

**Some Individual Taxpayers Are  
Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access  
for Disabled Americans**

**September 2001**

**Reference Number: 2001-30-158**



DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

September 14, 2001

MEMORANDUM FOR COMMISSIONER ROSSOTTI

*Gordon C. Milboin*

FROM: (for) Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Some Individual Taxpayers Are  
Inappropriately Receiving Tax Credits Intended for Businesses  
That Provide Access for Disabled Americans

The report presents the results of our review to determine whether taxpayers were allowed refunds when claiming business incentive credits<sup>1</sup> even though they had no eligible business.

In Calendar Year 2000, personnel from the Internal Revenue Service (IRS) and the Treasury Inspector General for Tax Administration (TIGTA) were made aware of taxpayers purchasing pay telephones with volume controls and claiming Disabled Access Credits on their individual income tax returns. Unless these taxpayers had incurred expenses to bring their businesses into compliance with the Americans with Disabilities Act (ADA),<sup>2</sup> they most likely do not qualify for the Disabled Access Credit. An article in the *USA Today*<sup>3</sup> in February 2001 provided further information regarding this issue. The article pointed out that older Americans are being fraudulently targeted for investments in pay phones and automated teller machines and are subsequently losing their investments. We reviewed material used by a promoter selling pay phones

---

<sup>1</sup> Business incentive credits are tax credits intended to provide special incentives for the achievement of certain economic objectives. These credits include the following: Investment Credit, Work Opportunity Credit, Welfare-to-Work Credit, Alcohol Fuel Credit, Credit for Increasing Research Activities, Low-Income Housing Credit, Enhanced Oil Recovery Credit, Disabled Access Credit, Renewable Electricity Production Credit, Indian Employment Credit, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips, Orphan Drug Credit, Credit for Contributions to Selected Community Development Corporations, Trans-Alaska Pipeline Liability Fund Credit, and Credit From an Electing Large Partnership.

<sup>2</sup> Americans with Disabilities Act (ADA), 42 U.S.C. §§ 12101-12213 (1994 & Supp. IV 1998).

<sup>3</sup> Noelle Knox and Greg Farrell, "Seniors Lose Big in Risky Deals Through Insurance Agents," *USA Today* (February 28, 2001).

to senior citizens, which stated that investments in the pay phones qualified the taxpayers for a tax credit of up to \$5,000.

In summary, we found some taxpayers appeared to have bona fide business reasons for claiming business incentive credits even though they did not file *Profit or Loss From Business* (Schedule C), or *Supplemental Income and Loss* (Schedule E), as part of their individual income tax returns. However, other taxpayers were allowed Disabled Access Credits even though their tax returns indicated no business reasons for taking the credits.

Using a computer program, we identified 391 *U.S. Individual Income Tax Returns* (Form 1040) for Tax Year 1999 which were allowed Disabled Access Credits but included no Schedule C or Schedule E. These taxpayers' returns contained no information to indicate business ownership or participation.

The 391 taxpayers received Disabled Access Credits on their tax returns totaling over \$1.09 million. The IRS issued refunds or allowed taxpayers to apply overpayments to subsequent years' taxes in 304 of these cases. The refunds and overpayments applied totaled \$1.02 million. The credits included in our review resulted from transactions that reportedly occurred during 1999. As indicated by the article in the *USA Today*, this issue may have significantly grown since then, so claims in Tax Year 2000 most likely would be even greater.

We recommended the IRS warn taxpayers who may be the victims of fraudulent promotions of investments in pay phones and automated teller machines that such investments most likely do not qualify for the Disabled Access Credit. We further recommended the Director, Strategy and Finance (Wage and Investment Division), and the Director, Strategy, Research and Performance Management (Small Business/Self-Employed Division), work with their respective Compliance functions and the Criminal Investigation function to develop a compliance approach for taxpayers taking the Disabled Access Credit without qualifying businesses. They should consider educational notices, examinations, and criminal prosecution where appropriate. By taking immediate action, the IRS can potentially increase revenue by more than \$2 million.

Management's Response: IRS management agreed with our overall finding that some individual taxpayers are inappropriately receiving Disabled Access Credits, and the Commissioner, Small Business/Self-Employed Division, agreed to analyze Tax Year 2000 data to identify potentially unallowable credits and take appropriate compliance actions when abusive schemes are identified. However, IRS management did not agree to issue a press release or provide information on its web site targeted at taxpayers who may be the victims of those individuals promoting investments in pay phones and automated teller machines as qualifying for the Disabled Access Credit. Rather, they opted to target the information to the promoters of such schemes. Management's complete response to the draft report is included as Appendix VII.

