



## Treasury Inspector General for Tax Administration Office of Audit

### BETTER USE OF AVAILABLE THIRD-PARTY DATA COULD IDENTIFY AND PREVENT MORE THAN ONE BILLION DOLLARS IN POTENTIALLY ERRONEOUS REFUNDS

Issued on July 13, 2010

## Highlights

Highlights of Report Number: 2010-40-062 to the Internal Revenue Service Deputy Commissioner for Operations Support and the Deputy Commissioner for Services and Enforcement.

### IMPACT ON TAXPAYERS

To verify the accuracy of the information that taxpayers report on their tax returns, the Internal Revenue Service (IRS) uses data from various sources such as employers, government agencies, and financial institutions. These types of data are referred to as third-party data. Effective use of these data helps to ensure taxpayer compliance.

### WHY TIGTA DID THE AUDIT

This audit was initiated because the IRS' use of third-party data to verify information reported on U.S. Individual Income Tax Returns (Form 1040) is one of its most important tools to ensure compliance.

### WHAT TIGTA FOUND

The IRS is not fully using the third-party data it receives during returns processing. Additional action is needed to use third-party data to validate EITC requirements and other questionable claims. Expanding the use of third-party data during processing would allow the IRS to decrease erroneous refunds, increase revenues and promote voluntary compliance.

In addition, the IRS does not have a centralized data log or control point for third-party data requested or received from outside sources. We requested that the IRS provide a list of all third-party data received from outside sources. It was unable to do so, stating it did not have a centralized control point for all of the data received from outside of the organization. Moreover, it could not provide cost data for obtaining third-party data files. The IRS' own work in this area in the past has shown multiple payments made for the same data. The IRS does not use standardized procedures for validating the data or formatting data received from third-party vendors.

### WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS use the authority already provided in the law to:

- 1) freeze refunds while contacting those taxpayers with potentially invalid EITC claims
- 2) require a valid response from the taxpayers before allowing the EITC, and
- 3) adjust the return if the taxpayer does not respond within a specific time period.

In addition, the IRS should maintain a control log that contains all third-party data, ensure all data sources are included, and the data elements are listed for each source. Procedures should also ensure that all data files received are validated upon receipt.

The IRS did not agree to freeze potentially invalid EITC refunds, and did not agree with the need for a centralized third-party control point. The IRS did agree to discuss with the Department of the Treasury, the merits of an administrative proposal to the Internal Revenue Code to obtain limited math error authority to freeze certain refunds while contacting taxpayers, and to institute procedures to ensure all data are validated upon receipt.

TIGTA is concerned with the IRS' lack of adequate corrective action to address improper EITC claims. The lack of action is not in accordance with Executive Order 13520, which was recently issued to help reduce improper payments in Federal programs.

### READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2010reports/201040062fr.pdf>