



RECOVERY ACT

Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit

June 17, 2010

Reference Number: 2010-41-069

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:

1 = Tax Return/Return Information



HIGHLIGHTS



ADDITIONAL STEPS ARE NEEDED TO PREVENT AND RECOVER ERRONEOUS CLAIMS FOR THE FIRST-TIME HOMEBUYER CREDIT

Highlights

Interim Report issued on June 17, 2010

Highlights of Reference Number: 2010-41-069 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Homebuyers who purchased a home in 2008, 2009, or 2010 may be able to take advantage of the First-Time Homebuyer Credit. The Credit may be an interest-free loan or a fully refundable Credit depending on when the taxpayer purchased his or her home.

Fraudulent and erroneous Credits totaling millions of dollars in refunds were issued, which increases an already burgeoning Federal deficit.

WHY TIGTA DID THE AUDIT

The First-Time Homebuyer Credit as expressed in the Housing and Economic Recovery Act of 2008 has been revised and extended by two subsequent bills. Taxpayers may be confused regarding which version of the Credit they qualify for, and unscrupulous individuals may make fraudulent claims for the refundable Credit.

The President of the United States has called on Federal agencies to ensure that recovery funds are used for authorized purposes and that every step is taken to prevent fraud, waste, error, and abuse. The Internal Revenue Service (IRS) faces significant challenges to ensure that the recovery funds it administers are used for authorized purposes. This report contains interim results of two audits. The overall objectives of these two audits are to determine whether the IRS has controls in place that effectively identify erroneous claims for the Credit and to determine whether the IRS has controls in place to ensure claims for the Credit claimed on amended income tax returns are appropriately processed.

WHAT TIGTA FOUND

The IRS has taken a number of positive steps to strengthen controls and help prevent inappropriate Credits from being issued. Primary among these controls was the implementation of filters to identify questionable claims for the Credit before they are processed.

However, additional controls are necessary to address erroneous claims for the Credit. Further, fraudulent and questionable claims processed prior to implementation of controls will need followup action by the IRS.

Control weaknesses allowed fraudulent claims filed by prison inmates totaling an estimated \$9.1 million to be processed. Multiple claims for the same home were allowed. In addition, claims totaling an estimated \$17.6 million were allowed for homes purchased prior to the dates allowed by the law.

Many questionable claims for the Credit made on amended tax returns were not appropriately sent to the IRS' Examination function for scrutiny.

Further, TIGTA found additional IRS employees that had made questionable claims for the Credit.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS ensure that steps are taken to reconcile Prisoner Files from year to year. The IRS should also ensure that erroneous Credits received by prisoners and by taxpayers claiming homes that do not qualify for the Credit (including those filed on amended returns) are identified and recovered through post-refund examination activities.

IRS management agreed with all of the recommendations. Management plans to continue to explore ways to enhance the accuracy and completeness of the Prisoner File and plans to take steps to ensure that the claims made by prisoners are given high priority and are subject to post-refund examinations. In addition, the IRS plans to provide additional compliance scrutiny to all other inappropriate claims.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 17, 2010

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Interim Audit Report – Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit (Audit # 201040138)

This report presents additional interim results of our review to determine whether the Internal Revenue Service (IRS) has controls in place that effectively identify erroneous claims for the First-Time Homebuyer Credit. This report also includes results of our review to determine whether the IRS has controls in place to ensure claims for the First-Time Homebuyer Credit claimed on amended income tax returns are appropriately processed. Our final reports will be issued in the fourth quarter of Calendar Year 2010 and will include updated results. The audits address the IRS major management challenges of Implementing Tax Law Changes and Erroneous and Improper Payments and Credits and present selected information related to the IRS implementation of Section 1006 of the American Recovery and Reinvestment Act of 2009 (Recovery Act).¹

The Recovery Act provides separate funding to the Treasury Inspector General for Tax Administration through September 30, 2013, to be used in oversight activities of IRS programs. These audits are being conducted using Recovery Act funds.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendations. 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.

¹ Pub. L. No. 111-5, 123 Stat. 115.



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Abbreviations

HERA	Housing and Economic Recovery Act of 2008
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration
WHBAA	Worker, Homeownership, and Business Assistance Act of 2009



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



Background

Section 1006 of the American Recovery and Reinvestment Act of 2009 (Recovery Act)¹ revised and extended the First-Time Homebuyer Credit (Homebuyer Credit) provided for in the Housing and Economic Recovery Act of 2008 (HERA).²

The HERA allowed taxpayers who purchased a principal residence after April 8, 2008, and before July 1, 2009, to claim a credit equal to 10 percent of the purchase price of the home, limited to \$7,500. The Homebuyer Credit, as expressed in this Act, served as an interest-free loan to be paid back over a 15-year period beginning two years after the Credit was claimed.



Section 1006 of the Recovery Act extended the Homebuyer Credit to include purchases made on or after January 1, 2009, and before December 1, 2009, increased the maximum Credit to \$8,000, and eliminated the repayment requirements as long as the taxpayer retains the residence for 36 months.

Taxpayers qualifying for the revised Homebuyer Credit may claim the \$8,000 Credit on their individual income tax returns for Tax Year 2008 or 2009. Taxpayers may be confused regarding which version of the Credit they qualify for, and unscrupulous individuals may make fraudulent claims for the refundable Credit.

The Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA),³ signed into law on November 6, 2009, extended and expanded the Homebuyer Credit allowed by the previous Acts.⁴ The WHBAA also added documentation requirements for claiming the Credit. The Treasury Inspector General for Tax Administration (TIGTA) reviewed the Internal Revenue Service's (IRS) implementation of the WHBAA as part of our annual audit of the IRS' filing season.

¹ Pub. L. No. 111-5, 123 Stat. 115.

² Pub. L. No. 110-289.

³ Pub. L. No. 111-92, 123 Stat 2984 (2009).

⁴ Under the new law, an eligible taxpayer must buy, or enter into a binding contract to buy, a principal residence on or before April 30, 2010, and close on the home by June 30, 2010. The law maintained that the taxpayer would not be required to repay the Credit and kept the maximum amount at \$8,000. For qualifying purchases in 2010, taxpayers have the option of claiming the Credit on either their 2009 or 2010 tax returns.



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



As discussed in our prior interim report,⁵ the focus of this audit is the IRS' efforts to identify erroneous Homebuyer Credits claimed on original 2008 U.S. Individual Income Tax Returns (Form 1040). However, this interim report also addresses issues we have identified in a separate audit (Audit #201040140) regarding claims for the Credit filed on Amended U.S. Individual Income Tax Returns (Forms 1040X).

The President of the United States has stated that every taxpayer dollar spent on the economic recovery must be subject to unprecedented levels of transparency and accountability. The President has called on Federal agencies to ensure that recovery funds are used for authorized purposes and every step is taken to prevent instances of fraud, waste, error, and abuse.

This interim audit report discusses additional controls necessary to address erroneous claims for the Homebuyer Credit. It also discusses fraudulent and questionable claims for the Credit processed prior to implementation of these controls that will need followup action by the IRS.

Congress estimated that \$13.6 billion would be paid to taxpayers for the Homebuyer Credit in the HERA. The Joint Committee on Taxation estimated that more than \$4.3 billion more would be paid to first-time homebuyers in Fiscal Years 2009 and 2010 as a result of the Recovery Act. As of December 31, 2009, more than 1.2 million original tax returns claiming the Homebuyer Credit had been processed.

In a prior interim report, we discussed a number of key controls that were missing to prevent individuals from erroneously claiming the Homebuyer Credit. The IRS has taken a number of positive steps to strengthen controls and help prevent inappropriate Credits from being issued. Primary among these controls was the implementation of filters to identify questionable claims for the Homebuyer Credit before they are processed. These filters were implemented in May 2009. Other steps taken by the IRS include the following:

- Require documentation to support the purchase of a house when a Credit is claimed.
- Enter data from First-Time Homebuyer Credit and Repayment of the Credit (Form 5405) into IRS computers.
- Implement additional age filters to identify returns filed by taxpayers under the age of 18 claiming the Credit.
- Initiate actions to follow up with taxpayers who claimed and received Credits for homes to be purchased in the future.

⁵ *The Internal Revenue Service Faces Significant Challenges in Verifying Eligibility for the First-Time Homebuyer Credit* (Reference Number 2009-41-144, dated September 29, 2009).



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



- Initiate actions to recover Credits, when appropriate, from taxpayers who had indications of prior home ownership but received the Credit before the IRS implemented filters to identify questionable claims.
- Develop criteria to identify amended returns with claims for the Credit for review by the Examination function.
- Send notices to taxpayers who purchased homes in Calendar Year 2009 and claimed a Credit of \$7,500, if those taxpayers have not amended their returns, to inform the taxpayers that they may be entitled to an additional refund.
- Revise instructions for Forms 1040 and 1040X and *Your Federal Income Tax For Individuals* (Publication 17) to include information to assist taxpayers in amending their returns if they did not claim the full amount of the Credit to which they were entitled.

This interim audit report discusses additional controls necessary to address erroneous claims for the Homebuyer Credit. It also discusses fraudulent and questionable claims for the Credit processed prior to implementation of these controls that will need followup action by the IRS. The report covers audit work completed as of March 31, 2010. Additional audit work is ongoing and will be reported in our final audit report. Our final report on this subject will be issued in the fourth quarter of Calendar Year 2010 and will include updated results.

This review is being performed onsite at the IRS Ogden, Utah, Campus.⁶ It includes a review of individual income tax returns filed nationwide as well as analysis of data provided by the IRS Wage and Investment Division Headquarters in Atlanta, Georgia; the Submission Processing function offices in Lanham, Maryland, and Cincinnati, Ohio; and the Submission Processing Sites in Fresno, California; Austin, Texas; and Ogden, Utah. We will provide more detailed objectives and scope in our final report.

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁶ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



Results of Review

Some Fraudulent Claims for the Homebuyer Credit Filed by Prison Inmates Were Not Stopped

Congress has held hearings urging the IRS to devote additional resources to improve its detection of fraudulent refunds, particularly those claimed by prisoners. To improve the Federal Government's ability to identify prison fraud, the Inmate Tax Fraud Prevention Act of 2008⁷ was enacted which allows the Department of the Treasury to disclose certain prisoner return information to the Federal Bureau of Prisons and for other purposes. It also requires the Secretary of the Treasury to annually submit to Congress and make publicly available a report on the filing of false and fraudulent returns by individuals incarcerated in Federal and State prisons.