Office of Audit Comment: We disagree with the IRS' approach of narrowly focusing on the promoter while ignoring the victim. The IRS' reluctance to warn taxpayers about investing in these fraudulent schemes, which are often offered under the guise of sound tax planning, is inconsistent with the IRS' mission of helping taxpayers understand and meet their tax responsibilities and applying the tax law with integrity and fairness to all. Many of these taxpayers are elderly Americans who become victims of promoters recommending unwise investments and taking advantage of complex tax laws. In addition, as the IRS has acknowledged that the taxpayers are inappropriately receiving the Disabled Access Credit, it is entirely possible that the IRS may subsequently examine and disallow credits of victims that it refused to warn.

While we disagree with the corrective action the IRS will take, we do not intend to elevate this issue as a significant management decision to which we disagree. Consequently, no further action on your part is required.

The TIGTA has designated this report as Limited Official Use (LOU) pursuant to Treasury Directive TD P-71-10, Chapter III, Section 2, "Limited Official Use Information and Other Legends" of the Department of Treasury Security Manual. Because this document has been designated LOU, it may only be made available to those officials who have a need to know the information contained within this report in the performance of their official duties. This report must be safeguarded and protected from unauthorized disclosure; therefore, all requests for disclosure of this report must be referred to the Disclosure Unit within the TIGTA's Office of Chief Counsel.

Please contact me at (202) 622-6510 if you have questions, or your staff may call Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

---

**Table of Contents**

Background..... Page 1

Some Taxpayers Appeared to Properly Claim Business Incentive  
Credits Without Filing a Schedule C or Schedule E..... Page 2

Taxpayers Inappropriately Received the Disabled Access Credit..... Page 3

Recommendation 1: ..... Page 5

Recommendation 2:..... Page 7

Appendix I – Detailed Objective, Scope, and Methodology..... Page 8

Appendix II – Major Contributors to This Report ..... Page 12

Appendix III – Report Distribution List..... Page 13

Appendix IV – Outcome Measures..... Page 14

Appendix V – Memorandum Issued to Director, Refund Crimes  
(Criminal Investigation)..... Page 15

Appendix VI – Unreliable Data in Samples of Other Business  
Incentive Credits ..... Page 18

Appendix VII – Management’s Response to the Draft Report..... Page 19

## Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

---

### Background

---

An article in *Forbes Magazine*<sup>1</sup> dated March 5, 2001, stated that shady tax shelters and tax cheating appear to be costing the Treasury well above \$200 billion a year. The article pointed out that underpayment of taxes begets more of the same. It stated that Americans are becoming ever more shameless about how they dodge the Internal Revenue Service (IRS), and because of the IRS' resource limitations and shift in emphasis from compliance to taxpayer service, they have become ever more confident that the IRS cannot keep up with them.

In Calendar Year 2000 as the IRS was processing Tax Year (TY) 1999 individual income tax returns, the Ogden Submission Processing Center and the Treasury Inspector General for Tax Administration (TIGTA) were made aware of taxpayers purchasing pay telephones with volume controls and claiming Disabled Access Credits on their individual income tax returns. Unless these taxpayers had incurred expenses to bring their businesses into compliance with the Americans with Disabilities Act (ADA),<sup>2</sup> the taxpayers most likely did not qualify for the Disabled Access Credits.

An article in the *USA Today*<sup>3</sup> in February 2001 provided further information regarding this issue. The article pointed out that older Americans are being fraudulently targeted for investments in pay phones and automated teller machines and are subsequently losing their investments. We reviewed material used by a promoter selling pay phones to senior citizens, which stated that investments in the pay phones qualified the taxpayers for a tax credit of up to \$5,000.

---

<sup>1</sup> Janet Novack, "Are You a Chump?" *Forbes Magazine* (March 5, 2001).

<sup>2</sup> Americans with Disabilities Act (ADA), 42 U.S.C. §§ 12101-12213 (1994 & Supp. IV 1998).

<sup>3</sup> Noelle Knox and Greg Farrell, "Seniors Lose Big in Risky Deals Through Insurance Agents," *USA Today* (February 28, 2001).

## Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

We initiated this audit to determine whether taxpayers were allowed refunds when claiming business incentive credits even though they had no eligible business.<sup>4</sup>

Our audit was conducted at the Ogden IRS Center from September 2000 through March 2001. This audit was performed in accordance with *Government Auditing Standards*. We performed in-depth analysis of tax returns claiming the Disabled Access Credit and lesser analyses of tax returns claiming other business incentive credits. However, errors made by IRS personnel when entering data from tax returns to the IRS' computer system caused most of the business incentive credit data in our samples to be unreliable. As a result, we could not comment on most of the other business incentive credits. These errors are discussed in more detail in Appendix VI. Details of our audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

