RECOVERY ACT

A Comprehensive Strategy Is Being Developed to Identify Individuals With First-Time Homebuyer Credit Repayment Requirements

August 16, 2010

Reference Number: 2010-41-086

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

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HIGHLIGHTS

A COMPREHENSIVE STRATEGY IS BEING DEVELOPED TO IDENTIFY INDIVIDUALS WITH FIRST-TIME HOMEBUYER CREDIT REPAYMENT REQUIREMENTS

Highlights

Final Report issued on August 16, 2010

Highlights of Reference Number: 2010-41-086 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Approximately 1.8 million taxpayers claimed a total of almost $12.5 billion in First-Time Homebuyer Credits in Calendar Year 2009. More than 950,000 taxpayers will be required to repay the Credits because their homes were purchased in 2008. Many more may have to repay the Credits if the homes cease to be the primary residences of the taxpayers within 36 months.

WHY TIGTA DID THE AUDIT

The Housing and Economic Recovery Act of 2008 created a new First-Time Homebuyer Credit equal to 10 percent of the purchase price of the home, limited to a maximum amount of $7,500. The Credit served as an interest-free loan that must be repaid over a 15-year period. Subsequent laws expanded the Credit and eliminated the repayment requirement, except in those instances in which the home is sold or no longer the taxpayer's primary residence within 36 months.

A prior TIGTA review reported that the Internal Revenue Service (IRS) could not distinguish between 2008 and 2009 home purchases and outlined concerns that controls would not be adequate to prevent erroneous or fraudulent claims for the Credit.

WHAT TIGTA FOUND

The IRS developed computer coding to record a special indicator during processing of tax returns and adjustment transactions to distinguish individuals with a 2008 home purchase from those with a 2009 home purchase. The IRS also created a Homebuyer Credit Entity Section on the tax accounts for individuals that received the Credit.

However, our analysis identified an estimated 73,119 (4.1 percent) of the 1,774,718 individuals receiving the Credit had incorrect purchase dates recorded on the IRS' system; 59,802 of these taxpayers purchased their homes in 2009, but the IRS incorrectly recorded the purchases as 2008 or the years were not recorded. These taxpayers could incorrectly receive notices requiring repayment.

Currently, the IRS does not have the ability to identify individuals who received the Credit and their purchased homes cease to be their main residences, which requires repayment. The IRS is developing a comprehensive strategy to address repayment provisions in the law. The strategy objectives include identifying third-party data sources to ensure individuals are complying with the provisions in the law.

TIGTA also identified 1,326 single taxpayers the Social Security Administration recorded as deceased who claimed $10.1 million in erroneous Credits. The IRS did not allow 528 of the 1,326 individuals to receive over $4 million they claimed for the Credit.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, 1) correct the purchase dates for the 68,924 accounts TIGTA identified as having incorrect purchase dates and 2) ensure the 798 individuals who TIGTA identified as being deceased prior to the purchase of the home are entitled to claim the Credit.

In their response to the report, IRS officials agreed the claims for the Credit for the 68,924 accounts were processed early in the program and some purchase dates were incorrectly recorded in IRS systems. The IRS plans to use third-party property records to verify home purchase or disposition information and to refer discrepancies for appropriate resolution. In addition, it plans to audit the 798 accounts and recapture the claims paid out, if necessary.

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

August 16, 2010

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Michael R. Phillips

FROM: Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – A Comprehensive Strategy Is Being Developed to Identify Individuals With First-Time Homebuyer Credit Repayment Requirements (Audit # 201040101)

This report presents the results of our review to determine whether the Internal Revenue Service has developed effective strategies to administer the First-Time Homebuyer Credit, recapture the Credit from taxpayers when appropriate, and prevent improper Credits. This review is included in our Fiscal Year 2010 Annual Audit Plan and addresses the major management challenge of Implementing Tax Law Changes.

The American Recovery and Reinvestment Act of 2009 (Recovery Act)[1] provides separate funding to the Treasury Inspector General for Tax Administration through September 30, 2013, to be used in oversight activities of Internal Revenue Service programs. This audit was conducted using Recovery Act funds.

Management's complete response to the draft report is included in 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 (Returns Processing and Account Services), at (202) 622-5916.

[1] Pub. L. No. 111-5, 123 Stat. 115 (2009).

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Abbreviations

IRS	Internal Revenue Service
SSA	Social Security Administration
TY	Tax Year

Background

The Housing and Economic Recovery Act of 2008[1] created a new First-Time Homebuyer Credit (Homebuyer Credit or Credit). The term "first-time homebuyer" means any individual who had no ownership interest in a principal residence during the 3-year period prior to the purchase of the home.[2] The Homebuyer Credit was originally available for a limited time only, applying to taxpayers who purchased a principal residence after April 8, 2008, and before July 1, 2009. Eligible taxpayers were allowed to claim a Credit equal to 10 percent of the purchase price of the home, limited to a maximum amount of $7,500. The Homebuyer Credit served as an interest-free loan that must be repaid (recaptured)[3] over a 15-year period beginning with the second taxable year following the purchase of the home. In most instances, the repayment of the Credit would begin in Tax Year (TY) 2010.

To stimulate the housing industry, Congress created the First-Time Homebuyer Credit.

