



*Processes Ensure That Taxpayer
Identification Numbers Used to Claim
Dependent Exemptions Are Valid*

June 4, 2013

Reference Number: 2013-40-059

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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HIGHLIGHTS

PROCESSES ENSURE THAT TAXPAYER IDENTIFICATION NUMBERS USED TO CLAIM DEPENDENT EXEMPTIONS ARE VALID

Highlights

Final Report issued on June 4, 2013

Highlights of Reference Number: 2013-40-059 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Individuals claimed \$641 billion in exemptions in Processing Year 2012. Exemptions reduce the amount of income on which an individual's tax is computed. Individuals can claim one personal exemption and one exemption for each person that they can claim as a dependent. Taxpayers must enter a valid Taxpayer Identification Number (TIN) for each dependent they claim. The IRS may disallow the exemption if a valid TIN is not provided.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether the validation of dependent TINs used to claim exemptions on tax returns is sufficient to reduce the risk of improper payments and loss of tax revenue.

WHAT TIGTA FOUND

The IRS verified more than 99.6 percent (95.2 million) of the 95.6 million dependents claimed on Processing Year 2012 tax returns. IRS controls ensure that dependent TINs used to claim dependent exemptions are valid numbers.

A TIN is considered valid if the identification number and name match Social Security Administration or IRS records. The IRS rejects electronically filed tax returns and sends them back to the taxpayer for correction if the TIN and/or name on the tax return do not match IRS records. If the TIN and/or name on a paper tax return do not match the IRS's information, the IRS disallows the exemption and sends the taxpayer a notice regarding the mismatch.

However, the IRS limits the number of dependent TINs it verifies on each tax return. Our review of a statistically valid sample of 519 of the 217,192 tax returns containing dependent TINs not verified by the IRS for Processing Year 2012 identified only three tax returns that contained invalid dependent TINs. Based on our review, TIGTA estimates that the unverified dependent TINs claimed on 215,937 (99.4 percent) of the 217,192 Processing Year 2012 tax returns were valid.

WHAT TIGTA RECOMMENDED

TIGTA made no recommendations in this report.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 4, 2013

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

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

SUBJECT: Final Audit Report – Processes Ensure That Taxpayer Identification
Numbers Used to Claim Dependent Exemptions Are Valid
(Audit # 201240042)

This report presents the results of our review to determine whether the validation of dependent Taxpayer Identification Numbers used to claim exemptions on tax returns is sufficient to reduce the risk of improper payments and loss of tax revenue. This audit is included in our Fiscal Year 2013 Annual Audit Plan and addresses the major management challenge of Erroneous and Improper Payments and Credits.

Because we made no recommendations in this report, the Internal Revenue Service decided not to provide a formal response.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report. If you have questions, please contact me or Russell P. Martin, Acting Assistant Inspector General for Audit (Returns Processing and Account Services).



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Claim Dependent Exemptions Are Valid*

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Abbreviations

e-filed	Electronically filed
IRS	Internal Revenue Service
SSN	Social Security Number
TIN	Taxpayer Identification Number



Processes Ensure That Taxpayer Identification Numbers Used to Claim Dependent Exemptions Are Valid

Background

Any person who files a tax return is required to include an identifying number, referred to as a Taxpayer Identification Number (TIN). For the majority of individuals, the TIN is their Social Security Number (SSN). Some individuals use an Individual Taxpayer Identification Number or an Internal Revenue Service (IRS) Number. An Individual Taxpayer Identification Number is used when an individual cannot obtain an SSN, and an IRS Number is used where there is a problem with an individual's tax account involving the individual's SSN. A valid TIN¹ must be provided on Form 1040, *U.S. Individual Income Tax Return*, for the:

- Primary taxpayer – the individual who is filing the tax return.
- Secondary taxpayer – the spouse of the primary taxpayer.
- Dependent(s) of the individual filing the tax return, if one or more are claimed.