---

### Some Taxpayers Appeared to Properly Claim Business Incentive Credits Without Filing a Schedule C or Schedule E

---

Some of the taxpayers claiming business incentive credits on their TY 1999 *U.S. Individual Income Tax Return* (Form 1040) without filing *Profit or Loss From Business* (Schedule C) or *Supplemental Income and Loss* (Schedule E)<sup>5</sup> still appeared to have bona fide business reasons for taking the credits. For example, over 31,000 tax

---

<sup>4</sup> Business incentive credits are tax credits intended to provide special incentives for the achievement of certain economic objectives. These credits include the following: Investment Credit, Work Opportunity Credit, Welfare-to-Work Credit, Alcohol Fuel Credit, Credit for Increasing Research Activities, Low-Income Housing Credit, Enhanced Oil Recovery Credit, Disabled Access Credit, Renewable Electricity Production Credit, Indian Employment Credit, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips, Orphan Drug Credit, Credit for Contributions to Selected Community Development Corporations, Trans-Alaska Pipeline Liability Fund Credit, and Credit From an Electing Large Partnership.

<sup>5</sup> Some of these tax returns had Schedules C or E attached, but the schedules contained zeros so the returns had been processed by the IRS as if these schedules were not attached.

## Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

returns claimed Low-Income Housing Credits for more than \$500 each, but appeared to be valid despite not filing a Schedule C or E with the return. We sampled 92 of these returns and found that in each case the credit amount came from a partnership. While no partnership income was claimed on the tax return, the tax form supporting the credit showed the source of the credit as being the taxpayer's participation in a partnership. A sample of tax returns claiming the Investment Credit showed similar results.

However, many taxpayers were allowed Disabled Access Credits even though their tax returns indicated no business reasons for taking the credits.

---

### **Taxpayers Inappropriately Received the Disabled Access Credit**

---

Using a computer program, we identified 391<sup>6</sup> Forms 1040 for TY 1999 on the IRS' Individual Returns Transaction File<sup>7</sup> which were allowed Disabled Access Credits but included no Schedule C or Schedule E. These taxpayers' returns contained no information to indicate business ownership or participation.

The Congress enacted the Disabled Access Credit as part of the Budget Reconciliation Act of 1990<sup>8</sup> to help eligible small businesses comply with the applicable requirements of

---

<sup>6</sup> During our review of TY 1999 tax returns claiming business incentive credits greater than \$500 but with no Schedule C or E, we identified 397 claiming the Disabled Access Credit. However, when verifying the information extracted from the IRS' file and performing other research, we found 6 instances where IRS employees had incorrectly input information from the tax returns or taxpayers had made an entry on the wrong line of the tax return. We reduced our reported figures based on these six cases. There may be other IRS or taxpayer errors that we did not discover. All our estimates are based on the best information available. In 44 of these 391 tax returns, 3 taxpayers indicated that the credits were reported to them from partnerships. However, there were no other indications that the credits were actually from partnerships.

<sup>7</sup> The IRS' Individual Returns Transaction File contains information from tax returns filed for the current and 2 previous years.

<sup>8</sup> Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388 (1990).



## Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

the ADA.<sup>9</sup> In order to successfully claim a Disabled Access Credit under Internal Revenue Code § 44, taxpayers need to establish that they have made “eligible access expenditures,” i.e., that the expenditures were reasonable and were made to enable compliance with the ADA or implementing regulations.

Some of the taxpayers we identified may not have understood the law related to the Disabled Access Credit, some may have been misled by unscrupulous investment promoters, and others may have knowingly claimed a fraudulent credit. We performed further analysis on the 391 tax returns discussed above and identified 2 groups of taxpayers (filing 46 tax returns) who were most likely misled into claiming the credit or fraudulently took the credit. The tax returns in question contained similar characteristics linking them to one another in some way, such as taxpayer name, amount of credit, name of preparer, etc. The remaining 345 tax returns were equally questionable, but we did not find characteristics specifically linking them to the 2 groups of taxpayers discussed. We referred the returns in the two groups to the IRS’ Examination and Criminal Investigation functions. An in-depth discussion of our findings related to these taxpayers is included in a memorandum we issued to the IRS’ Director, Refund Crimes, on March 16, 2001 (see Appendix V).<sup>10</sup>

The IRS’ mission is to provide America’s taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all. To help ensure fair treatment to taxpayers and to help taxpayers understand and meet their

---

<sup>9</sup> The ADA is a national mandate for the elimination of discrimination against individuals with disabilities. Section 302(a) of the Act provides that no individual may be discriminated against on the basis of disability in the full and equal enjoyment of the goods, service, and facilities of any place of public accommodation.

b(3);26 U.S.C. 6103,(b)(7)(C)

## Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

---

tax responsibilities, the IRS has committed to identify and deal with compliance problems earlier in its process. This involves identifying issues early, educating taxpayers, and using educational letters to inform taxpayers of problems and to allow taxpayers to correct problems on their tax returns without IRS enforcement actions.

