



*Screening Electronically Filed Returns
for Errors Provides a Significant Benefit
and Does Not Appear to Be a Barrier
to Electronic Filing*

May 25, 2007

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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.

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

May 25, 2007

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: *Michael R. Phillips*
Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Screening Electronically Filed Returns for Errors Provides a Significant Benefit and Does Not Appear to Be a Barrier to Electronic Filing (Audit # 200540036)

This report presents the results of our review to evaluate whether the acceptance controls for electronically filed tax returns were creating an unnecessary barrier to increasing electronic filing. This audit was initiated because, although the Internal Revenue Service (IRS) has made significant inroads to electronic filing, it has not yet reached its goal of having 80 percent of all tax returns filed electronically.

Impact on the Taxpayer

Each year, millions of individual income tax returns are submitted electronically with error conditions that cause them to be rejected by the IRS. The tax return acceptance controls (1) ensure error conditions on electronically filed tax returns are corrected before processing and (2) benefit taxpayers filing electronically by providing immediate notification of any error requiring correction. In contrast, taxpayers that file on paper encounter processing delays, IRS correspondence, and corrections to the amount of taxes owed or refunds due.

Synopsis

The IRS Restructuring and Reform Act of 1998¹ set a goal that at least 80 percent of all returns should be filed electronically by 2007. In Tax Year 2005, approximately 73.3 million

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).



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(54 percent) individual income tax returns were filed electronically. To achieve its electronic filing goal, the IRS recognizes that it must reduce or eliminate barriers to electronic filing while still maintaining effective controls necessary to ensure the accuracy and validity of tax returns.

To maintain effective control over the acceptance of electronic returns, the IRS uses more than 600 Error Reject Codes to identify and reject electronic tax returns back to taxpayers for correction of the various errors identified. We reviewed the data related to electronically filed tax returns that were rejected in Tax Year 2004, when the IRS electronically processed more than 68.5 million individual income tax returns. Of these returns, approximately 5.7 million were submitted electronically with error conditions that caused them to be rejected by the IRS electronic filing system. Subsequently, about 4.5 million returns were corrected, resubmitted electronically, and accepted by the IRS. Thus, the error identification process is working as intended.

The process also helps the IRS protect tax revenues. More than 600,000 rejected returns were electronically refiled with the error condition for the duplicate use of a Social Security Number removed. This helps the IRS protect tax revenues by ensuring taxpayers claim only the tax benefits to which they are entitled. However, under certain circumstances, the taxpayer whose return was rejected is rightfully entitled to use the duplicated Social Security Number. To reduce the burden on taxpayers and paper processing, the IRS has approved modifications to certain error conditions for the duplicate use of a Social Security Number. This will reduce the number of electronic returns subject to these conditions and eliminate forcing some taxpayers to refile their returns on paper. We believe the IRS could apply the same approach to additional error conditions that are discussed in this report.

Recommendations

We recommended the Commissioner, Wage and Investment Division, modify the reject criteria in conjunction with currently approved modifications for accepting electronic returns from qualified taxpayers with duplicate Social Security Number use conditions and modify the reject criteria for accepting electronic returns from married taxpayers filing jointly using a duplicated Social Security Number.

Response

IRS management agreed with both recommendations and has submitted or plans to submit Work Requests to address both. The submitted Work Request modified the reject criteria for Qualifying Social Security Number use for child and dependent care expenses and the Earned Income Tax Credit. The planned Work Request will allow returns of married taxpayers filing jointly using a duplicated Social Security Number to be accepted electronically. Management's complete response to the draft report is included as Appendix VI.



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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 (Wage and Investment Income Programs), at (202) 622-5916.



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Abbreviations

EITC	Earned Income Tax Credit
ERC	Error Reject Code
IRS	Internal Revenue Service
SSN; Number	Social Security Number



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Background

The Internal Revenue Service (IRS) Restructuring and Reform Act of 1998¹ set a goal that at least 80 percent of all returns be filed electronically by 2007.² One of the reasons stated for setting this goal was that paperless (electronic) filing was the preferred and most convenient means of filing Federal income tax and information returns.

