



*Processes for the Direct Deposit of  
Tax Refunds Need Improvement to  
Increase Accuracy and Minimize Fraud*

**September 25, 2012**

**Reference Number: 2012-40-118**

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:**

2(f) = Risk Circumvention of Agency Regulation or Statute

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Phone Number | 202-622-6500

E-mail Address | [TIGTACommunications@tigta.treas.gov](mailto:TIGTACommunications@tigta.treas.gov)

Website | <http://www.tigta.gov>





TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 25, 2012

**MEMORANDUM FOR** DEPUTY COMMISSIONER FOR SERVICES AND  
ENFORCEMENT

**FROM:** Michael E. McKenney  
Acting Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Processes for the Direct Deposit of Tax Refunds  
Need Improvement to Increase Accuracy and Minimize Fraud  
(Audit # 201140021)

This report presents the results of our review to evaluate the Internal Revenue Service's controls over the direct deposit of refunds. This audit is included in our Fiscal Year 2012 Annual Audit Plan and addresses the major management challenges of Providing Quality Taxpayer Service Operations and Fraudulent Claims and Improper Payments.

Management's complete response to the draft report is included as Appendix IV.

Copies of the report are also being sent to the Internal Revenue Service managers affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or Augusta R. Cook, Acting Assistant Inspector General for Audit (Returns Processing and Account Services), at (770) 617-6434.



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*Abbreviations*

IRS	Internal Revenue Service
NACHA	National Automated Clearing House Association
TIGTA	Treasury Inspector General for Tax Administration

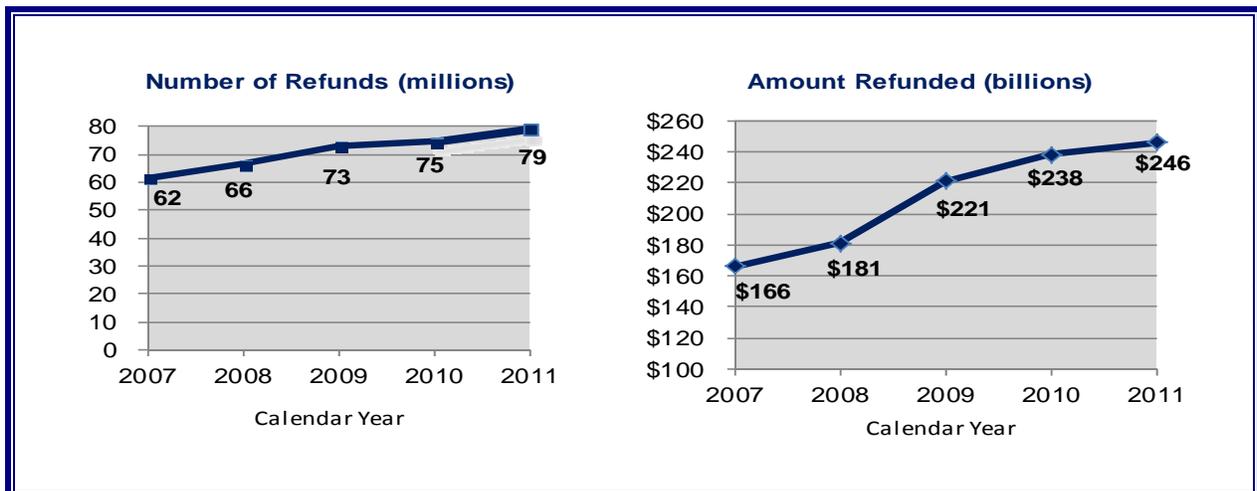


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## *Background*

The majority of individual taxpayers are now choosing to have their Federal tax refunds directly deposited to their checking or savings accounts or to a debit card.<sup>1</sup> The Internal Revenue Service (IRS) deposited more than 79 million refunds (72 percent of total refunds) directly into taxpayers' bank accounts during Calendar Year 2011. These direct deposits accounted for more than \$246 billion in refunds, averaging \$3,109 each. Figure 1 shows the increase in the use of direct deposits over the last five calendar years.