We identified 4,608 prisoners listed on the IRS 2009 Prisoner File who attempted to claim the Homebuyer Credit on their Tax Year 2008 returns.

In our analysis of First-Time Homebuyer Credits, we checked to determine whether any prisoners were improperly claiming the Credit. We identified 4,608 prisoners listed on the IRS 2009 Prisoner File⁸ who attempted to claim the Homebuyer Credit on their Tax Year 2008 returns, despite the fact that they were in prison at the time their qualifying home was reportedly purchased (951 of these claims were filed by paid preparers).

From the file of 4,608 prisoners claiming the Homebuyer Credit, we researched a judgmental sample of those that we considered to be the most egregious. These included 715 prisoners whose filing statuses were something other than joint (i.e., they were not filing with a spouse) and who were serving life sentences during the period their home would had to have been purchased (174 of these claims were filed by paid preparers).⁹ We found 241 of these prisoners received Homebuyer Credits totaling more than \$1.7 million.

⁷ Pub. L. No. 110-428, 122 Stat. 4839 (codified at 26 U.S.C. §§ 6103 and 7803 and 28 U.S.C. § 376 (2010)).

⁸ In general, this file contains individuals incarcerated in September 2009 or prior.

⁹ Forty-one of the 715 claims were incorrectly identified on IRS records as claims from prisoners and, in some cases, the refunds were delayed. The Social Security Numbers listed for these prisoners were inaccurate and actually belonged to other taxpayers that appear to have legitimate claims for the Homebuyer Credit.



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



A prior TIGTA report¹⁰ identified that prison facilities located in Florida were among the top prisons with fraudulent refund returns. In this review, we found that 61 percent of the prisoners serving life sentences who received the Credit were incarcerated in Florida.

To obtain an understanding of the population overall, we analyzed a statistically valid sample of 306 of the 4,608 claims¹¹ and found that 86 resulted in refunds that appeared to be fraudulent totaling more than \$600,000.¹² For 72 (84 percent) of these 86 claims, we found no indication of any IRS post-refund compliance activities to recover the refunds.

We estimate that at least 1,295 prisoners received fraudulent Homebuyer Credits from their 2008 tax returns totaling more than \$9.1 million.

The IRS implemented filters in May 2009 to identify questionable claims for the Credit. Among these was a filter to check against the 2008 Prisoner File.¹³ We found, in general, that this filter was programmed properly to stop claims for the Credit made by individuals who were identified on the Prisoner File. However, the Prisoner File used by the IRS (2008 Prisoner File) was missing some prisoner records. Only 39 of the 86 individuals receiving refunds from claims made from prison were shown as prisoners on the 2008 Prisoner File even though the 2009 Prisoner File showed all 86 individuals as in prison in Calendar Year 2008. The IRS did not stop 32 of these claims because they were processed prior to the implementation of the IRS' filters. Another three claims were processed after the filters were implemented, but they were not scrutinized by the IRS.

The IRS updates its Prisoner File data just once each year. The information for this file is provided by prisons on a voluntary basis. As detailed in a prior audit report,¹⁴ the IRS receives most of the data for the file in August and September. Prisoners incarcerated after the information is compiled are not included in the controls established by the IRS to identify fraudulent claims filed by prisoners in the succeeding filing season. For example, in this case, prisoners incarcerated after September 2008 would not have been on the 2008 Prisoner File, which was used in the IRS' filters to identify fraudulent claims for the Credit filed in Calendar Year 2009.

¹⁰ *The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners* (Reference Number 2005-10-164, dated September 28, 2005).

¹¹ Thirty-six of the 306 claims were incorrectly identified on IRS records as claims from prisoners and, in some cases, the refunds were delayed. The Social Security Numbers listed for these prisoners were inaccurate and actually belonged to other taxpayers that appear to have legitimate claims for the Homebuyer Credit.

¹² We considered a refund to be fraudulent if the individual used a filing status other than married filing jointly and was in prison at the time they would have purchased their home to qualify for the particular credit they claimed (HERA or Recovery Act).

¹³ In general, this file contains individuals incarcerated in September 2008 or prior.

¹⁴ *The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners* (Reference Number 2005-10-164, dated September 28, 2005).



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However, this was not the reason the IRS failed to stop most of the fraudulent refunds we identified. None of the 86 individuals receiving refunds from claims made from prison were first incarcerated after September 2008.

Figure 1 lists the incarceration dates of the 86 prisoners receiving refunds resulting from claims made for the Homebuyer Credit from prison.

Figure 1: Incarceration Dates for Prisoners Receiving Homebuyer Credits – From a Sample of 306 Homebuyer Credit Claims of Prisoners

Year Incarcerated	Number of Prisoners Receiving the Credit
2008 ¹⁵	12
2007	14
2006	5
2005	6
2004	8
2003	5
2002	6
2001	6
2000 and prior	24
Total	86¹⁶

Source: Statistical sample of 306 individuals listed on the IRS 2009 Prisoner File.

