$127,000,000	203,000	\$161,000,000
2004	1,038,000	422,000	\$326,000,000	626,000	\$778,000,000
2005	1,312,000	538,000	\$425,000,000	810,000	\$1,063,000,000
2006	1,622,000	672,000	\$544,000,000	1,016,000	\$1,407,000,000
2007	1,835,000	774,000	\$622,000,000	1,220,000	\$1,777,000,000

Source: TIGTA analysis of U.S. Individual Income Tax Returns (Forms 1040, 1040A, and 1040EZ) filed by primary taxpayers with ITINs and reporting wages. The numbers were rounded to the nearest thousand or million.

In addition, the IRS in 2007 directed its Accounts Management employees [REDACTED] despite these employees raising significant concerns regarding abusive claims. In most cases, the only way a child with an ITIN can qualify for the CTC and ACTC is to be a resident of the U.S. Of the 2.4 million dependents listed in support of the ACTC claims, 1.3 million (54 percent) had ITINs.

2(e), 2(f)

²⁵ The data in Figure 5 are based on actual population data of tax returns filed by a primary taxpayer with an ITIN and reporting wages. If a return was allowed the CTC and ACTC, the return was counted under both categories. TY 2000 and TY 2001 data were obtained from TIGTA report, *The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration* (Reference Number 2004-30-023, dated January 2004). TY 2004 through TY 2007 data were obtained from computer analysis of the IRS Returns Transaction File. We did not analyze TY 2002 and TY 2003 data during this review.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

Prior to the enactment of the Taxpayer Relief Act of 1997,²⁶ the tax law did not provide tax credits based solely on a taxpayer's number of dependent children. Congress created the CTC and the ACTC because the individual income tax structure did not reduce tax liability enough to reflect a family's reduced ability to pay taxes as family size increases. Congress further believed that a tax credit for families with dependent children would reduce the individual income tax burden for families, better recognize the financial responsibilities of raising dependent children, and promote family values.

For TY 2006, the CTC can reduce an individual's taxes owed by as much as \$1,000 for each qualifying child. The ACTC is given in addition to the CTC to individuals who receive less than the full amount of the CTC. The ACTC is a *refundable tax credit*, which means an individual can receive a refund even if no income tax was withheld or paid. To qualify for the CTC and/or ACTC, a child must meet certain tests (see Appendix VI). The [redacted] test is of particular importance for children that have an ITIN because a child must [redacted] to qualify for the CTC and ACTC.²⁷

2(a),2(e),2(f)

2(a),2(e),2(f)
2(a),2(e),2(f)

2(e),2(f)

[redacted]

Accounts Management function employees responsible for resolving errors on tax returns, including those filed by individuals with an ITIN, raised concerns to IRS management about its policies for handling errors on ITIN tax returns. These employees stated that management did not take any subsequent action to address their concerns. A formal complaint was subsequently filed with the TIGTA.

3(d),5

[redacted]

Prior to management's directive, Accounts Management employees were disallowing the CTC and/or ACTC when they determined the children were not eligible for the CTC and ACTC

2(a),2(e),2(f)

[redacted] However, when this came to the attention of Headquarters, Accounts Management function, in May 2007, Local Procedures were issued stating that if, based on return information only, it appears that the CTC and/or ACTC are allowable per the assignment of ITINs, the employees must follow the taxpayer's intent and allow the CTC and/or ACTC. Employees were told that ITINs are assigned without regard to [redacted]. The employees told us they were directed only to ensure that children listed in support of claims for the CTC and/or ACTC met the age requirement. The employees also told

2(a),2(e),2(f)

²⁶ Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., 42 U.S.C., and 46 U.S.C. app.).

²⁷ I.R.C. § 24.



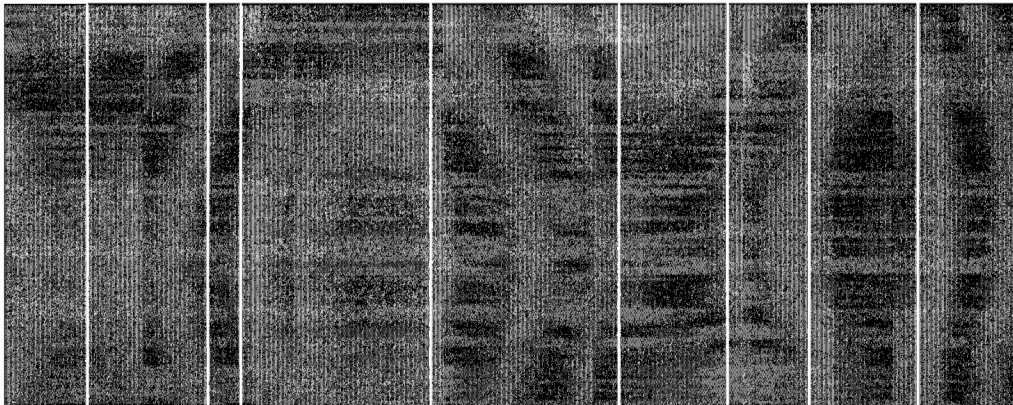
Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

2(a),2(e),2(f) us they were not to refer ITIN tax returns with potential fraud to the IRS Criminal Investigation Unit because the potential dollar amounts do not meet Criminal Investigation's minimum dollar criteria. The employees believe managements' change was made because research to determine [REDACTED] slowed their productivity and increased case inventories.