**Figure 1: Calendar Year Direct Deposit Refund Statistics**



Source: IRS.gov, the IRS's public Internet site, and IRS management reports.

Taxpayers have more choices and flexibility for direct deposits of their Federal income tax refunds than ever before. Taxpayers can opt to split their refunds among up to three different checking or savings accounts by simply filling out Form 8888, *Allocation of Refund (Including Savings Bond Purchases)*. To obtain a tax refund via direct deposit, the taxpayer is required to provide the bank routing and account numbers and the type of bank account (checking or savings).

<sup>1</sup> These include prepaid debit cards as well as reloadable cards. Currently, the IRS cannot differentiate between direct deposits of tax refunds made to a bank account and tax refunds deposited or loaded to debit cards.





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Results of Review

Processes Are Not Sufficient to Ensure Tax Refunds Are Deposited

\*\*\*\*\*2(f)\*\*\*\*\*

Treasury Inspector General for Tax Administration (TIGTA) auditors analyzed the 79 million Tax Year<sup>3</sup> 2010 Form 1040, *U.S. Individual Income Tax Return*, refund returns with direct deposits<sup>4</sup> and selected a statistically valid random sample of 400 of these tax returns for further analysis. The results showed that although the IRS takes actions to ensure the accuracy of direct deposit information, \*\*\*\*\*2(f)\*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\*

The IRS ensures that \*\*\*\*\*2(f)\*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\*

The IRS also educates taxpayers and tax return preparers of the requirement that direct deposits

\*\*\*\*\*2(f)\*\*\*\*\*

- Form 1040 and Form 8888 instructions both inform taxpayers that the direct deposit request will be rejected if their refund is deposited to an account that is not in their name.
- Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*, informs Electronic Return Originators<sup>5</sup> that taxpayers should not request a deposit of their refund to an account that is not in their own name (such as their tax return preparer's own account).
- Publication 4491, *VITA/TCE Training Guide*, instructs volunteers to advise taxpayers that their refunds may only be directly deposited into their own accounts.

Nevertheless, tax refunds \*\*\*\*\*2(f)\*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\* and certain accounts continue to receive multiple tax refunds.

<sup>3</sup> A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is the same as the calendar year.

<sup>4</sup> This includes debit cards.

<sup>5</sup> An Electronic Return Originator originates the electronic submission of returns it either prepares or collects from taxpayers after receiving authorization from the taxpayers to electronically file (e-file) the returns.



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By matching bank routing and account numbers listed on the 400 tax returns sampled to the direct deposits population database, we found that that the account numbers listed on 10 (2.5 percent) of the 400 returns had received multiple<sup>6</sup> direct deposits. More than 2,100 refunds totaling \$2.2 million were deposited to the bank accounts listed on these 10 tax returns. Overall, of the approximately 79 million Tax Year 2010 Forms 1040 with direct deposits of refunds, more than 65,300 unique bank accounts had multiple direct deposits – accounting for approximately 949,000 refunds totaling \$1.6 billion.

Federal regulations specify that direct deposit payments should be made only to a bank account \*\*\*\*\*2(f)\*\*\*\*\*. For consumer protection, the regulations are designed to ensure that payments reach the intended recipient \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*.<sup>7</sup>

**The IRS provides financial institutions with identifying information that could be used to ensure that refunds are deposited only into an account in the name of the taxpayer**

Information that could be used to ensure that tax refunds are deposited into an account \*\*2(f)\*\*\*\*\* is provided by the IRS to the Financial Management Service, which then transmits the information to financial institutions. This information includes \*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*. Rules and regulations that govern the Automated Clearing House<sup>8</sup> network are established by the NACHA.  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*. Financial Management Service guidance also states that the financial institution is not liable for any loss when deposits are made in accordance with instructions from the IRS (*i.e.*, the refund is deposited into the bank account specified by the IRS).