The information from the IRS Prisoner File is inconsistent from year to year. We found that 74 of the 86 individuals receiving fraudulent claims were first incarcerated in 2007 or earlier. Further, 38 of these 86 individuals were listed as prisoners on the IRS’ 2007 Prisoner File, but were not listed on the 2008 Prisoner File, then reappeared on the 2009 Prisoner File. Overall, of the 854,776 prisoners listed on the 2007 Prisoner File with incarceration dates extending beyond December 31, 2008, we found 84,305 of these prisoners were omitted from the 2008 Prisoner File. We selected a judgmental sample of 50 of these prisoners and researched them on prison inmate web sites¹⁷ to determine whether they were in prison during all of Calendar Year 2008.

¹⁵ The latest incarceration date for these 86 prisoners was September 12, 2008.

¹⁶ Sixty-nine of these 86 prisoners were also listed on the 2007 Prisoner File.

¹⁷ Prison Search-http://www.ancestorhunt.com/prison_search.htm; and Federal Bureau of Prisons-<http://www.bop.gov/iloc2/LocateInmate.jsp>.



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We found that 47 of the 50 were incarcerated through the entire year, *****1*****
*****1*****.

We believe the IRS' Prisoner Files are incomplete for two reasons. First, IRS officials told us the prisons' contributions to this file are voluntary and many prisons do not contribute data from year to year. Second, the IRS does not resolve issues regarding individuals known to be incarcerated in a given year (based on prior year information) but not included on the current year's Prisoner File. In other words, no action was taken to add a prisoner to the 2008 Prisoner File when the prisoner was omitted from that file but the 2007 Prisoner File showed that prisoner to be incarcerated in 2008 and beyond. Had the IRS appended its 2008 Prisoner File with individuals whose names were not on the file, but were shown on the 2007 Prisoner File to be incarcerated for all of 2008, it would have identified 38 (44 percent) of the 86 prisoners receiving refunds from fraudulent claims in our sample.¹⁸

Based on our statistical sample of 306 returns, we estimate that at least 1,295 prisoners received refunds totaling more than \$9.1 million for fraudulent Homebuyer Credits claimed on their 2008 tax returns.

Recommendations

Recommendation 1: The Director, Refund Crimes, Criminal Investigation Division, should ensure that steps are taken to reconcile Prisoner Files from year to year to account for individuals known to be incarcerated in a given year (based on prior year information) but not included on the current year's Prisoner File.

Management's Response: IRS management agreed to continue to explore further enhancements to the accuracy and completeness of the Prisoner File. However, the responsibility for the Prisoner File has been transitioned to the Wage and Investment Division.

Office of Audit Comment: While we agree that the IRS needs to continue to explore further enhancements that will improve the accuracy and completeness of the Prisoner File, the reconciliation of the Prisoner Files from year to year should be an essential part of that directive.

Recommendation 2: The Director, Reporting Compliance, Wage and Investment Division, should ensure that steps are taken to recover fraudulent Homebuyer Credits refunded to prisoners.

Management's Response: IRS management agreed with this recommendation. The Director, Reporting Compliance, Wage and Investment Division, will work with the

¹⁸ This assumes the IRS' filters would have been in place the entire processing year.



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



Director, Campus Reporting Compliance, Small Business and Self-Employed Division, and the Director, Research, Wage and Investment Division, to ensure that prisoners identified by the TIGTA as having received refunds due to inappropriate claims for the Homebuyer Credit will be subject to post-refund examination during Fiscal Years 2011 and 2012. These cases will be given high priority and may be referred for criminal investigation.

Multiple Claims Exceeding the Maximum Homebuyer Credit Were Paid for the Purchase of the Same Home

We identified a large number of taxpayers who claimed the Homebuyer Credit using an address for which other taxpayers also claimed the Credit. We determined 18,832 taxpayers filed claims for the Homebuyer Credit using a total of only 7,695 addresses. In order to be included in our population, the street addresses (including unit numbers if included) and the zip codes had to match exactly. In each instance, more than \$8,000 was being claimed for one address. The amount of these 18,832 claims totaled more than \$134 million (5,331 of the 18,832 claims were filed by 1,941 paid preparers).¹⁹ We analyzed a statistically valid sample of 377 of these claims and found 206 claims totaling more than \$1.4 million were refunded to the taxpayer with no IRS scrutiny.²⁰

We found instances in which large numbers of taxpayers used the address of one home to claim the Homebuyer Credit. We found as many as 67 taxpayers using the same home to claim the Credit.

Of the 7,695 addresses used to claim the Homebuyer Credit, we identified the five addresses used most often and researched the 256 taxpayers listing those addresses on their returns.²¹ None of the 256 claims have indications of being filed by a paid preparer. We identified 148 instances (58 percent) totaling almost \$1.2 million in which the Credit was allowed without any IRS scrutiny. Figure 2 contains a breakdown of what happened to the 256 claims during or after IRS processing. Even though the IRS examined some of the claims that appeared to be erroneous

¹⁹ We found 6,414 addresses used by 16,247 taxpayers where the combined claims totaled \$13,000 or more.