***Congress set a goal that
80 percent of all Federal tax
and information returns be
electronically filed by 2007.***

For Tax Year 2004, the IRS received approximately 133.9 million individual income tax returns, 51 percent of which were electronically filed. Electronically filed returns increased to 73.3 million (54 percent) for Tax Year 2005, and the IRS is projecting that more than 66 percent of all individual income tax returns will be filed electronically by Tax Year 2010.

To ensure continued growth in the volume of electronically filed returns, the IRS must take further steps to increase participation in electronic filing and reduce barriers that hinder or prevent the acceptance and processing of these returns. The Electronic Tax Administration Advisory Committee has identified three major barriers to increasing electronic filing:

- Electronic filing must be faster, easier, and more accurate than paper filing, and the initial experience must be positive.
- Electronic payments must be faster, easier, and more foolproof than paying by paper check, and the first experience needs to be positive.
- Electronic services offered by the IRS must be faster; easier; and more efficient than paper, telephone, or fax-based communications.

The Electronic Tax Administration Advisory Committee, in its 2006 Annual Report to Congress, stated (1) too many situations continue to exist that impose additional burdens on those who electronically file and (2) steps need to be taken to eliminate some of the major disparities between paper and electronic filing, which center on the differences in how electronic and paper returns are accepted for processing. It is these differences that can contribute to the barriers to electronic filing growth.

¹ Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² IRS Restructuring and Reform Act of 1998, Section 2001 (a).



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Electronic returns submitted to the IRS must go through front-end controls before they are accepted. If a return is submitted with conditions that do not pass these controls, the IRS rejects the tax return and provides the taxpayer with an explanation through the use of an Error Reject Code (ERC). The IRS uses more than 600 ERCs to explain why electronically submitted returns cannot be accepted for processing.³ The ERC explanations are published annually prior to the filing season⁴ in *Filing Season Supplement for Authorized IRS e-file Providers*⁵ and in *Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns*.

In contrast, paper returns cannot be subjected to the electronic front-end acceptance controls before they are accepted for processing because there are legal and logistical differences in the way paper returns must be handled by the IRS. For example, when a taxpayer mails a paper tax return to the IRS, the return is considered legally “filed” once it is postmarked by the Post Office.⁶ An electronic return is not considered legally filed until it is received and accepted by the IRS. Paper returns can be rejected back to taxpayers in only a limited number of situations (e.g., if they are incomplete and cannot be processed). In addition, the acceptance controls applied to electronically filed returns would be virtually impossible to conduct manually on the millions of paper tax returns received by the IRS. While both electronic and paper returns are subjected to the same processing controls after they are considered legally filed, electronic returns have significantly fewer errors and are less costly to process as a result of the front-end acceptance controls placed on them.

We evaluated whether the acceptance controls for electronically filed tax returns were creating a barrier to increasing electronic filing and whether the controls could be modified to reduce taxpayer burden. We analyzed the differences between the controls over how electronic returns are accepted for processing and the controls for processing paper returns and evaluated whether more returns could be accepted electronically without increasing the risk of accepting returns with inappropriate refunds claimed or errors that require significant additional correspondence to correct.

This review was performed at the Wage and Investment Division Headquarters in Atlanta, Georgia; the Submission Processing offices in Lanham, Maryland, and Cincinnati, Ohio; and the Austin, Texas, Submission Processing Site⁷ during the period August 2005 through January 2007. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

³ See Appendix V for explanations of ERCs 506, 507, 509, 510, and 526.

⁴ The period from January through mid-April when most individual income tax returns are filed.

⁵ Publications 1345A and 1346, respectively.

⁶ This includes the United States Postal Service and other mail delivery services.

⁷ These sites process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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Results of Review

Screening Electronically Filed Tax Returns for Errors Benefits Taxpayers and the Internal Revenue Service

Overall, the controls established by the IRS to screen electronically filed returns for errors prior to accepting them for processing are working as intended and do not create significant barriers to electronic filing. For Tax Year 2004, approximately 5.7 million individual income tax returns were submitted electronically with error conditions that caused them to be rejected by the IRS. There were approximately 11.9 million error conditions identified on the rejected returns (many returns contained multiple error conditions), and the top 10 errors accounted for more than 70 percent of the ERCs generated, as shown in Figure 1.

