



*Better Screening and Monitoring of
E-File Providers Is Needed to Minimize the
Risk of Unscrupulous Providers Participating
in the E-File Program*

September 19, 2007

Reference Number: 2007-40-176

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
- 2(e) = Law Enforcement Procedure(s)
- 2(f) = Risk Circumvention of Agency Regulation or Statute (whichever is applicable)
- 3(d) = Identifying Information - Other Identifying Information of an Individual or Individuals

Phone Number | 202-927-7037

Email Address | Bonnie.Heald@tigta.treas.gov

Web Site | <http://www.tigta.gov>



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 19, 2007

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Better Screening and Monitoring of E-File
Providers Is Needed to Minimize the Risk of Unscrupulous Providers
Participating in the E-File Program (Audit # 200740020)

This report presents the results of our review to determine whether the Internal Revenue Service's (IRS) screening and monitoring of electronic filing (*e-file*) Providers is effective. This audit is a followup to prior Treasury Inspector General for Tax Administration (TIGTA) reviews.¹

Impact on the Taxpayer

The primary means by which the IRS regulates *e-file* Providers are the application screening process and the monitoring program. The application screening process does not ensure the integrity of the individuals applying for participation in the *e-file* Program and the monitoring program does not ensure *e-file* Providers are compliant with *e-file* Program requirements. Inadequate screening and monitoring increases the risk to both the taxpaying public and the Federal Government for potential losses associated with unscrupulous *e-file* Providers.

¹ *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 2003), *Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud* (Reference Number 2004-40-013, dated November 2003), and *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Synopsis

There were 259,009 authorized electronic return originators² as of May 22, 2007, who electronically filed (*e-filed*) about 55 million (71 percent) of the approximately 77.1 million *e-filed* tax returns accepted in Calendar Year 2007. The application screening process is used to ensure individuals applying for entry into the *e-file* Program have met required screening and verification checks before they are authorized to participate in the *e-file* Program. Monitoring visits are the primary means to verify compliance with many of the *e-file* Program requirements.

The IRS has an effective process for ensuring applicants meet age requirements and *e-file* Providers meet certain suitability checks, such as tax compliance. A review of 98 applications found that tax compliance checks were correctly performed for the 137 Principal and Responsible officials³ and the 94 businesses listed on these applications. However, the IRS does not have an independent verification process to confirm the accuracy of applicants who claim they are a Not-for-Profit service. In addition, the IRS does not verify citizenship. Tests of

Applicant requirements and suitability checks are not verified or consistently performed.

98 applications showed 3 of the 137 applicants were either aliens not allowed to work or alien students with restricted work authorizations. In a previous audit,⁴ we conducted a similar test to identify individuals whose citizenship indicator identified them as not being a citizen or legal resident alien. A total of 85 individuals were referred to the IRS for research. Of the 85 individuals,

52 (61 percent) were eventually removed from the *e-file* Program. For 40 (77 percent) of the 52 individuals removed, the applicants falsified their applications by identifying themselves as United States citizens or legal resident aliens.

Furthermore, credit checks are not performed and criminal background checks are limited. The IRS does verify the status of individuals who submit a professional certification in lieu of a fingerprint card to ensure they are still in good standing with the organization that issued the certification. It also verifies all new applicants are at least 21 years of age and not deceased.

² Electronic Return Originators (ERO) originate the electronic submission of income tax returns to the IRS. An ERO electronically submits income tax returns that are either prepared by the ERO firm or collected from a taxpayer.

³ A Principal includes the sole proprietor, partners, or individuals authorized to act for the entity in legal and/or tax matters. A Responsible Official is the first point of contact with the IRS and has the authority to sign revised IRS *e-file* applications and ensures the *e-file* Provider adheres to the provisions of the revenue procedure as well as all publications and notices governing the IRS. There were a total of 138 Principal and Responsible Officials on the 98 applications. One individual did not list a Social Security Number on the application, so their tax compliance or citizenship status could not be verified.

⁴ *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Testing also identified that deficiencies prevent the IRS from measuring program performance and ensuring that authorized *e-file* Providers are in conformance with *e-file* Program guidelines. For example:

- Current procedures do not ensure *e-file* Providers most at risk of noncompliance are selected for monitoring visits, including the scheduling of required followup visits.
- *E-file* Providers who were issued written reprimands were not subject to the required followup visits.
- Procedures have not been developed requiring *e-file* Monitoring Coordinators to record the receipt and disposition of referrals.
- *E-file* Providers determined to be in violation of *e-file* Program requirements were not suspended.
- Documentation supporting *e-file* Provider appeal requests and decisions associated with these requests is inadequate.
- *E-file* Monitoring Program management information is inaccurate.

Finally, the IRS does not have a process to review *e-file* Provider cases, worked by its Criminal Investigation function, to identify opportunities to improve on the screening checks and selection criteria for monitoring visits. Characteristics of these cases could identify risk factors or indicators to be used to screen unscrupulous individuals from entry into the *e-file* Program and identify unscrupulous *e-file* Providers in the *e-file* Program. The Criminal Investigation function initiated 315 criminal cases involving tax return preparers during Fiscal Years 2006 and 2007 (as of April 30, 2007).

Recommendations

The Commissioner, Wage and Investment Division, should ensure applicants who claim to be a Not-For-Profit are in fact a Not-For-Profit and revise screening procedures to require validation of an applicant's citizenship. The Commissioner, Small Business/Self Employed Division, should develop processes to ensure risk-based selection criteria is used to select *e-file* Providers for monitoring visits, the receipt and disposition of referrals are recorded, *e-file* Providers are suspended when recommended, adequate documentation supporting appeals is maintained, and management information accurately reflects *e-file* Monitoring Program results. In addition, procedures should be clarified as to when followup visits should be performed. Both Commissioners should ensure results of criminal cases involving *e-file* Providers are used to identify potential risk factors or indicators that can be built into the screening and monitoring process to improve on the identification of unscrupulous *e-file* Providers.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Response

IRS management agreed with eight of our nine recommendations and partially agreed with one recommendation. The Electronic Tax Administration Office is currently partnering with Stakeholder Partnerships, Education, and Communication Headquarters office to establish formal procedures for validating existing authorized IRS *e-file* Providers as an organization providing a Not-for-Profit service. The Electronic Tax Administration Office has taken steps to review the citizenship verification process and develop a solution. The citizenship codes of applicants can be checked using the Data Master One⁵ tape from the Social Security Administration before they are accepted into the IRS *e-file* Program. Applicants found to have a citizenship code that shows they are an alien in the United States and are not a legal resident alien will be manually contacted for verification before the application can be completed. For existing applicants, a one-time query will be made using these same procedures. Individuals who are not able to verify that they are United States citizens or legal resident aliens will be suspended from the IRS *e-file* Program.

IRS management has developed a risk-based selection criterion and procedures regarding followup visits. Both of these items should be published by January 30, 2008. IRS management has developed a process to keep track of referrals and Electronic Filing Identification Number suspension cases through a new control log.

IRS management has clarified procedures requiring the maintenance of adequate documentation supporting an *e-file* Provider's request for an appeal, as well as documentation supporting the review and outcome of an appeal. They have also developed a process to keep track of results that are kept by the Area E-File Monitoring Coordinators.

IRS management will study the feasibility of using results of criminal cases involving *e-file* Providers to identify risk factors or indicators for the suitability process. This will require working with the Criminal Investigation Division to obtain criminal case characteristics of providers of *e-file* returns and any other information they might have. We believe management's action satisfies the intent of our recommendation. Management's complete response to the draft report is included as Appendix VI.

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.

⁵ The Data Master One (DM-1) File Data Store contains data from the Social Security Administration used to verify taxpayers who do not have a primary Master File account.



