



*Stolen and Falsely Obtained Employer
Identification Numbers Are Used to
Report False Income and Withholding*

September 23, 2013

Reference Number: 2013-40-120

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 = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

STOLEN AND FALSELY OBTAINED EMPLOYER IDENTIFICATION NUMBERS ARE USED TO REPORT FALSE INCOME AND WITHHOLDING

Highlights

Final Report issued on September 23, 2013

Highlights of Reference Number: 2013-40-120 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

The IRS issues Employer Identification Numbers (EINs) to identify taxpayers' business accounts. Individuals attempting to commit tax refund fraud commonly steal or falsely obtain an EIN to file tax returns reporting false income and withholding. TIGTA estimates that the IRS could issue almost \$2.3 billion in potentially fraudulent tax refunds based on these EINs yearly (or about \$11.4 billion over the next five years).

WHY TIGTA DID THE AUDIT

This audit was initiated because perpetrators of fraud are using stolen or falsely obtained EINs to submit tax returns with false income and withholding documents to the IRS for the sole purpose of receiving a fraudulent tax refund. The overall objective of this review was to assess the IRS's process for issuing EINs and its process to identify stolen or falsely obtained EINs used to report income and withholding.

WHAT TIGTA FOUND

The IRS has developed processes to both authenticate individuals applying for an EIN and to ensure that there is a valid business reason to obtain an EIN.

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TIGTA identified 767,071 Tax Year 2011 electronically filed individual tax returns with refunds based on falsely reported income and withholding.

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There were 285,670 EINs used on these tax returns:

- 277,624 were stolen EINs used to report false income and withholding on 752,656 tax returns with potentially fraudulent refunds issued totaling more than \$2.2 billion.
- 8,046 were falsely obtained EINs used to report false income and withholding on 14,415 tax returns with potentially fraudulent refunds issued totaling more than \$50 million. For these EINs, *****2*****

The IRS has developed a number of processes to prevent fraudulent refunds claimed using stolen and falsely obtained EINs. However, the IRS does not have the third-party Form W-2 information needed to make significant improvements in its detection efforts.

Nonetheless, the IRS does maintain data that could increase its ability to detect tax returns with false income and withholding associated with stolen or falsely obtained EINs.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS update fraud filters *****2*****

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during the filing season to identify potentially fraudulent tax returns. *****2*****
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In their response to the report, IRS officials agreed with our recommendations and plan to update fraud filters *****2*****

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 23, 2013

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

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

SUBJECT: Final Audit Report – Stolen and Falsely Obtained Employer Identification Numbers Are Used to Report False Income and Withholding (Audit # 201240026)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) process for issuing Employer Identification Numbers (EINs) and its process to identify stolen or falsely obtained EINs used to report income and withholding. This audit was included in our Fiscal Year 2012 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included in Appendix V.

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



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Abbreviations

e-file(d)	Electronically File(d)
EIN	Employer Identification Number
IRS	Internal Revenue Service
SSA	Social Security Administration
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number



Stolen and Falsely Obtained Employer Identification Numbers Are Used to Report False Income and Withholding

Background

An Employer Identification Number (EIN) is a Federal Tax Identification Number (TIN)¹ used to identify a taxpayer’s business account. The EIN is a nine-digit number (in the format of XX-XXXXXXX) assigned by the Internal Revenue Service (IRS) and used by employers, sole proprietors, corporations, partnerships, nonprofit associations, trusts and estates, government agencies, certain individuals, and other types of businesses.

Process to obtain an EIN

Taxpayers can apply for an EIN in various ways. This includes online through the IRS’s public website (IRS.gov) or by telephone, fax, or mail using Form SS-4, *Application for Employer Identification Number*. In Fiscal Year² 2012, the IRS issued more than 4.6 million EINs with approximately 3.3 million of the applications submitted through IRS.gov. Figure 1 provides a breakdown of the EINs issued in Fiscal Year 2012 by the method of request.