Figure 1: Top 10 Error Conditions for Tax Year 2004

Rank	Error Reject Code	Error Description	Volume	Percentage of Overall Total
1	504	Dependent SSN ⁸ and Name Must Match IRS Data	1,511,849	12.7%
2	679	PIN Information ⁹ Must Match IRS Data	1,243,591	10.4%
3	501	EITC Child ¹⁰ SSN and Name Must Match IRS Data	1,114,396	9.4%
4	507	Dependent's SSN Used on Another Return	955,922	8.0%
5	502	Employer Identification Number Must Match IRS Data	865,933	7.3%
6	500	Taxpayer SSN and Name Must Match IRS Data	626,050	5.3%
7	503	Spouse's SSN and Name Must Match IRS Data	603,331	5.0%
8	522	Taxpayer Date of Birth Must Match IRS Data	563,889	4.7%
9	680	PIN Information for Spouse Must Match IRS Data	469,621	3.9%
10	510	Husband or Wife SSN Claimed As a Dependent SSN on Another Return	443,544	3.7%
		Total Volume for Top 10 Error Conditions	8,398,126	70.4%

Source: Treasury Inspector General for Tax Administration analysis of Error Reject Codes as of October 20, 2005.

⁸ SSN = Social Security Number.

⁹ PIN = Personal Identification Number. When filing electronically, a taxpayer must include a Personal Identification Number in place of a signature to authenticate the tax return. The Personal Identification Number is the Adjusted Gross Income amount from the previous year's tax return.

¹⁰ EITC = Earned Income Tax Credit. This refers to the Child's SSN and name used to qualify for the Credit.



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Of the approximately 5.7 million rejected returns, about 4.5 million (79 percent) were corrected, resubmitted electronically, and accepted by the IRS. More than 777,000 of the remaining returns were refiled on paper, and more than 426,000 had not been refiled by the date of our analysis. Based on this high percentage of taxpayers who corrected and refiled their returns electronically, it appears the acceptance process and rejection of tax returns containing errors is not a barrier to taxpayers filing electronically and benefits both the IRS and taxpayers. The IRS benefits because error-free electronic returns require no human intervention and are fast and easy to process. Taxpayers benefit by being notified immediately of any errors that would have delayed the processing of their returns and the issuance of any refunds. The IRS notifies the taxpayer of the error requiring correction via an ERC(s), which allows the taxpayer to correct the information or condition and electronically resubmit the tax return in a matter of days. In contrast, a taxpayer who files a paper return with an error (1) encounters processing delays as a result of the IRS having to directly correspond with the taxpayer to resolve the error or (2) may have his or her tax owed or refund due systemically adjusted based on the information on the return as filed.

For example, as shown in Figure 1, the most common error condition identified by electronic acceptance controls is a difference between IRS records and what the taxpayer shows on his or her return as a dependent's name and Social Security Number (hereafter referred to as SSN or Number). When a taxpayer files electronically and the return is rejected because of a discrepancy in the dependent's name and/or SSN, the taxpayer can correct the error and immediately resubmit the return. However, if the return was filed on paper, the IRS will attempt to correct the error during processing based on other information available on the return. If that is not possible, the IRS will adjust the return for the tax benefits related to the dependent and send the taxpayer a notice stating the taxpayer's refund has been reduced due to the discrepancy. Correcting errors such as this before the return is accepted benefits taxpayers by eliminating potential problems up front and by preventing processing delays, which ultimately provides taxpayers with faster refunds.

The rejection of duplicate SSN errors helps the IRS protect tax revenue

When a person is claimed as the primary taxpayer, the secondary (spouse) taxpayer, or a dependent on two or more tax returns, the IRS refers to this as a duplicate condition. The duplicate use of a dependent's SSN to claim a dependent exemption was ranked fourth for all error conditions and occurred more than 950,000 times on Tax Year 2004 electronic returns, as shown in Figure 1.

Two other duplicate use conditions also involved significant numbers of taxpayers: duplicate use to claim the Earned Income Tax Credit (EITC) and use of a primary and/or secondary SSN on a return that was previously used on another return as a dependent's Number.

Preventing duplicate SSN use on electronically filed returns helps the IRS protect tax revenues by ensuring taxpayers claim only the tax benefits to which they are entitled. Taxpayers claimed



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a duplicate Number on more than 600,000 rejected returns that were subsequently refiled electronically with the condition removed. Our analysis of these electronically refiled returns after the duplicated SSNs had been removed found that:

- A total of 186,144 SSNs were no longer being used to qualify for and claim the EITC.
- A total of 554,115 SSNs were no longer being used to claim a dependent exemption.