Subsequent legislation, the American Recovery and Reinvestment Act of 2009 (Recovery Act)[4] and the Worker, Homeownership, and Business Assistance Act of 2009,[5] revised, extended, and expanded the Homebuyer Credit. Figure 1 provides a comparison of the various provisions as they relate to the Homebuyer Credit.

[1] Pub. L. No. 110-289. 122 Stat. 2654 (2008).
[2] Throughout this report, any reference to a year is intended as a calendar year unless otherwise designated.
[3] If a First-Time Homebuyer Credit is allowed to a taxpayer, that taxpayer's income tax is increased by 6⅔ percent of the amount of such Credit for each taxable year in the 15-year "recapture period." The recapture period begins with the second taxable year following the year of purchase for which the Credit is taken.
[4] Pub. L. No. 111-5, 123 Stat. 316 (2009).
[5] Pub. L. No. 111-92, 123 Stat. 2984 (2009).

Figure 1: Comparison of the First-Time Homebuyer Credit Legislation Provisions

Legislation	Housing and Economic Recovery Act of 2008	American Recovery and Reinvestment Act of 2009	Worker, Homeownership, and Business Assistance Act of 2009
Home Purchase Dates	April 9, 2008, through June 30, 2009.	January 1, 2009, through November 30, 2009.	December 1, 2009, through April 30, 2010, with the closing date of the purchase by June 30, 2010. Dates extended for 1 year for individuals on qualified official extended duty outside of the United States for at least 90 days from December 31, 2008, to May 1, 2010.
Qualifying Individual	Individual (and spouse, if married) having no ownership interest in a principal residence in the preceding 36 months. Phase-out of the Credit begins at $75,000-$95,000 for individuals ($150,000-$170,000 for married filing jointly). Individual cannot be a nonresident alien or related to the seller of the home.	Individual (and spouse, if married) having no ownership interest in a principal residence in the preceding 36 months. Phase-out of the Credit begins at $75,000-$95,000 for individuals ($150,000-$170,000 for married filing jointly). Individual cannot be a nonresident alien or related to the seller of the home.	Individual (and spouse, if married) having no ownership interest in a principal residence in the preceding 36 months. Phase-out of the Credit begins at $125,000-$145,000 for individuals ($225,000-$245,000 for married filing jointly). Also includes a Long-Time Resident provision if the individual (and spouse, if married) maintained the same principal residence for any 5 consecutive years during the 8 years ending on the date of the purchase.
Amount of the Credit	10 percent of the purchase price up to a maximum of $7,500 ($3,750, if married filing separately).	10 percent of the purchase price up to a maximum of $8,000 ($4,000, if married filing separately).	10 percent of the purchase price up to a maximum of $8,000 ($4,000, if married filing separately). Long-Time Resident: Maximum of $6,500 ($3,250 if married filing separately).
Accelerated Repayment		Fully recaptured in year of sale if home is sold within 3 years of purchase.	Fully recaptured in year of sale if home is sold within 3 years of purchase.

Legislation	Housing and Economic Recovery Act of 2008	American Recovery and Reinvestment Act of 2009	Worker, Homeownership, and Business Assistance Act of 2009
Recapture of the Credit	Fully recaptured over 15 years beginning in TY 2010 (if 2008 claim) or TY 2011 (if 2009 claim). If the taxpayer sells the home (or the home ceases to be the principal residence of the taxpayer or the taxpayer's spouse) before the end of the 15-year recapture period, any remaining Credit repayment amount is immediately due on the tax return for the year in which the home is sold. In the case of an involuntary conversion, recapture is not accelerated if a new principal residence is acquired within a 2-year period.	Fully recaptured in year of sale if home is sold within 3 years of purchase. In the case of an involuntary conversion, recapture is not accelerated if a new principal residence is acquired within a 2-year period.	Fully recaptured in year of sale if home is sold within 3 years of purchase. In the case of an involuntary conversion, recapture is not accelerated if a new principal residence is acquired within a 2-year period.
Waiver of the Recapture of the Credit	Death of the taxpayer. Sale of the home (including through foreclosure) to an unrelated person with no gain on the sale.	Death of the taxpayer. Sale of the home (including through foreclosure) to an unrelated person with no gain on the sale.	Death of the taxpayer. Individuals (and spouses, if married) on qualified extended duty outside the United States. Sale of the home (including through foreclosure) to an unrelated person with no gain on the sale.
Documentation Requirement	None.	None.	Settlement Statement (HUD-1) must be attached.

Source: Treasury Inspector General for Tax Administration analysis of legislation.

Figure 2 shows the total number of taxpayers who claimed the Homebuyer Credit and the amount they received in Calendar Year 2009.

Figure 2: Taxpayers Receiving the First-Time Homebuyer Credit in Calendar Year 2009

Type of Return	Number of Tax Returns	Total Credit Allowed
Electronic Tax Returns	1,048,124	$7,209,087,792
Paper Tax Returns	211,607	$1,457,841,430
Adjusted Tax Accounts	514,987	$3,795,671,929
Totals	1,774,718	$12,462,601,151

Source: Computerized analysis of Internal Revenue Service (IRS) files representing tax return processing through December 31, 2009.