When individuals or entities apply for an EIN, they must provide the type of entity, the reason they are applying for the EIN, *e.g.*, started a new business or hired an employee, and responses to additional questions the IRS asks based on the type of business associated with the EIN. In addition, most EIN applicants must disclose the name and TIN of the principal officer, general partner, grantor, owner, or trustor.³

In Fiscal Year 2012, the IRS issued more than 4.6 million EINs, with approximately 73 percent of the applications submitted through IRS.gov.

The IRS defines these individuals or entities as the “responsible party” who controls, manages, or directs the applicant entity and the disposition of its funds and assets.⁴ If there is more than one responsible party, the entity may list whichever party the entity wants the IRS to recognize as the responsible party. The IRS’s Submission Processing site located in Covington, Kentucky, processes all EIN applications.

¹ A TIN includes a Social Security Number, EIN, or Individual TIN.

² A 12-consecutive-month period ending on the last day of any month. The Federal Government’s fiscal year begins on October 1 and ends on September 30.

³ This is not required when a foreign individual or business requests the EIN. A trustor is the creator of a trust.

⁴ *****2*****



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Figure 1: EIN Issued in Fiscal Year 2012 by Type of Application Request

Method	Volume	Percentage
Online	3,373,927	73%
Telephone	857,473	18%
Bulk Program ⁵	233,369	5%
Fax	104,138	2%
IRS-Created ⁶	51,652	1%
Mail	22,501	<1%
Total	4,643,060	100.00%

Source: IRS Wage and Investment Division, Accounts Management Office.

*****7 *****2*****
*****2*****

Individuals who report wages (income) and withholding on a Form 1040, *U.S. Individual Income Tax Return*, must attach a Form W-2, *Wage and Tax Statement*, to a paper-filed tax return to support the income and withholding reported. For an electronically filed (e-filed) tax return, the filer must input the information from the Form W-2 into the e-filed tax return.

Individuals attempting to commit tax refund fraud commonly file tax returns reporting false income and withholding to generate a fraudulent tax refund. Claiming false income can inflate a fraudulent tax refund, as some credits are income based. *****2*****
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⁵ Certain businesses, such as banks or law firms that represent estates, trusts, bankruptcy estates, or pension or retirement trusts, may request that large quantities of EINs be assigned to them. Those businesses then assign the EINs to their customers.

⁶ When a business tax return is filed without an EIN or with an invalid EIN, the IRS creates an EIN to allow processing of the tax return.

⁷*****2*****.



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This review was performed at the IRS Wage and Investment Division Customer Account Services function and Return Integrity and Correspondence Services function at the Submission Processing site in Covington, Kentucky, during the period July 2012 through May 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.



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Results of Review

Individuals Use Stolen and Falsely Obtained Employer Identification Numbers to Receive Fraudulent Tax Refunds

Our review of Tax Year⁸ 2011 e-filed individual tax returns identified 767,071 tax returns with potentially fraudulent refunds totaling almost \$2.3 billion. These refunds were based on income and withholding reported on the tax return. There were 285,670 EINs used on these tax returns:

- 277,624 were stolen EINs used to report false income and withholding on 752,656 tax returns with potentially fraudulent refunds issued totaling more than \$2.2 billion.
8,046 were falsely obtained EINs used to report false income and withholding on 14,415 tax returns with potentially fraudulent refunds issued totaling more than \$50 million.

Based on our analysis, we estimate that the IRS could issue approximately \$11.4 billion in fraudulent refunds over the next five years because of stolen and falsely obtained EINs.

The IRS has developed processes in an effort to both authenticate individuals applying for an EIN and ensure that there is a valid business reason to obtain an EIN. In an effort to combat filing fraud, the IRS has established a number of processes to identify and prevent the fraudulent use of EINs to report false income and withholding. These EIN verification and confirmation processes continue to prevent the issuance of millions of dollars in fraudulent refunds and include:

- Validating information provided when individuals are applying for an EIN.

8 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.
9 This includes almost \$7.5 billion in refunds that were identified in a separate Treasury Inspector General for Tax Administration audit, Ref. No. 2012-42-080, Effectiveness of Efforts to Detect and Prevent Identity Theft Follow-up (Jul. 2012), as having the characteristics of IRS-confirmed identity theft cases and almost \$3.9 billion in outcomes claimed in this audit report. See Appendix IV for the outcome measures.