*Better Screening and Monitoring of E-File Providers Is Needed to
Minimize the Risk of Unscrupulous Providers Participating
in the E-File Program*

Table of Contents

Background	Page 1
Results of Review	Page 5
The Application Screening Process Does Not Ensure the Integrity of the Individuals Applying for Participation in the E-File Program	Page 5
<u>Recommendations 1 and 2:</u>	Page 9
The Monitoring Program Does Not Ensure E-File Providers Are Compliant With Program Requirements.....	Page 10
<u>Recommendations 3 through 5:</u>	Page 16
<u>Recommendations 6 through 8:</u>	Page 17
Reviews of Closed Criminal Cases Involving E-File Providers May Identify Risk Factors or Indicators to Detect Unscrupulous E-File Providers	Page 18
<u>Recommendation 9:</u>	Page 19
Appendices	
Appendix I – Detailed Objective, Scope, and Methodology	Page 20
Appendix II – Major Contributors to This Report	Page 22
Appendix III – Report Distribution List	Page 23
Appendix IV – Prior Treasury Inspector General for Tax Administration Report Recommendations.....	Page 24
Appendix V – Examples of E-File Provider Requirements Verifiable Only Through a Monitoring Visit.....	Page 28
Appendix VI – Management’s Response to the Draft Report	Page 29



*Better Screening and Monitoring of E-File Providers Is Needed to
Minimize the Risk of Unscrupulous Providers Participating
in the E-File Program*

Abbreviations

<i>e-file, e-filed</i>	Electronic Filing, Electronically Filed
ERO	Electronic Return Originator
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration
U.S.	United States



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Background

The Internal Revenue Service's (IRS) electronic filing (*e-file*) Program offers taxpayers an alternative to filing a traditional paper tax return. The *e-file* Program enables tax returns to be sent to the IRS in an electronic format via an authorized IRS *e-file* Provider. An *e-file* Provider is generally the first point of contact for most taxpayers filing a tax return through the IRS' *e-file* Program. Figure 1 lists types of authorized *e-file* Providers.



Figure 1: Types of Authorized IRS E-File Providers

Electronic Return Originator (ERO)	EROs originate the electronic submission of income tax returns to the IRS. An ERO electronically submits income tax returns that are either prepared by the ERO firm or collected from a taxpayer.
Intermediate Service Providers	Intermediate Service Providers receive tax return information from EROs or from taxpayers who file electronically using a personal computer, modem, and commercial tax preparation software on an Internet site; process the tax return information; and either forward the information to a transmitter or send the information back to the EROs or taxpayers.
Transmitters	Once the return is prepared, the income tax return data is sent to the IRS by a transmitter. Transmitters must have software and modems that allow them to connect with IRS computers. EROs and Intermediate Service Providers may also apply to be transmitters and transmit return data themselves or they may contract with accepted third-party transmitters who will transmit the data for them.
Software Developers	Software Developers write the <i>e-file</i> programs according to IRS file specifications and record layouts making IRS <i>e-file</i> and Federal/State <i>e-file</i> possible. The IRS and participating States require that all software pass a series of tests each year. Once approved, this software may be sold and used by EROs.

Source: IRS training guidance provided to individuals interested in becoming e-file Providers.

There were 259,009 authorized EROs as of May 22, 2007, who electronically filed (*e-filed*) about 55 million (71 percent) of the approximately 77.1 million *e-filed* tax returns accepted in Calendar Year 2007. The primary means by which the IRS regulates *e-file* Providers are the application screening process and the monitoring program.

The application screening process is used to ensure individuals applying for entry into the *e-file* Program have met required screening and verification checks before they are authorized to



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

participate in the Program. To become an *e-file* Provider, an applicant is required to complete an Application to Participate in the IRS *e-file* Program (Form 8633) and submit it and a fingerprint card to the IRS. The IRS allows an individual with a professional certification to send a copy of the certification in lieu of a fingerprint card. Certifications include Attorney, Certified Public Accountant, Enrolled Agent, and Banking Official. Each application is required to identify Principal(s) and at least one Responsible Official.

- A Principal includes the sole proprietor, partners, or individuals authorized to act for the entity in legal and/or tax matters. At least one such individual must be listed on the application.
- A Responsible Official is the first point of contact with the IRS and has the authority to sign revised IRS *e-file* applications. A Responsible Official ensures the *e-file* Provider adheres to the provisions of the revenue procedure as well as all publications and notices governing IRS *e-file*.

The requirements and suitability checks outlined in the *IRS e-file Application and Participation* (Publication 3112) include:

- Applicant must be a United States (U.S.) citizen or legal resident alien.
- Applicant must be 21 years of age as of the date of the application.

Suitability checks may include:

- Criminal background check.
- Credit history check.
- Tax compliance check to ensure all required tax returns are filed and paid and to identify fraud and preparer penalties.

All authorized *e-file* Providers, except those that function solely as Software Developers, must meet requirements and pass suitability checks prior to acceptance in the *e-file* Program. If an individual does not meet the requirements and/or fails a suitability check, the application will be denied. Applicants denied participation in IRS *e-file* will be notified in writing and may appeal the decisions.

E-file Program requirements are meant to protect the Program's image and integrity.

Once approved, *e-file* Providers must maintain strict adherence to Program requirements to ensure continued participation. Program requirements are outlined in Revenue Procedure 2005–60, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns* (Publication 1345), and the *Filing Season Supplement for Authorized IRS e-file Providers* (Publication 1345A). Requirements include the need to ensure tax returns are accurately filed, are supported by the appropriate documentation, are signed by the taxpayers, and security



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

systems are in place to prevent unauthorized access to taxpayer accounts and personal information by third parties.

The *e-file* Monitoring Program requires IRS employees visiting *e-file* Provider sites to, for example, review the quality of IRS *e-file* submissions for rejects,¹ check adherence to signature requirements on tax returns, scrutinize advertising material, and examine records and office procedures. A monitoring visit is the primary means to verify compliance with many of the *e-file* Program requirements. Appendix V provides examples of those *e-file* Program requirements that can only be verified via a monitoring visit.

The *e-file* Monitoring Program is designed to ensure *e-file* Providers are in compliance with requirements.

Each year during the filing season,² specially trained IRS employees visit approximately 1 percent of all authorized *e-file* Provider establishments to perform comprehensive operational reviews. Figure 2 shows the trends in the *e-file* Monitoring Program during the 2005 through 2007 Filing Seasons.

Figure 2: Trends in E-File Monitoring Program for the 2005-2007 Filing Seasons

Tax Return Filing Season	Total <i>e-file</i> Providers Included in Selection Process	Total <i>e-file</i> Monitoring Visits Planned
2007	127,000	1,270
2006	105,300	1,053
2005	117,571	1,175

Source: IRS documentation related to planning its annual e-file Provider monitoring visits.

Monitoring visits involve an assessment of *e-file* Provider business practices, including methods for advertising, preparing tax returns, and safeguarding sensitive taxpayer information. Violations of *e-file* requirements can result in the following:

- Verbal warning – oral admonishment to the *e-file* Provider for not adhering to *e-file* Program rules and entails discussion of possible consequences relating to further noncompliance.

¹ When an *e-filed* return is transmitted to the IRS, it is run through a series of validity and error checks. These checks look for such things as names and Social Security Numbers that match IRS records, math errors, and other common errors. If errors are found, the return is rejected back to the *e-file* Provider to fix the error and resubmit the return.

² The filing season is the period from January through mid-April when most individual income tax returns are filed.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

- Written reprimand – issuance of a formal written warning, communicating more serious violations.
- Suspension – a 1 to 2 year removal from the *e-file* Program.
- Expulsion – permanent removal from the *e-file* Program.

The IRS Wage and Investment Division is responsible for the oversight of the *e-file* Provider screening process. The Small Business/Self-Employed Division is responsible for the Monitoring Program. This review is a followup review to previous audits the Treasury Inspector General for Tax Administration (TIGTA) performed assessing the effectiveness of the IRS' screening and monitoring of *e-file* Providers.³ Appendix IV provides a list of the recommendations and corrective actions associated with these reviews.