A prior Treasury Inspector General for Tax Administration review raised concerns as to the IRS' ability to distinguish between 2008 and 2009 home purchases

In our 2009 Filing Season report[6] we noted that taxpayer accounts were not properly coded to indicate they purchased their homes during 2009 and outlined our concerns that controls would not be adequate to prevent erroneous or fraudulent claims for the Credit.[7] Because these taxpayers purchased their homes in 2009, they should not be required to repay the Homebuyer Credit. These taxpayers could be subject to the IRS collection process if their accounts are incorrectly coded. The analysis performed during the prior review identified 47,276 taxpayers and found that 93 percent (43,967) did not have their IRS accounts properly coded to indicate their homes were acquired in 2009.

We recommended that the IRS ensure taxpayer accounts were properly coded by identifying previously processed tax returns that were not coded accurately and ensuring subsequently processed tax returns are properly coded. The IRS disagreed with this recommendation and stated that it had gone to considerable lengths to mark accounts with year of purchase and the dollar value of the Credit issued. The IRS intends to track this information for taxpayers who are required to pay back the Credit based on the legal requirements in the legislation, and as it determines what compliance activities will be conducted, it will validate the information to ensure only those taxpayers who have not met their responsibilities are contacted. This will include ensuring the date of purchase was accurately captured.

This review was performed at the Austin, Texas, Submission Processing Site. It includes review of individual income tax returns filed nationwide as well as analysis of data provided by the Wage and Investment Division Headquarters in Atlanta, Georgia; the Submission Processing

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[6] *The 2009 Filing Season Was Successful Despite Significant Challenges Presented by the Passage of New Tax Legislation* (Reference Number 2009-40-142, dated September 21, 2009).

[7] Taxpayers who purchased homes before specific dates in 2009 had the option to either claim a Credit on their TY 2008 return or on their TY 2009 tax return.

function offices in Lanham, Maryland, and Cincinnati, Ohio; and the Applications Development function of the Modernization and Information Technology Services in Lanham, Maryland, during the period August 2009 through March 2010. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Results of Review

Actions Have Been Taken to Implement Recapture/Repayment Provisions Relating to the First-Time Homebuyer Credit

Legislation relating to the First-Time Homebuyer Credit contained specific provisions that require recapture/repayment of the Credit (see Figure 1). In response to legislation, the IRS performed extensive programming and created numerous tax products to address the recapture/repayment provisions. For example, the IRS developed the First-Time Homebuyer Credit and Repayment of the Credit (Form 5405) which includes:

- Part III – Disposition or Change in Use of Main Home for Which the Credit was Claimed.
- Part IV – Repayment of Credit Claimed for 2008.

To implement Homebuyer Credit provisions for recapture/repayment, the IRS developed new tax products and created a Homebuyer Credit Entity Section on the tax accounts of individuals receiving the Credit.

These parts are to be prepared by those individuals who claimed the Homebuyer Credit in 2008 and will have to repay the Credit and/or those individuals who disposed of their homes,[8] requiring immediate recapture of the Credit. We reviewed tax products affected by the Homebuyer Credit and found all were accurately updated for Parts III and IV to provide individuals with the information needed to report a disposition or a change in the use of their main home. However, because the IRS did not expect individuals to start repaying the Credit until TY 2010, there are only instructions for capturing the data for Parts III and IV. There are no current instructions for IRS employees; however, the computer programs are in place to automatically adjust the taxpayers' accounts. The IRS stated it expects to have instructions available for the 2011 Filing Season. As part of our annual Filing Season review, we identified tax returns with information in Parts III and IV to determine if they were accurately processed. Appendix V provides an example of Form 5405, Parts III and IV.

Computer coding was developed to record a special indicator during processing of tax returns and adjustment transactions to show whether the Credit must be repaid. In addition, the IRS also created a Homebuyer Credit Entity Section on the tax accounts for each individual that received the Credit. The Entity Section contains Homebuyer Credit data for the primary and secondary taxpayer (for married taxpayers filing jointly) including the amount of the Credit and year in

[8] See Figure 1 for specific provisions relating to repayment and immediate recapture of the First-Time Homebuyer Credit.

which the home was purchased. The Homebuyer Credit Entity Section will also show the cumulative amount of the Credit that has been repaid. The IRS plans to update the Entity Section when tax returns with Form 5405 with entries in Part III or Part IV are processed. Computer programs will be run quarterly to analyze information in taxpayers' accounts and determine whether the Credit must still be repaid and how much of the Credit still needs to be recaptured. Figure 3 provides an example of the information included in this Entity Section.

Figure 3: Example of New Homebuyer Credit Entity Section

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IMFOLF123-45-6789 P01     IMF FTHB SCREEN     NM CTRL:MISS                        UP-CYC:01

PRIMARY FILING STATUS CD: 2                   <FILING STATUS ON RETURN WHEN CREDIT RECEIVED
PRIMARY YEAR: 09                              <YEAR OF HOME PURCHASE FOR PRIMARY TAXPAYER
PRIMARY DECEASED IND: 0                       <INDICATES WHETHER PRIMARY TAXPAYER DECEASED
PRIMARY CREDIT AMT:     4,000.00              <PRIMARY TAXPAYER'S SHARE OF CREDIT
PRIMARY TOT RECAPTURE AMT:         .00        <TOTAL RECAPTURED OR REPAID BY PRIMARY TAXPAYER

SECONDARY FILING STATUS CD: 2                 < FILING STATUS ON RETURN WHEN CREDIT RECEIVED
SECONDARY YEAR: 09                            <YEAR OF HOME PURCHASE FOR SECONDARY TAXPAYER
SECONDARY DECEASED IND: 0                     <INDICATES WHETHER SECONDARY TAXPAYER DECEASED
SECONDARY CREDIT AMT:     4,000.00            < SECONDARY TAXPAYER'S SHARE OF CREDIT
SECONDARY TOT RECAPTURE AMT:         .00      <TOTAL RECAPTURED OR REPAID BY SECONDARY TP
SECONDARY SSN: 987-65-4321                    <IDENTIFICATION OF SECONDARY (SPOUSAL) TAXPAYER

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Source: Homebuyer Credit Entity Section on the IRS computer systems.