Representatives from the NACHA indicated that some banks, possibly those with fewer direct deposits, \*\*\*\*\*2(f)\*\*\*\*\*. However, the representatives stated that not all financial institutions have the capability to perform such a match using an automated process. Consequently, expenses would be incurred to either upgrade the automated systems or to manually process the tax refund transactions.

<sup>6</sup> \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*

<sup>7</sup> Federal Register, Vol. 76, No.185, September 23, 2011, pp. 59024–59031.

<sup>8</sup> An automated clearing house is a facility that clears debit and credit items for banks.



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**TIGTA has previously reported that processes are insufficient to ensure the accuracy of tax refund direct deposits and minimize fraud**

A Fiscal Year 2008 TIGTA review found that the IRS had not developed processes to ensure tax refunds were deposited only to an account \*\*\*\*2(f)\*\*\*\*\*.<sup>8</sup> We recommended that the IRS coordinate with responsible Federal agencies and banking institutions to develop a process to ensure that direct deposit payments are made \*\*\*\*\*2(f)\*\*\*\*\* \*\*2(f)\*\* and to limit the number of direct deposits being sent to the same account. In response, the IRS considered limiting the number of direct deposits being sent to the same account; however, it had numerous concerns, including circumstances where multiple deposits to a single account were legitimate and acceptable because the accounts were held in the names of multiple individuals.

The IRS asked the Financial Management Service to consider proposing a regulation to require financial institutions to match account numbers with another piece of information, such as a Social Security Number or name, in Federal direct deposit payments to reduce the number of tax refunds that are delivered to the wrong account. The Financial Management Service responded that it did not believe that it would be productive to propose such a regulation. It explained that it published a proposed regulation in 1998 that would have required financial institutions to match the account number against another piece of information in the entry, such as the name or Social Security Number. After considering the comments received, it decided to not finalize the proposal. However, since that time, tax-related identity theft and refund fraud have grown significantly.

**The inability to ensure the accuracy of direct deposits increases fraud potential**

In a July 2012 audit report on identity theft, we reported that direct deposit, including debit cards, continues to be a key method individuals use to obtain fraudulent tax refunds.<sup>9</sup> Limiting the number of tax refunds that can be deposited to the same account could potentially decrease losses associated with fraud.

Direct deposit is frequently the payment method used by individuals who attempt to commit filing fraud. Direct deposit provides the ability to quickly receive fraudulent tax refunds without the difficulty of having to negotiate a tax refund paper check. To cash a check, individuals usually have to provide picture identification matching the name on the tax refund check—in the case of identity theft, the name of the legitimate taxpayer. This means that the identity thief would need to obtain false identification to cash the fraudulently obtained tax refund check.

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<sup>8</sup> TIGTA, Ref. No. 2008-40-182, *Processes Are Not Sufficient to Minimize Fraud and Ensure the Accuracy of Tax Refund Direct Deposits* (Sept. 2008).

<sup>9</sup> TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).



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In our July 2012 report, we recommended that the IRS:

- As previously recommended, coordinate with responsible Federal agencies and banking institutions to develop a process to ensure that tax refunds issued via direct deposit to either a bank account or a debit card account are made only to an account in the taxpayer's name.
- As previously recommended, limit the number of tax refunds issued via direct deposit to the same bank account or debit card account in an attempt to reduce the potential for fraud.
- Develop processes to identify and quantify direct deposits of tax refunds to accounts associated with a debit card as well as the ability to associate tax refunds deposited to a debit card to a specific tax account.
- Work with the Department of the Treasury to ensure financial institutions and debit card administration companies authenticate the identity of individuals purchasing a debit card. Furthermore, prevent the direct deposit of tax refunds to debit cards issued or administered by financial institutions and debit card administration companies that do not take reasonable steps to authenticate individuals' identities.