This review was performed at the Electronic Tax Administration function in Washington, D.C.; the *e-file* Unit in the Andover, Massachusetts, Submission Processing Site; and the Small Business/Self-Employed Division Headquarters located in New Carrollton, Maryland. Additionally, visits were made to the Los Angeles, California, and Philadelphia, Pennsylvania, Small Business/Self-Employed Division Planning and Special Programs offices. Records were obtained from the Small Business/Self-Employed Division Planning and Special Programs offices in Chicago, Illinois, and Jacksonville, Florida. This audit was conducted during the period December 2006 through June 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 *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 2003), *Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud* (Reference Number 2004-40-013, dated November 2003), and *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Results of Review

The Application Screening Process Does Not Ensure the Integrity of the Individuals Applying for Participation in the E-File Program

The IRS has an effective process for ensuring applicants meet age requirements and *e-file* Providers meet certain suitability checks, such as tax compliance. However, the IRS does not have an independent verification process to confirm the accuracy of applicants who claim they are a Not-For-Profit service. Additionally, the IRS does not verify citizenship; credit checks are not performed; and criminal background checks are limited.

Program requirements and suitability checks are not verified or consistently performed.

The IRS does verify the status of applicants who submit professional certifications in lieu of a fingerprint card to ensure they are still in good standing with the particular organizations that issued the certifications. It also verifies

all new applicants are at least 21 years of age and not deceased. Additionally, the IRS developed an automated process to check and monitor tax compliance of both applicants and existing approved *e-file* Providers.

There are currently no national standards an individual is required to satisfy before presenting himself or herself as a Federal tax preparer and selling tax preparation services to the public. Tax compliance checks, validation of professional certification, confirmation of age requirements, and sampled criminal background checks reduce the risk of non-integrity of *e-file* Providers. However, it is important that the IRS adequately screens *e-file* Provider applicants to protect both the taxpaying public and the Federal Government from losses resulting from actions by unscrupulous Providers.

An automated process checks and monitors tax compliance for applicants and existing e-file Providers

In Fiscal Year 2004, the IRS developed the Automated *e-file* Application Processing system. This system automates the process of checking and monitoring tax compliance and ensures applicants and approved *e-file* Providers are current with their tax return filings and tax payments. In addition, this process ensures individuals and businesses have not been assessed



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

fraud and/or preparer penalties.⁴ A review of 98 applications found that tax compliance checks were correctly performed for the 137 Principal and Responsible officials⁵ and the 94 businesses listed on these applications.

Validations are not performed on applicants who claim they are a Not-For-Profit service

Applicants claimed they were a Not-For-Profit service for 5 of the 98 applications reviewed. However, only four were a Not-For-Profit service. The remaining applicant, who claimed to be a Not-For-Profit service, was a commercial business. IRS management informed us this applicant had erroneously claimed it was a Not-For-Profit service; however, 1,2(e)

1,2(e) E-file Provider applicants who claim they are a Not-for-Profit service select one of five options on the Form 8633, as shown in Figure 3.

Figure 3: Information Required by Applicants Claiming Not-for-Profit Status

- 3 If you are a Not for Profit service, check the one box that applies below:
- | | |
|---|--|
| <input type="checkbox"/> VITA | <input type="checkbox"/> TAC (Tax Assistance Center) |
| <input type="checkbox"/> TCE (Tax Counseling for the Elderly) | |
| <input type="checkbox"/> Military Base | <input type="checkbox"/> Employee Member Benefit |

Source: Excerpt from Form 8633.

Not-for-Profit applicants are excluded from all e-file Program requirements and suitability checks. When IRS assistors review applications, they only ensure the applicant has checked one of the boxes identifying the appropriate service (see Figure 3). No further verification is performed to ensure the applicant is a Not-For-Profit service.

Without validation, the risk increases that 2(f)

As of December 31, 2006, there were 14,149 e-file Providers who claimed Not-For-Profit status.

⁴ Some of the preparer penalties include penalties for failure to exercise due diligence in determining eligibility and/or the amount of the earned income credit, aiding and abetting an understatement of tax liability, and failure to sign a return or claim for refund. Fraud penalties result from violations of the Internal Revenue Code with the intent to evade income taxes.

⁵ There were a total of 138 Principal and Responsible Officials on the 98 applications. One individual did not list a Social Security Number on the application, so we could not verify their tax compliance.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Validations are not performed to ensure applicants are U.S. citizens or legal resident aliens

Tests of 98 applications showed 3 (2 percent) of the 137 applicants were either aliens not allowed to work or alien students with restricted work authorizations. For the remaining 134 applicants, 51 did not have a citizenship indicator (the citizenship field on IRS records was blank) and 83 were found to be citizens. IRS officials explained that citizenship or legal resident alien status is not validated because applicants are required to provide a valid Social Security Number. If an applicant is found to have an invalid Social Security Number, the applicant is ineligible to participate in the *e-file* Program.

We previously recommended the IRS verify the citizenship of applicants before acceptance into the *e-file* Program.⁶ Management disagreed with the recommendation stating they would continue to use current procedures that require Principals and Responsible Officials to possess valid Social Security Numbers. However, the IRS already receives information from the Social Security Administration that indicates whether an individual is a U.S. citizen. The IRS could build into its current automated screening process a check for citizenship or legal resident alien status.

Concerns have been raised about the completeness and accuracy of the citizenship indicator information provided by the Social Security Administration. According to a Social Security Administration Inspector General report,⁷ citizenship indicators were not required until 1978 (Social Security Numbers issued prior to 1978 may not contain a citizenship indicator). In addition, inaccuracies with the citizenship indicator were also reported. Approximately 7 percent of the non-citizens reviewed were found to be misclassified.

However, the IRS should use this information to ensure applicants are U.S. citizens or legal resident aliens as required. For example, during our previous audit,⁸ we conducted a similar test to identify individuals whose citizenship indicators identified them as not being a citizen or legal resident alien. A total of 85 individuals were referred to the IRS for research. Of the 85 individuals, 52 (61 percent) were eventually removed from the *e-file* Program.

For 10 of the individuals, the IRS never contacted the individuals to confirm citizenship.

Prior cases worked by the IRS resulted in the removal of 52 of the individuals TIGTA identified as having questionable citizenship or legal resident alien status. In addition,

⁶ *Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud* (Reference Number 2004-40-013, dated November 2003).

⁷ *Accuracy of the Social Security Administration's Numident File* (Reference Number A-08-06-26100, dated December 2006).

⁸ *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

[REDACTED]

Of the remaining 22 individuals, 1 case is still open and 21 passed suitability after submitting documentation that they were U.S. citizens or legal resident aliens.

For 40 (77 percent) of the 52 individuals removed, the applicants falsified their applications by identifying themselves as U.S. citizens or legal resident aliens. Each of the 52 individuals removed used a valid Social Security Number, even though they were not citizens or legal resident aliens, thereby confirming that possessing a valid Social Security Number does not mean the individual is a citizen.

Credit checks are not performed and criminal background checks are limited

IRS e-file Application and Participation (Publication 3112) and the IRS public web site (IRS.gov) advise that *e-file* Provider applicants may be subjected to credit history checks and criminal background checks. Yet, the IRS does not conduct credit history checks on applicants and criminal background checks are generally limited to random selections of every fourth applicant that submits a fingerprint card. The IRS will conduct a criminal background check when any individual indicates on the application that he or she has been assessed preparer penalties, been convicted of a crime, failed to file personal tax returns, failed to pay tax liabilities, or been convicted of any criminal offense under the U.S. Internal Revenue laws.

In response to a prior TIGTA report,⁹ IRS management responded that credit checks were not performed because the checks were ineffective. *E-file* Providers also raised concerns that their credit history reports showed inquiries by the IRS. Management previously indicated that additional criminal background checks are not necessary and cited an IRS business case study, which showed that, while 10 percent of the investigations revealed information, it was usually not significant enough to deny participation in the *e-file* Program. Management's position on not performing credit checks and limiting criminal background checks has not changed.

IRS management previously indicated they rely on voluntary compliance and the IRS requirement for fingerprint cards or professional certifications is a sufficient deterrent for individuals with criminal backgrounds who would attempt to apply to the *e-file* Program. They acknowledged the risks involved in limiting checks, noting "simply increasing the number of applicants we subject to an existing compliance check does not necessarily equal a more effective screening method."