Some employees at the IRS were aware of the inappropriate Disabled Access Credits, but they were unaware how widespread the problem was. No steps were taken organization-wide to identify or analyze the questionable accounts.

We discussed this issue with the IRS Commissioner on March 15, 2001. In his statement before the Senate Finance Committee on April 5, 2001, he informed the committee of two nationwide alerts the IRS had issued, warning taxpayers not to fall victim to other tax scams. A similar alert would be appropriate for this issue before it becomes more widespread.

The 391 taxpayers that we identified received Disabled Access Credits on their tax returns totaling over \$1.09 million. The IRS issued refunds or allowed taxpayers to apply overpayments to subsequent years' taxes in 304 of these cases. The refunds and overpayments applied totaled \$1.02 million. The average refund/credit elect received by these 304 taxpayers was over \$3,300. The credits included in our review resulted from transactions that reportedly occurred during 1999. As indicated by the article in the *USA Today*, this issue may have significantly grown since then, so claims in TY 2000 most likely would be even greater.

### Recommendations

1. The Director, Partnership Outreach, Small Business/Self-Employed Taxpayer Education and Communication, should issue a press release or provide information on its web site targeted at taxpayers who may be the victims of those individuals promoting

## Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

---

investments in pay phones and automated teller machines as qualifying for the Disabled Access Credit. We recommend wording similar to the following:

*Various state and federal agencies have recently reported that many Americans (particularly older Americans) are being targeted for fraudulent investments in pay phones and automated teller machines.*

*The TIGTA has recently discovered that some of the promoters of these schemes may also be promising that investments in their pay phones and automated teller machines qualify the investors for a tax credit, called the Disabled Access Credit, of up to \$5,000.*

*This tax credit was intended to assist eligible small businesses to comply with the applicable requirements of the Americans with Disabilities Act. However, many of the taxpayers identified by the TIGTA study did not even participate in a business or partnership. The IRS is scrutinizing many of these tax returns and may disallow the credits.*

**Management's Response:** The Director, Partnership Outreach, Small Business/Self-Employed Taxpayer Education and Communication, will ensure that information will be added to the Small Business/Self-Employed Community web site to alert taxpayers regarding fraudulently promoting investments in pay phones and automated teller machines as qualifying for the Disabled Access Credit.

**Office of Audit Comment:** We disagree with the IRS' approach of narrowly focusing on the promoter while ignoring the victim. The IRS' reluctance to warn taxpayers about investing in these fraudulent schemes, which are often offered under the guise of sound tax planning, is inconsistent with the IRS' mission of helping taxpayers understand and meet their tax responsibilities and applying the tax law with integrity and fairness to all. Many of these taxpayers are elderly Americans who become victims of

## Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

---

promoters recommending unwise investments and taking advantage of complex tax laws. In addition, as the IRS has acknowledged that the taxpayers are inappropriately receiving the Disabled Access Credit, it is entirely possible that the IRS may subsequently examine and disallow credits of victims that it refused to warn.

The TIGTA agreed to transfer ownership of this recommendation at the closing conference because the IRS agreed, in the same meeting, that the new owner would include information regarding this issue in its pre-filing strategy. This would include not only posting information on the web page but also addressing the issue in outreach programs with tax practitioners, etc.

2. The Director, Strategy and Finance (Wage and Investment Division), and the Director, Strategy, Research and Performance Management (Small Business/Self-Employed Division), should analyze the results of our computer program; perform similar analyses of TY 2000 returns; and develop, in conjunction with their Compliance functions and the Criminal Investigation function, a compliance approach to address this issue.

This compliance approach could include educational notices, examinations, and criminal prosecution where appropriate.

Management's Response: Upon obtaining (*Tax Year*) 2000 data, Strategy, Research and Performance Management (Small Business/Self-Employed Division) will perform similar analyses to identify potentially unallowable credits. They will continue their investigation targeting the promoters and take appropriate compliance actions towards abusive schemes.

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

---

**Appendix I**

**Detailed Objective, Scope, and Methodology**

The objective of this audit was finalized after the planning phase that focused on several potential fraud schemes involving business returns and/or issues. Research was conducted on each potential scheme type to determine the potential for audit and best use of resources. The objective of this audit was to determine whether taxpayers were allowed refunds when claiming business incentive credits even though they had no eligible business.

