

# **IRS OVERSIGHT BOARD PUBLIC MEETING**

“Panel 2: Working Together to Combat Fraud”



**Statement of  
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**May 1, 2013**

**Washington, D.C.**

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*before the*  
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Chairman Cherecwich and members of the Oversight Board, thank you for the invitation to discuss our work regarding refund fraud, identity theft, and return preparers.

In Fiscal Years (FY) 2011 and 2012, the Treasury Inspector General for Tax Administration, commonly referred to as TIGTA, has reported significant concerns with the growth in noncompliance and fraud in refundable tax credits and identified billions of dollars in improper payments. The Internal Revenue Service (IRS) administers numerous refundable tax credits, including the American Opportunity Tax Credit, the Additional Child Tax Credit, and the Earned Income Tax Credit (EITC).

In September 2011, TIGTA reported that the IRS may have erroneously allowed \$3.2 billion in American Opportunity Tax Credits from January 1, 2010 through March 28, 2010. Furthermore, in September 2012, we reported that the IRS had allowed more than \$159 million in these questionable Credits during the 2012 Filing Season for individuals who were of an age not likely to be pursuing a college or vocational degree. TIGTA also reported in September 2012 that the IRS refunded \$108 million in erroneous Additional Child Tax Credit claims during the period 2006 through 2009.

The EITC remains the largest refundable credit based on the total claims paid, and it continues to be vulnerable to incorrect or erroneous claims caused by taxpayer error or resulting from fraud. TIGTA has reported that the IRS does not have effective processes to ensure that claimants qualify for these credits prior to issuance of any fraudulent tax refunds. The IRS estimates that it has paid between \$110 billion and \$133 billion in improper EITC payments from FYs 2003 through 2012.

Another area of refund fraud involves prisoners. In September 2012, TIGTA reported that the IRS identified over 210,000 tax returns filed by prisoners as of the end of April 2012. These returns were sent to tax examiners for screening.

The IRS has described identity theft as the number one tax scam for 2013.<sup>1</sup> In many cases, an identity thief uses a legitimate taxpayer's identity to fraudulently file a tax return and claim a refund early in the filing season. If the victim is required to file a tax return, the taxpayer will not realize his or her identity has been fraudulently used until the legitimate tax return is filed and the IRS identifies it as a duplicate tax return. Other victims who are not required to file a tax return will not realize their identity has been used to file a fraudulent tax return unless the IRS identifies it and sends the taxpayers a letter informing them that they are a victim of identity theft.

Incidents of identity theft affecting tax administration have continued to rise since 2011, when the IRS identified approximately 940,000 tax returns resulting from identity theft and prevented the issuance of approximately \$6.5 billion in potentially fraudulent refunds. By the end of 2012, the IRS had identified almost 1.8 million tax returns during the year and prevented the issuance of approximately \$12.1 billion in potentially fraudulent refunds.

The total impact of identity theft on tax administration is significantly greater than the amount the IRS detects and prevents. Using the characteristics of tax returns that the IRS confirmed as involving identity theft, we identified 1.5 million undetected Tax Year 2010 tax returns processed during the 2011 Filing Season with potentially fraudulent refunds totaling \$5.2 billion. While the IRS is continuing to address these weaknesses, there is still work to be done.

Every year, more than half of all taxpayers pay someone else to prepare their Federal income tax returns. Near the end of 2009, the IRS announced a suite of proposed reforms that were designed to improve taxpayer compliance by providing comprehensive oversight and support of tax professionals through its Return Preparer Program. The IRS stated that a well-educated and competent tax return preparer can prevent inadvertent errors, possibly saving the taxpayer from unwanted problems later. In September 2010, TIGTA reported that it will take years for the IRS to implement this Program and to realize its impact.

In January of this year, the United States District Court for the District of Columbia enjoined the IRS from enforcing the regulatory requirements for return preparers. The IRS subsequently announced that it had reopened its preparer tax identification number (PTIN) system for new applications and renewals after the court clarified that the injunction did not affect regulations requiring tax preparers to have a PTIN.

Tax preparers who steal and disclose any taxpayer's Federal tax information as part of an identity theft scheme cause serious harm to taxpayers. TIGTA focuses its limited investigative resources on investigating identity theft and refund fraud that

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<sup>1</sup> IRS Press Release, IR-2013-33 (March 26, 2013), available at <http://www.irs.gov/uac/Newsroom/IRS-Releases-the-Dirty-Dozen-Tax-Scams-for-2013>.

involves any type of IRS employee involvement, the misuse of client information by tax preparers, or the impersonation of the IRS through phishing schemes and other means. For example, TIGTA found that a preparer stole the personal identifiers of several individuals and unlawfully disclosed the information to co-conspirators so they could fraudulently obtain refunds. The subject of the investigation and his co-conspirators ultimately defrauded or attempted to defraud the IRS of at least \$560,000 in tax refunds.

TIGTA has made numerous recommendations on the subject of tax fraud, identity theft, and the Return Preparer Program. These included recommendations that the IRS should implement additional controls to identify and stop erroneous claims for refundable credits before refunds are issued. In addition, we recommended the IRS develop or improve processes that will increase its ability to detect and prevent the issuance of fraudulent tax refunds resulting from identity theft. Further, we recommended that the IRS improve its oversight of return preparers and better ensure preparers are electronically filing tax returns as required.

The IRS works closely with other Federal, State, and local agencies to help identify and stop potentially fraudulent tax refunds. These include the Social Security Administration, Department of the Treasury Fiscal Service, Department of Health and Human Services, State and local law enforcement, and the Federal Bureau of Prisons and State Departments of Corrections. However, further cooperation is needed.

In conclusion, we at TIGTA remain concerned about the ever-increasing growth of identity theft and refund fraud and their impact on tax administration. We plan to provide continuing audit coverage of the IRS's efforts to address these challenges and to work with other agencies to more effectively stop tax fraud. In addition, we will continue to conduct criminal investigations of identity theft violations and tax fraud involving IRS employees, tax return preparers, and individuals impersonating the IRS.

Chairman Cherecwich and members of the Oversight Board, thank you for the opportunity to present my assessment of these critical tax administration issues.