The Homebuyer Credit Entity Section was accurate for individuals receiving the Credit

The accuracy of the Homebuyer Credit Entity Section is dependent upon the presence and accuracy of the special indicator. Our review of the 1,774,718 individuals who received the Homebuyer Credit identified that the Homebuyer Credit Entity Section for 1,763,189 (99.4 percent) individuals was accurate (i.e., the Homebuyer Credit amount received agreed with the amounts on the Homebuyer Credit Entity Section). The remaining 11,529 did not have a Homebuyer Credit Entity Section created because the amount of the Homebuyer Credit was insignificant—the amount of the Credit was less than the cost to recover the Credit.

Processes were developed to distinguish between most of the 2008 and 2009 purchases; however, some dates were recorded incorrectly

The IRS recognized the need to distinguish individuals with a 2008 home purchase from those with a 2009 home purchase. Nonetheless, our analysis identified that in some instances the IRS did not accurately distinguish between individuals with a 2008 home purchase and those with a

2009 home purchase. We identified that an estimated[9] 73,119 (4.1 percent) of the 1,774,718 individuals receiving the Homebuyer Credit had incorrect purchase dates shown on the IRS computer system.

Figure 4: Homebuyer Credit Claims Recorded Incorrectly by the IRS

Claims	Problem With the Recording of the Claim by the IRS
59,802	Home purchased in 2009 but incorrectly recorded as 2008 or the year was not recorded. These taxpayers could incorrectly receive notices requiring repayment (49,480 were electronically filed tax returns and 10,322 were estimated paper tax returns).
9,122	Home purchased in 2008 but incorrectly recorded as 2009 or the year was not recorded. This could result in potential revenue loss of $30.6 million as these individuals would not be required to repay the Homebuyer Credit even though their purchase was in 2008 (6,541 were electronically filed tax returns and 2,581 were estimated paper tax returns).
4,195	No purchase date on the Form 5405 or the purchase date was prior to 2008. These claims should not have been processed. *(This issue is being addressed in a separate audit on the review of erroneous claims of the Credit and is only provided for informational purposes.)*

Source: Treasury Inspector General for Tax Administration analysis of IRS data.

In addition, 514,987 (29 percent) of the 1,774,718 claims have purchase dates that cannot be verified to the Homebuyer Credit Entity Section because the data were not captured by IRS computers. These Homebuyer Credits involve Amended Tax Returns and other account adjustments. We have a separate audit to verify the accuracy of the purchase date information for these individuals.[10]

The identification of the year in which the home was purchased is important because different requirements exist for mandatory repayment of the Homebuyer Credit.

- ***Property Purchased in 2008*** **–** The law mandates that individuals repay the Homebuyer Credit in 15 equal annual installments beginning with the 2010 income tax year. The

[9] Our figures are provided as estimates because complete information for all returns was not available electronically for analysis. We were able to identify a specific number of individuals with incorrect/incomplete purchase dates for electronically filed tax returns as all the information from Forms 5405 is captured. However, for paper-filed tax returns, the IRS did not store the purchase date from Forms 5405 into electronic records during the period January 1 to December 31, 2009. As a result, we projected the figure based on a statistically valid review of paper-filed tax returns.

[10] TIGTA Audit Number 201040140 – Review of First-Time Homebuyer Credit on Amended Returns is reviewing the coding of purchase dates.

Homebuyer Credit amount paid is added to the total tax for the year. Our analysis of Forms 5405 identified 959,813 taxpayers who had a 2008 purchase requiring repayment of $6.5 billion. Accelerated repayment (i.e., the taxpayer pays the outstanding amount of the Homebuyer Credit) is required if the home ceases to be the taxpayer's main residence within the 15-year repayment time period.

- ***Property Purchased in 2009*** **–** The law does not mandate that individuals repay the Homebuyer Credit unless the purchased home ceases to be the taxpayer's main residence within a 3-year period following the purchase. Our analysis of Forms 5405 identified 295,723 taxpayers who had a 2009 purchase.

Recommendation

Recommendation 1: The Commissioner, Wage and Investment Division, should correct the purchase dates for the 68,924 accounts we identified as having incorrect purchase dates recorded.

> ***Management's Response:*** The IRS agreed with this recommendation. The First-Time Homebuyer Credit claims for these accounts were processed early in the program and some purchase dates were incorrectly recorded in IRS systems. The IRS will use third-party property records to verify home purchase or disposition information and will refer discrepancies for appropriate resolution.

A comprehensive recapture/repayment strategy is being developed

Currently, the IRS does not have the ability to identify individuals who received the Homebuyer Credit and their purchased home later ceases to be their main residence, requiring accelerated recapture. Figure 5 outlines the events that require immediate/accelerated repayment of the Homebuyer Credit.