Of those taxpayers who did not refile electronically after their returns had been rejected for duplicate SSN use, approximately 337,000 refiled using paper returns. To determine whether these taxpayers refiled paper returns with the same duplicate condition as that identified on the taxpayers' electronic returns, we took judgmental samples from five ERC groups.¹¹ Our sampling results showed most paper returns were processed without resolution of the duplicate use condition that had caused the original electronic returns to be rejected from the electronic filing system. Although the IRS identifies the duplicate use condition on all returns processed, it is generally unable to resolve the duplicate use on returns during processing because it cannot readily ascertain which taxpayer is rightfully entitled to claim the duplicated Number. However, as subsequently explained, the IRS has found in certain instances that it may be possible to determine which taxpayer is correctly entitled to claim a duplicated SSN by using alternate sources of internal IRS information.

Acceptance Controls Could Be Modified for Certain Circumstances in Which Taxpayers May Be Rightfully Claiming Exemptions and/or Credits

The IRS has identified some situations in which it can avoid rejecting electronically filed tax returns. These situations involve taxpayers claiming an SSN that had previously been claimed by another taxpayer, such as an ex-spouse or other family member, for EITC and dependent exemption purposes. When the second taxpayer electronically filed a tax return claiming a dependent previously claimed by another taxpayer, the acceptance controls would identify the duplicate condition and reject the second return. However, the IRS has internal information that may be used during the acceptance process to validate whether the second taxpayer is entitled to claim the duplicated Number (i.e., the dependent).

¹¹ See Appendix V for individual sample results.



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When the electronic tax return acceptance controls identify duplicate conditions, the IRS will now use internal information derived from the Federal Case Registry¹² and the IRS Master File¹³ to determine whether a taxpayer is the custodial parent and entitled to claim the dependant for EITC purposes. The information available from the Federal Case Registry and the Master File can be used to determine the eligibility of the taxpayer claiming the SSN, thus avoiding the need to reject tax returns that are correct.

The IRS has modified the reject criteria for the error conditions related to these specific situations and will allow these tax returns to be accepted for processing as filed if the second taxpayer is entitled to claim the duplicate SSN, thus reducing for taxpayers the burden of having to refile their tax returns on paper. However, if the second taxpayer is not entitled to claim the duplicated Number, the electronic tax return will still be rejected. In all situations, if the first taxpayer is not entitled to claim the SSN, he or she is subject to future compliance reviews. Prior to this modification to the reject criteria, if the second taxpayer claiming the duplicated Number is legally entitled to claim the EITC and dependant exemption, the only way that taxpayer could refile the tax return was on paper.

We believe this same internal information could also be used to allow certain electronic tax returns with duplicate SSN claims for Child and Dependent Care Expenses (Form 2441) to be accepted for electronic processing. For example, if a noncustodial parent using his or her child's SSN files his or her return claiming the EITC, a dependent exemption, and the Credit for Child and Dependent Care Expenses, and the custodial parent subsequently files his or her return claiming the same tax benefits, the custodial parent's return will encounter a duplicate condition and be rejected from the electronic filing system. This occurs because the IRS' current criteria for applying internal data to allow the duplicated Number consider only the EITC and dependent exemption but ignore the Form 2441 expenses. However, by modifying its criteria to include the Form 2441 expenses in addition to the EITC and the dependent exemption, the IRS would be able to allow returns filed by the custodial parent to be electronically accepted rather than being refiled on paper, so the custodial parent can claim his or her rightful tax benefits.

For Tax Year 2004, we identified 3,685 electronic returns that were rejected because of duplicate use of the qualifying person's SSN shown for Form 2441, the Earned Income Credit: Qualifying Child Information (Schedule EIC), and a dependent.¹⁴ As a result, we believe the IRS' plan to check its internal data sources to allow acceptance of certain returns may be more effective in

¹² The Federal Case Registry is a national database, provided to the IRS by the Department of Health and Human Services, that includes all child support cases handled by State support agencies and all established or modified support orders.

¹³ The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data. The IRS Master File also includes information from previous years' tax returns and related transactions that can be used to determine whether the taxpayer is entitled to claim the EITC.