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- Verifying that a valid EIN is used to support income and withholding on tax returns.
- Developing a list of suspicious EINs.
- Obtaining income and withholding information from certain businesses during the filing season.
- Creating the Business Master File¹⁰ Identity Theft Team.

Validating key information when individuals are applying for an EIN. The IRS confirms that the responsible party TIN is valid.¹¹ The IRS also ensures that an EIN with the same business name does not already exist under the requestor’s TIN. If the responsible party TIN is not valid and/or an EIN already exists, the IRS rejects the application. During Calendar Year¹² 2012, the IRS rejected 591,177 EIN applications submitted online. Figure 2 provides examples of the different levels of authentication performed based on the method used to apply for an EIN.

Figure 2: Taxpayer Authentication Based on Application Method

Method of Requesting EIN	Responsible Party TIN Validation Performed	Responsible Party Date of Birth Verification Performed	Existing EIN Verification
Online	Yes	No	Yes
Telephone	Yes	Yes	Yes
Bulk Program	No	No	Yes
Fax	Yes	No	Yes
Mail (Form SS-4)	Yes	No	Yes

Source: IRS Internal Revenue Manual.

Verifying that a valid EIN is used in support of income and withholding on tax returns. The IRS has processes to verify that the EIN on Forms W-2 associated with income and withholding reported on tax returns is valid (issued by the IRS). The IRS’s e-file system rejects e-filed tax returns if the EIN used to report income is not valid. For Calendar Year 2013 as of May 27, 2013, the IRS rejected more than 1.1 million e-filed tax returns because an invalid EIN was used to report income and withholding. The IRS will also correspond with taxpayers to request the Form W-2 if one is not included with a paper-filed tax return. In addition, the IRS

¹⁰ The IRS database that consists of Federal tax-related transactions and accounts for businesses. These include employment taxes, income taxes on businesses, and excise taxes.

¹¹ A TIN is valid if the number and name provided on the tax return match IRS records.

¹² The 12-consecutive-month period ending on December 31.



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has established a process to ensure that the EIN is issued prior to the current processing year.¹³ For the Calendar Year 2013 as of May 27, 2013, the IRS rejected 28,696 e-filed tax returns because the EIN was issued during Calendar Year 2013.

Developing a list of suspicious EINs. When tax examiners screen tax returns for fraud potential in the IRS's Integrity and Verification Operation function, the tax examiners may identify a trend relating to a particular EIN used to report false income and withholding. Tax examiners perform extensive research in an attempt to locate the employers associated with these EINs. If the employer is ultimately determined to be a fictitious business, tax examiners designate the associated EIN as suspicious. The IRS maintains a list of the suspicious EINs used to identify additional tax returns that have income reported using those EINs. The list is cumulative, and the IRS confirmed 6,333 EINs as suspicious since January 2003. Figure 3 provides the number of fraudulent tax returns identified and the associated refunds prevented using the Suspicious EIN List.

Figure 3: Fraudulent Refunds Prevented Using the Suspicious EIN List for Processing Years 2010 Through 2012

Processing Year	Fraudulent Tax Returns	Fraudulent Refunds Prevented
2010	7,490	\$48,626,250
2011	5,244	\$19,540,458
2012	5,680	\$35,127,321

Source: IRS fraudulent tax return statistics for Processing Years 2010 through 2012.

Obtaining income and withholding information from certain businesses. When tax examiners screen tax returns for fraud, they contact employers to verify the income and withholding information reported on the tax return. Many times during the filing season, tax examiners make numerous verification telephone calls to the same businesses for a number of different tax returns that have potentially false income reported using the businesses' EINs. For the businesses subject to these frequent verification contacts, each year the IRS reaches an agreement with the businesses to voluntarily send employee income and withholding information to the IRS. During Calendar Year 2012, the IRS had such agreements with 999 businesses.¹⁴ The IRS then uses the information provided to verify income and withholding information on potentially fraudulent tax returns rather than contacting the employer for confirmation. Figure 4 shows the number of

¹³ Many businesses that have employees are required to file employment tax returns and pay employment taxes during the tax year. The employers would need to obtain an EIN in the tax year they are filing employment tax returns and making employment tax payments, not the year following that tax year.