Figure 5: Events That Require Immediate/Accelerated Repayment of the Homebuyer Credit

Events That Require Repayment
• Home ceases to be the taxpayer's main home before the end of the 15-year recapture period. • Home ceases to be the taxpayer's main home within the 36-month period beginning on the purchase date and there is a gain on the sale. • Primary residence is sold (or otherwise disposed of) to an unrelated individual and the amount of repayment is limited to the amount of gain realized on the sale. • Sale of the home to a related person. • Primary residence is destroyed or condemned and taxpayer does not acquire a new home in 2 years. • The entire home is converted to business or rental property.

Source: Worker, Homeownership, and Business Assistance Act of 2009.

The IRS relies on individuals to comply with recapture/repayment tax laws and provide correct information on their tax returns, including accurately reporting the disposition of their main residence. The IRS has initiated programming to capture information from Part III and Part IV of the Form 5405. The IRS plans to use the information included by individuals on Forms 5405 to automatically adjust taxpayer accounts and to update the Homebuyer Credit Entity Section.

The IRS is developing a comprehensive strategy to address recapture/repayment provisions included in the Housing Economic Recovery Act; the Recovery Act; and the Worker, Homeownership, and Business Assistance Act of 2009. The strategy objectives include identifying third-party data sources to ensure individuals are complying with the provisions in the legislation and focuses on individuals who identify the disposition of their main residence and individuals who do not identify the disposition of their main residence.

Processes will need to be established to identify taxpayers meeting waiver of recapture requirements

Legislation includes specific events that waive recapture requirements for individuals. Figure 6 outlines the various events that waive recapture requirements.

Figure 6: Waiver of the First-Time Homebuyer Credit Repayment Requirements

Special Events That Waive Accelerated Repayment
• Death of a taxpayer. • Primary residence is destroyed or condemned and taxpayer acquires a new home in 2 years. • Primary residence is sold to an unrelated individual and there is no gain on the sale. • Individuals (and spouses, if married) on qualified extended duty outside the United States and the home is disposed or ceases to be the primary residence. • The primary residence is foreclosed and there is no gain.

Source: Worker, Homeownership, and Business Assistance Act of 2009.

Currently, the IRS is unable to identify these events that waive recapture except for the death of an individual and, like the accelerated recapture requirements, the IRS will have to rely on individual self-identification of waiver events. However, in the future, these events should be identified with the new strategy. The IRS' draft strategy addresses the challenges it will face in validating waivers of recapture of the Homebuyer Credit. The IRS is evaluating the use of internal sources (e.g., death records from the Social Security Administration (SSA), military indicators), external sources (e.g., services that provide information on condemned or destroyed homes, real estate transactions), or a blend of both to identify valid waivers of recapture. We will continue to monitor the IRS' development of its Recapture/Repayment Strategy.

Social Security Administration Information Can Be Used to Identify Erroneous Claims Filed by Individuals Using Social Security Numbers of Deceased Individuals

The IRS regularly receives information from the SSA identifying individuals with an issued Social Security Number, including Date of Birth and the Date of Death (when applicable). The IRS' Draft Recapture/Repayment Strategy includes evaluating the use of SSA information to identify taxpayers waived from recapture. The IRS regularly uses SSA information during the processing of tax returns to ensure the eligibility of dependents and eligibility for certain tax credits, including the Earned Income Tax Credit and the Child Tax Credit.

During our evaluation of the use of SSA data to proactively identify individuals who were deceased and no longer had repayment requirements we identified individuals who erroneously claimed the TY 2008 Homebuyer Credit. We identified 1,326 individuals claiming

$10.1 million in Homebuyer Credits where the home purchase date was after the individual's date of death. The IRS did not allow 528 of the 1,326 individuals to receive over $4 million they claimed for the Homebuyer Credit. The remaining individuals received the Credit.

When a return is filed on behalf of a taxpayer who is recently deceased, the return must be appropriately notated by the return preparer so that the taxpayer's account can be properly coded; however, few of these taxpayers' accounts were coded to indicate the taxpayers were deceased. Furthermore, none of these instances were joint returns. Although the purchase may have been in progress at time of the death, the taxpayer would not have occupied the property as a primary residence and, therefore, would not have qualified for the Credit. Figure 7 provides a comparison of the individuals' dates of death with the dates that the homes were purchased.

Figure 7: Comparison of Home Purchase Dates and Dates of Death

Taxpayer Deceased Before the Home Was Purchased	Tax Returns	Total Credit Claimed
0 to 30 Days	50	$355,134
31 to 60 Days	65	$468,832
61 to 91 Days	73	$522,527
92 to 121 Days	57	$421,521
122 to 152 Days	65	$480,437
153 to 182 Days	65	$486,322
183 to 213 Days	93	$671,568
214 to 243 Days	63	$480,869
244 to 274 Days	74	$566,679
275 to 304 Days	84	$646,165
305 to 335 Days	77	$579,458
336 to 365 Days	80	$624,655
More Than 1 Year	480	$3,749,740
Totals	**1,326**	**$10,053,907**

Source: Computerized analysis of IRS files representing tax return processing through December 31, 2009.