Relying on voluntary compliance will not address the risks associated with this Program. Losses to both the taxpaying public and the Federal Government could result from actions taken by unscrupulous *e-file* Providers. In addition, information on tax forms (including names;

⁹ *E-File Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Social Security Numbers; and income, employment, and bank account details) is regarded as a prime target for identity thieves.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Verify that Not-for-Profit applicants are a Not-for-Profit service. For existing authorized *e-file* Providers who are a Not-for-Profit service, a validation should be performed to ensure these *e-file* Providers are in fact a Not-for-Profit service.

Management's Response: IRS management agreed with this recommendation. The Electronic Tax Administration Office is currently partnering with Stakeholder Partnerships, Education, and Communication Headquarters to establish formal procedures for validating existing authorized IRS *e-file* Providers as an organization providing a Not-for-Profit service via management reports, screening prior to acceptance for the IRS *e-file* Program, etc.

Recommendation 2: Revise screening procedures to require validation of an applicant's citizenship. This process should require corresponding with potential applicants whose citizenship indicators reflect a non-citizenship status. For existing authorized *e-file* Providers, the IRS should conduct a validation to identify individuals with non-citizenship statuses and develop a process to confirm the citizenship of these individuals.

Management's Response: IRS management agreed with this recommendation. The Electronic Tax Administration Office has already taken steps to review the citizenship verification process and develop a solution. The citizenship codes of applicants can be checked, using the Data Master One¹⁰ tape from the Social Security Administration, before they are accepted into the IRS *e-file* Program. Any applicants found to have a citizenship code that shows they are an alien in the U.S. and are not a legal resident alien will be manually contacted for verification before the application can be completed. For existing applicants, the Electronic Tax Administration Office will perform a one-time query prior to implementing the same procedures. Individuals who are unable to verify that they are U.S. citizens or legal resident aliens will be suspended from the IRS *e-file* Program.

¹⁰ The Data Master One File Data Store contains data from the Social Security Administration used to verify taxpayers who do not have a primary Master File account.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

The Monitoring Program Does Not Ensure E-File Providers Are Compliant With Program Requirements

Deficiencies prevent the IRS from measuring program performance and ensuring that authorized *e-file* Providers are in conformance with *e-file* Program guidelines. Current procedures do not ensure Providers most at risk of noncompliance are selected for monitoring visits and Providers in violation of Program requirements are suspended. *E-file* Provider appeals are not well documented and the *e-file* Monitoring Program management information is inaccurate.

Improvements are needed to ensure the *e-file* Monitoring Program will have the most impact in detecting and stopping unscrupulous Providers. Taxpayers and the Federal Government's risk from fraudulent tax return filings increases when noncompliant *e-file* Providers are not identified. The recent filing of civil injunction suits against five corporations that operate tax preparation businesses shows the importance of adequate oversight over *e-file* Providers. The lawsuits allege the *e-file* Providers created and fostered an environment in which fraudulent tax return preparation is encouraged and flourishes. The suits allege more than \$70 million in combined losses to the Federal Government.

Throughout the audit, as we brought the following issues to IRS management's attention, management understood the significance of the issues and took immediate actions to address these concerns. These actions often included the immediate development and issuance of interim guidance.

Targeted monitoring visits are not based on risk factors and required followup visits are not being conducted

Current procedures do not ensure the established risk-based selection process is followed when selecting *e-file* Providers for monitoring visits. Required followup visits are not being conducted. In addition, documentation is not maintained to support referrals from internal and external sources and the actions taken based on these referrals.

There are three types of monitoring visits, prioritized by: Referrals, Follow up, and Targeted/Random. For Targeted monitoring visits, the established risk-based selection criteria is to include *e-file* Providers who *e-filed* 100 or more tax returns, had a reject rate of at least 25 percent, and/or had 25 percent or more missing U.S. Individual Income Tax Declaration for an IRS *e-file* Return (Form 8453). These criteria were established in response to a prior TIGTA audit¹¹ that recommended the IRS develop

Deficiencies in the e-file Monitoring Program put the integrity of the e-file Program at risk.

¹¹ *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 2003).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

uniform risk-based selection criteria to take advantage of available information and data for selecting *e-file* Providers for its monitoring visits. In addition, guidelines require that all *e-file* Providers who are issued written reprimands be subject to followup monitoring visits in the subsequent tax return filing season to ensure corrective actions have been taken.

Risk-based selection criteria to identify those *e-file* Providers to be visited is not being followed

Testing at two Area Offices¹² identified that monitors were not following the risk-based criteria when selecting *e-file* Providers to review. A review of the characteristics of 40 randomly sampled *e-file* Providers selected for monitoring visits for the 2007 Filing Season identified that:

Monitoring Coordinators were not aware of the risk-based criteria to be followed when identifying e-file Providers for a monitoring visit.

- Three (8 percent) of the 40 *e-file* Providers e-filed fewer than 100 tax returns. Of the 3, 1 *e-file* Provider did not have any tax returns filed, while 2 others had filed returns totaling 15 and 23.
- Thirty-two (80 percent) of the 40 *e-file* Providers had reject rates below 25 percent. For example, 2 *e-file* Providers had reject rates of only 4 and 8 percent.

An ample number of *e-file* Providers that met specific risk-based criteria could have been selected for monitoring visits. Analysis of tax data for these 2 Area Offices identified 453 *e-file* Providers that met the criteria of having filed 100 or more tax returns and a 25 percent or greater reject rate – 200 in one of the Areas and 253 in the other Area. Workload planning required these two Areas in total to perform 220 visits.

Monitoring Coordinators¹³ in these two Area Offices stated they were unaware of selection criteria. The criteria had not been added to formal guidance documents. Coordinators acknowledged that selections were often tied to visits conducted as part of the Earned Income Tax Credit Due Diligence Program. As a result, monitoring visits were at times limited geographically and had no relationship to any of the selection criteria. The coupling of visits for the two Programs was a resource driven decision to save on travel and staff expenditures.

¹² A geographic organizational level used by IRS business units and offices to help their specific types of taxpayers understand and comply with tax laws and issues.

¹³ Monitoring Coordinators develop annual monitoring visit plans including identification of subject *e-file* Providers and train territory office employees (i.e. monitors) responsible for performing the monitoring visits. The Monitoring Coordinators also review monitoring visit case files.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

E-file Providers who were issued written reprimands were not subjected to the required followup visits

Sixty-six monitoring visits, conducted during the 2006 Filing Season, in the two Area Offices tested, resulted in written reprimands. A review of these reprimands found that 24 (36 percent) of 66 were not scheduled for required followup visits during the 2007 Filing Season. Infractions detailed in the written reprimands included:

- Use of leave and earnings statements to prepare tax returns without waiting for the Wage and Tax Statements (Form W-2).
- Violations of advertising guidelines, including misleading advertising.
- Form 8633 was not updated when information such as an *e-file* Provider telephone number had changed.

The IRS manual requires all *e-file* Providers issued written reprimands be subject to followup monitoring visits in the subsequent tax return filing season to ensure corrective actions have been taken.

3(d) [REDACTED]

Furthermore, guidelines were not clear when a followup was required. Management agreed to take corrective action and revised the 2007 visit plan, as appropriate, to include the cases that were overlooked.

Documentation is not maintained to show referrals from internal and external sources and actions taken based on these referrals

Procedures have not been developed requiring Monitoring Coordinators to record the receipt and disposition of referrals. Referrals can come from internal and external sources. For example, an internal referral is when a Monitoring Coordinator sees an *e-file* Provider has tax compliance issues and an external referral is when a taxpayer alleges an *e-file* Provider prepared fraudulent tax returns.