A dependent may be a child or other relative. To qualify as a dependent, the child or other relative must meet specific criteria. Figure 1 provides an overview of the rules for claiming an exemption for a dependent. Detailed rules for claiming a dependent exemption can be found in the instructions for completing Form 1040 and in IRS Publication 501, *Exemptions, Standard Deduction, and Filing Information*.

¹ A TIN is considered valid if the number and name provided on the tax return match Social Security Administration or IRS records.



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Figure 1: Overview of the Rules for Claiming an Exemption for a Dependent

- You cannot claim any dependents if you, or your spouse if filing jointly, could be claimed as a dependent by another taxpayer.
- You cannot claim a married person who files a joint return as a dependent unless that joint return is only a claim for refund and there would be no tax liability for either spouse on separate returns.
- You cannot claim a person as a dependent unless that person is a U.S. citizen, a U.S. resident alien, a U.S. national, or a resident of Canada or Mexico.²
- You cannot claim a person as a dependent unless that person is your **qualifying child** or **qualifying relative**.

Tests To Be a Qualifying Child	Tests To Be a Qualifying Relative
1. The child must be your son, daughter, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them.	1. The person cannot be your qualifying child or the qualifying child of any other taxpayer.
2. The child must be (a) under age 19 at the end of the year and younger than you (or your spouse, if filing jointly), (b) under age 24 at the end of the year, a full-time student, and younger than you (or your spouse, if filing jointly), or (c) any age if permanently and totally disabled.	2. The person either (a) must be related to you in one of the ways listed under <i>Relatives who do not have to live with you</i> , or (b) must live with you all year as a member of your household ³ (and your relationship must not violate local law).
3. The child must have lived with you for more than half of the year.	3. The person's gross income for the year must be less than \$3,700 (\$3,800 for TY 2012). ⁴
4. The child must not have provided more than half of his or her own support for the year.	4. You must provide more than half of the person's total support for the year. ⁵
5. The child is not filing a joint return for the year (unless that joint return is filed only as a claim for refund).	
If the child meets the rules to be a qualifying child of more than one person, only one person can actually treat the child as a qualifying child. See the <i>Special Rule for Qualifying Child of More Than One Person</i> described later to find out which person is the person entitled to claim the child as a qualifying child.	

Source: IRS Publication 501 for Tax Year⁶ 2011 tax returns available at www.irs.gov.

² There is an exception for certain adopted children.

³ There are exceptions for temporary absences, children who were born or died during the year, children of divorced or separated parents or parents who live apart, and/or kidnapped children.

⁴ There is an exception if the person is disabled and has income from a sheltered workshop.

⁵ There are exceptions for multiple support agreements; children of divorced or separated parents, or parents who live apart; and/or kidnapped children.

⁶ 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 synonymous with the calendar year.



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An individual can claim up to four dependents on the front of his or her tax return. Individuals claiming more than four dependents must check the box in the exemptions section of Form 1040 and attach a statement to the tax return listing the name, TIN, and relationship for each additional dependent.

Individuals are allowed one exemption for each person they can claim as a dependent. Exemptions reduce the amount of income on which an individual's tax is computed. Individuals claimed \$641 billion in dependent exemptions in Processing Year⁷ 2012. Figure 2 shows the location of each TIN on Form 1040, as well as the information required to claim a dependency exemption.

Figure 2: Tax Year 2011 Form 1040, U.S. Individual Income Tax Return

The image shows a portion of the 2011 Form 1040, specifically the Exemptions section. The form is for the year 2011. The Exemptions section includes:

- 6a** Yourself. If someone can claim you as a dependent, do not check box 6a.
- 6b** Spouse.
- 6c Dependents:** A table with columns for (1) First name, Last name, (2) Dependent's social security number, (3) Dependent's relationship to you, and (4) if child under age 17 qualifying for child tax credit (see instructions).
- 6d** Total number of exemptions claimed.