¹⁴ This includes subsidiaries.



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fraudulent tax returns identified and the associated refunds prevented by using the information provided by these businesses.

**Figure 4: Fraudulent Refunds Identified Using
Employer-Provided Information for
Processing Years 2010 Through 2012**

Processing Year	Fraudulent Tax Returns	Fraudulent Refunds Prevented
2010	22,328	\$93,103,886
2011	41,285	\$147,709,862
2012	92,616	\$417,570,295

Source: IRS fraudulent tax return statistics for Processing Years 2010 through 2012.

Creating the Business Master File Identity Theft Team. The team was formed in September 2012 to define and identify instances of identity theft related to business tax returns. This team will develop a process for businesses to report instances where they believe they were a victim of business identity theft, *i.e.*, the businesses' EINs were used to commit tax refund fraud.

The previously mentioned processes have resulted in the detection of individuals attempting to falsely obtain EINs and in the prevention of fraudulent refunds based on both stolen and falsely obtained EINs. However, as we have previously reported, the IRS does not have the third-party Form W-2 information needed to make significant improvements in its detection efforts. We identified billions of dollars more in undetected potentially fraudulent refunds. Each of the tax returns we identified involves either a stolen or a falsely obtained EIN to report income and withholding. The IRS does not have access to third-party reported Form W-2 information at the time tax returns are processed. As a result, the IRS is unable to verify income and withholding reported on tax returns when they are processed, *i.e.*, match income and withholding reported on tax return to a third-party Form W-2. The deadline for filing most third-party Form W-2 information with the Social Security Administration (SSA) is March 31. However, taxpayers can begin filing their tax returns as early as mid-January each year.

In April 2011, the IRS Commissioner introduced the IRS's vision of an initiative that would allow matching of data on tax returns with data on third-party information returns at the time tax returns are processed. A system such as this would reduce the number of "erroneous" refunds paid, as it would allow the IRS to substantiate claims or entries made by the taxpayers on the tax returns as they are processed. To date, the IRS has conducted stakeholder sessions to discuss the impact, opportunities, and constraints around earlier data matching.

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The Suspicious EIN List could be used to identify potentially fraudulent tax returns

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*****2*****. Our review identified 402 Tax Year 2011 tax returns with refunds issued totaling approximately \$1.6 million that the IRS could have identified as potentially fraudulent tax returns. These individuals reported income and withholding using an EIN identified by the IRS as suspicious, *****2*****
*****2*****. These 402 tax returns reported income using 132 EINs included on the Suspicious EIN List.

IRS management agreed that the Suspicious EIN List would enhance fraud detection activities. The IRS indicated that on February 5, 2013, it implemented processes to use the Suspicious EIN List during the remainder of the 2013 Filing Season¹⁵ as part of its fraud detection efforts. The IRS noted that it developed computer queries to identify all tax returns reporting income using a confirmed suspicious EIN. Once identified, the tax returns are sent to tax examiners for income and withholding verification. As of June 19, 2013, the IRS informed us that it had identified 3,104 potentially fraudulent tax returns for verification of income. These tax returns claimed refunds totaling \$18,250,444.

Income information provided by employers for IRS verifications can be used to identify potentially fraudulent tax returns

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2. Our review identified 32,267 Tax Year 2011 tax returns with refunds issued totaling approximately \$81 million that the IRS could have identified as potentially fraudulent tax returns. These individuals filed tax returns using the stolen EIN *****2*****
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*****2*****. We determined that 411 EINs were stolen to falsely report income and withholding on the 32,267 tax returns. One stolen EIN was used to falsely report income and withholding on 8,573 tax returns.

We notified management of this issue on February 15, 2013. IRS management responded that *****2*****
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¹⁵ The period from January through mid-April when most individual income tax returns are filed.