The IRS agreed with all four recommendations; therefore, we are not making recommendations related to this issue at this time.

***The Option to Split Income Tax Refunds Could Increase the Risk of Fraud, Misuse, and Abuse***

Tests results showed multiple direct deposits of refunds were made to bank accounts listed on tax return preparers' own personal tax returns. This could indicate that tax return preparers are using the split refund option as a way for taxpayers to pay for their tax preparation services or to pay for Refund Anticipation Loans and Refund Anticipation Checks.<sup>10</sup> The purpose of Form 8888 is to provide taxpayers the ability to allocate their refunds to more than one of their bank accounts. The law specifically prohibits the deposit of an income tax refund into a tax return preparer's bank account.<sup>11</sup> However, the IRS \*\*\*\*\*2(f)\*\*\*\*\*.

Our analysis of the more than 79 million Tax Year 2010 returns identified 4,406 bank accounts listed on tax return preparers' personal tax returns that had multiple tax refunds directly

<sup>10</sup> A Refund Anticipation Loan is a short-term loan secured by the taxpayer's expected tax refund. A Refund Anticipation Check is the nonloan bank product that many commercial tax return preparers and their bank partners offer in addition to Refund Anticipation Loans.

<sup>11</sup> Internal Revenue Code Section 6695(f).



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deposited.<sup>12</sup> More than 202,000 taxpayer refunds totaling more than \$309 million<sup>13</sup> were sent to these bank accounts. Figure 3 provides a breakdown of the most significant examples of multiple taxpayer tax refunds being deposited to bank accounts listed on tax return preparers' personal tax returns.

**Figure 3: Examples of Bank Accounts Listed on Preparers' Tax Returns Receiving More Than 1,500 Direct Deposits From Other Taxpayers**

Number of Direct Deposits Per Bank Account	Amount of Tax Refunds Deposited to Account	Average Tax Refunds Deposited to Account
1,550	\$199,738	\$129
1,578	\$666,166	\$422
1,637	\$250,622	\$153
2,039	\$6,356,687	\$3,118
2,063	\$582,526	\$282
2,458	\$585,260	\$238
3,282	\$1,536,368	\$468
3,934	\$15,756,854	\$4,005
4,618	\$15,686,254	\$3,397

Source: TIGTA analysis of Tax Year 2010 returns.

Our analysis of 4,406 bank accounts listed on tax return preparer's personal Tax Year 2010 returns with multiple direct deposits showed that almost 60 percent of the refunds directed to the accounts were for \$500 or less. Figure 4 shows the stratification by refund amount deposited to the account. Figure 5 shows the top five common refund amounts deposited to the accounts.

<sup>12</sup> Starting in January 2011, preparers are required to register with the IRS for a Preparer Tax Identification Number and include it on all tax returns they prepare. We were unable to perform this match on 7,092 Preparer Tax Identification Number holders \*\*\*\*\*2(f)\*\*\*\*\* on the Preparer Registration file. We were also unable to perform this match on the tax return preparers who \*\*\*\*\*2(f)\*\*\*\*\* \*\*\*\*\*2(f)\*\*\*\*\*.

<sup>13</sup> Tax return preparers' own tax refunds may be included in the \$309 million.



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**Figure 4: Stratification, by Dollar Amount, of Refunds Directly Deposited to Bank Accounts Listed on Preparers' Tax Returns (Accounts With Multiple Refunds)**

Range of Amount of Tax Refunds	Number of Tax Refunds Deposited to Accounts With Multiple Refunds	Total Dollar Amount of Refunds	Percentage of Number of Tax Refunds Deposited to the Accounts **
\$1 – \$500	114,684	\$22,193,120	56%
\$501 – \$1,000	15,956	\$12,153,632	8%
\$1,001 – \$1,500	10,318	\$12,867,513	5%
\$1,501 – \$2,000	9,359	\$16,699,341	5%
\$2,001 – \$2,500	6,000	\$13,466,711	3%
\$2,501 – \$3,000	7,081	\$19,864,347	3%
\$3,001 – \$3,500	5,314	\$17,241,321	3%
Over \$3,501	33,852	\$194,776,217	17%
<b>Total</b>	<b>202,564</b>	<b>\$309,262,202</b>	<b>100%</b>

Source: TIGTA analysis of Tax Year 2010 returns. \*\* Percentage differences are due to rounding.