As part of our annual Filing Season audit, we will identify similar erroneous claims for TY 2009 tax returns and provide these to the IRS to initiate compliance and recovery efforts.

Recommendation

Recommendation 2: The Commissioner, Wage and Investment Division, should ensure 798 individuals who we identified as being deceased prior to the purchase of the home are entitled to claim the Homebuyer Credit.

> ***Management's Response:*** The IRS agreed with this recommendation. The 798 accounts, where the Credit appears to have been allowed, will be audited and the claims paid out may be recaptured as the facts warrant.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine whether the IRS has developed effective strategies to administer the First-Time Homebuyer Credit, recapture the Credit from taxpayers when appropriate, and prevent improper Credits.

To accomplish our objective, we:

I. Assessed the effectiveness of the IRS' ability to distinguish between tax accounts that had received the Homebuyer Credit requiring recapture from those that do not have to be repaid.

   A. Interviewed computer programmers and Submission Processing function managers to determine whether a strategy plan had been created to document the controls needed to monitor repayment obligations.

   B. Determined whether special indicators input during return processing and adjustments were accurate to differentiate between homes purchased during 2008 and 2009.

      1. Identified from IRS files electronic returns processed during 2009 with a Homebuyer Credit and compared for accuracy the return information to the Homebuyer Credit Entity Section recorded on the Master File.[1]

         a) Used computer analysis to compare information from First-Time Homebuyer Credit and Repayment of the Credit (Form 5405) to the Homebuyer Credit Entity Section to identify consistency in the home purchase date information.

         b) Used judgmental samples of each category of date groupings to verify the accuracy of the analysis by researching the accounts on IRS systems.

   C. Identified 211,607 TY 2008 paper returns processed during 2009 with Homebuyer Credits. For a statistical sample (95 percent confidence level, 4 percent expected error rate, and ±3 percent precision) of ***1*** taxpayer accounts, we obtained Forms 5405 and verified the accuracy of the purchase date and Credit amounts recorded on the Master File.

   D. Researched IRS computer program documentation and the Internal Revenue Manual to determine whether the IRS had requested the programming and developed procedures for processing Form 5405 in 2010.

[1] The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

E. Reviewed the updated Form 5405 (Revised December 2009) and related instructions to determine whether the information on the form is sufficient to accurately compute the Credit amount.

II. Assessed IRS processes for identifying events that require immediate recapture of the Homebuyer Credit.

A. Reviewed Housing and Urban Development information reporting documents and interviewed IRS program analysts to determine whether the IRS can monitor the sale of homes for which the Homebuyer Credit was claimed.

B. Identified 3,391 returns with a Homebuyer Credit and by a taxpayer with SSA date of death information.

1. Reviewed a statistical sample (95 percent confidence level, 4 percent expected error rate, and ±3 percent precision) of 156 returns to determine whether the account information on the Master File was recorded accurately.

2. Computer analyzed the accounts of 2,115 single taxpayers and compared the information to Form 5405 information to determine whether the taxpayer date of death preceded the home purchase date.

C. Determined whether the IRS had requested the necessary computer programming to identify returns subject to the repayment of the Homebuyer Credit.

1. Researched the IRS' Work Request Tracking System to determine whether requests for computer programming had been timely submitted with criteria for identifying the returns requiring recapture and appropriate coordination meetings had been scheduled.

2. Determined whether any special computer extracts from the Master File had been requested to identify accounts with address changes after a Homebuyer Credit had been issued.

3. Requested clarification of documentation from analysts as necessary.

D. Reviewed the Homebuyer Credit Compliance Strategy to determine whether the IRS can identify taxpayers who become subject to the immediate recapture provisions of the Act(s) by selling or abandoning the home within 3 years of the purchase date.

1. Determined whether the IRS has any special third-party reporting requirements for homes sold after the owner receives the Homebuyer Credit.

2. Determined whether the Underreporter Program has established criteria to identify abandonments.

3. Determined whether any special computer extracts from the Master File have been requested to identify accounts with address changes after a Homebuyer Credit has been issued.

4. Determined whether the IRS may use the United States Postal Service Change of Address file to identify taxpayers who received the Homebuyer Credit and then cease to use the home as a primary residence.

III. Determined whether IRS employees are improperly generating Homebuyer Credit adjustments. We determined whether indicators can be identified for Homebuyer Credit integrity abuses by preparers, taxpayers, and employees.

A. Identified Homebuyer Credit adjustments to determine whether the transactions were posted accurately to the Master File and supported.

1. Computer analyzed Forms 5405 and tax return information to identify trends that may indicate inappropriate claims of the Homebuyer Credit.

Following procedures in The Practice of Modern Internal Auditing, we selected all statistical samples based upon a 95 percent confidence level, 4 percent error rate, and ±3 percent precision rate.

We researched accounts using IRS systems to validate the accuracy of information received from computer analyses. When computer analyses were performed by staff outside of the audit team, data validation steps were also conducted by those employees to ensure accuracy of information.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the processes for planning, organizing, directing, and controlling program operations and controls over information processing for the 2009 and 2010 Filing Seasons. We also evaluated the controls that were incorporated to ensure accurate and timely recording of transactions and events and to appropriately document changes to computer programming.

Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Operations Support OS
Deputy Commissioner for Services and Enforcement SE
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Director, Electronic Tax Administration and Refundable Credits, Wage and Investment Division SE:W:ETARC
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Audit Liaisons:
Senior Operations Advisor, Wage and Investment Division SE:W:S
Chief, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PRA:PEI

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.