2(a),2(e),2(f) IRS management stated that the Local Procedures were issued because the information contained in the ITIN Database does not provide enough information to be able to make a determination as to whether the [REDACTED] test has been met, particularly with respect to the [REDACTED] test.²⁸ Without sufficient information to make a clear determination, it is necessary for the IRS to conduct an audit to afford taxpayers the opportunity to provide documentation prior to denial of such a claim and to afford taxpayers due process if denied, including a notice of deficiency and appeal rights. Accounts Management employees are not auditors. Their role is to process claims. 2(a),2(e),2(f)

2(e),2(f) Notwithstanding the basis for management's decision, [REDACTED] 2(e),2(f) [REDACTED] despite employees raising significant concerns regarding abusive claims and the importance of having a process to validate [REDACTED] for ITIN 2(a),2(e),2(f) filers with ACTC claims. As noted by IRS employees, information submitted with Form W-7 and/or information stored in the ITIN Database could be used to identify children being claimed 2(a),2(e),2(f) for the CTC and/or ACTC [REDACTED]

2(e),2(f) The following text contains a hypothetical example of the type of improper claim that is being allowed by the IRS:



28 [REDACTED] 2(a),2(e),2(f)



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Legislation should be considered to require an SSN in order to be eligible for the Additional Child Tax Credit consistent with the requirements for the Earned Income Tax Credit

Prior to 1996, ITIN filers were entitled to claim the Earned Income Tax Credit. However, concerns were raised by the Government Accountability Office, the IRS, and Congress regarding noncompliance with Earned Income Tax Credit requirements. The Government Accountability Office reported that awarding the Earned Income Tax Credit to illegal aliens²⁹ was at cross purposes with Federal Government policies that prohibit illegal aliens from working in the U.S.³⁰ The law was subsequently changed to deny the Earned Income Tax Credit to individuals who file a tax return without an SSN valid for work.³¹ As such, ITIN filers are not eligible for the Earned Income Tax Credit. In addition, the IRS was given the authority to systemically identify these claims and disallow the portion of the refund associated with the erroneous Earned Income Tax Credit claim through the use of its “math error authority.”³²

The change in the law was made prior to the establishment of the ACTC. However, the language of the law is such that it could be interpreted to apply to the ACTC. It prohibits aliens residing without authorization in the U.S. from receiving most³³ Federal public benefits and defines a Federal public benefit as:

Any grant, contract, loan, professional license, or commercial license provided by an agency of the United States or by appropriated funds of the United States; and any retirement, welfare, health, disability, public or assisted housing, postsecondary education, food assistance, unemployment benefit, or any other similar benefit for which payments or assistance are provided to an individual, household, or family eligibility unit by an agency of the United States or by appropriated funds of the United States.

The ACTC is paid with appropriated funds and is provided only after any income taxes are totally offset by other credits, such as the CTC. As shown in Figure 5, the amount of ACTC allowed to ITIN filers has increased substantially, from \$62 million for TY 2000 to almost \$1.8 billion for TY 2007. The number of tax returns allowed the ACTC increased from 62,000 to more than 1.2 million for the same period. Each ITIN filer receiving the ACTC owed no taxes.

IRS management’s view is that the law does not provide sufficient legal authority for the IRS to disallow the ACTC to ITIN filers. In addition, the Internal Revenue Code does not require an

²⁹ The Government Accountability Office defined an “illegal alien” as a foreign person who is in the U.S. without a lawful immigration status.

³⁰ *Earned Income Credit – Targeting to the Working Poor* (GAO/GGD-95-122BR, dated March 1995).

³¹ Personal Responsibility and Work Opportunity Reconciliation Act of 1996, P.L. 104-193 § 401(c).

³² Math error authority provides the IRS with the ability to systemically identify errors and disallow associated claims for refunds associated with the erroneous claims.

³³ Except for specified emergency services and programs.



Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims

SSN to claim the credit and does not provide the IRS math error authority to deny the credit without an examination.