**Figure 5: Top Five Common Refund Amounts Deposited to the Bank Accounts Listed on Preparers' Tax Returns**

Amount of Tax Refunds Deposited to the Accounts	Number of Refunds Deposited to the Accounts
\$100	7,930
\$125	5,407
\$150	8,122
\$200	7,508
\$250	4,917

Source: TIGTA analysis of Tax Year 2010 returns.

We could not verify that the tax return preparers owned the bank accounts. However, the same account on the tax preparer's individual tax return was used on multiple returns he or she prepared.

Many tax return preparers may have diverted funds to their own bank accounts to pay tax preparation fees or provide Refund Anticipation Loans. Publication 1345 states that taxpayers



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should not request a deposit of their refund to an account that is not in their own name (such as their tax preparer’s own account). Additionally, it directs tax return preparers to work with a separate financial institution to provide Refund Anticipation Loans. Financial institutions generally use \*\*\*\*2(f)\*\*\*\*\* of the taxpayer as part of the account number to differentiate recipients and to make each account unique.

**Multiple direct deposits of refunds were sent to bank accounts listed on IRS employees’ tax returns**

Our analysis of the Tax Year 2010 returns identified 209 bank accounts listed on IRS employees’ tax returns that had multiple direct deposits.<sup>14</sup> There were 10,601 refunds sent to these bank accounts, and the refunds totaled more than \$14 million. Figure 6 provides a breakdown of the most significant examples.

**Figure 6: Examples of Bank Accounts Listed on IRS Employees’ Tax Returns Receiving More Than 200 Direct Deposits<sup>15</sup>**

Number of Direct Deposits Per Bank Account	Amount of Tax Refunds Deposited to the Account	Average Tax Refunds Deposited to the Account
204	\$18,099	\$89
211	\$450,651	\$2,136
249	\$82,435	\$331
268	\$1,080,310	\$4,031
344	\$1,208,998	\$3,515
394	\$1,817,482	\$4,613
410	\$191,252	\$466
418	\$587,970	\$1,407
490	\$106,401	\$217
630	\$3,233,818	\$5,133

Source: TIGTA analysis of Tax Year 2010 returns.

<sup>14</sup> These bank accounts could overlap and be included in the 4,406 bank accounts listed on the tax return preparer’s personal returns that had multiple direct deposits.

<sup>15</sup> The employee data includes both current employees as of February 11, 2012, and former employees who separated from the IRS during Calendar Year 2011.



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As with the return preparers, we could not verify that the IRS employees owned the bank accounts in question.

***Recommendation***

**Recommendation 1:** The Deputy Commissioner for Services and Enforcement should \*\*\*\*\*2(f)\*\*\*\*\* tax return preparers and IRS employees who potentially \*\*\*\*\*2(f)\*\*\*\*\*.

**Management's Response:** New filters are being developed for the 2013 Filing Season regarding multiple deposits to the same account. These filters will assist in addressing the issues identified in the report. The IRS is also developing a messaging strategy for the 2013 Filing Season to remind taxpayers and tax return preparers that refunds due to taxpayers may not be \*\*\*\*\*2(f)\*\*\*\*\*  
The strategy will also inform taxpayers they should not permit any portion of their refund to be \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*2(f)\*\*. In addition to the communication strategy and efforts already underway to restrict direct deposits of tax refunds to taxpayer-owned accounts, the IRS is developing controls to identify instances where it appears tax return preparers and IRS employees may be improperly using the direct deposit program for unintended purposes.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to evaluate the IRS's controls over the direct deposit of refunds. To meet this objective, we performed the following tests:

- I. Determined whether conditions identified in the prior TIGTA audit<sup>1</sup> still existed and whether the recommendations were implemented and corrective actions were effective.
  - A. Reviewed the Joint Audit Management Enterprise System report from the prior TIGTA audit and determined if the recommendations had been implemented. We identified the industry standards for controlling direct deposit transmission and whether compliance with 31 Code of Federal Regulation Section 210.5 was being enforced.
  - B. Interviewed IRS staff in the Wage and Investment Division and the National Taxpayer Advocate office to evaluate material changes to controls over direct deposits and their impact on tax administration.
  - C. Interviewed officials from the Financial Management Service and the Federal Reserve and determined whether material changes had been made to direct deposit processing since the prior TIGTA audit.
  - D. Interviewed NACHA officials and determined whether material changes had been made to direct deposit processing since the prior TIGTA audit. We discussed matching direct deposit refund payments using taxpayer \*\*\*2(f)\*\*\*\*\* identity indicators before the acceptance of the direct deposit.
- II. Determined whether controls over the direct deposit of refunds into taxpayer bank accounts were adequate to ensure that deposits were accurately processed.
  - A. Researched TIGTA and Government Accountability Office audit reports for previously reported control breakdowns.
  - B. Researched the Internal Revenue Manual and determined if procedures used by the IRS to process direct deposits requested on Forms 1040, *U.S. Individual Income Tax Return*, and Forms 8888, *Allocation of Refund (Including Savings Bond Purchases)*, were adequate.

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<sup>1</sup> TIGTA, Ref. No. 2008-40-182, *Processes Are Not Sufficient to Minimize Fraud and Ensure the Accuracy of Tax Refund Direct Deposits* (Sept. 2008).



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- C. Obtained an Individual Master File<sup>2</sup> computer extract and identified more than 79 million Tax Year 2010 Form 1040 refund returns with direct deposits. A statistically valid random sample of 400 returns was selected using a 5 percent margin of error, a 95 percent confidence level, and a 50 percent response distribution. We reviewed the sample of 400 returns to determine if direct deposits requested on Forms 1040 and Forms 8888 were accurately processed.
- III. Analyzed the TIGTA Data Center Warehouse<sup>3</sup> Individual Master File Refund Files<sup>4</sup> and identified potential fraud cases involving direct deposits, including the misuse of Forms 8888.
- A. Interviewed IRS officials in the Wage and Investment Division Customer Account Services function, the National Taxpayer Advocate's office, and Criminal Investigation regarding current and past procedures for misdirected direct deposits by employees or third parties, misuse or abuse of Forms 8888 to collect fees by tax return preparers, refund theft steps taken to advocate for affected taxpayers and the IRS, and preventive controls in place.
- B. Analyzed trends in IRS employee-related direct deposit fraud cases. We obtained the TIGTA Office of Investigations database of completed direct deposit fraud cases. We obtained employee data from the Treasury Integrated Management Information System<sup>5</sup> on current and separated employees. We matched employees to the Refund Files and obtained employee bank information. We queried the match and identified multiple direct deposits going into same bank account. We reviewed cases that represented anomalies.
- C. Analyzed trends in tax return preparer-related direct deposit fraud cases or misuse of Forms 8888. We matched the Preparer Tax Identification Number Files (all years) to the Refund Files and obtained tax return preparer bank information.<sup>6</sup> We queried the

<sup>2</sup> The IRS database that maintains transactions or records of individual taxpayer accounts.

<sup>3</sup> A collection of IRS databases containing various types of taxpayer account information that is maintained by the TIGTA for the purpose of analyzing data for ongoing audits.