To accomplish our objective, we performed the following audit tests:

- I. To identify controls in place to ensure that only taxpayers with eligible businesses received any of the business incentive credits, we:
  - A. Researched the Internal Revenue Manual (IRM) and identified the return processing controls in place to ensure that only eligible businesses received business incentive credits. We specifically reviewed the portions of the IRM that instruct the Code and Edit and Error Resolution functions how to process returns claiming the credit.
  - B. Interviewed Ogden Internal Revenue Service (IRS) Submission Processing management and employees responsible for processing returns and determined controls and methods in place for identifying and correcting returns that erroneously take business incentive credits.
  - C. Interviewed Ogden IRS Criminal Investigation Branch managers to determine methods used to identify and correct returns taking erroneous business incentive credits. We also determined if the Questionable Refund Program reviewed tax returns for erroneous business credits or if the Electronic Fraud Detection System incorporated the credits into its detection process.
- II. To determine the effectiveness of controls in place to ensure ineligible taxpayers did not receive business incentive credits, we:
  - A. Identified all *U.S. Individual Income Tax Returns* (Form 1040) filed for Tax Year 1999 that claimed a business incentive credit but did not include a *Profit or Loss From Business* (Schedule C) or *Supplemental Income and Loss* (Schedule E). We also verified this data to ensure its reliability.
    1. Performed research to determine how the IRS processed returns claiming business incentive credits and input them into IRS computers.

## Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

---

2. Designed and submitted two computer program requests that identified tax returns on the IRS' computer files that claimed a business incentive credit but did not include a Schedule C or Schedule E.
3. Developed two computer programs that ran against the IRS' data files and identified and extracted IRS records that met the criteria. These data were downloaded into two separate files.
  - The first computer program identified 45,241 tax returns that met the criteria but did not identify the specific type of credit claimed. These data were randomly sampled and analyzed as described in steps II.B.1 and II.B.2. The Low-Income Housing Credit (one of the business incentive credits) was claimed on 93 percent of the returns. Therefore, this sample was used to evaluate the Low-Income Housing Credit. All other business incentive credits were evaluated using the second computer run.
  - The second computer program identified records meeting the criteria but also included the specific type of credit claimed. We electronically separated this file by the type of business incentive credit claimed. We eliminated duplicates and any records not claiming greater than \$500 in business incentive credits. A specific database was created for the following 13 types of credits (number of records identified are included in parenthesis).
    - Investment Credit (1,833)
    - Work Opportunity Credit (94)
    - Credit for Alcohol Used as Fuel (7)
    - Credit for Increasing Research Activities (203)
    - Enhanced Oil Recovery Credit (25)
    - Disabled Access Credit (397)<sup>1</sup>
    - Renewable Electricity Production Credit (13)
    - Indian Employment Credit (35)
    - Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips (157)

---

<sup>1</sup> We identified 397 Tax Year 1999 tax returns on the IRS' Individual Returns Transaction File claiming the Disabled Access Credit but with no Schedule C or E. However, when verifying the information extracted from the IRS' file and performing other research, we found 6 instances where IRS employees had incorrectly input information from the tax returns or taxpayers had made an entry on the wrong line of the tax return. We reduced our reported figures based on these six cases. There may be other IRS or taxpayer errors that we did not discover.

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans**

- Orphan Drug Credit (b)(3):26 U.S.C. 6103,(b)(7)(C)
- Credit for Contributions to Selected Community Development Corporations (8)
- Trans-Alaska Pipeline Liability Fund Credit (35)
- Credits From an Electing Large Partnership (110)

4. Created computer files that included the IRS' records that claimed the business incentive credits and met our criteria. We performed validity tests of the data received to ensure that the computer runs accurately identified appropriate returns. This included reviewing samples and matching the data to the original IRS files as well as to actual tax returns. We also performed tests to ensure that records identified by the computer runs included nationwide data and to ensure the information was for the correct time period. In addition, we perfected the data by removing duplicate records and any other records that did not meet the criteria.

B. Sampled a portion of the returns identified, reviewed the returns, and determined whether the taxpayers qualified for the credit(s) claimed. We also determined whether erroneous credits claimed were properly denied.

1. Using the data obtained from the first computer run (used to review the Low-Income Housing Credit), computer analyzed the file and identified 20,215 records receiving refunds and claiming greater than \$500 in business incentive credits.
2. Randomly sampled 100 records using the Microsoft Excel "randbetween" command. This feature generates a series of random numbers that were used to select the corresponding records within the file. We ordered and received 99 of the actual tax returns (b)(3):26 U.S.C. 6103,(b)(7)(C) was not available) and reviewed them to determine the types of credits claimed, whether the taxpayers qualified for the credit, and if the IRS denied the credit if erroneously claimed. This also included performing research on each type of credit claimed. Extensive research was conducted on the 92 returns claiming the Low-Income Housing Credit.

(b)(3):26 U.S.C. 6103,(b)(7)(C)

3. Using the data from the second computer run that were sorted into 13 separate databases by business incentive credit, we computer analyzed each database to include only those records that claimed greater than \$500 in business credits. We randomly sampled from each database using the Microsoft Excel random number generator and ordered a total of 180 records claiming the following credits (specific number in parenthesis).