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that using the verification information provided by employers would help the IRS avoid needless use of its resources by allowing it to focus on those individuals who falsely report income and withholding. For example (*hypothetically*):

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The EINs of ***2***** can be used to identify potentially fraudulent tax returns**

Our review identified 6,085 Tax Year 2011 potentially fraudulent tax returns with refunds issued totaling more than \$21 million to individuals reporting income and withholding using an EIN of *****2*****. These 6,085 tax returns included falsely reported income and withholding using 2,896 EINs *****2*****.¹⁶ *****2*****

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We notified IRS management of this issue on February 15, 2013. IRS management responded

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¹⁶*****2*****
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Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Update fraud filters *****2*****

Management's Response: The IRS agreed with this recommendation. The Return Review Program will perform fraud screening *****2*****

Recommendation 2: Update fraud filters *****2*****

Management's Response: The IRS agreed with this recommendation. The IRS will update fraud filters *****2*****

Recommendation 3: Develop processes to identify individuals submitting tax returns reporting income and withholding using the EIN *****2*****

Management's Response: The IRS agreed with this recommendation. The IRS will evaluate the use *****2*****

Stolen Employer Identification Numbers Are Used to Create Fraudulent Forms W-2, Wage and Tax Statement, *****2*****

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the IRS's process for issuing EINs and its process to identify stolen or falsely obtained EINs used to report income and withholding. To accomplish this objective, we:

- I. Assessed the effectiveness of the IRS's process for assigning EINs to ensure the validity of the taxpayers requesting the numbers.
- II. Assessed the effectiveness of the IRS's process to ensure that EINs,*****2*****
*****2*****.
- III. Determined if individuals are using EINs to obtain fraudulent tax refunds.
- IV. Identified additional actions the IRS could take based on the EIN used on an information document to prevent erroneous refund returns from being processed.
 - A. Identified the IRS's process for using the large employer list of employees as a tool for preventing erroneous refunds.
 - B. Identified the population of 87,631,583 e-filed refund returns with wages filed during the 2012 Filing Season*****2*****
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 2. *****2*****
*****2*****.
- V. Validated the data obtained to complete our audit tests.



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Data validation methodology

During this review, we relied on data extracted from the IRS's Individual and Business Returns Transaction Files for Processing Year 2012, the Individual and Business Master Files for Tax Year 2011, and the W-2 File for Tax Year 2011 located on the Treasury Inspector General for Tax Administration (TIGTA) Data Center Warehouse. We also relied on data extracts from the IRS's Tax Returns Database and Modernized Tax Returns Database, and an extract of Forms 1099, *Miscellaneous Income*, from the IRS's Information Returns Processing database for Tax Year 2011 provided by the TIGTA Office of Investigations' Strategic Data Services. We also obtained from the IRS an extract of employee information for the employers participating in the IRS's Disk Verification Program. We selected random samples from our data analysis using the above data and validated the results using the IRS's Integrated Data Retrieval System. Through our testing, we determined the data used in our review were reliable.

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 controls over the issuance of EINs and the controls over the identification of fraudulent tax returns based on the EINs used. We evaluated these controls by interviewing IRS management and analyzing how individuals used EINs on Forms W-2 with tax returns that appeared to be fraudulent.



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Appendix II

Major Contributors to This Report

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Steven E. Vandigriff, Information Technology Specialist



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Appendix III

Report Distribution List

Acting Commissioner
Office of the Commissioner – Attn: Chief of Staff C
Office of the Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Operations, Wage and Investment Division SE:W
Deputy Commissioner, Support, Wage and Investment Division SE:W
Associate Chief Information Officer, Applications Development OS:CTO:AD
Director, Return Integrity and Correspondence Services, Wage and Investment Division
SE:W:RICS
Director, Strategy and Finance, Wage and Investment Division SE:W:S
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Chief Program Evaluation and Improvement, Wage and Investment Division
SE:W:S:PEI



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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.

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; \$738,764,917 (\$3,693,824,585 over five years) from 221,971 tax returns receiving fraudulent tax refunds based on income and withholding reported under either a stolen or a falsely obtained EIN (see page 4).