3(d) [REDACTED] In addition, cases with additional tax compliance issues were not timely transferred to other IRS functions. At times, IRS employees conducting monitoring visits identify tax compliance issues that warrant a referral of an *e-file* Provider to the IRS Examination or Criminal Investigation functions. In one Area Office, four *e-file* Providers were referred to the Examination function and 1 3(d) [REDACTED] function. However, the 1 3(d) [REDACTED]



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

(b) (5) - DPP Despite the monitoring visits being completed in April 2006, (b) (5) - DPP (b) (5) - DPP *Standards for Internal Controls in the Federal Government* mandate that all transactions and other significant events need to be clearly documented and the documentation should be readily available for examination.

E-file providers violating Program requirements are not always suspended

A review of cases in 3 Area Offices showed that 6 (17 percent) of 35 *e-file* Providers who had received written notifications of suspension were not suspended. Suspension recommendations resulted from violations identified during 2006 Filing Season monitoring visits. *E-file* Program requirements violated by these six *e-file* Providers include: misleading advertisements, failure to secure taxpayer signatures prior to *e-filing* their tax returns, questionable signatures on tax returns, failing to cooperate with an *e-file* monitor, and/or preparing tax returns based on the last pay stub received rather than an employer issued end-of-year wage and income statement as required. (b) (5) - DPP *e-file* Providers continued to *e-file* during the 2007 Filing Season; the remaining (b) (5) - DPP retained *e-filing* capability but had not *e-filed* a tax return.

After issuing a notification of suspension, procedures require Monitoring Coordinators to prepare an *e-file* Monitoring Sanction Sheet and fax the Sheet to the *e-file* Unit at the Andover, Massachusetts, Submission Processing Site. Once received, the *e-file* Unit updates the system used to monitor *e-file* Providers and suspends *e-filing* privileges. The *e-file* Monitoring Sanction Sheets were not faxed to the *e-file* Unit for four of the six noncompliant *e-file* Providers. For the remaining two, *e-file* Unit personnel mistakenly believed the suspensions were only proposed suspensions and therefore did not require any action on their part.

In addition, three Monitoring Coordinators in three Area Offices were not aware of the requirement to include the Principal(s) and/or Responsible Official(s) on the *e-file* Monitoring Sanction Sheet when the removal of these officials was warranted. Instead, the Coordinators were only including the name of the business specific to that of the *e-file* business location. Depending on the violation, officials at the business location may warrant removal from the *e-file* Program. Without identifying the specific individuals, the only action that will be taken is revoking *e-filing* privileges for the specific business location. The Principal(s) and/or Responsible Official(s) are then permitted to reapply once again and receive *e-filing* privileges at the same location previously suspended or a different location. Removing an individual from the *e-file* Program prevents the individual from participating for a period of time (usually 2 years).

Once we brought these issues to management's attention, immediate action was taken to ensure all *e-file* Providers who should be suspended from participation in the *e-file* Program were in fact suspended. Also, management quickly alerted responsible employees of issues identified and issued interim guidance.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Decisions for reversing e-file Provider suspensions are not well documented

Documentation supporting decisions to reverse recommended suspensions is not maintained by Area Offices. A review of 18 proposed suspensions from 2 Area Offices found that 8 (44 percent) of the proposed suspensions were reversed by the Monitoring Coordinators. The suspensions were reduced to either warnings or written reprimands. For 5 (63 percent) of 8 reversals documentation was not available to show either the rationale for the reversals or the specific individuals involved in the reversal decisions.

An *e-file* Provider advised of either a proposed suspension (i.e., not effective until all appeal options are exhausted) or an immediate suspension has the right to submit, to the IRS within 30 days, a written request for appeal that must be accompanied by supporting documentation. The appeal process is comprised of two levels, the first being an administrative review decided by Area Office officials. If the *e-file* Provider is not satisfied with the outcome of the administrative review, he or she may proceed to the second level and file a formal appeal.

Formal guidelines state the Monitoring Coordinator will decide whether to reverse the suspensions. Guidance also outlines that an administrative review committee will review and decide the appeals. However, guidance does not detail specific documentation to be maintained.

Standards for Internal Controls in the Federal Government mandate that all transactions and other significant events need to be clearly documented and the documentation should be readily available for examination.

Adequate documentation was not maintained supporting appeal decisions.

Management information used to monitor e-file Providers is not accurate

Three of four Monitoring Coordinators submitted inaccurate management information reports to National Program Management at the conclusion of the 2006 Filing Season. Reviews of *e-file* monitoring case files in two of four Area Offices identified inaccuracies in reporting the disposition of monitoring visits.

Figure 4 provides a comparison of the actual disposition to what was reported (excluding suspension information for which separate testing was performed).

Inaccuracies in management information resulted from the lack of a reconciliation process.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Figure 4: Comparison of Actual Results of 2006 Filing Season Monitoring Visits With Information Reported

Results per TIGTA Review for Two Sampled Area Offices		Results Reported to National Program Management	
			Difference
In Compliance	89	97	8%
Verbal Warning	20	25	20%
Written Reprimand	57	44	-30%
In Compliance	28	36	22%
Verbal Warning	4	14	71%
Written Reprimand	9	9	---

Source: TIGTA review of monitoring case files maintained in two Area Monitoring Coordinator offices sampled.

In addition, two of four Area Offices' management information relating to suspensions was inaccurate. Figure 5 provides a comparison of what was reported to actual results.

Figure 5: Comparison of Actual Suspensions With the Number Reported

	Results Per TIGTA Review		Results Reported to National Management	
	Proposed	Immediate	Proposed	Immediate
Area A	17	0	16	3
Area B	11	0	11	0
Area C	5	2	0	5
Area D	0	0	0	0
Total	33	2	27	8

Source: TIGTA review of suspension documentation obtained from Area Offices Monitoring Coordinators included in our sample.

Beginning the last week of January each year and throughout the filing season, Monitoring Coordinators are required to report weekly, to the National Program Management, the number of *e-file* monitoring visits completed, along with the specific results of those monitoring visits. These weekly reports are based on data the Coordinators receive from the offsite monitors who performed the visits.

Inaccuracies result when the Monitoring Coordinators review the cases after they have already reported the weekly results to the National Management. The Monitoring Coordinators review



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

the monitoring visit case files after the end of the filing season, and at times the reviews result in a change to the disciplinary actions recommended by the offsite monitor who performed the visit. However, Monitoring Coordinators are not updating management information with changes based on their reviews.

Not updating results when proposed suspensions are reversed on appeal and a lesser disciplinary action is recommended also contributes to the inaccuracies in management information. Inaccurate management information impedes the IRS' ability to effectively quantify the scope and results of the *e-file* Monitoring Program and to make informed business decisions relative to Program direction.

Recommendations

The Commissioner, Small Business/Self Employed Division, should:

Recommendation 3: Develop a process that ensures established risk-based selection criteria is used to identify *e-file* Providers for monitoring visits.

Management's Response: IRS management agreed with this recommendation. A risk-based selection criterion has been developed and added to Internal Revenue Manual 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

Recommendation 4: Clarify procedures regarding when followup visits should be performed and implement a process that ensures followup visits are conducted in accordance with the clarified guidelines.

Management's Response: IRS management agreed with this recommendation. Procedures regarding followup visits have been clarified and added to Internal Revenue Manual 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

Recommendation 5: Develop a process to record the receipt and disposition of referrals from internal and external sources. This process should also ensure the timely referral to other IRS functions, if recommended.

Management's Response: IRS management agreed with this recommendation. A process has been developed to keep track of these cases through a new control log kept by the Area E-File Monitoring Coordinators to be forwarded to the Headquarters analyst at the end of each quarter, including the end of the calendar year. This new procedure has been added to Internal Revenue Manual 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Recommendation 6: Develop a process to ensure *e-file* Provider privileges are suspended when recommended and consideration is given and notated if Principal(s) and/or Responsible Official(s) should be removed from the *e-file* Program.

Management's Response: IRS management agreed with this recommendation. A process has been developed to keep track of Electronic Filing Identification Number suspension cases through a new control log kept by the Area E-File Monitoring Coordinators to be forwarded to the Headquarters analyst at the end of each quarter, including the end of the calendar year. This new procedure has been added to Internal Revenue Manual 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

Recommendation 7: Develop procedures requiring the maintenance of adequate documentation supporting an *e-file* Provider's request for an appeal, as well as documentation supporting the review and outcome of an appeal.