¹⁴ See ERC 526 in Appendix V.



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increasing electronic filing and reducing taxpayer burden if the IRS considers including additional criteria in its recently approved modifications. IRS management acknowledged that this additional criteria change could benefit the IRS' original intent of allowing those tax returns with valid dependent claims to be accepted for processing.

Additionally, we found the reject criteria for duplicate conditions involving a primary or secondary (spouse's) SSN versus a dependent SSN could be modified to prevent certain tax returns from being rejected from the electronic filing system. This situation occurs, for example, when a person gets married during the year and files a joint tax return with his or her spouse. The newly married person is legally entitled to claim himself or herself as an exemption on the joint tax return, but in some situations his or her parents may have also claimed him or her as a dependent on their tax return, possibly believing they provided more than one-half the support for the child during the year and were entitled to claim him or her as a dependent. If the person files a joint return with his or her spouse first, the parents' tax return claiming the person as a dependent will create a duplicate condition and will be properly rejected. However, if the person files his or her joint return after the parents file their return, the person's joint return will create the duplicate condition and will be rejected.¹⁵

In Tax Year 2004, duplicate use conditions involving a secondary versus a dependent SSN were identified on 28,126 electronic returns. In our judgmental sample of paper returns identified with this error, we determined approximately one-half were initially electronically filed as married filing jointly but were rejected because the secondary SSN had been previously claimed as a dependent's Number on another taxpayer's return.¹⁶ These taxpayers all refiled paper returns that were the same as the electronic returns (i.e., married filing jointly using the same primary/secondary SSN as an exemption), which indicates they may be rightfully claiming the exemption as illustrated in the previous example. In addition, duplicate use conditions involving a primary and/or secondary SSN versus a dependent SSN were identified on 346,881 Tax Year 2004 electronic returns.¹⁷ IRS management acknowledged that consideration should be given to additional modifications to prevent the electronic rejection of returns with these circumstances.

Using further computer analysis, we identified a total of 6,318 taxpayers that had refiled paper returns as married filing jointly after their electronic returns were initially rejected. We believe modifying reject criteria to allow taxpayers who use the Married Filing Jointly status to file electronically could relieve taxpayers from the burden of having to refile their returns on paper and could benefit the IRS by increasing electronic filing and reducing processing costs. In our

¹⁵ Internal Revenue Code Section 151, *Allowance of deductions for personal exemptions*, provides that a dependent exemption is denied in the case of certain married dependents. No exemption shall be allowed for any dependent who has filed a joint return with a spouse under Internal Revenue Code Section 6013.

¹⁶ See ERC 509 in Appendix V.

¹⁷ See ERC 510 in Appendix V.



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analysis, such modifications would provide relief to 31,590 taxpayers (6,318 taxpayers per year for 5 years) and save the IRS \$62,230 in paper processing costs (\$12,446 per year for 5 years).¹⁸

Recommendations

Recommendation 1: The Commissioner, Wage and Investment Division, should modify the reject criteria for ERC 526, in conjunction with the modifications previously approved for ERCs 506 and 507, to reduce the number of rejected electronic returns involving the duplicate use of an SSN.

Management's Response: IRS management agreed with the recommendation. On December 28, 2006, the Wage and Investment Division Compliance function submitted a Work Request entitled, "Enhancement to Earned Income Tax Credit Taxpayer Burden Reduction for Electronic Filing," to address this recommendation.

Recommendation 2: The Commissioner, Wage and Investment Division, should modify the reject criteria for ERCs 509 and 510 to reduce the number of rejected electronic returns submitted by married taxpayers filing jointly using a duplicated SSN.

Management's Response: IRS management agreed with the recommendation. The Submission Processing function E-Submission Branch will submit a Work Request for Tax Year 2007 requesting that the returns of married taxpayers filing jointly using a duplicated SSN be accepted electronically.