- Investment Credit (30)
- Work Opportunity Credit (20)

## Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

- Credit for Increasing Research Activities (20)
- Enhanced Oil Recovery Credit (10)
- Disabled Access Credit (50)
- Indian Employment Credit (10)
- Credit for Social Security and Medicare Taxes Paid on Certain Employee Tips (10)
- Trans-Alaska Pipeline Liability Fund Credit (10)
- Credits from an Electing Large Partnership (20)

Some databases did not include a significant number of records and were therefore not sampled or reviewed. This included the databases with the Credit for Alcohol Used as a Fuel (7), Renewable Electricity Production Credit (13), Orphan Drug Credit [REDACTED] and Credit for Contributions to Selected Community Development Corporations (8).

(b)(3):26 U.S.C. 6103,(b)(7)(C)

4. The records sampled for each type of credit were evaluated to determine whether there was support for the credit and whether there appeared to be an appropriate business purpose for taking the credit. This included reviewing criteria for each credit and reviewing the taxpayers' returns and attached forms and schedules. Besides the criteria already mentioned, we looked for *Profit or Loss From Farming* (Schedule F) and researched the tax return to determine if the business incentive credit claimed resulted from the taxpayer's involvement with a partnership. Errors made by IRS personnel when entering data from tax returns to IRS' computer system caused most of the business incentive credit data in our samples to be unreliable. As a result, we could comment only on the Disabled Access Credit, the Low-Income Housing Credit, and the Investment Credit. The errors are discussed in more detail in Appendix VI.
5. Compiled additional information from these returns to help determine if any of the claims were fraudulent. This included return preparer information, taxpayer's occupation, location of filer, adjusted gross income amount, business incentive credit amount(s), total tax, withholding, refund amount or amount owed, and other credit supporting schedules such as Schedule F.
6. Searched for patterns and/or indicators of fraud on both the databases containing the records and the actual returns reviewed. We reviewed for common amounts claimed, common preparers, common locales, etc.



**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

---

**Appendix II**

**Major Contributors to This Report**

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

Richard J. Dagliolo, Director

Kyle R. Andersen, Audit Manager

Bill R. Russell, Senior Auditor

Roy E. Thompson, Senior Auditor

Annette B. Hodson, Auditor

Layne D. Powell, Computer Specialist

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

---

**Appendix III**

**Report Distribution List**

Deputy Commissioner N:DC  
Chief, Criminal Investigation CI  
Commissioner, Small Business/Self-Employed Division S  
Commissioner, Wage and Investment Division W  
Director, Compliance, Small Business/Self-Employed Division S:C  
Director, Compliance, Wage and Investment Division W:CP  
Director, Refund Crimes CI:RC  
Director, Strategy and Finance, Wage and Investment Division W:S  
Director, Strategy, Research and Performance Management, Small Business/Self-Employed  
Division S:SR  
Deputy Chief Financial Officer, Department of the Treasury

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

---

**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 the Congress.

Type and Value of Outcome Measure:

- Increased Revenue/Revenue Protection – Potential; \$2.18 million affecting 782 taxpayer accounts (see page 3).

Methodology Used to Measure the Reported Benefit:

Using a computer program, we identified all Tax Year (TY) 1999 *U.S. Individual Income Tax Returns* (Form 1040) on the Internal Revenue Service's (IRS) Individual Returns Transaction File<sup>1</sup> claiming business incentive credits greater than \$500 without an accompanying *Profit or Loss From Business* (Schedule C) or *Supplemental Income and Loss* (Schedule E). Our program identified 397 returns claiming the Disabled Access Credit. However, when verifying the information extracted from the IRS' file, we found 6 instances where IRS employees had incorrectly entered information from the tax returns or taxpayers had made an entry on the wrong line of the tax return. We reduced our reported figures based on these 6 cases to 391 returns receiving Disabled Access Credits totaling over \$1.09 million. There may be other IRS or taxpayer errors among these 391 tax returns that we did not discover. All our figures are based on the best information the IRS had available. Based on the evidence in the article in *USA Today*, we concluded that the number of taxpayers claiming the credit in TY 2000 at least remained the same as in TY 1999 (and probably increased). Therefore, to account for both tax years, we doubled the number of taxpayers and the amount of credit when valuing the outcome.

---

<sup>1</sup> The IRS' Individual Returns Transaction File contains information from tax returns filed for the current and 2 previous years.

Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

Appendix V

Memorandum Issued to Director, Refund Crimes (Criminal Investigation)



INSPECTOR GENERAL for TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY WASHINGTON, D.C. 20220

March 16, 2001

MEMORANDUM FOR DIRECTOR, REFUND CRIMES (CRIMINAL INVESTIGATION)

*Gordon C. Millbauer*

FROM: Associate Inspector General for Audit (Small Business and Corporate Programs)

SUBJECT: Referral of Potential Refund Scheme or Tax Fraud Cases involving the Disabled Access Credit

As part of an ongoing audit, the Treasury Inspector General for Tax Administration (TIGTA) identified taxpayers filing 1999 Individual Income Tax Returns claiming general business credits despite showing no eligible business. The purpose of this memorandum is to inform you of two potential schemes we identified involving taxpayers who significantly decreased or eliminated their tax liabilities by improperly claiming the disabled access credit. The majority of the taxpayers involved received refunds. We have been informed that investigators from the Federal Bureau of Investigation (FBI) have interest in the details of both these schemes because they are investigating individuals who they believe are promoting the schemes.

You do not need to respond to this memorandum. Some of the information included in this memorandum will be included in our draft report to be issued soon, and we will ask for a formal response at that time.

Disabled Access Credits for Investments in Pay Phones

We identified 26 taxpayers from Arizona and Nevada whose tax returns showed no eligible business, yet who claimed the disabled access credit (a general business credit). We reviewed data from these taxpayers' 1999 individual income tax accounts and identified the following trends.

- 7 of the 26 taxpayers' returns were prepared by the same tax preparer. Attached to each of these tax returns was a confirmation letter from [redacted] indicating the taxpayer had purchased pay telephones. The per unit cost of these telephones was \$5,000. The letter attached to [redacted] of the returns stated that the telephones qualified under the 1990 Americans with Disabilities Act, as amended.

(b)(3);26 U.S.C. 6103,(b)(7)(C)

Official Use Only

(b)(3);26 U.S.C. 6103

### Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

2

- 23 of the 26 taxpayers claimed disabled access expenditures in increments of \$5,000. This is significant since the pay phone promoter charges \$5,000 per phone.
- 18 of the 26 taxpayers claimed disabled access credits of \$4,875.
- 14 of the 26 taxpayers received refunds averaging \$3,165. The other taxpayers elected to apply any overpayments to their succeeding tax year's liability, still owed taxes after taking the disabled access credit, or broke even after taking the credit.

We obtained the tax returns for 20 of these taxpayers and found that 17 were retired.

We discussed this information with (b)(7)(C) a Special Agent from the Internal Revenue Service's (IRS) Criminal Investigation Division in Yuma, Arizona. He indicated

(b)(3), 26 U.S.C. 6103, (b)(7)(C)

(b)(7)(C) Special Agent (b)(3), 26 U.S.C. 6103, (b)(7)(C)

#### Disabled Access Credits for Investments in Automated Teller Machines

We identified another 18 tax returns showing no eligible business but claiming the disabled access credit with the following characteristics:

- All 18 were prepared for taxpayers with Asian surnames.
- All 18 returns claimed the maximum disabled access credit of \$5,000. We reviewed 8 of the 18 tax returns and found that taxpayers claimed disabled access credit expenditures of \$12,500 on all 8 returns.
- 10 of the 18 returns were for taxpayers from Illinois.
- 15 of the 18 returns were prepared by the same tax preparer in Schaumburg, Illinois. This included returns for taxpayers living in Brooklyn, NY; Durham, NC; Bryan, TX; Lafayette, CO; and Edison, NJ.
- 16 of the 18 returns resulted in refunds for the taxpayers involved averaging \$3,212.
- We obtained the tax returns for 8 of the 18 taxpayers and found the forms used to claim the disabled access credit (Form 8826) were identical on each return with the

Official Use Only

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

3

exception of the name and social security number entered on the form. This may not seem unusual with the return preparation software now available; however, in each case, the font on the Form 8826 did not match the rest of the prepared return.

(b)(3), 26 U.S.C. 6103, (b)(7)(C)

We were informed that the FBI in Indiana is investigating a case with similar characteristics. (b)(7)(C)

(b)(7)(C)

At their request, we have provided information regarding specific taxpayers involved in these schemes to the IRS' Examination functions in Portland, OR, and Chicago, IL. Because of disclosure provisions in Section 6103 of the Internal Revenue Code,<sup>1</sup> we were unable to provide the FBI with any information regarding the taxpayers or tax returns identified during our review. However, we are forwarding this information to you for whatever legal or enforcement action you deem necessary. Attachments I and II contain specific tax information from the tax returns involved in the two potential schemes discussed in this memorandum.

Articles in the *USA Today* on February 28 and March 14, 2001 point out that older Americans are being targeted for fraudulent investments in pay phones and automated teller machines. The promoters of these schemes are being investigated by various state and federal agencies.

We are also providing you a computer database containing information from all the tax returns we identified showing no eligible business but claiming the disabled access credit. This database contains close to 400 tax returns. While we have not identified characteristics linking all of these returns to the schemes discussed in this memorandum, each of these returns is suspect because of the inconsistency of claiming a business credit with no eligible business.