<sup>4</sup> The Refund File captures all refunds which are sent by the IRS to the Financial Management Service for processing. The Financial Management Service is responsible for generating the actual refunds based upon the information provided by the IRS. The refunds are sent by the Financial Management Service to the taxpayers in the form of bank account direct deposits or mailed paper checks. These files capture the associated name, address, and account information for the entity receiving the refunds and are useful for identifying tax refund fraud.

<sup>5</sup> The official automated personnel and payroll system for storing and tracking all employee personnel and payroll data.

<sup>6</sup> Starting in January 2011, preparers are required to register with the IRS for a Preparer Tax Identification Number and include it on all tax returns they prepare. We were unable to perform this match on 7,092 tax return preparers in the Preparer Tax Identification Number File \*\*2(f)\*\*\*\*\*. We were also unable to perform this match on the tax return preparers who were not in the Preparer Tax Identification Number File \*\*\*\*\*2(f)\*\*\*\*\*.



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match and identified multiple direct deposits going into same bank account. We reviewed cases that represented anomalies.

- D. Identified multiple direct deposits going to the same account number. We analyzed returns and determined if there was a logical reason for the multiple refunds.

**Data validation methodology**

During this review, we relied on data extracted from the TIGTA Data Center Warehouse of the IRS's Individual Master File and the Refund Files for Processing Year<sup>7</sup> 2011. Before relying on the data, we ensured that each file contained the specific data elements we requested. In addition, we reviewed random samples of 25 records from both the Individual Master File and Refund File extracts and verified that the data in the extracts was the same as the data captured in the IRS's Integrated Data Retrieval System.<sup>8</sup> These tests demonstrated that the data were sufficiently reliable and could be used to meet the objectives of this audit.

We also relied on data extracts of the Preparer Tax Identification Number Files, the Treasury Integrated Management Information System, and the Bank Routing Number File. Before relying on the data, we ensured that each file contained the specific data elements we requested. However, for these data files we relied on data validity and reliability checks routinely done by the Data Center Warehouse staff.

**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: Accounts Management and Submission Processing functions' policies, procedures, and practices related to processing direct deposit tax refunds. We evaluated those internal controls by interviewing management and operational personnel, reviewing policies and procedures, participating in walkthroughs, and analyzing actual direct deposit refunds that were processed.

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<sup>7</sup> The calendar year in which the tax return or document is processed by the IRS.

<sup>8</sup> IRS computer system capable of retrieving or updating stored information. It works in conjunction with taxpayer account records.



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## **Appendix II**

### *Major Contributors to This Report*

Augusta R. Cook, Acting Assistant Inspector General for Audit (Returns Processing and Account Services)

Kyle R. Andersen, Director

Roy E. Thompson, Audit Manager

Jane G. Lee, Lead Auditor

Jennie G. Choo, Senior Auditor

Laura Paulsen, Senior Auditor



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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  
Commissioner, Wage and Investment Division SE:W  
Chief, Criminal Investigation SE:CI  
Chief Technology Officer OS:CTO  
Deputy Commissioner, Services and Operations, Wage and Investment Division SE:W  
Director, Customer Account Services, Wage and Investment Division SE:W:CAS  
Director, Refund Integrity and Correspondence Services SE:W:RICS  
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP  
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**Appendix IV**

*Management's Response to the Draft Report*

**DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA. 30308**

**COMMISSIONER  
WAGE AND INVESTMENT DIVISION**

September 12, 2012

MEMORANDUM FOR MICHAEL E. MCKENNEY  
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Peggy Bogadi /s/ Peggy Bogadi  
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report - Processes for the Direct Deposit of Tax Refunds Need  
Improvement to Increase Accuracy and Minimize Fraud (Audit #201140021)

With the rapid growth in the use of direct deposits for receiving tax refunds, the ability for taxpayers to allocate their refunds among up to three accounts was introduced as a means by which to give taxpayers greater control over their refunds and encourage saving. The split refund option was first offered to taxpayers during the 2007 Filing Season, and the ability to purchase United States Savings Bonds with a refund was added in 2010. As the use of the option increased, some taxpayers began directing refunds for seemingly innocuous purposes, \*\*\*\*\*2(f)\*\*\*\*\*, but, as noted in the report, this is an impermissible use of the split refund program. As discussed in more detail below, the IRS is taking a number of actions in this area.