Management's Response: IRS management agreed with this recommendation. Procedures have been clarified and incorporated into Internal Revenue Manual 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

Recommendation 8: Develop a process to ensure management information accurately reflects the results of the *e-file* Monitoring Program.

Management's Response: IRS management agreed with this recommendation. A process has been developed to keep track of results that are kept by the Area E-File Monitoring Coordinators to be forwarded to the Headquarters analyst at the end of each quarter, including the end of the calendar year. This new procedure has been added to Internal Revenue Manual 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Reviews of Closed Criminal Cases Involving E-file Providers May Identify Risk Factors or Indicators to Detect Unscrupulous E-file Providers

The IRS does not have a process to review *e-file* Provider cases worked by its Criminal Investigation function to identify opportunities to improve on the screening checks and selection criteria for monitoring visits. Characteristics of these cases could identify risk factors or indicators to be used to screen unscrupulous individuals from entry into the *e-file* Program and identify unscrupulous *e-file* Providers in the *e-file* Program. The Criminal Investigation function initiated 315 criminal cases involving tax return preparers during Fiscal Years 2006 and 2007 (as of April 30, 2007). The Criminal Investigation function currently does not track tax preparer cases by whether or not the individual was an *e-file* Provider, but an analyst stated that most of these cases involve *e-file* Providers.

An example included in a prior TIGTA report¹⁴ detailed a closed criminal case concerning an *e-file* Provider who pled guilty to filing false tax returns. This case exemplifies the importance of the IRS including reject rates as a risk factor in the monitoring visit selection criteria. This *e-file* Provider had a reject rate in excess of 40 percent for tax returns submitted during the 2001 and 2002 Filing Seasons. The high reject rate resulted from a process known as “washing.”

The washing entailed the *e-file* Provider submitting tax returns using fraudulently obtained Social Security Numbers. As part of the IRS’ validity checks, it verified the Social Security Numbers using computer files to determine if they were valid and/or were previously used on another tax return. If the checks identified problems, the tax return was rejected and the *e-file* Provider was provided an explanation on why the tax return was rejected. The *e-file* Provider would keep track of the rejected Social Security Numbers to ensure they were not used on subsequently submitted fraudulent tax returns. The IRS has since added a high reject rate as one of the indicators for identifying an *e-file* Provider for a monitoring visit.

This *e-file* Provider filed approximately 9,000 fraudulent tax returns over a 3-year period and received approximately \$7 million in fraudulent tax refunds in 1 year alone. This *e-file* Provider had a criminal history before being accepted into the Program. The *e-file* Provider pled guilty to filing false, fictitious, and fraudulent claims against the U.S. (tax returns); conspiracy to file false claims against the U.S.; and conspiracy to negotiate forged U.S. Treasury checks of approximately \$33,000.

¹⁴ *Improvements Are Needed in the Screening and Monitoring of E-File Providers to Protect Against Filing Fraud* (Reference Number 2004-40-013, dated November 2003).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Recommendation

The Commissioners, Wage and Investment Division, and Small Business/Self Employed Division, should:

Recommendation 9: Ensure results of criminal cases involving *e-file* Providers are used to identify potential risk factors or indicators that can be built into the screening and monitoring process to improve on the identification of unscrupulous *e-file* Providers.

Management's Response: IRS management partially agreed with this recommendation. The Wage and Investment and Small Business/Self-Employed Divisions will study the feasibility of using results of criminal cases involving *e-file* Providers to identify risk factors or indicators for the suitability process. This will require working with the Criminal Investigation Division, to obtain criminal case characteristics of providers of *e-file* returns and any other information they might have. If a work request is needed for enhancements to the electronic *e-file* Application, more time will be needed for funding and implementation of new electronic processes.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the IRS' screening and monitoring of *e-file* Providers is effective. To accomplish this objective, we:

- I. Determined whether the initial and periodic screening process is effectively identifying those *e-file* Providers that are not in compliance with Program requirements.
 - A. Assessed actions taken by the IRS in response to prior TIGTA recommendations.
 - B. Determined whether applicants met *e-file* requirements prior to acceptance in the Program.
 1. Obtained a list of active *e-file* Providers from the Third Party Data Store.¹ To validate this data, we selected five records from the Third Party Data Store extract and validated them to printouts from the Third Party Data Store.
 2. Selected a statistically valid sample of 98 active *e-file* Providers out of 29,454 *e-file* applications that were accepted in 2006 to assess compliance with *e-file* requirements. Our sample size was selected based on a 10 percent error rate, a 5 percent precision rate, and a 90 percent confidence level.
 - a) Performed data matches for all Principal(s) and Responsible Official(s)² listed on the application to confirm that they were in compliance with age and citizenship requirements and that the individuals were not deceased.
 - b) Performed data matches for the business, all Principal(s), and Responsible Official(s) to ensure they were tax compliant.
 - c) Determined whether a fingerprint card or professional certification was received for all Principal(s) and Responsible Official(s) listed on the application.
 - d) Determined whether a mandatory criminal background check was performed for those applicants who indicated on the application that the firm failed to file

¹ The Third Party Data Store is an electronic database that houses all pertinent information on third parties that interact with the IRS through e-Services. For example, this database contains information on all registered users and *e-file* Providers, along with information on their *e-file* activity.

² A Principal includes the sole proprietor, partners, or individuals authorized to act for the entity in legal and/or tax matters. A Responsible Official is the first point of contact with the IRS and has the authority to sign revised IRS *e-file* applications and ensures the *e-file* Provider adheres to the provisions of the revenue procedure as well as all publications and notices governing IRS *e-file*.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

business tax returns or pay tax liabilities, or an individual on the application indicated they had been assessed preparer penalties, been convicted of a crime, failed to file personal tax returns or pay tax liabilities, or been convicted of any criminal offense under the U.S. Internal Revenue laws.

- e) For those individuals in our sample selected for a criminal background check, assessed the actions taken based on any results received back from the Federal Bureau of Investigation and determined whether results were received prior to acceptance.
- C. Determined whether the IRS has a process to ensure applicants selecting Not-for-Profit are in fact Not-For-Profit.
- D. Determined whether the IRS' screening process is effective.
- II. Determined whether the IRS' *e-file* monitoring process effectively identifies any *e-file* Providers who are not complying with Program requirements.
 - A. Assessed related actions the IRS took in response to prior TIGTA recommendations.
 - B. Determined whether the IRS has established a process to effectively track and resolve referrals received.
 - C. Assessed the process for *e-file* Monitoring Coordinators to follow when referring an *e-file* Provider to the Examination and/or Criminal Investigation function.
 - D. Evaluated whether the checklist that *e-file* monitors use to ensure completeness of monitoring visits includes an assessment of all Program requirements.
 - E. Assessed the effectiveness of the process followed for selecting *e-file* Providers for monitoring visits.
 - F. Determined if disciplinary actions resulting from violations identified during 2006 monitoring visits were carried out in accordance with guidelines. For the two Area Offices we visited, we determined whether written reprimands issued to noncompliant *e-file* Providers were followed-up on, as required.
 - G. For the two Area Offices visited, reviewed the effectiveness of actions taken to suspend *e-file* Providers. Sites visited were selected to ensure broad geographic coverage. Because of significant issues identified, we expanded testing to two other Area Offices, selected based on the relative high volume of suspensions in Calendar Year 2006. In total, we assessed the processing of all 35 proposed and immediate suspensions imposed in Calendar Year 2006.
 - H. Identified control breakdowns and attempted to assess the impact on taxpayers and the IRS.