We believe legislation is needed to clarify whether or not refundable tax credits such as the ACTC may be paid to filers without an SSN and, if these credits may not be paid, to provide IRS math error authority to disallow associated claims for the credits. This would not affect claims for the CTC to reduce taxable income, but would stop the payment of appropriated funds associated with the ACTC. Such a legislative change could result in cost savings to the Federal Government of \$1.8 billion annually (\$8.9 billion dollars over 5 years). As it now stands, the payment of Federal funds through this tax benefit appears to provide an additional incentive for aliens to enter, reside, and work in the U.S. without authorization, which contradicts Federal law and policy to remove such incentives.³⁴

2(a),2(e),2(f) Limiting the ACTC to only those filers with SSNs would also address the concern [REDACTED] before allowing the ACTC. If a change in eligibility is not made, at a minimum, a process is needed to verify whether or not taxpayers without SSNs are eligible to receive the ACTC and to disallow improper claims. IRS employees have provided examples of the abuse and how the IRS can use its information to address this abuse. 2(a),2(e),2(f)

Recommendation

2(a),2(e),2(f) **Recommendation 4:** The Commissioner, Wage and Investment Division, should develop a process to ensure the [REDACTED] being claimed for the 2(a),2(e),2(f) CTC and/or ACTC. This process should ensure [REDACTED] 2(a),2(e),2(f)

2(a),2(e),2(f) **Management's Response:** Management disagreed with this recommendation. Absent a legislative change, the IRS does not have legal authority to verify and disallow the CTC and/or ACTC based on [REDACTED] during return processing. The current process for verification of eligibility is an examination, where the taxpayer would need to provide: 2(a),2(e),2(f) [REDACTED] The solution to this would be addressed by the proposed legislation in Recommendation 5 below.

Office of Audit Comment: While management states that it disagrees with the recommendation, management also states on page 4 of the response that its "SP [Submission Processing] and Reporting Compliance organizations are partnering in a pilot to explore options to better identify false claims for examination." This appears as if it is intended to address our recommendation, so the basis for disagreement is not clear. We do agree that this recommendation would be addressed by Recommendation 5 for the ACTC if legislation was enacted to require an SSN to claim the ACTC.

³⁴ P.L. 104-193 § 401(c).



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Legislative Recommendation

Recommendation 5: Legislation is needed to clarify whether or not refundable tax credits such as the ACTC may be paid to filers without a valid SSN and, if these credits may not be paid, to provide IRS math error authority to disallow associated claims for the credits. Disallowance of the ACTC to filers without a valid SSN would reduce Federal outlays by \$8.9 billion over 5 years.

Management's Response: Management agreed with this recommendation. The Wage and Investment Division, in coordination with the Office of Chief Counsel, will discuss with the Office of Tax Policy, Department of the Treasury, the merits of an administration proposal to amend the Internal Revenue Code to limit eligibility for the CTC and ACTC to individuals who have an SSN issued by the SSA other than a number issued to an alien not authorized to work in the U.S. This discussion with the Office of Tax Policy will include a dialogue on the merits of a proposal to expand the Commissioner's math error authority to any claims for the credits made on returns that are disallowed because the individual did not provide the required identifying number.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the IRS has proper controls in place to detect and deter improper use of ITINs when processing tax returns. To accomplish our objective, we:

- I. Researched IRS, DHS, SSA, and Government Accountability Office web sites, forms, publications, reports, Congressional testimony, and other documentation for background information pertaining to ITINs and to determine employers' legal obligations for hiring employees.
- II. Researched the Internal Revenue Code, Federal regulations, and Federal income tax laws for information pertaining to ITINs and for information pertaining to the CTC.
- III. Conducted computer analyses to identify trends and characteristics of individual tax returns or Wage and Income Statements (Form W-2) containing ITINs and compared the results to information reported in a prior TIGTA report.¹
 - A. Conducted computer analysis to identify from the IRS Returns Transaction File² all individual income tax returns³ processed in Calendar Years 2005 through 2008 that were filed by a primary taxpayer⁴ with an ITIN and reported wages. We assessed the reliability of the Returns Transaction File by performing run-to-run balancing and verifying a sample of all fields against the IRS Integrated Data Retrieval System.⁵ The Returns Transaction File data appeared to be reasonably accurate for the purpose of this audit.
 1. Conducted computer analysis to identify the preparers of *e-filed* returns in the universe of 1,621,846 TY 2006 returns. We contacted 4 of the top 10 preparers to determine if their tax preparation software automatically overwrites the employee identification number on the Form W-2.

¹ *The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration* (Reference Number 2004-30-023, dated January 2004).

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

³ The individual income tax returns included Form 1040, Form 1040A, and Form 1040EZ.

⁴ A primary taxpayer is the first name and SSN reported on an individual tax return. If a joint return is filed, a secondary taxpayer is the second name and SSN, e.g., spouse, reported on the return.

