



Treasury Inspector General for Tax Administration Office of Audit

PROCESSES TO ADDRESS ERRONEOUS ADOPTION CREDITS RESULT IN INCREASED TAXPAYER BURDEN AND CREDITS ALLOWED TO NONQUALIFYING INDIVIDUALS

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Highlights

Highlights of Report Number: 2012-40-065 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

One of the challenges the IRS addresses each year in processing tax returns is the implementation of new tax law changes. The passage of the Patient Protection and Affordable Care Act made the Adoption Credit refundable for Tax Years 2010 and 2011. As of December 23, 2011, the IRS had received 101,627 Adoption Credit claims totaling more than \$1.2 billion for Tax Year 2010. Although the Adoption Credit provides benefits to many individuals who qualify, the unintended consequence of refundable credits is that they are often the target of unscrupulous individuals who file erroneous claims for these credits.

WHY TIGTA DID THE AUDIT

This audit was initiated because, for Tax Years 2010 and 2011, the Adoption Credit became a refundable credit and the maximum credit amount was increased to \$13,170 per adopted child for Tax Year 2010. The overall objective of this review was to assess the IRS's efforts to ensure the accuracy of Adoption Credit claims for tax returns filed from January 1 through August 6, 2011.

WHAT TIGTA FOUND

The law did not provide and the IRS did not seek math error authority for Adoption Credit claims that did not include sufficient documentation. As a result, 43,295 (42.6 percent) of the 101,627 total Adoption Credit claims were referred to the IRS's Examination function because of incomplete or missing documentation. Math error authority would have allowed the IRS to spend approximately \$1.9 million for other high-priority programs in the Examination function.

Our review also found that, as of August 6, 2011, the IRS processed 94,092 tax returns with an Adoption

Credit claim and found that 4,258 (4.5 percent) taxpayers received almost \$49.3 million in Adoption Credits without sufficient supporting documentation. Of these 4,258 taxpayers, TIGTA estimated that 953 tax returns claiming Adoption Credits totaling more than \$11 million were erroneous.

In addition, TIGTA found that 333 taxpayers who had valid Adoption Credit claims totaling \$2 million had their Credits incorrectly suspended and their tax returns were referred to the Examination function. These taxpayers had previously provided documentation when they applied for a Taxpayer Identification Number for a pending U.S. adoption.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS develop a process to prevent taxpayers from receiving the Adoption Credit when a foreign adoption is in process and to ensure that taxpayers identified as erroneously claiming the Adoption Credit are reviewed in the Examination function. The IRS should also ensure that computer programming accurately excludes tax returns that list Adoption Taxpayer Identification Numbers on Form 8839, *Qualified Adoption Expenses*, and indicate the adoption is in process so these taxpayers do not have their refunds erroneously suspended and delayed.

IRS management agreed and implemented corrective actions for all the recommendations. The corrective actions included changing processing procedures, updating instructions, and training employees to ensure erroneous adoption benefits are identified when a foreign adoption is in-process. In addition, programming changes were implemented for the 2012 Filing Season to prevent refund delays when an Adoption Taxpayer Identification Number is used. Returns TIGTA identified for taxpayers who potentially received erroneous adoption credits were selected for examination, when warranted.

READ THE FULL REPORT

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

<http://www.treas.gov/tigta/auditreports/2012reports/201240065fr.pdf>.