Treasury Inspector General for Tax Administration
Office of Audit

EXPANSION OF CONTROLS OVER REFUNDABLE CREDITS COULD HELP REDUCE THE BILLIONS OF DOLLARS OF IMPROPERLY PAID CLAIMS

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Highlights

Highlights of Report Number: 2012-40-105 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

Refundable credits, unlike other tax credits, not only have the potential to reduce a taxpayer's tax liability to zero, but also allow the taxpayer to receive a cash payment of any remaining credit amount. This makes refundable tax credits more susceptible to fraud. Without proper controls, billions of taxpayer dollars are vulnerable to erroneous claims and fraudulent tax schemes.

WHY TIGTA DID THE AUDIT

Erroneous credits discovered after the refund is released may require more costly enforcement actions, and the likelihood of collection diminishes over time.

This audit was initiated to determine the effectiveness of the IRS's efforts to recover refundable credits disallowed during post-refund examinations and consider options the IRS could implement to decrease the issuance of erroneous refundable credits in the future.

WHAT TIGTA FOUND

During Tax Years 2006 through 2009, taxpayers claimed almost $470 billion in refundable credits. Due to post-refund examinations, taxpayers were required to repay more than an estimated $2.3 billion in erroneous credits. By the end of December 2011, the IRS had recovered an estimated $1.3 billion, of which more than 70 percent was collected through refund offsets.

TIGTA found that taxpayers repeatedly claimed erroneous Additional Child Tax Credits (ACTC) after being disallowed the previous year. The IRS could have saved more than $108 million by reviewing claims made by taxpayers who were previously disallowed the credit.

In addition, TIGTA found that when the IRS freezes and reviews a questionable Earned Income Tax Credit (EITC) but releases a related ACTC, the ACTC will later be disallowed 67 percent of the time, and the IRS will have to employ post-refund collection methods to recover the credits. The IRS could have prevented approximately $419 million in erroneous ACTC refunds from being released had it reviewed the ACTC at the same time the EITC was being reviewed.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS implement additional controls to identify and stop erroneous claims for refundable credits before refunds are issued, including:

- Implementing an account indicator to identify taxpayers who claim erroneous refundable credits. Taxpayers with such an indicator should be required to provide documentation before their claims for refundable credits are processed and should be considered for pre-refund examinations of claims for all refundable credits. Such an indicator should be applied for a specified time period.
- Freezing and verifying claims for the ACTC on all returns for which the EITC is frozen.
- Working with the Department of the Treasury's Office of Tax Policy to seek legislation to expand the EITC due diligence requirements and penalties to include the ACTC.

IRS management agreed with TIGTA's recommendations and plans to take appropriate corrective actions. Rather than implementing an account indicator to identify taxpayers who claim erroneous refundable credits, the IRS will develop pre-refund examination filters to ensure historical information is available and used as selection criteria. Although this planned action is different than what TIGTA recommended, TIGTA believes that it is a viable alternative.

READ THE FULL REPORT

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

http://www.treas.gov/tigta/auditreports/2012reports/201240105fr.pdf.