¹⁸ The National Taxpayers Advocate's 2004 Report to Congress reported the cost to the IRS of processing a paper return is \$2.59 and the cost of processing an electronic return is \$0.62, a difference of \$1.97.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate whether the acceptance controls for electronically filed tax returns were creating an unnecessary barrier to increasing electronic filing. This audit focused on comparing the front-end controls for accepting and processing electronically filed returns with the controls for processing paper returns and evaluating whether it would be appropriate to modify any of the controls to reduce taxpayer burden. To accomplish our objective, we:

- I. Determined whether the controls for accepting and processing paper returns are less stringent than the front-end controls for accepting or rejecting electronically filed returns for processing.
 - A. Analyzed the front-end electronic filing ERCs and identified 30 conditions causing taxpayers and preparers the greatest amount of electronic filing difficulty.
 - B. Compared the controls associated with the 30 ERCs identified in Step I.A. to the paper processing controls to determine whether similar controls exist for paper filed returns.
- II. Determined whether less stringent controls over paper return processing allow paper returns that were initially filed electronically and rejected to be processed with the same conditions that caused them to be rejected from the electronic filing system.
 - A. Identified a population of 777,023 Tax Year 2004 individual income tax returns on the IRS Tax Return Database that were rejected from the electronic filing system and subsequently filed on paper.¹
 - B. Analyzed the population of returns identified and determined the reasons the returns had been rejected from the electronic filing system.
 - C. Reviewed 5 judgmental samples of 30 returns each from a population of 337,249 duplicate SSN ERC returns to determine whether the paper returns were processed with the same error conditions that had caused them to be rejected from the electronic filing system. See Appendix V for details.

¹ To assess the reliability of computer-processed data, programmers in the Treasury Inspector General for Tax Administration Office of Information Technology validated the data that were extracted, and we verified the appropriate documentation. Judgmental samples were selected and reviewed to ensure the amounts presented were supported by external sources. Based on these tests, we determined the computer-processed data were reliable.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
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Deputy Commissioner, Wage and Investment Division SE:W
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division
SE:W:CAR
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Audit Liaison: Senior Operations Advisor, Wage and Investment Division SE:W:S



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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 Congress.

Type and Value of Outcome Measure:

- Taxpayer Burden – Actual; 31,590 taxpayers would be affected over 5 years (see page 5).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify two populations of Tax Year 2004 individual income tax returns that had been rejected from the electronic filing system. A population of 28,126 returns was rejected with an ERC 509 for the duplicate use of a secondary SSN; a population of 346,881 returns was rejected with an ERC 510 for the duplicate use of a primary and/or secondary SSN. We further analyzed these returns and determined 6,318 were refiled on paper as married filing jointly using a primary or secondary SSN that had been claimed by another taxpayer as a dependent's SSN. Using these results, we estimated that over 5 years the benefit produced from modifying return reject criteria could extend to 31,590 taxpayers (6,318 taxpayers per year X 5 years).

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Actual; \$62,230 in paper processing costs over 5 years (see page 5).

Methodology Used to Measure the Reported Benefit:

According to the National Taxpayers Advocate's *2004 Report to Congress*, the cost to the IRS of processing a paper return is \$2.59 and the cost of processing an electronic return is \$0.62, a difference of \$1.97.¹ By allowing the 6,318 taxpayers to file electronically, the IRS could save \$12,446. Using these results, we estimated that over 5 years the benefit could result in a reduction of \$62,230 in processing costs (\$12,446 per year X 5 years).

¹ The National Taxpayer Advocate's *Report* referenced Internal Revenue Manual Exhibit 3.30, Cost Estimate Reference, Exhibit 3.30.10-39 (Rev. 11-01-2003).



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Appendix V

Error Reject Code Sampling Results for Returns Refiled on Paper

- **ERC 506** – Indicates the Qualifying SSN (or Number) on the Earned Income Credit: Qualifying Child Information (Schedule EIC) was previously used for the same purpose. Our review of a sample of 30 returns refiled on paper determined 24 returns (80 percent) were refiled claiming the EITC using the duplicated Number.
- **ERC 507** – Indicates the dependent’s SSN was previously used for the same purpose. Our review of a sample of 30 returns refiled on paper determined 27 returns (90 percent) were refiled with the same duplicated Number.
- **ERC 509** – Indicates the secondary SSN was previously used as a dependent’s SSN, or a Schedule EIC Qualifying SSN, on a previous or current return. It also indicates a dependent’s Number or a Schedule EIC Qualifying Number was used as a secondary SSN on a previous or current return. Our review of a sample of 30 returns determined 26 returns (87 percent) were refiled with the same condition. On 15 of the 26 returns, the secondary SSN was claimed as a dependent on another taxpayer’s return, and on 6 returns the dependent was used as a secondary Number on another taxpayer’s return.
- **ERC 510** – Indicates the primary and/or secondary SSN was claimed as an exemption on the return and was also used as a dependent’s SSN on another return. Our review of a sample of 30 returns refiled on paper determined that 27 returns (90 percent) were refiled on paper with the same condition. On 21 of the 27 returns, the taxpayer claimed a dependent that also filed a return as the primary taxpayer claiming a personal exemption. On 6 of the 27 returns, the taxpayer was claimed as a dependent on another return.
- **ERC 526** – Indicates the Qualifying Person’s SSN used for Child and Dependent Care Expenses (Form 2441) or for Child and Dependent Care Expenses on Form 1040A Filers (Schedule 2) was previously used for the same purpose. Our review of a sample of 30 returns refiled on paper determined 21 returns (70 percent) were refiled claiming the Credit for Child and Dependent Care Expenses.