²⁰ We also found six claims underwent some IRS review prior to refunding but it does not appear the issue of multiple claims for the same home was addressed; 55 claims were initially refunded to the taxpayer but have indications of post-refund audits or other IRS scrutiny (most of these reviews appear related to the Homebuyer Credit but unrelated to the issue of multiple claims from the same address); 75 claims are undergoing pre-refund examinations (it appears most of these claims were selected for examination because they were caught by the IRS' filters to identify other questionable issues related to the Homebuyer Credit); and 35 claims were disallowed before refunding.

²¹ We performed research using Google Earth, Accurint, and realtor.com to ensure these claims were not from taxpayers purchasing condominiums or apartments but omitting their unit numbers.



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modified Homebuyer Credit regulations and extended the Credit to homes purchased, in general, before May 1, 2010.

To claim the Credit, eligible taxpayers must complete and file Form 5405. The IRS developed this new form for eligible taxpayers to calculate and claim the Homebuyer Credit. This form requires the taxpayer to provide the amount of Credit being claimed, the address of the home qualifying for the Credit, and the date the home was purchased. The General Instructions provided with the Form clearly indicate that taxpayers must purchase the home after April 8, 2008, to qualify for the Credit.

We estimate that 2,555 taxpayers inappropriately received Homebuyer Credits based on homes purchased prior to the dates allowed for in the law.

We identified 2,751 claims filed on Tax Year 2008 electronic tax returns totaling almost \$18.8 million that were based on homes reportedly purchased prior to April 9, 2008. The acquisition dates for most of the homes were early in 2008; however, 748 claims (27 percent) included acquisition dates in 2007 or prior. Figure 3 lists the purchase dates of these homes.

Figure 3: Purchase Dates of 2,751 Homes Inappropriately Used to Claim Homebuyer Credits

Year of Acquisition	Number of Claims
2008 ²²	2,003
2007	501
2006	107
2005	52
2004	40
2003	15
2002	10
2001	11
2000	12
Total	2,751

Source: IRS' Individual Master File²³ data.

From the 2,751 claims, we reviewed a statistically valid sample of 338 claims and found the following:

²² These homes were purchased in 2008, but prior to April 9.

²³ The IRS database that maintains transactions or records of individual tax accounts.



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- 314 claims (93 percent) totaling almost \$2.2 million were refunded to taxpayers without receiving either pre-refund or post-refund scrutiny.
- 17 claims (5 percent) were initially refunded to taxpayers but had indications of a post-refund exam or other IRS scrutiny ongoing as of March 30, 2010 (eight of these reviews appear to be related to the Homebuyer Credit).
- Six claims (2 percent) were initially refunded but the taxpayer voluntarily repaid the Credit in a subsequent amended return. No exam indicators exist for these claims.
- *****] *****

All 2,751 claims were processed prior to July 2009. For Tax Year 2009 returns processed in 2010, the IRS has initiated controls to identify and disallow such claims prior to them being refunded. However based on our sample, we estimate that for Tax Year 2008, approximately 2,555 taxpayers filing electronic returns inappropriately received Homebuyer Credits totaling \$17.6 million based on homes purchased prior to dates allowed by the law.

Recommendation

Recommendation 4: The Director, Reporting Compliance, Wage and Investment Division, should identify those claims for homes purchased prior to the effective date of the legislation and initiate post-refund examinations (including the use of soft notices) to ensure refunds for the invalid claims are recovered. The TIGTA has the list of taxpayers described above and will make it available to IRS functions upon request.

Management’s Response: IRS management agreed with this recommendation. The Director, Research, Wage and Investment Division, will conduct additional analyses of Homebuyer Credit claims to identify home purchase dates before the appropriate enactment dates. The Director, Accounts Management, Wage and Investment Division, will send letters to the impacted taxpayers. Depending upon the responses from taxpayers, the Credits will be reversed, or the accounts will be adjusted to reflect the correct information supplied by the taxpayers.

Many Questionable Claims for the First-Time Homebuyer Credit Made on Amended Tax Returns Were Not Appropriately Sent to the Examination Function for Scrutiny

In a separate audit (Audit #201040140), we analyzed claims for the Homebuyer Credit made on amended returns to determine whether controls were in place to ensure questionable claims were receiving appropriate scrutiny from the IRS’ Examination function. For qualifying homes



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purchased in 2008 or 2009, the Homebuyer Credit could be claimed on an original filed Tax Year 2008 or 2009 return or by amending the 2008 tax return using Form 1040X. Amending the 2008 tax return allows taxpayers to claim the Homebuyer Credit for a home purchased in 2009 without waiting to claim it on their 2009 return.

The IRS developed specific criteria to identify questionable claims for Homebuyer Credits on amended returns and implemented controls to apply these criteria during processing of the amended returns. The IRS reported that the controls were implemented on June 10, 2009. The controls were designed, in part, to identify taxpayers that had indications of home ownership within the last three years and route these returns to the Examination function for further scrutiny.

We determined that not all amended claims for the Homebuyer Credit are receiving appropriate scrutiny even though they meet IRS examination criteria. We selected a statistically valid sample of 379 Forms 1040X (206 processed before the IRS' criteria were implemented, and 173 processed after the criteria were implemented). Of the 173 amended returns processed after the implementation of the criteria, we found 50 with indications of prior home ownership within the last three years (which should have met the criteria for further scrutiny). However, 25 (50 percent) of these 50 were not identified as questionable and/or not referred to the Examination function. The average claim for the Homebuyer Credit on these 25 returns was \$7,126.