⁵ IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

2. Conducted computer analysis to identify the number of returns allowed the CTC or the ACTC and the total credits allowed for TY 2004 through TY 2007.
 - a) Obtained the same information for TY 2000 and TY 2001 from TIGTA report, *The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration* (Reference Number 2004-30-023, dated January 2004).
3. We separated the universe of 1,621,846 TY 2006 returns into 3 strata:
 - 1) 1,620,822 returns with wages ranging from \$1 to \$99,999; 2) 1,011 returns with wages ranging from \$100,000 to \$499,999; and 3) 13 returns with wages of \$500,000 and more. We used statistical sampling to identify and review 203 returns from stratum 1 and 18 returns from stratum 2. We used a confidence level of 95 percent, a precision level of ± 3 percent, and an expected error rate of 5 percent for our sampling criteria. We intended to review the 13 returns in stratum 3, but only 9 returns were available. In summary, we reviewed a sample of 230 returns from the universe.
 - a) Determined if the names and identification numbers on the Forms W-2 belonged to the individuals filing the returns by researching IRS records and SSA information.
 - b) For the *e-filed* returns, determined if the taxpayers' names and identification numbers on the attached Forms W-2 were accurately input into IRS systems.
- B. Determined the growth in ITIN returns between TY 2001 and TY 2007. We obtained the TY 2001 data from TIGTA report, *The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration* (Reference Number 2004-30-023, dated January 2004).
- C. Obtained an extract of the IRS ITIN Database⁶ and queried the data to determine the volumes of ITINs issued to resident aliens and nonresident aliens in Calendar Years 1996 through 2008. We established the reliability of the IRS ITIN Database extract by comparing the yearly totals in the ITIN Database to figures received separately from the IRS. We also verified the data for several records by conducting an online query of the IRS ITIN Database and by comparing the records to information on the ITIN Database and on the Integrated Data Retrieval System. The ITIN Database data appeared to be reasonably accurate for the purpose of this audit.

⁶ The ITIN Database is a modernized application processing system used to control and track Applications for IRS Individual Taxpayer Identification Number (Form W-7) and Acceptance Agent Applications. It also provides management information.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

- D. Conducted computer analysis to identify from the IRS Information Returns Master File⁷ the number of Forms W-2 received by the IRS and the number of invalid Forms W-2 for TY 2003 through TY 2006. We assessed the reliability of the Information Returns Master File by performing run-to-run balancing and verifying a sample of all fields against the Integrated Data Retrieval System. The Information Returns Master File data appeared to be reasonably accurate for the purpose of this audit.
 - E. Conducted computer analysis to identify from the IRS Information Returns Master File all Forms W-2 for TY 2004 through TY 2006 that reported an ITIN in the box for the employee's SSN.
- IV. Met with IRS personnel in the Accounts Management function to discuss issues involving individual income tax returns containing ITINs.
- A. Reviewed documentation provided by the Accounts Management function personnel and reviewed IRS procedures for correcting returns with errors involving claims for the CTC or ACTC.
 - B. Reviewed Government Accountability Office report, *Earned Income Credit – Targeting to the Working Poor* (GAO/GGD-95-122BR, dated March 1995) for information regarding their concerns about awarding the Earned Income Tax Credit to illegal aliens.

⁷ The Information Returns Master File contains tax information reported from third parties for the current and prior 5 tax years.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)
Russell P. Martin, Director
Gary L. Young, Audit Manager
Sharon A. Buford, Lead Auditor
Elizabeth A. Miller, Senior Auditor
Tina M. Parmer, Senior Auditor
Steven E. Vandigriff, Senior Auditor
Van A. Warmke, Senior Auditor
Lawrence N. White, Senior Auditor
Martha A. Stewart, Information Technology Specialist



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Assistant Secretary of the Treasury for Tax Policy
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Wage and Investment Division SE:W
Director, Compliance, Wage and Investment Division SE:W:CP
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, ETA and Refundable Credits, Wage and Investment Division SE:W:ETARC
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Director, Accounts Management, Wage and Investment Division SE:W:CAS:AM
Director, Reporting Compliance, Wage and Investment Division SE:W:CP:RC
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
Program Manager, Automated Underreporter Program, Wage and Investment Division
SE:W:CP:RC:AUR
Program Manager, ITIN Program Office, Wage and Investment Division SE:W:CAS:SP:ITIN
Chief, Performance Improvement, Wage and Investment Division SE:W:S:PI
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Senior Operations Advisor, Wage and Investment Division SE:W:S



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; taxpayer identification numbers on 503,303 Wage and Income Statements (Form W-2) and attached to 359,523 TY 2006 *e-filed* tax returns were incorrectly input into IRS systems (see page 6).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify from the IRS Returns Transaction File¹ a universe of 1,621,846 TY 2006 individual tax returns filed by a primary taxpayer with an ITIN and reporting wages. The returns were processed by the IRS Submission Processing sites during 2007 and were posted to the Individual Master File.² We separated the universe of 1,621,846 TY 2006 returns into 3 strata: 1) 1,620,822 returns with wages ranging from \$1 to \$99,999; 2) 1,011 returns with wages ranging from \$100,000 to \$499,999; and 3) 13 returns with wages of \$500,000 and more. We used statistical sampling to identify and review 203 returns from stratum 1 and 18 returns from stratum 2. We used a confidence level of 95 percent, a precision factor of ± 3 percent, and an expected error rate of 5 percent for our sampling criteria. We intended to review the 13 returns in stratum 3, but only 9 returns were available. In summary, we reviewed a sample of 230 returns from the universe.

The 230 returns (86 *e-filed* and 144 paper-filed) had 363 Forms W-2 attached to the returns with wages totaling more than \$11.8 million. We examined the 86 *e-filed* returns and found that 77 (90 percent) had 115 (83 percent) attached Forms W-2 with ITINs.³ Based on the results, we suspected that the tax return software was overwriting an employee's SSN on the Form W-2 to match the return filer's ITIN reported on the return.