*Screening Electronically Filed Returns for Errors
Provides a Significant Benefit and Does Not Appear
to Be a Barrier to Electronic Filing*

Appendix VI

Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

April 26, 2007

RECEIVED
APR 27 2007

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard J. Morgante *Richard J. Morgante*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Screening Electronically Filed Returns for
Errors Provides a Significant Benefit and Does Not Appear to Be
a Barrier to Electronic Filing (Audit # 200540036)

I reviewed the subject draft report and appreciate your recognition that the controls to screen electronically filed returns for errors prior to accepting them for processing are working as intended, and do not create significant barriers to electronic filing.

As noted in your report, 5.7 million tax year 2004 individual returns were submitted with error conditions that caused them to be rejected by the IRS. Of those 5.7 million rejected returns, 4.5 million (79 percent) were corrected, resubmitted electronically, and accepted by the IRS. The high percentage of taxpayers who corrected errors and re-filed their returns electronically helped IRS ensure taxpayers claim only the tax benefits to which they are entitled and benefited taxpayers by eliminating potential problems and processing delays up-front, resulting in those taxpayers receiving their refunds more quickly.

Even though we experience a high percentage of accepted re-filed electronic returns, we are always looking for ways to improve application of Error Reject Codes (ERC) to reduce the number of rejected electronic returns. Therefore, we agree with both your recommendations to modify certain ERCs to help reduce disallowance of electronic returns involving the duplicate use of a social security number.

We also agree with the Outcome Measures as stated in Appendix IV. Our detailed comments to your recommendations are attached. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact Betsy Kinter, Director, Customer Account Services, at (404) 338-8910.

Attachment



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Attachment

RECOMMENDATION 1

The Commissioner, Wage and Investment Division, should modify the reject criteria for Error Reject Code 526 (Qualifying Person SSN on a Form 2441 was previously used for the same purpose) in conjunction with the modifications previously approved for Error Reject Codes 506 (Qualifying SSN of Schedule EIC was previously used for the same purpose) and 507 (dependent's number was previously used for the same purpose) to reduce the number of rejected electronic returns involving the duplicate use of an SSN.

CORRECTIVE ACTION

We agree with this recommendation. Wage and Investment Compliance submitted a Work Request (WR) dated December 28, 2006, entitled "Enhancement to Earned Income Tax Credit Taxpayer Burden Reduction for Electronic Filing" to address this recommendation.

IMPLEMENTATION DATE

January 15, 2008

RESPONSIBLE OFFICIAL

Director, Submission Processing, 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 Commissioner, Wage and Investment Division, should modify the reject criteria for Error Reject Code 509 (secondary SSN was previously used as a dependent's SSN, or vice versa, on a previous or current return) and Error Reject Code 510 (primary and/or secondary SSN was claimed as an exemption on the return and was also used as a dependent's number on another return, or vice versa) to reduce the number of rejected electronic returns submitted by married taxpayers filing jointly using a duplicated SSN.

CORRECTIVE ACTION

We agree with this recommendation. The Submission Processing, E-Submission Branch, will submit a WR for Tax Year 2007, requesting that the returns of married taxpayers filing jointly using a duplicated social security number be accepted electronically.

IMPLEMENTATION DATE

January 15, 2008



*Screening Electronically Filed Returns for Errors
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2

RESPONSIBLE OFFICIAL

Director, Submission Processing, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

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