Methodology Used to Measure the Reported Benefit:

We conducted an analysis of Tax Year 2011 e-filed individual tax returns claiming wages and the Forms W-2, *Wage and Tax Statement*, submitted with the tax returns. *****2*****
 *****2*****
 *****2*****
 *****2*****
 *****2*****.

Our review of Tax Year 2011 tax returns identified 767,071 tax returns with refunds totaling \$2,273,177,371 for which the IRS did not receive third-party documents supporting the income and withholding claimed on the tax returns. We eliminated \$1,494,356,437 in potentially fraudulent refunds for 533,118 tax returns that were claimed as part of the five-year outcome projections in the previous TIGTA audit as having the characteristics of IRS-confirmed identity theft cases (TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012)). We also eliminated \$40,056,016 in potentially fraudulent refunds for 11,982 tax returns that are claimed as an outcome because the IRS has data that it maintained which can be used to improve detection of stolen or falsely obtained EINs used to report income and withholding.



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Computation of Estimated Cost Savings for Potentially Fraudulent Refunds Issued

\$2,273,177,371	Total potentially fraudulent refunds issued in Tax Year 2011
(\$1,494,356,437)	Potentially fraudulent refunds claimed in prior audit
<u>(\$40,056,016)</u>	Potentially fraudulent refunds identified in next outcome
\$738,764,917 ¹	Estimated cost savings

Computation of Estimated Number of Tax Returns Identified As Receiving Potentially Fraudulent Refunds

767,071	Total tax returns identified
(533,118)	Tax returns identified in prior audit
<u>(11,982)</u>	Tax returns identified in next outcome
221,971	Estimated number of tax returns receiving potentially fraudulent refunds

Type and Value of Outcome Measure:

- Cost Savings (Funds Put to Better Use) – Potential; \$40,056,016 (\$200,280,080 over five years) from 11,982 tax returns for which the IRS maintains data that could be used to identify fraudulent tax refunds based on income and withholding reported under either a stolen or a falsely obtained EIN (see page 8).

Methodology Used to Measure the Reported Benefit:

We conducted an analysis of Tax Year 2011 e-filed individual tax returns claiming wages and the Forms W-2 submitted with the tax returns. *****2*****
 *****2*****
 *****2*****. This comparison identified 53,169 tax returns for which the IRS issued refunds totaling \$153,891,289. ****2*****
 *****2*****
 *****2*****. We eliminated \$92,390,505 in potentially fraudulent refunds for 35,067 tax returns that were claimed as outcomes in the TIGTA audit report discussed earlier. We also eliminated \$21,444,767 in potentially fraudulent refunds for 6,120 tax returns that we identified in more than one category. We then compared these tax returns to the Suspicious EIN List, *****2*****
 *****2*****. Through this comparison, we identified the following:

- 402 Tax Year 2011 potentially fraudulent tax returns with refunds issued totaling \$1,557,784 to individuals who reported income and withholding using an EIN that was identified by the IRS as being suspicious, *****2*****

¹ Numbers do not total due to rounding.



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*****2*****. These 402 tax returns reported income using 132 EINs included on the Suspicious EIN List.

- 32,267 Tax Year 2011 potentially fraudulent tax returns with refunds issued totaling \$80,916,658 issued to individuals using an EIN *****2*****. We identified that 411 EINs were used to falsely report income and withholding on the 32,267 tax returns.
- 6,085 Tax Year 2011 potentially fraudulent tax returns with refunds issued totaling \$21,290,890 to individuals using the EINs*****2*****. These 6,085 tax returns reported income using 2,896 EINs*****2*****.²
- 8,046 EINs with no filing history that were used to report income and withholding on 14,415 Tax Year 2011 tax returns with potentially fraudulent refunds issued totaling \$50,125,957. For each of these EINs, we found*****2*****. *****2*****.