¹ The Returns Transaction File contains all edited, transcribed, and error-corrected data from the U.S. Individual Income Tax Returns (Form 1040 series) and related forms for the current processing year and 2 prior years.

² The IRS database that maintains transactions or records of individual tax accounts.

³ The 86 *e-filed* returns had 139 Forms W-2 attached to the returns.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

To verify our suspicion, we used the wage amount and employer identification number on the attached Form W-2 and researched the Information Returns Master File⁴ to find the “true” employee SSN that was reported on the Form W-2 and submitted by the employer. We found that 51 (66 percent) of the 77 *e-filed* returns had 74 attached Forms W-2s that showed a different employee SSN than the employee SSN actually reported by the employer.

Based on the sample results, we estimate that the population contains 359,523 *e-filed* returns with 503,303 Forms W-2 affected by the tax return software’s overwrite feature. We are 95 percent confident that number of affected *e-filed* returns in the population is between 266,686 and 452,360 (the margin of error is $\pm 92,837$). In addition, we are 95 percent confident that the number of affected Forms W-2 is between 346,869 and 659,737 (the margin of error is $\pm 156,434$).

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; ACTC payments of \$1.8 billion on 1,219,643 TY 2007 individual tax returns; \$8.9 billion ACTC over 5 years (see page 6). It should be noted that realization of this outcome measure is contingent upon interpretation or enactment of legislation (see page 17).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify from the IRS Returns Transaction File a universe of 1,835,035 TY 2007 individual tax returns filed by a primary taxpayer with an ITIN and reporting wages. The returns were processed by the IRS Submission Processing sites during 2008 and were posted to the Individual Master File. We analyzed the returns in the universe and determined that 568,998 returns were allowed the ACTC only of \$755,914,567. None of these 568,998 returns were allowed the CTC because they did not have any tax liability after other offsetting credits. We also determined that 650,645 returns were allowed both the CTC of \$434,294,565 and ACTC of \$1,020,825,261. In summary, a total of 1,219,643 returns were allowed the ACTC of \$1,776,739,828, or almost \$1.8 billion annually. If the tax law is changed to discontinue the ACTC for ITIN filers, ACTC payments of \$8.9 billion over 5 years could be put to better use. The \$8.9 billion was computed by multiplying \$1,776,739,828 by 5.

⁴ The Information Returns Master File contains tax information reported from third parties for the current and prior 5 tax years.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Appendix V

Methods for Employers to Verify Work Eligibility

To assist employers in meeting new hire verification procedures, the SSA provides various methods for employers to verify work eligibility. These methods include the Employee Verification Services, which provide both paper and telephone/fax options, and the Social Security Number Verification Service, which provides online employee SSN verification. The SSA provides employers with instructions on what to do if an SSN fails to verify.

The DHS is responsible for identifying and classifying the work status of foreign individuals in the U.S. and, where needed, enforcing legal action against illegal workers. In 1996, Congress passed the Illegal Immigration Reform and Immigrant Responsibility Act,¹ which required the SSA and the U.S. Citizenship and Immigration Services² (then the Immigration and Naturalization Service and now a part of the DHS) to initiate employment eligibility verification pilot programs. The DHS, working in partnership with the SSA, implemented the E-Verify program, which electronically compares information on the Employment Eligibility Verification (Form I-9) with records contained in SSA (444 million records) and DHS (60 million records) databases.



This program is important because while the SSA is required to provide unauthorized employment information to the DHS, the DHS does not have to notify the SSA when a person's work status changes from unauthorized to authorized. Therefore, unless the individual notifies the SSA, the SSA information will have incorrect work statuses. By working together with both the DHS and the SSA, the E-Verify program provides the ability to compare both databases to provide an employer with the current employment eligibility of an individual.

While use of the E-Verify program currently encompasses only 1 percent of employers, usage is growing by about 1,000 employers per week, and by summer 2008 the program had approximately 90,000 employers. To help in this effort, 15 States have passed legislation requiring, either explicitly or implicitly, that certain employers within those States participate in the E-Verify program. Other States have pending legislation that would require certain employers to register and utilize the E-Verify program.

Some of the differences in the DHS E-Verify program and the various SSA programs are shown in Figure 7.

¹ Pub. L. No. 104 -208, 110 Stat. 3009-546 (1996).

² Responsibility for oversight of the verification pilot program was assigned to the Attorney General, who assists and coordinates the departments involved.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

**Figure 7: Characteristics of the E-Verify Program and
the SSA’s Various Employer Verification Programs**

Verification Programs	Verifies users identity	Uses name matching software	Provides a death indicator response	Verifies information without providing corrected SSN	Verifies work authorization status
EVS Telephone/Fax ERSC ³ (SSA)	No	N/A	No	N/A	No
EVS Telephone/Fax Teleservice Center (SSA)	No	N/A	Yes ⁴	N/A	Yes ⁵
EVS Registered Users (SSA)	No	No	Yes	No	No
SSNVS (SSA)	Yes	No	Yes	Yes	No
E-Verify (DHS & SSA)	No	Yes	Yes ⁴	Yes	Yes

Source: SSA Office of the Inspector General Report, Controls Over Employee Verification Programs (A-03-06-15036, dated September 2007). EVS =Employee Verification Service and SSNVS = Social Security Number Verification Service.