*Better Screening and Monitoring of E-File Providers Is Needed to
Minimize the Risk of Unscrupulous Providers Participating
in the E-File Program*

Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Augusta R. Cook, Director

Russell P. Martin, Audit Manager

Pamela DeSimone, Lead Auditor

Robert Howes, Senior Auditor

Andrea Hayes, Auditor

Mary Keyes, Auditor



*Better Screening and Monitoring of E-File Providers Is Needed to
Minimize the Risk of Unscrupulous Providers Participating
in the E-File Program*

Appendix III

Report Distribution List

Acting Commissioner C
Office of the Commissioner – Attn: Acting Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
Director, Compliance, Small Business/Self-Employed Division SE:S:C
Director, Customer Account Services, Wage and Investment Division SE:W:CAS
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division
SE:W:CAR
Director, Electronic Tax Administration, Wage and Investment Division SE:W:ETA
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Chief, Performance Improvement, Wage and Investment Division SE:W:S:PI
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Senior Operations Advisor, Wage and Investment Division SE:W:S



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Appendix IV

Prior Treasury Inspector General for Tax Administration Report Recommendations

Report Reference	Recommendation	Corrective Action per the IRS
2004-40-013 November 2003 ¹	Ensure citizenship and age requirements are met.	Agreed – will ensure responsible officials possess valid Social Security Numbers.
	Ensure criminal background checks are obtained electronically.	Agreed - process requires the purchase of scanning hardware and software. Completion of this acquisition process will not occur before the 2004 Filing Season.
	For unprocessable fingerprint cards, a name check should be used as the basis for the criminal background check.	Agreed - guidelines revised and the Federal Bureau of Investigation will be requested to perform a background check using name and other available information on unprocessable cards.
	Ensure individuals who provide professional certifications are in current standing.	Agreed - revised <i>IRS e-file Application and Participation</i> (Publication 3112) as well guidelines and procedures. Also, enrolled agents will be validated during application process. There is no central repository for a systemic check for the other categories of professionals. Will pursue other methods to perform check of other categories.

¹ *Improvements Are Needed in the Screening and Monitoring of E-file Providers to Protect Against Filing Fraud* (Reference Number 2004-40-013, dated November 2003).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Report Reference	Recommendation	Corrective Action per the IRS
2004-40-013 November 2003 (continued)	Periodic updates of criminal investigations.	Disagreed – no action.
	Use <i>e-file</i> reject rates for selecting monitoring visits.	Agreed – will develop related guidance.
	Establish a system to measure the effectiveness of the <i>e-file</i> Provider monitoring program.	Agreed – will revise monitoring reports to reflect the results broken down by referral type.
2003-30-039 January 2003 ²	Establish a goal and method for measuring program effectiveness for improving ERO compliance, such as results of followup visits.	Disagreed – cannot accurately measure results of visits.
	Maintain case documentation - re-enforce that followup visits are a measure of monitoring the impact on compliance.	Agreed - issued memo guidance.
	Allow time for case building.	Agreed - training provided.
	Ensure ease of identifying referral sites.	Agreed - guidance issued.
	Develop process for proper mix of random/mandatory visits - broad geographic coverage.	Agreed - guidance issued.
	Develop uniform risk-based criteria for selecting <i>e-file</i> Providers to include in monitoring visit plans.	Agreed - Guidance issued on use of indicators in selecting <i>e-file</i> Providers for monitoring visits.
	Provide clear and unambiguous infraction and sanction guidelines.	Agreed - Guidelines revised.

² *Improvements to the Electronic Return Originator Monitoring Program Are Needed* (Reference Number 2003-30-039, dated January 2003)



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Report Reference	Recommendation	Corrective Action per the IRS
2003-30-039 January 2003 (continued)	Revise <i>e-file</i> Monitoring Guidelines to consider Earned Income Tax Credit due diligence when determining <i>e-file</i> Provider compliance with Internal Revenue Service <i>e-file</i> Program requirements.	Agreed - instructed monitors to pursue due diligence penalties when appropriate.
	Ensure complete case documentation is maintained.	Agreed - guidance issue.
2002-40-111 June 2002 ³	Screening procedures should include independent validation of citizenship and age.	Disagreed - due to view that number of ineligible applicants based on age and citizenship is small.
	All applicants should be subjected to credit and criminal background checks before acceptance in the <i>e-file</i> Program.	Disagreed – Experience shows credit checks are ineffective. Case study showed background investigations reveal information usually not of significance to deny participation in the <i>e-file</i> Program. <i>E-file</i> growth and return preparation for low-income taxpayers would be adversely affected with checks at volunteer sites.
	Perform subsequent credit/criminal checks at regular intervals.	Disagreed - report does not justify need. Regular monitoring of Providers occurs ensuring compliance with rules, and the audit report does not show screening and monitoring processes produce negative results, thus justifying additional checks.

³ *E-file Providers Are Not Adequately Screened* (Reference Number 2002-40-111, dated June 2002).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Report Reference	Recommendation	Corrective Action per the IRS
2002-40-111 June 2002 (continued)	Guidelines for handling fingerprint cards returned as unprocessable should be followed and individuals with unprocessable fingerprint cards should be contacted and a new card provided for completion of criminal check.	Agreed - will request new fingerprint cards from applicants and resubmit them to the Federal Bureau of Investigation. No need to contact those who were already identified to date since those individuals are already participants in the Program. Will issue interim guidance on obtaining new fingerprint cards.

Source: Prior TIGTA Reports as cited.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Appendix V

Examples of E-File Provider Requirements Verifiable Only Through a Monitoring Visit

- Accepting tax returns from persons other than taxpayers or authorized *e-file* Providers.
- Conduct of a disreputable nature.
- Earned Income Tax Credit Due Diligence Checklist and Worksheet not on file.
- Failure to check identification of tax return filers.
- Failure to notify the IRS of changes in Application to Participate in the IRS *e-file* Program (Form 8633) (e.g., not notifying the IRS of business address and contact information changes).
- Failure to protect taxpayer information from potential misuse.
- Failure to retain required records.
- Knowingly employing a denied/suspended *e-file* Provider.
- Not complying with advertising standards (e.g., posting misleading advertising material).
- Preparation of tax returns using leave and earnings statements rather than required Wage and Tax Statement (Form W-2).
- Unethical practices in tax return preparation.
- Untimely, missing, or incomplete U.S. Individual Income Tax Declaration for an IRS *e-file* Return (Form 8453) (i.e., failure to adhere to taxpayer signature requirements).



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Appendix VI

Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

RECEIVED
AUG 24 2007

AUG 23 2007

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Better Screening and Monitoring of E-File Providers is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program (Audit # 200740020)

I have reviewed the subject draft report and appreciate your acknowledgement that the Internal Revenue Service has an effective suitability process, specifically our Automated Suitability Acceptability Program (ASAP). I want to assure you of our commitment to maintaining the intent and integrity of our suitability and monitoring programs, and that we continually evaluate opportunities for improvements. As reflected in your report, the ASAP program implemented in FY 2004 effectively automated the tax compliance check of every active provider in our databases on a continuous basis.

We also appreciate the partnership we have experienced through the years with TIGTA in our common desire to cost effectively enhance our processes. For example, your previous recommendation to install the electronic fingerprinting interface with the Federal Bureau of Investigation has accelerated the screening process by reducing the time needed to obtain criminal checks from 30 days to an average of less than 2 minutes. We will continue to evaluate and improve our ability to independently verify applicants' eligibility and suitability status, such as age or professional credentials.

We agree with the recommendation to verify that Not-for-Profit applicants are a Not-for-Profit service and to require validation of an applicant's citizenship. We will also analyze the feasibility of using results of criminal cases involving e-file Providers to identify risk factors or indicators for the suitability process.

We also agree to develop a process that ensures risk-based selection criteria are used to identify e-file Providers for monitoring visits. We will clarify procedures regarding follow-up visits; develop a process to record the receipt and disposition of referrals and ensure e-file Provider privileges are suspended when recommended. We will provide procedures requiring the maintenance of adequate documentation supporting an e-file Provider's request for an appeal and documentation supporting the review and



*Better Screening and Monitoring of E-File Providers Is Needed to
Minimize the Risk of Unscrupulous Providers Participating
in the E-File Program*

2

outcome of an appeal. We will also ensure management information reflects the results of the e-file Monitoring Program.

Our response to your recommendations is detailed in the attachment. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact David R. Williams, Director, Electronic Tax Administration and Refundable Credits, at (202) 622-7990.