The table for dependents is as follows:

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if child under age 17 qualifying for child tax credit (see instructions)
Dependent 1		x x x x x x x x x x	son	<input checked="" type="checkbox"/>
Dependent 2		x x x x x x x x x x	daughter	<input checked="" type="checkbox"/>
Dependent 3		x x x x x x x x x x	son	<input checked="" type="checkbox"/>
Dependent 4		x x x x x x x x x x	son	<input type="checkbox"/>

Other summary boxes on the right of the Exemptions section show: Boxes checked on 6a and 6b: 2; No. of children on 6c who: • lived with you: 3; • did not live with you due to divorce or separation (see instructions): 0; Dependents on 6c not entered above: 1; Add numbers on lines above: 6.

Source: Tax Year 2011 Form 1040 available at www.irs.gov.

Taxpayers were allowed to deduct \$3,700 of income per exemption (whether personal or dependency) for Tax Year 2011. For example, individuals claiming four dependents could qualify for four dependency exemptions resulting in a deduction of \$14,800 from taxable income. The exemption amount for Tax Year 2012 is \$3,800.

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



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This review was performed at the IRS Wage and Investment Division Headquarters in Atlanta, Georgia, and the Customer Account Services Submission Processing function in Cincinnati, Ohio, during the period August 2012 through February 2013. 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.



Processes Ensure That Taxpayer Identification Numbers Used to Claim Dependent Exemptions Are Valid

Results of Review

Controls Ensure That Dependent Taxpayer Identification Numbers Used to Claim Exemptions Are Valid

IRS controls are effective in ensuring that individuals provide valid TINs when claiming dependency exemptions. A TIN is considered valid if the number and name provided on the tax return match Social Security Administration or IRS records. Our review identified that the IRS verified the TINs of more than 99.6 percent (95.2 million) of the 95.6 million dependents claimed on Processing Year 2012 tax returns.⁸ However, the IRS limits the number of dependent TINs it verifies on each tax return. The remaining 344,670 dependent TINs not verified by the IRS were claimed as exemptions on 217,192 tax returns. Figure 3 shows the number of dependent TINs claimed and verified on Processing Year 2012 tax returns.

Figure 3: Number of Dependent TINs Claimed and Verified for Processing Year 2012

	Dependents Claimed	Dependents Verified	Percentage Verified
Paper Tax Returns	13,683,709	13,341,812	97.5%
Electronically filed (e-filed) Tax Returns	81,924,604	81,921,831	99.9%
Total	95,608,313	95,263,643	99.6%

Source: IRS Individual Return Transaction File⁹ for Processing Year 2012 tax returns.

A review of a statistically valid sample of dependent TINs that were not verified confirmed that most taxpayers provided valid TINs

Our review of a statistically valid sample of 519¹⁰ of the 217,192 tax returns with dependent TINs that the IRS did not verify for Processing Year 2012 identified that only three tax returns

⁸ Our assessment was limited to whether the IRS ensured that the dependent TIN was valid. We did not assess whether the individual claiming the dependent met specific requirements for claiming a dependent, *i.e.*, income, residency, *etc.*

⁹ The Individual Returns Transaction File contains all edited, transcribed, and error-corrected tax return data from the Form 1040 series tax returns and related forms.

¹⁰ We selected a statistically valid sample of 300 paper returns. Of the 300 paper returns, only 269 returns were available for review. We selected a statistically valid sample of 250 e-filed tax returns.



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contained invalid dependent TINs. Based on our review, we estimate that the unverified dependent TINs claimed on 215,937 (99.4 percent) of the 217,192 Processing Year 2012 tax returns were valid TINs.

IRS instructions caution taxpayers that they must enter a TIN for each dependent they are claiming as an exemption. Taxpayers should ensure that the name and TIN entered agree with the dependent’s social security card or IRS records if the TIN was assigned to the individual by the IRS.¹¹ Once a tax return is received, the IRS matches the dependent TINs listed on the tax return to internal IRS records and to information provided by the Social Security Administration. The IRS rejects e-filed tax returns back to the taxpayer for correction if the TIN and/or name on the tax return do not match IRS records. This gives taxpayers the opportunity to correct any errors in the dependent TIN or name before the tax return is processed. If the TIN and/or name on a paper tax return do not match the IRS’s information, the IRS disallows the exemption. Figure 4 illustrates the process the IRS uses to verify dependent TINs.