³ Within the SSA, there are two components primarily responsible for phone verifications – Teleservice Centers and the Employer Reporting Service Center.

⁴ While the program does not specifically note that the agency’s records showed a death, the program will not verify any data related to an individual shown as deceased in the agency’s records.

⁵ While the program does not specifically note that the agency’s records showed the individual was unauthorized to work, the program will not verify any record related to an individual recorded as unauthorized to work in the Agency’s records.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Appendix VI

Rules for Claiming the Child Tax Credit and the Additional Child Tax Credit

The child must meet all five tests listed below to qualify for the CTC and ACTC.

1. The child must be the taxpayer's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendant of any of them (for example, a grandchild, niece, or nephew).
2. The child must be under age 17 at the end of the tax year.
3. The child must not have provided over one-half of his or her own support for the tax year.
4. The child must have lived with the taxpayer for more than one-half of the tax year.¹
5. The child must be a U.S. citizen, a U.S. national,² or a resident of the U.S. *U.S. Tax Guide for Aliens* (Publication 519) states that an individual will be considered a U.S. resident for tax purposes if they meet the substantial presence test for the calendar year. To meet this test, the individual must be physically present in the U.S. on at least 31 days during the current year, and 183 days during the 3-year period that includes the current year and the 2 years immediately before.

¹ Child Tax Credit (Publication 972) contains some exceptions to the time lived with the taxpayer.

² A U.S. national is an individual who, although not a U.S. citizen, owes his or her allegiance to the United States. U.S. nationals include American Samoans and Northern Mariana Islanders who chose to become U.S. nationals instead of U.S. citizens.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

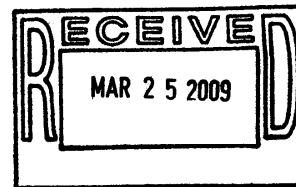
Appendix VII

Management's Response to the Draft Report

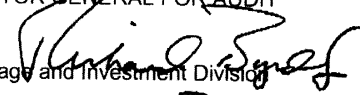


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

MAR 25 2009



MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr. 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report - Actions Are Needed to Ensure
Proper Use of Individual Taxpayer Identification Numbers
and to Verify or Limit Refundable Credit Claims
(Audit # 200840020)

I reviewed the subject draft report and appreciate your acknowledgement of the positive steps the IRS has taken to improve the processing of Application for IRS Individual Taxpayer Identification Numbers (Form W-7), and processing of returns from individuals who are unable to obtain a Social Security Number (SSN). However, I have concerns with two items contained in your report and disagree with several of the recommendations and one of the outcome measures.

Individual Taxpayer Identification Numbers (ITINs) were introduced in 1996 by the IRS and are issued only to non-resident and resident aliens that do not have, and do not qualify for, SSNs. Under the Internal Revenue Code (the Code), many non-resident aliens are subject to U.S. tax on earnings in the U.S. and all resident aliens, regardless of immigration status or qualification for an SSN, are subject to tax on worldwide income in the same manner as U.S. citizens (see IRC sections 6012 and 7701(b)). The ITINs provide an identifier for aliens that do not qualify for SSNs in order to facilitate their compliance with U.S. tax laws and provide the IRS a means to effectively process and account for their tax returns and payments. In this regard, since the inception of the ITIN program, as of December 31, 2008, the IRS has assigned over 13.9 million ITINs. During calendar year 2008 alone, the IRS successfully processed 2.5 million Form W-7 applications, assigned 1.6 million new ITINs, and processed over 1.5 million tax returns associated with these applications. At the same time, the IRS has significantly improved ITIN processing timeliness and implemented a number of additional improvements specifically designed to reduce duplicate filings and erroneous refunds that are described in more detail below. There are two items in your report that are a cause of some concern. First, your report highlights information from an internal study by the Wage and Investment Division Lean Six Sigma office indicating "Individuals are



**Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims**

assigned multiple ITINs which results in the issuance of erroneous refunds." As explained to the Treasury Inspector General for Tax Administration (TIGTA) audit team (and acknowledged in a footnote in your report), the Lean Six Sigma study was conducted solely for purposes of refining the Tax Examiner pre-screening process. This study was based on a sample that included data collected only during October and November 2007 and is not statistically valid for the entire ITIN applicant pool. We believe the way TIGTA represented the results of the IRS study is misleading.

Your report also refers to Accounts Management functional employees that were disallowing the Child Tax Credit (CTC) and/or Additional Child Tax Credit (ACTC) on ITIN returns.

You also report that these employees filed a formal complaint with TIGTA regarding this decision and that they believe managements' change was made because slowed productivity and increased case inventories.