If you would like to discuss this information or need additional information, please contact Richard Dagnolo, Director, at (631) 654-6028, or Kyle Andersen, Audit Manager, at (801) 620-6547.

<sup>1</sup> I.R.C. §6103 (2000)

Official Use Only

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

---

**Appendix VI**

**Unreliable Data in Samples of Other Business Incentive Credits**

Internal Revenue Service (IRS) personnel made a significant number of errors when entering some business incentive credits from tax returns to IRS computers. We reviewed 90 tax returns reporting the following business incentive credits:


- Work Opportunity Credit
- Indian Employment Credit
- Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips
- Enhanced Oil Recovery Credit
- Credits from Electing Large Partnerships
- Trans-Alaska Pipeline Liability Fund Credit
- Credit for Increasing Research Activities

On over half of the tax returns (48 of 90), taxpayers had not claimed the credit input into the IRS' computer. In each case, an IRS employee had input the amount of one credit into the field meant for data from another credit. As a result, the IRS' computerized data included in our samples for these credits were unreliable.

Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses That Provide Access for Disabled Americans

Appendix VII

Management's Response to the Draft Report



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

COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

SEP - 6 2001

RECEIVED  
SEP 06 2001

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Joseph G. Kehoe  
Commissioner, Small Business/Self Employed Division

SUBJECT: Draft Letter Report – Some Individual Taxpayers Are Inappropriately Receiving Tax Credits Intended for Businesses that Provide Access for Disabled Americans (200030016)

Thank you for the opportunity to respond to your draft audit report that focuses on taxpayers receiving inappropriate tax credits intended for businesses that provide access for disabled Americans. We agree with your overall findings that some individual taxpayers are inappropriately receiving the credits.

As stated in your report, the IRS is aware of the potentially abusive scheme and has been addressing it through our established IRC 6700 investigation program. This program focuses at the promoter level, rather than on the investors. [REDACTED]

[REDACTED] We will continue focusing on this area to develop leads for additional promoters.

Our comments on the recommendations in this report are as follows:

**IDENTITY OF RECOMMENDATION 1:** The IRS' Criminal Investigation function should issue a press release or provide information on its web site targeted at taxpayers who may be victims of those individuals promoting investments in pay phones and automated teller machines as qualifying for the Disabled Access Credit.

**ASSESSMENT OF CAUSE:** We allowed many taxpayers Disabled Access Credits even though their tax returns showed no business reasons for taking the credits.

(b)(3); 26 U.S.C. 6103, (b)(7)(C)



TDP 15-71

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

---

TDP 15-71

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

**CORRECTIVE ACTION:** The Director, Partnership Outreach, SB/SE Taxpayer Education and Communication will add information to the Small Business/Self-Employed Community Website to alert taxpayers regarding fraudulently promoting investments in pay phones and automated teller machines as qualifying for the Disabled Access Credit.

Note: TIGTA agreed during our closing conference on 8/14/01, to transfer ownership of Recommendation 1 to the Director of Partnership Outreach, SB/SE Taxpayer Education and Communication.

**IMPLEMENTATION DATE:** Completed by 12/31/2001

**RESPONSIBLE OFFICIALS:** Commissioner, SB/SE

**CORRECTIVE ACTION MONITORING PLAN:** The appropriate staff will advise the Commissioner, SB/SE of any delay, change, or problem with the implementation.

**IDENTITY OF RECOMMENDATION 2:** The Director, Strategy and Finance (Wage and Investment Division) and the Director, Strategy, Research and Performance Management (Small Business/Self-Employed Division) should analyze the results of our computer program; perform similar analyses of TY2000 returns; and develop, in conjunction with their Compliance functions and the Criminal Investigation function, an enforcement approach to this issue.

**ASSESSMENT OF CAUSE:** We issued refunds or allowed taxpayers to apply overpayments to subsequent years' taxes in a number of cases.

**CORRECTIVE ACTION:** when we have the FY 2000 return data, Strategy, Research and Performance Management, SB/SE will perform similar analyses to identify potentially unallowable credits. We will continue our investigation targeting the promoters and take appropriate compliance actions when we find abusive schemes.

Note: In Recommendation 2, TIGTA agreed during our closing conference on 8/14/01, to change the phrase "enforcement approach" to "compliance approach."

**IMPLEMENTATION DATE:** By 9/30/2002

**RESPONSIBLE OFFICIAL:** Commissioner, SB/SE

**CORRECTIVE ACTION MONITORING PLAN:** The appropriate staff will advise the Commissioner, SB/SE of any delay, change, or problem with the implementation.

**Some Individual Taxpayers Are Inappropriately Receiving Tax Credits  
Intended for Businesses That Provide Access for Disabled Americans**

Please call Martha Sullivan, Deputy Director, Compliance Policy, Small  
Business/Self Employed, at (202) 283-2144, if you have any questions.