Attachment



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

Attachment

RECOMMENDATION 1

The Commissioner, Wage and Investment Division, should verify that Not-for-Profit applicants are a Not-for-Profit service. For existing authorized *e-file* Providers who are Not-for-Profit service, a validation should be performed to ensure these *e-file* Providers are in fact a Not-for-Profit service.

CORRECTIVE ACTION

We agree with this recommendation. The Electronic Tax Administration (ETA) Office is currently partnering with Stakeholder Partnerships, Education & Communication Headquarters to establish formal procedures for validating existing authorized IRS *e-file* Providers as an organization providing a Not-for-Profit service via management reports, screening prior to acceptance for IRS *e-file*, etc.

IMPLEMENTATION DATE

December 15, 2008

RESPONSIBLE OFFICIAL

Director, Electronic Tax Administration and Refundable Credits, Wage and Investment (W&I) Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Electronic Tax Administration and Refundable Credits, will advise the W&I Commissioner of any delays in implementing this corrective action.

RECOMMENDATION 2

The Commissioner, Wage and Investment Division, should revise screening procedures to require validation of an applicant's citizenship. This process should require corresponding with potential applicants whose citizenship indicators reflect a non-citizenship status. For existing authorized *e-file* Providers, the IRS should conduct a validation to identify individuals with non-citizenship statuses and develop a process to confirm the citizenship of these individuals.

CORRECTIVE ACTION

We agree with this recommendation. Of the three applicants mentioned in the report who were assumed to be either aliens, not allowed to work, or students with restricted work authorization, all three have since provided evidence that they possess a valid green card to the IRS, showing that they are indeed legal resident aliens and allowed to participate in the IRS *e-file* program.

The ETA Office has already taken steps to review the citizenship verification process and develop a solution. The citizenship codes of applicants can be checked, using the DM-1 tape from the Social Security Administration, before they are accepted into the



*Better Screening and Monitoring of E-File Providers Is Needed to
Minimize the Risk of Unscrupulous Providers Participating
in the E-File Program*

2

IRS *e-file* program. Any applicants found to have a citizenship code that shows they are an alien in the United States (U.S.) and are not a legal resident alien will be manually contacted for verification before the application can be completed. Individuals will be suspended if verification is not received.

For existing applicants, the ETA Office will perform a one-time query prior to implementing the above procedures to obtain a listing of individuals whose citizenship codes show they are an alien in the U.S. and are not legal resident aliens. Contact will be made with everyone on the list for verification of their current status. Individuals who are not able to verify that they are U.S. citizens or legal resident aliens will be suspended from the IRS *e-file* program.

IMPLEMENTATION DATE

August 15, 2008

RESPONSIBLE OFFICIAL

Director, Electronic Tax Administration and Refundable Credits, W&I Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Electronic Tax Administration and Refundable Credits, will advise the W&I Commissioner of any delays in implementing this corrective action.

RECOMMENDATION 3

The Commissioner, Small Business/Self Employed Division (SB/SE) should develop a process that ensures established risk-based selection criteria is used to identify *e-file* Providers for monitoring visits.

CORRECTIVE ACTION

We agree with this recommendation. A "risk-based" selection criterion has been developed and added to Internal Revenue Manual (IRM) 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

IMPLEMENTATION DATE

February 15, 2008

RESPONSIBLE OFFICIAL

Director, Examination, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Examination, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.



*Better Screening and Monitoring of E-File Providers Is Needed to
Minimize the Risk of Unscrupulous Providers Participating
in the E-File Program*

3

RECOMMENDATION 4

The Commissioner, Small Business/Self Employed Division should clarify procedures regarding when follow-up visits should be performed and implement a process that ensures follow-up visits are conducted in accordance with the clarified guidelines.

CORRECTIVE ACTION

We agree with this recommendation. We have clarified procedures regarding follow-up visits and have added them to IRM 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

IMPLEMENTATION DATE

February 15, 2008

RESPONSIBLE OFFICIAL

Director, Examination, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Examination, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.

RECOMMENDATION 5

The Commissioner, Small Business/Self Employed Division should develop a process to record the receipt and disposition of referrals from internal and external sources. This process should also ensure the timely referral to other IRS functions, if recommended.

CORRECTIVE ACTION

We agree with this recommendation and have developed a process to keep track of these cases through a new control log kept by the Area E-File Monitoring Coordinators (EMC's) to be forwarded to the Headquarters analyst at the end of each quarter, including the end of the calendar year. This new procedure has been added to IRM 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

IMPLEMENTATION DATE

February 15, 2008

RESPONSIBLE OFFICIAL

Director, Examination, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Examination, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.



Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program

4

RECOMMENDATION 6

The Commissioner, Small Business/Self Employed Division should develop a process to ensure *e-file* Provider privileges are suspended when recommended and consideration is given and notated if Principal(s) and/or Responsible Official(s) should be removed from the *e-file* Program.

CORRECTIVE ACTION

We agree with this recommendation and have developed a process to keep track of Electronic Filing Identification Number suspension cases through a new control log kept by the Area EMC's to be forwarded to the Headquarters analyst at the end of each quarter, including the end of the calendar year. This new procedure has been added to IRM 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

IMPLEMENTATION DATE

February 15, 2008

RESPONSIBLE OFFICIAL

Director, Examination, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Examination, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.

RECOMMENDATION 7

The Commissioner, Small Business/Self Employed Division should develop procedures requiring the maintenance of adequate documentation supporting an *e-file* Provider's request for an appeal, as well as documentation supporting the review and outcome of an appeal.

CORRECTIVE ACTION

We agree with this recommendation. We have clarified procedures and incorporated them into IRM 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

IMPLEMENTATION DATE

February 15, 2008

RESPONSIBLE OFFICIAL

Director, Examination, SB/SE Division



*Better Screening and Monitoring of E-File Providers Is Needed to
Minimize the Risk of Unscrupulous Providers Participating
in the E-File Program*

5

CORRECTIVE ACTION MONITORING PLAN

The Director, Examination, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.

RECOMMENDATION 8

The Commissioner, Small Business/Self Employed Division should develop a process to ensure management information accurately reflects the results of the *e-file* Monitoring Program.

CORRECTIVE ACTION

We agree with this recommendation and have developed a process to keep track of results that are kept by the Area EMCs to be forwarded to the Headquarters analyst at the end of each quarter, including the end of the calendar year. This new procedure has been added to IRM 4.21.1, *Electronic Filing Program-Monitoring the IRS e-file Program*, which should be published by January 30, 2008.

IMPLEMENTATION DATE

February 15, 2008

RESPONSIBLE OFFICIAL

Director, Examination, SB/SE Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Examination, SB/SE Division, will advise the SB/SE Commissioner of any delays in implementing this corrective action.

RECOMMENDATION 9

The Commissioners, Wage and Investment Division and Small Business/Self Employed Divisions, should ensure results of criminal cases involving e-file Providers are used to identify potential risk factors or indicators that can be built into the screening and monitoring process to improve on the identification of unscrupulous *e-file* Providers

CORRECTIVE ACTION

We partially agree with this recommendation. The W&I and SB/SE Divisions will study the feasibility of using results of criminal cases involving e-file Providers to identify risk factors or indicators for the suitability process. This will require working with the Criminal Investigation Division, to obtain criminal case characteristics of providers of e-file returns and any other information they might have. If a work request is needed for enhancements to the electronic e-file Application, more time will be needed for funding and implementation of new electronic processes.



*Better Screening and Monitoring of E-File Providers Is Needed to
Minimize the Risk of Unscrupulous Providers Participating
in the E-File Program*

6

IMPLEMENTATION DATE

March 15, 2008

RESPONSIBLE OFFICIAL

Director, Electronic Tax Administration and Refundable Credits, W&I Division

CORRECTIVE ACTION MONITORING PLAN

The Director, Electronic Tax Administration and Refundable Credits, and Director, Examination, SB/SE Division, will advise the W&I Commissioner and SB/SE Commissioner of any delays in implementing this corrective action.