Computation of Estimated Cost Savings for Potentially Fraudulent Refunds Issued

\$153,891,289	Total potentially fraudulent refunds issued in Tax Year 2011
(\$92,390,505)	Potentially fraudulent refunds claimed in prior audit
<u>(\$21,444,767)</u>	Potentially fraudulent refunds identified in other categories
\$40,056,016 ³	Estimated cost savings

Computation of Estimated Number of Tax Returns Identified As Claiming Potentially Fraudulent Refunds

53,169	Total tax returns identified
(35,067)	Tax returns identified in prior audit
<u>(6,120)</u>	Tax returns identified in other categories
11,982	Estimated number of tax returns receiving potentially fraudulent refunds

²*****2*****. *****2*****.

³ Numbers do not total due to rounding.



*Stolen and Falsely Obtained Employer
Identification Numbers Are Used to Report False Income
and Withholding*

Appendix V

Management's Response to the Draft Report



COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

SEP 06 2013

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

FROM: Peggy Bogadi 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Stolen and Falsely Obtained Employer
Identification Numbers Are Used to Report False Income and
Withholding (Audit # 201240026)

We appreciate the opportunity to review the subject draft report, as well as the recognition of the effective processes we have developed to identify and prevent the fraudulent use of Employer Identification Numbers (EIN) in reporting false income and withholding. The creation of the Business Master File Identity Theft Team is a substantial step forward in identifying threats associated with the misuse of EINs and developing effective mitigation strategies. Concurrent with the work being performed by the team, we are also preparing to test and evaluate the performance of the Return Review Program (RRP) during the 2014 Filing Season. The RRP will eventually assume the fraud detection role of the Electronic Fraud Detection System (EFDS), and will incorporate EIN validation into the fraud detection process.

We agree with the recommendations made in the report; however, it is important to note some challenges that must be considered and addressed as we implement corrective actions. Using the business tax return filing and withholding information will be helpful in identifying potentially fraudulent refund claims by individuals using false wage and withholding information; however, there is a risk of delaying the processing of legitimate tax returns filed by individuals whose employers are not compliant with their tax and/or information return filing obligations. Our sample review of the potentially fraudulent tax returns, identified by the Treasury Inspector General for Tax Administration, found situations where the employers had remitted payroll tax deposits, but were delinquent in filing employment tax returns. We also noted instances where wage and withholding information from the employer was present for prior and/or subsequent periods that, in our experience, indicate either data anomalies or non-compliance with filing requirements. In these situations, non-compliance by employers does not equate to refund fraud by employees. With filings of individual income tax returns exceeding 140



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2

million, annually, we must ensure that corrective actions do not have the unintended result of flagging legitimate returns as being potentially fraudulent.

Pending implementation of long-term corrective actions, we are reviewing options to adjust current processes to increase the effectiveness of fraud detection. We are developing a process to identify EINs that are obtained for entities fabricated for the purpose of submitting false income and withholding information. Similar processes are being developed for valid EINs that appear to be stolen. In both cases, fraud filters will be set to identify returns containing those EINs as needing additional review.

Attached are our comments on your recommendations. If you have any questions, please contact me, or a member of your staff may contact Jodi L. Patterson, Director, Return Integrity and Correspondence Services, Wage and Investment Division, at (404) 338-9042.

Attachment



Stolen and Falsely Obtained Employer Identification Numbers Are Used to Report False Income and Withholding

Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1

Update fraud filters to*****2*****
*****2*****
*****2*****.

Corrective Action

The Return Review Program will perform fraud screening *****2*****
*****2*****
*****2*****.

Implementation Date

January 15, 2016

Responsible Official

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

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.

Recommendation 2

Update fraud filters*****2*****
*****2*****
*****2*****.

Corrective Action

We will update fraud filters*****2*****.

Implementation Date

January 15, 2015

Responsible Official

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

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.



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Recommendation 3

Develop processes to identify individuals submitting tax returns reporting income and withholding using the EIN

*****2***** . *****2*****
*****2***** .

Corrective Action

We evaluate the use of*****2*****

*****2*****
*****2***** .

Implementation Date

January 15, 2015

Responsible Official

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

Corrective Action Monitoring Plan

We will monitor this corrective action as part of our internal management control system.