Based on our sample, we estimate that a total of 1,713 amended returns processed after June 10, 2009, met examination criteria but were not appropriately evaluated by the Examination function. We are working with the IRS to determine why these cases were missed and to develop appropriate recommendations.

We also reviewed the 206 amended returns processed prior to the implementation of the criteria and found that none of the 64 cases that would have met Examination criteria, based on prior home ownership, had been examined. The average claim totaled \$7,225. Based on our sample, we estimate that an additional 4,385 amended claims received by the IRS prior to the implementation of the criteria had indications of prior home ownership but were never examined. The IRS agreed to include all of the claims with indications of prior home ownership processed before implementation of its criteria in its post-refund examination program.

Internal Revenue Service Employees Made Questionable Claims for the Homebuyer Credit

To qualify as a first-time homebuyer, a taxpayer (or a taxpayer's spouse) may not have previously owned a principal residence for three years prior to the purchase date of the home for which the Homebuyer Credit is claimed.



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



We developed computer programs to identify IRS employees claiming this Credit who potentially do not qualify as first-time homebuyers. Our determination was based on whether the employees had entered information on their individual income tax returns for one of the prior three years indicating that they may have owned a home. These entries included deductions for home mortgage interest, real estate taxes, deductible points, and qualified mortgage insurance premiums. We also considered whether they had claimed a portion of the Residential Energy Credit. In August 2009, we referred to the TIGTA Office of Investigations 53 IRS employees who claimed the Credit despite indications that they owned a home within the last three years. While the entries we focused on do indicate home ownership, the homes involved may or may not have been the employee's principle residence, so the deductions do not automatically disqualify these employees from receiving the Credit. The Office of Investigations continues to investigate these cases.

We have identified another 34 IRS employees that claimed the Homebuyer Credit despite indications that they owned a home within the past three years. We referred them to the TIGTA Office of Investigations in February 2010.

Provisions for the Homebuyer Credit were included in the HERA, the Recovery Act, and most recently, the WHBAA. The cases detailed in this referral include those claims made only under the first two Acts. However, because the WHBAA extends the eligibility period for the Credit into 2010, there may be additional cases.



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of the audits addressed in this interim report are to determine whether the IRS has controls in place that effectively identify erroneous claims for the Homebuyer Credit and to determine whether the IRS has controls in place to ensure claims for the Homebuyer Credit claimed on amended income tax returns are appropriately processed. To accomplish our objectives, we:

- I. Identified prisoners who have made claims for the Homebuyer Credit and determined whether they received the refund and determined whether they received appropriate scrutiny from the IRS.
 - A. Developed computer programs to match prisoners listed on the IRS' 2009 Prisoner File with taxpayers on the Data Center Warehouse¹ claiming the Homebuyer Credit that met our criteria (incarcerated before April 9, 2008, and released after January 1, 2010. We also included prisoners if they claimed more than \$7,500 and began their incarceration between April 8, 2008, and January 1, 2009).
 - B. From the population of 4,608 prisoners identified in Step I. A. claiming the Credit, evaluated a statistical sample² of 306 to determine if any of the claims were refunded or had received scrutiny from either the IRS' Examination function or Criminal Investigation Division. We assessed the reliability of the data by comparing 30 records with the Federal Bureau of Prisons web site and the Prison Inmate Search web site.
 - C. Researched a judgmental sample³ of 715 prisoners that we considered to be the most egregious and determined whether the claims were refunded and whether they had received scrutiny from either the Examination function or Criminal Investigation Division.

¹ A collection of IRS databases containing various types of taxpayer account information that is maintained by the TIGTA for the purpose of analyzing data for ongoing audits.

² The statistical sample size was selected by using a five percent precision, 30 percent expected error rate, and a 95 percent confidence level.

³ We selected the 715 cases using a nonstatistical sample including all prisoners whose filing status was something other than joint and who were serving life sentences during the period their home would had to have been purchased. We used a judgmental sample because we did not intend to project the results of this sample to the entire population.



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



- D. Identified preparers who appear to be routinely filing returns for prisoners claiming the Homebuyer Credit.
- E. Determined if prisoners receiving the Homebuyer Credit appeared on the IRS' 2007 Prisoner File and/or the IRS' 2008 Prisoner File.
- II. Identified and reviewed claims originating from the same address for more than the maximum amount allowed.
 - A. Combined information from the Data Center Warehouse and files received from TIGTA Information Services employees to identify 18,832 taxpayers who claimed the Homebuyer Credit on the same address where the total amount of the claim was more than \$8,000 per address. We identified valid taxpayers filing electronically who claimed the Credit on their original 2008 tax return during the 2009 Processing Year as of December 31, 2009.
 - B. Validated and assessed the reliability and completeness of the computer data by comparing 30 records to IRS Master File⁴ data.
 - C. Selected and reviewed a statistically valid sample⁵ of 377 claims to determine whether the claims had received scrutiny from either the IRS' Criminal Investigation Division or Examination function.
 - D. Selected and reviewed an additional judgmental sample⁶ of 256 claims to determine whether the claims had received scrutiny from either the IRS' Criminal Investigation Division or Examination function.
 - E. Added information from the Data Center Warehouse preparer files to the 18,832 taxpayer records to determine if preparers appeared to be filing claims for the same address.
 - F. Conducted research through third-party sources to verify the top five addresses were not multi-family dwellings or apartment complexes that may have been legitimately claimed by multiple taxpayers.
- III. Identified and reviewed claims with acquisition dates prior to the effective date of the HERA.⁷

⁴ The IRS database that maintains transactions or records of individual tax accounts.