However, you provide no information regarding the results of TIGTA's investigation of this complaint. Further, you state that

for CTC and/or ACTC despite these employees concerns. I want to emphasize that this management decision was entirely appropriate and based on the fact that Accounts Management employees do not have the legal authority to deny CTC or ACTC claims, regardless of what they may be able to discern from a review of the ITIN database. Currently, the only way the IRS can disallow CTC or ACTC based on is during an examination. As TIGTA is fully aware, the IRS routinely makes cost/benefit determinations regarding the compliance issues that warrant examination based on our limited enforcement resources.

With regard to ITIN improvement efforts, the following chart shows the total number of Forms W-7 received each year since 2004 and the total number of ITINs assigned. The reduced number of ITINs assigned compared to the number of applications received is due to our rigorous screenings of Form W-7 applications to screen out duplicates, incomplete, or unacceptable applications.

Year	Form W-7 Receipts Received	ITIN Assigned	Percent Unassigned
2004	1,492,506	838,070	44%
2005	1,652,100	1,195,397	28%
2006	1,909,147	1,375,944	28%
2007	2,313,288	1,768,902	24%
2008	2,557,478	1,628,354	35%
Total	9,924,519	6,806,667	32%

Source: The ITIN Production and the ITIN Comparative Data reports.



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

3

Also as noted above, the IRS has taken many positive steps to reduce duplicate filings and the resulting erroneous refunds. These efforts include:

Reduction of Duplicate Returns

- Procedural guidance in Internal Revenue Manual (IRM) 3.21.263 was updated to direct ITIN Operation Tax Examiners to identify duplicate return filings from subsequent ITIN application submissions by marking the returns as "Copy". The implementation of this measure coupled with the existing guidance to check for duplicate applications, decreases the potential for duplicate ITINs.
- The ITIN notices were updated to include instructions for the applicant to identify a duplicate filing by marking the return as "Copy" prior to submission.
- Programming changes were implemented to notify applicants who submitted multiple ITIN applications of a prior ITIN assignment and identified the appropriate number to use. Programming changes were also implemented to refine the selection criteria (filter) that identified duplicate applications.
- The ITIN Program Office Policy Section (IPS) is working in conjunction with the Submission Processing (SP) Entity function and Accounts Management to ensure all identified duplicate Taxpayer Identification Number (TIN) assignments (e.g. ITIN, SSN, Internal Revenue Service Number (IRSN), etc.) are properly handled in order to prevent erroneous refunds and reduce taxpayer burden. The ITIN Operation is notified of all merge actions completed by either the SP Entity Function or Accounts Management via a referral if the action involves multiple ITINs or an ITIN to SSN merge. Once notified, the ITIN Operations will revoke the ITIN as appropriate.

Reduction of Erroneous Refunds

- The IPS revised ITIN procedures and software, and coordinated efforts with the Criminal Investigation Division to identify and refer refund schemes. The ITINs used in these schemes were revoked and over \$2 million in erroneous refunds stopped.
- The IPS has developed and referred several preparer projects to the Small Business/Self-Employed Division Examination function resulting in a 95 percent tax change rate or nearly \$148,000 of additional tax for the first 19 returns audited.

Your report also states that ITINs are improperly used for employment and recommends that the IRS develop a process to identify individuals who are improperly using ITINs for



**Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims**

4

work purposes and identify the employers who accept ITINs for wage reporting. The recommendation further asks that the IRS develop outreach efforts with the Social Security Administration (SSA) to address the improper use of ITINs. We disagree with this recommendation because the SSA already has a program called the Employee No-Match Letter that is used to request an individual to provide the correct information to SSA. The SSA identifies the individual to whom the earnings belong so that these earnings can be posted to the correct earning record. The SSA has also been sending similar letters to employers. However, your auditors told us that pending resolution of a court case, SSA stopped sending No-Match letters to employers. Regardless of the current status of the employer No-Match letters, we believe the SSA is the correct agency to work with both the individual taxpayers and their employers regarding this issue. Involvement by the IRS would only be a duplication of SSA efforts.

We agree with the recommendation to work with electronic tax software preparation companies to limit the auto-populate feature. Software preparation companies already have a directive in place located in Electronic Return File Specifications and Record Layouts for Individual Tax Returns (Publication 1346). We will continue to remind the software companies of this problem.

You also recommend that the IRS develop a process to ensure the Wage and Tax Statement (Forms W-2) attached to paper returns filed with an ITIN is transcribed. This information is not transcribed during returns processing due to the costs associated with the development and implementation of such an effort.

Finally, your report states that billions of dollars in tax credits are provided to ITIN filers without verification of eligibility. Absent a legislative change, during return processing, IRS does not have the legal authority to verify and disallow CTC or ACTC. The current process for verification of eligibility is an examination, where the taxpayer would need to provide

2(e),2(f)

2(a),2(e),2(f)

2(a),2(e),2(f)

Nevertheless, we are taking several positive steps to better educate the public on CTC and ACTC eligibility requirements and our SP and Reporting Compliance organizations are partnering in a pilot to explore options to better identify false claims for examination. I also note that this issue would be addressed through the legislative changes you are recommending, which we agree to explore with the Treasury Department.