For all of the outcomes listed in this appendix, we conducted computer analyses of Calendar Year 2009 individual income tax returns. The returns were processed by the IRS Submission Processing sites between January 1 and December 31, 2009, and were posted to the Individual Master File.[1]

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 59,802 taxpayers that claimed the First-Time Homebuyer Credit for a 2009 home purchase, but the Homebuyer Credit Entity Section incorrectly identifies the purchase as a 2008 home purchase. These taxpayers could incorrectly receive notices requiring repayment (see page 6).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify taxpayers who electronically filed a tax return claiming the Homebuyer Credit and compared the home purchase date from the First-Time Homebuyer Credit and Repayment of the Credit (Form 5405) to the information in the Homebuyer Credit Entity Sections. We identified 49,480 Forms 5405 with 2009 home purchase dates that were incorrectly identified on the Homebuyer Credit Entity Section.[2]

In addition, we also used computer analysis to identify a universe of 211,607 TY 2008 paper-filed tax returns claiming the Homebuyer Credit. We used statistical sampling to identify and review ***1** returns using a confidence level of 95 percent, a precision factor of ± 3 percent, and an expected error rate of 4 percent for our sampling criteria. Of the ***1*** tax returns sampled, we identified ***1*** tax accounts (4.9 percent) with 2009 home purchases recorded incorrectly as 2008 home purchases. Based on the sample results, we estimate that the paper-filed tax return population contains 10,322 taxpayers with incorrect 2008 home purchase dates. We are

[1] The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
[2] Taxpayers who purchased homes before specific dates in 2009 had the option to either claim a credit on their TY 2008 return or on their TY 2009 tax return.

95 percent confident the number of affected paper-filed tax returns in the population is between 10,012 and 10,632 (the margin of error is ± 310).

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; $30.6 million from 9,122 taxpayers with 2008 home purchases that were improperly identified as 2009 home purchases that do not require repayment (see page 6).

Methodology Used to Measure the Reported Benefit:

We used computer analysis to identify taxpayers who electronically filed a tax return claiming the Homebuyer Credit and compared the home purchase date from the Forms 5405 to the information in the Homebuyer Credit Entity Sections. We identified 6,541 Forms 5405 with a 2008 home purchase date that are incorrectly identified on the Homebuyer Credit Entity Section as a 2009 home purchase date. These taxpayers are required to repay $15.5 million.

In addition, we also used computer analysis to identify a universe of 211,607 TY 2008 paper-filed tax returns claiming the Homebuyer Credit. We used statistical sampling to identify and review ***1*** returns using a confidence level of 95 percent, a precision factor of ± 3 percent, and an expected error rate of 4 percent for our sampling criteria. Of the ***1*** tax returns sampled, we identified ***1*** tax accounts (1.2 percent) that had incorrect purchase dates recorded as 2009 purchases. Based on the sample results, we estimate the population of paper-filed tax returns contains 2,581 taxpayers with incorrect 2009 home purchase dates that are required to repay $15.1 million in Homebuyer Credits. We are 95 percent confident the number of affected paper-filed tax returns in the population is between 2,504 and 2,658 (the margin of error is ± 77).

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; $6 million for 798 deceased single or head of household taxpayers that erroneously claimed a Homebuyer Credit (see page 11).

Methodology Used to Measure the Reported Benefit:

We identified a total population of 2,115 Homebuyer Credit tax returns for single taxpayers who received the Homebuyer Credit but were shown by SSA information to be deceased at the time the return was processed. We identified that the 2,115 deceased single or head of household taxpayers claimed more than $15.5 million in Homebuyer Credits. Of the 2,115 taxpayers, we found that 1,326 of these taxpayers with Credits claimed of $10.1 million were identified as buying the home after their death. IRS compliance efforts did not allow 528 of the 1,326 individuals to receive over $4 million they claimed for the Homebuyer Credit.

Appendix V

New Sections of the First-Time Homebuyer Credit and Repayment of the Credit (Form 5405) for Reporting the Disposition or Changes in Use of Main Home and Repayment of the Credit

Form 5405 (Rev. 12-2009) Page **2**

Note. If you are not filing this form to report a disposition or change in use of your main home for which you claimed the credit, skip this page.

Name(s) shown on return | **Your social security number**

Part III Disposition or Change in Use of Main Home for Which the Credit Was Claimed

11 Enter the date you disposed of, or ceased using as your main home, the home for which you claimed the credit (MM/DD) . . . . . ▶ ____ / ____ / 2009

12 If you meet the following conditions, check here . . . . . ▶ ☐
I (or my spouse if married) am a member of the uniformed services or Foreign Service, or an employee of the intelligence community. I sold the home, or it ceased to be my main home, in connection with Government orders for qualified official extended duty service. No repayment of the credit is required (see instructions). Stop here.