⁵ The statistical sample size was selected by using a 95 percent confidence level, a five percent precision, and a 50 percent expected error rate.

⁶ We selected a nonstatistical sample by identifying the top five addresses most used and researched all the taxpayers listing those addresses as their home. We used a judgmental sample because we did not intend to project the results of this sample to the entire population.

⁷ Pub. L. No. 110-289.



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- A. Computer identified 2,751 claims from the IRS' Individual Return Transaction File⁸ with an acquisition date prior to April 9, 2008, the effective date of the HERA legislation. We identified original electronic 2008 Forms 1040 processed during the 2009 Processing Year.
 - B. Assessed the validity and completeness of the computer data by comparing 35 records to IRS Master File information and third-party sources.
 - C. Selected and reviewed a statistically valid sample⁹ of 338 of the 2,751 claims to determine whether they received scrutiny from either the IRS' Criminal Investigation Division or Examination function.
- IV. Identified and evaluated controls over amended returns for identifying, stopping, and correcting erroneous claims of the Homebuyer Credit.
- A. Reviewed documented procedures (e.g., Internal Revenue Manual, desk procedures) to identify CAT-A criteria¹⁰ used by the IRS' "1040X" unit when processing amended returns.
 - B. Worked with TIGTA Information Services programmers to develop a computer program to identify taxpayers with returns on the Individual Return Transaction File indicating prior home ownership and claiming the Homebuyer Credit on their 2008 tax return during the 2009 Processing Year. The records were obtained from the IRS Master File. We validated the data received by comparing 30 records to IRS Master File data.
 - C. From a population of 25,970 claims, selected and reviewed a statistically valid sample¹¹ of 379 claims for indications that the return was identified for meeting CAT-A criteria and was forwarded to the Examination function for further scrutiny.
- V. Identified and reviewed 34 additional IRS employees that had indications of prior home ownership and claimed the Homebuyer Credit on their 2008 tax return. Our first interim report focused on IRS employees who were the primary taxpayers on the original tax return. In this interim report, we focused on IRS employees filing as secondary taxpayers on original returns and both primary and secondary filers on amended returns.

⁸ The IRS computer file containing individual tax return data.

⁹ The statistical sample size was selected by using a 95 percent confidence level, a five percent precision, and a 50 percent expected error rate.

¹⁰ CAT-A criteria identifies issues that require a referral to the Examination function classifiers prior to allowing a taxpayer's claim.

¹¹ The statistical sample size was selected by using a 95 percent confidence level, a five percent precision, and a 50 percent expected error rate.



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Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the IRS' policies, procedures, and practices related to the identification of erroneous claims for the First-Time Homebuyer Credit filed on both original and amended returns.



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Appendix II

Major Contributors to This Report

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First-Time Homebuyer Credit*



Appendix III

Report Distribution List

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Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



Appendix IV

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

RECEIVED
MAY 24 2010

BY: *MS*

MAY 24 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit (Audit # 201040138)

We have reviewed the draft audit report and appreciate the Treasury Inspector General for Tax Administration's (TIGTA) on-going independent review of the IRS administration of the First-Time Homebuyer Credit (FTHBC). The IRS has moved aggressively to implement this important program as intended by Congress and the Administration. The IRS has run a balanced program to meet the needs of compliant taxpayers trying to purchase a home during a severe housing market downturn, while at the same time detecting and minimizing errors and fraud.

The IRS has worked hard to ensure that the millions of taxpayers who are eligible for the FTHBC receive it. In fact, through February 2010, over 1.8 million taxpayers received over \$12.6 billion in FTHBC.

As your report notes, between August 2008 and November 2009, Congress passed three different versions of the credit, each of which required the IRS to develop new forms and guidance, re-program systems, and develop compliance filters. We appreciate that the report recognizes many of the steps we have taken to prevent inappropriate claims from being paid. Since your interim audit report, *The Internal Revenue Service Faces Significant Challenges in Verifying Eligibility for the First-Time Homebuyer Credit* (Audit Report # 2009-41-144), issued September 29, 2009, we have continued our aggressive approach to ensure compliance with this important program. The IRS is running a well-rounded compliance program that has helped protect the interest of the nation's taxpayers. This effort includes:

- identifying 98 potential criminal schemes, opening 155 open criminal investigations and recommending 7 prosecutions;



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



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- denying 285,504 claims that lacked adequate documentation during upfront return processing by exercising math error authority;
- freezing 112,852 refunds totaling over \$785 million pending civil examination; and
- proposing additional assessments and protecting revenue through denied claims totaling over \$438 million, as a result of 114,418 post-refund and amended return audits.