I agree with the first outcome measure in the report regarding e-filed returns with Forms W-2 containing ITINs. However, I do not agree with the second outcome measure regarding ACTC payments. These figures are based on two contingencies. The first is based on an interpretation of the IRC that the IRS does not agree with. The second is based on enactment of legislation to specifically disallow ACTC to filers without a valid



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

5

SSN. Should such legislation come to pass, we will reconsider the outcome measure as stated.

Attached are our comments to your specific recommendations. If you have any questions regarding this response, please call me at (404) 338-7060, or a member of your staff may contact Peter J. Stipek, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

Attachment

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1

Develop a process to identify individuals who are improperly using ITINs for work purposes, as well as those employers accepting the ITIN for wage reporting, and develop outreach efforts with the SSA to address the improper use of the ITIN.

CORRECTIVE ACTION

We disagree with this recommendation because the Social Security Administration (SSA) has a program in place called the Employee No-Match Letter that requests correct information from individuals. The SSA has also been sending similar letters to employers but this was suspended pending resolution of a court case. Regardless of the current status of the employer No-Match letters, we believe SSA is the correct agency to work with the taxpayers and their employers regarding this issue. Our involvement would be a duplication of the SSA efforts.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

Coordinate with electronic tax software preparation companies to initiate actions to limit the automatic population feature of the taxpayer identification numbers on Forms W-2 for Forms W-2 associated with *e-filed* ITIN tax returns.

CORRECTIVE ACTION

We agree with this recommendation and have already implemented this procedure. For tax year 2007, the electronic filing (e-file) program was revised to discourage the filing of Wage and Tax Statements (Forms W-2) containing Individual Taxpayer Identification Numbers (ITINs). The e-file preparation software containing the automatic feature that populated the ITIN from the return to the W-2 had to be disabled so that the ITINs would not be captured as the identification number on the Form W-2. The software should direct the user to input the Taxpayer Identification Number from the Form W-2 exactly as it was issued by the employer. This information is contained in Electronic Return File Specifications and Record Layouts for Individual Tax Returns (Publication 1346) and we will continue to remind the software companies of this issue.



**Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims**

2

IMPLEMENTATION DATE

Completed January 2008

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 3

Develop a process to ensure that accurate tax information is input into IRS systems from both paper and e-filed tax returns filed with an ITIN.

CORRECTIVE ACTION

We disagree with this recommendation. As noted above, e-file software should already direct the user to input the Taxpayer Identification Number from the Form W-2 exactly as it was issued by the employer to ensure that accurate information is input into IRS systems. With regard to paper returns, it is currently cost prohibitive to transcribe W-2 data during processing.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 4

The Commissioner, Wage and Investment Division, should develop a process to ensure the [REDACTED] with ITINs being claimed for the CTC and/or ACTC. This process should ensure [REDACTED]

2(a),2(e),2(f)

2(a),2(e),2(f)

CORRECTIVE ACTION

We disagree with this recommendation. Absent a legislative change, during return processing IRS does not have the legal authority to verify and disallow the Child Tax Credit (CTC) and/or Additional Child Tax Credit (ACTC) [REDACTED]. The current process for verification of eligibility is an examination, where the taxpayer would

2(a),2(e),2(f)



**Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims**

3

2(a),2(e),2(f)

need to provide [REDACTED] [REDACTED]. The solution to this issue would be addressed by the proposed legislation in Recommendation 5 below.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

LEGISLATIVE RECOMMENDATION

RECOMMENDATION 5

Legislation is needed to clarify whether or not refundable tax credits such as the ACTC may be paid to filers without a valid SSN and, if these credits may not be paid, to provide IRS math error authority to disallow associated claims for the credits. Disallowance of the ACTC to filers without a valid SSN would reduce Federal outlays by \$8.9 billion over 5 years.

CORRECTIVE ACTION

We agree with this recommendation. The Wage and Investment Division, in combination with the Office of Chief Counsel, will discuss with the Office of Tax Policy, Department of Treasury, the merits of an administration proposal to amend the Internal Revenue Code to limit eligibility for the CTC and ACTC to individuals who have a social security number issued by the SSA other than a number issued to an alien not authorized to work in the United States. This discussion with the Office of Tax Policy will include a dialogue on the merits of a proposal to expand the Commissioner's math error authority to any claims for the credits made on returns that are disallowed because the individual did not provide the required number.

IMPLEMENTATION DATE

July 15, 2009

RESPONSIBLE OFFICIAL

Director, Submission Processing, Wage and Investment Division



*Actions Are Needed to Ensure Proper Use of Individual
Taxpayer Identification Numbers and to Verify
or Limit Refundable Credit Claims*

4

CORRECTIVE ACTION MONITORING PLAN

This corrective action will be monitored as part of our internal managerial control system. The Director, Submission Processing will report progress to the Director, Customer Account Services.