As noted in the report, when tax refunds are issued, the IRS passes additional identifying information to the Financial Management Service (FMS), which, in turn, provides that information to the financial institutions when electronic payments are transmitted. However, \*\*\*\*\*2(f)\*\*\*\*\* and have contributed to our efforts to stop fraudulent refunds.

With regard to the finding of accounts receiving multiple deposits from multiple taxpayers, it is important to note that the Treasury Inspector General for Tax Administration (TIGTA) has not verified ownership of the bank accounts in question. There are circumstances where multiple deposits to a single account are legitimate and acceptable. Thus, the IRS must initiate appropriate investigatory proceedings to ascertain ownership. Nonetheless, we agree with the TIGTA that the findings are



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indicative that additional controls are needed to identify and question these multiple deposits and the IRS is making changes in this area for the 2013 filing season. Still, caution must be exercised in drawing conclusions as to the extent of fraudulent activity present.

As mentioned, we are taking steps to address the split refund issue for the 2013 Filing Season. We believe, first and foremost, that taxpayer education is essential in effectively restricting direct deposits to accounts actually owned by the taxpayers. We are developing a communication strategy to address the issue and are considering modifying the instructions for Form 8888, *Allocation of Refund (Including Savings Bond Purchases)*, to remind taxpayers that refunds should not be directed to accounts they do not own. We are also refining fitters for next filing season to be more effective in this area in

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Finally, regarding the finding of multiple deposits to accounts listed on the tax returns of IRS employees, we take this very seriously and have reviewed these transactions. We must stress caution in drawing conclusions until all facts are known, including ownership of the accounts listed, and whether spousal activity could be affecting the data. IRS employees like other taxpayers may have directed a portion of their refunds for impermissible, but nonfraudulent purposes,

\*\*\*\*\*2(f)\*\*\*\*\*. Your report indicates that 209 accounts listed on employee returns had multiple direct deposits. It is important to note that this does not represent 209 different employees receiving multiple direct deposits to their accounts. The smaller number of employee accounts that appear to have received questionable deposits have been referred to the TIGTA Office of Investigations to determine if any conduct violations have been committed by the employees.

Attached are our comments to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Peter J. Stipek, Director, Customer Account Services, Wage and Investment Division, at (404) 338-8910.

Attachment



*Processes for the Direct Deposit of Tax Refunds  
Need Improvement to Increase Accuracy and Minimize Fraud*

Attachment

**RECOMMENDATION**

**RECOMMENDATION 1**

The Deputy Commissioner for Services and Enforcement should \*\*\*2(f)\*\*\*\*\* \*\*\*\*\*2(f)\*\*\*\* tax return preparers and IRS employees \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*.

**CORRECTIVE ACTION**

New filters are being developed for the 2013 filing season regarding multiple deposits to the same account. These will assist in addressing the issues identified in the report. We are also developing a messaging strategy for the 2013 Filing Season to remind taxpayers and tax return preparers that refunds due to taxpayers may not be \*\*\*\*\*2(f)\*\*\*\*\* \*\*\*\*\*2(f)\*\*\*\*\* . The strategy will also inform taxpayers they should not permit any portion of their refund to be \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\* . In addition to the communication strategy and efforts already underway to restrict direct deposits of tax refunds to taxpayer-owned accounts, we are developing controls to identify instances where it appears tax return preparers and IRS employees may be improperly using the direct deposit program for unintended purposes.

**IMPLEMENTATION DATE**

Communication Strategy - January 15, 2013  
Development of Controls - January 15, 2013

**RESPONSIBLE OFFICIAL**

Director, Return Integrity and Correspondence Services, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

We will monitor these corrective actions as part of our internal management control system.