We have also developed a comprehensive Recapture and Repayment Strategy where we plan to use third party data to identify instances where taxpayers fail to self-identify. We will use this information to help identify dispositions that trigger a recapture. In addition, this data may also help us identify the proper year of the home purchase, which determines the taxpayer's obligation to pay back the credit.

In addition, we implemented an extensive outreach and education campaign to inform taxpayers and industry partners about eligibility requirements, as well as the consequences of filing erroneous FTHBC claims.

Given the complexity of tax administration and the time constraints the IRS is faced with in implementing legislation, it would be impossible for us to either stop or address every potentially erroneous claim. However, through activities outlined above, we believe we have substantially minimized the number of erroneous claims being paid out. Clearly, more can be done to ensure the accuracy and legitimacy of FTHBC claims – and we plan to continue our aggressive approach. We will continue to consider high risk claims that we were not able to address during our pre-refund compliance and enforcement activities in our pool of post-refund work selection.

Your report highlights some of the challenges that IRS faces in detecting situations where incarcerated individuals claim tax benefits to which they may not be entitled. The IRS has devoted substantial resources to working with state and federal prison systems to collect and maintain information on the prison population. These steps have significantly improved our compliance capabilities, and we remain focused on adapting our techniques to address this type of fraud.

However, without Congressional action to require state and federal prisons to report the status of inmates to the IRS, there will be gaps in the data and compliance problems will persist. The prison population changes frequently and it is simply not feasible for the IRS to maintain 100% accurate records based on information that is reported to us voluntarily by the various prison authorities.



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With regard to potential erroneous claims filed by IRS employees, all of our employees have the responsibility to uphold the tax law. We take this issue very seriously. We will continue to work closely with TIGTA on their investigative efforts to identify and address intentional employee non-compliance with the tax code, including the FTHBC.

Attached are our responses to your specific recommendations. If you have any questions, please contact me, or a member of your staff may contact Robin Canady, Director, Strategy and Finance, Wage and Investment Division, at (404) 338-8801.

Attachment



Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit



Attachment

RECOMMENDATION 1: The Director, Refund Crimes, Criminal Investigation Division, should ensure that steps are taken to reconcile Prisoner Files from year to year to account for individuals known to be incarcerated in a given year (based on prior year information) but not included on the current year's Prisoner File.

CORRECTIVE ACTION

The IRS agrees to continue to explore further enhancements to the accuracy and completeness of the prisoner file. As a result of the transition of revenue protection work to Wage and Investment (W&I) Division, responsibility for the prisoner file has been transitioned to W&I.

IMPLEMENTATION DATE

September 15, 2011

RESPONSIBLE OFFICIAL

Director, Earned Income Tax Credit, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2: The Director, Reporting Compliance, Wage and Investment Division, should ensure that steps are taken to recover fraudulent Homebuyer Credits refunded to prisoners.

CORRECTIVE ACTION

The IRS agrees with this recommendation. The Director, Reporting Compliance, W&I, will work with the Director, Campus Reporting Compliance, Small Business and Self-Employed Division, and the Director, Research, W&I Division, to ensure that prisoners identified by Treasury Inspector General for Tax Administration as having received refunds due to inappropriate claims for First-Time Homebuyer Credit (FTHBC) will be subject to post-refund examination during Fiscal Year (FY) 2011 and FY 2012. These cases will be given high priority and may be referred for criminal investigation.

IMPLEMENTATION DATE

September 15, 2011

RESPONSIBLE OFFICIAL

Director, Reporting Compliance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.



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RECOMMENDATION 3: The Director, Reporting Compliance, Wage and Investment Division, should perform a computer run similar to TIGTA's to identify multiple taxpayers claiming the same home for the Homebuyer Credit and perform post-refund examinations to ensure refunds for the invalid claims are recovered. The TIGTA has the listing of taxpayers described above and will make it available to IRS functions upon request.

CORRECTIVE ACTION

The IRS agrees with this recommendation and has identified this issue as an important element of the overall examination plan. The IRS will include these returns in the pool of potential post-refund audit work and will select cases for examination from this pool, in accordance with our overall post-refund Compliance plan.

IMPLEMENTATION DATE

September 15, 2011

RESPONSIBLE OFFICIAL

Director, Reporting Compliance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 4: The Director, Reporting Compliance, Wage and Investment Division, should identify those claims for homes purchased prior to the effective date of the legislation and initiate post-refund examinations (including the use of soft notices) to ensure refunds for the invalid claims are recovered. The TIGTA has the list of taxpayers described above and will make it available to IRS functions upon request.

CORRECTIVE ACTION

The IRS agrees with this recommendation. The Director, Research, W&I Division, will conduct additional analyses of FTHBC claims to identify home purchase dates before the appropriate enactment dates. The Director, Accounts Management, W&I Division, will send a correspondence letter to the impacted taxpayers. Dependent upon the response from the taxpayer, the credit will be reversed, or the account will be adjusted to reflect the correct information supplied by the taxpayer.

IMPLEMENTATION DATE

September 15, 2011

RESPONSIBLE OFFICIAL

Director, Accounts Management, Customer Account Services, Wage and Investment Division



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First-Time Homebuyer Credit*



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Corrective Action Plan

We will monitor this corrective action as part of our internal management control system.