Figure 4: Process to Identify Invalid Dependent TINs

E-filed Tax Returns	Paper Tax Returns
The taxpayer submits an e-filed tax return claiming dependents.	The taxpayer completes and mails a tax return claiming dependent(s) exemption.
Prior to accepting the tax return for processing, the IRS matches the dependent’s TIN and name to IRS and Social Security Administration records.	The tax return is received and IRS employees enter the tax return into the IRS’s computer processing system.
If the TIN and/or name do not match, the IRS rejects the tax return and provides the taxpayer the reason the tax return was rejected.	The IRS matches the dependent’s TIN and name to IRS and Social Security Administration records.
The taxpayer corrects the dependent TIN or name and resubmits the tax return to the IRS.	If the TIN and/or name do not match, the IRS disallows the exemption. ¹²
The IRS accepts and processes the tax return and issues a tax refund, if applicable.	The IRS processes the tax return and issues a tax refund, if applicable.

Source: IRS Internal Revenue Manual.

We also determined that unverified TINs were used to claim exemptions on more than one tax return. For example, the 519 tax returns we sampled had 792 unique TINs listed on the tax returns that were not verified by the IRS. We found that 27 (3 percent) TINs were used to claim

¹¹ An Individual Taxpayer Identification Number or an IRS Number is assigned by the IRS to individuals who cannot obtain an SSN or there is a problem with an individual’s tax account involving their SSN.

¹² Taxpayers have 60 calendar days to dispute an adjustment to their tax return.



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an exemption on more than one tax return. The IRS generally must conduct an audit of the tax returns involved in the multiple use of a TIN to determine which TIN use is correct. In Fiscal Years 2010 through 2012, the IRS closed 140,959 audits of tax returns using multiple TINs and recommended additional tax assessments totaling more than \$413 million.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the validation of dependent TINs used to claim exemptions on tax returns is sufficient to reduce the risk of improper payments and loss of tax revenue. To accomplish this objective, we:

- I. Identified the procedures and guidelines for verifying dependent TINs on paper and e-filed tax returns.
- II. Determined if unverified dependent TINs claimed on paper and e-filed tax returns are valid.
 - A. Obtained a computer extract from the Treasury Inspector General for Tax Administration Data Center Warehouse¹ for all returns containing one or more dependents for Processing Year 2012 listed on the Individual Return Transaction File.² We then identified tax returns where the taxpayer claimed more dependents on the tax return than the number of dependents the IRS verifies per tax return.
 - B. Reviewed two statistically valid samples of tax returns with more dependents than the IRS will verify for Processing Year 2012. Statistical samples were selected in order to project to the population. We selected a statistical sample of 300 paper tax returns from a population of 215,508 tax returns. Our sample size was based on a 95 percent confidence level, an expected error rate of 25 percent, and a precision of ± 5 percent. In addition, we selected a statistical sample of 250 e-filed tax returns from a population of 1,684 e-filed tax returns. Our sample size was based on a 95 percent confidence level, an expected error rate of 25 percent, and a precision of ± 5 percent. The data from the first 30 returns in both samples were matched to the Integrated Data Retrieval System³ to validate that the data were accurate.
 - C. Obtained the Processing Year 2012 tax returns of the taxpayers in our samples and reviewed the dependents on the Integrated Data Retrieval System to determine if the dependents' TINs were valid.

¹ A collection of IRS databases containing various types of taxpayer account information that is maintained by the Treasury Inspector General for Tax Administration for the purpose of analyzing data for ongoing audits.

² The Individual Return Transaction File contains all edited, transcribed, and error-corrected tax return data from the Form 1040, *U.S. Individual Income Tax Return*, series tax returns and related forms.

³ An IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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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 IRS's policies, procedures, and practices related to processing claims for dependent exemptions, and the identification of potential erroneous claims for these exemptions. We assessed these controls through interviews with IRS management, analysis of IRS policies and procedures, and review of dependent exemptions not verified by the IRS.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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