13 Check the box below that applies to you. See the instructions for the definition of "related person."

a ☐ I sold (including through foreclosure) the home to a person who is not related to me and had a gain on the sale (as figured after reducing the basis of my home by the credit I claimed in 2008). Go to Part IV below.

b ☐ I sold (including through foreclosure) the home to a person who is not related to me and did not have a gain on the sale (as figured after reducing the basis of my home by the credit I claimed in 2008). No repayment of the credit is required. Stop here.

c ☐ I sold the home to a related person. Go to Part IV below.

d ☐ I converted the entire home to a rental or business use OR I still own the home but no longer use it as my main home. Go to Part IV below.

e ☐ I transferred the home to my ex-spouse as part of my divorce settlement. The full name of my ex-spouse is ▶ ________

The responsibility for repayment of the credit is transferred to your ex-spouse. Stop here.

f ☐ My home was destroyed, condemned, or disposed of under threat of condemnation and I acquired or plan to acquire a new home within 2 years of the event.

- For homes purchased in 2008, repayment of the credit over a 15-year period begins with your 2010 tax return. If you purchase a new home within 2 years of the event, your annual payment requirement does not change.
- For homes purchased in 2009 or a later year, you may not have to repay the credit (see instructions).

g ☐ My home was destroyed, condemned, or disposed of under threat of condemnation and I do not plan to acquire a new home within 2 years of the event (see instructions).

h ☐ The taxpayer who claimed the credit died in 2009. No repayment of the credit is required of the deceased taxpayer. If you are filing a joint return for 2009 with the deceased taxpayer, see instructions. Otherwise, stop here.

Part IV Repayment of Credit Claimed for 2008

14	Enter the amount of the credit you claimed on Form 5405 for 2008. See instructions if you filed a joint return for 2008. If you checked box 13a above, go to line 15. Otherwise, skip line 15 and enter the amount from line 14 on line 16	**14**	
15	Enter the gain on the sale of your main home (as figured after reducing your basis by the amount on line 14 above)	**15**	
16	Enter the smaller of line 14 or line 15	**16**	

Next: Include the amount from line 16 on your 2009 Form 1040, line 60. On the dotted line to the left of line 60, enter "FTHCR".

Form **5405** (Rev. 12-2009)

Appendix VI

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

RECEIVED
JUL 2 7 2010
BY: DAR

July 22, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard Byrd, Jr.
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – A Comprehensive Strategy Is Being Developed to Identify Individuals with First-Time Homebuyer Credit Repayment Requirements (Audit # 201040101)

Thank you for the opportunity to review and respond to the subject draft report on the Treasury Inspector General for Tax Administration's (TIGTA) on-going independent review of the IRS administration of the First-Time Homebuyer Credit (FTHBC). Between January 2009 and April 2010, over 2.6 million taxpayers have received nearly $19 billion in FTHBC. The IRS was given the task of delivering this important support to the housing market during an unprecedented crisis, and responded by making the credit available within weeks of enactment of the legislation. The IRS continues to process FTHBC claims as expeditiously as possible, while carefully screening these claims to deter fraud and maintain the integrity of the tax system.

We appreciate your acknowledgment of the significant progress the IRS has made to accurately update our tax products, processes, and computer programs to meet this challenge. Also, your report noted that we capture relevant information about the home purchase that enables us to identify which taxpayers claimed each version of the three separate FTHBC laws.

In your report you identified 1,326 individuals, claiming $10.1 million in FTHBC, being deceased prior to the purchase of the home. Of that amount, IRS denied over $4 million of the $10.1 million claimed and prevented payment from being made. Of the remaining cases where the credit was allowed, the individuals will be audited, and the claims paid out may be recaptured as the facts warrant.

Your report also identified 68,924 accounts where an incorrect purchase date was recorded. We agree that earlier in the process, some claims were processed and incorrect dates were logged in IRS systems. It is important to note that the report is not questioning whether the taxpayer's claim of the credit was valid. Instead, for the vast majority of the accounts in question, the report notes that individuals who claimed the 2009 Recovery Act credit were improperly coded as claiming the 2008 Housing and Economic Recovery Act credit. The net effect of this miscoding is that some individuals may currently appear in IRS records to be subject to the 15-year repayment provision of the 2008 credit, when in fact no such repayment will be required. The IRS is now correcting the incorrect dates, and we expect to resolve these issues behind-the-scenes without impact to taxpayers.

Attached are our responses to your specific recommendations. If you have any questions, please contact me, or a member of your staff may contact Robin Canady, Director, Strategy and Finance, Wage and Investment Division, at (404) 338-8801.

Attachment

Attachment

RECOMMENDATION 1: The Commissioner, Wage and Investment Division, should correct the purchase dates for the 68,924 accounts we identified as having incorrect purchase dates recorded.

CORRECTIVE ACTION
The First-Time Homebuyer Credit claims for these accounts were processed early in the program. The IRS will use third-party public property records to verify home purchase or disposition information, and will refer discrepancies for appropriate resolution.

IMPLEMENTATION DATE
September 15, 2011

RESPONSIBLE OFFICIAL
Director, Reporting Compliance, Wage and Investment Division
Director, Accounts Management, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
IRS will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 2: The Commissioner Wage and Investment, should ensure 798 individuals who TIGTA identified as being deceased prior to the purchase of the home are entitled to claim the Homebuyer Credit.

CORRECTIVE ACTION
As noted above, the subset of the 798 accounts where the credit appears to have been allowed will be audited.

IMPLEMENTATION DATE
September 15, 2011

RESPONSIBLE OFFICIAL
Director, Reporting Compliance, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN
IRS will monitor this corrective action as part of our internal management control system.