



Treasury Inspector General for Tax Administration Office of Audit

THE LAW WHICH PENALIZES ERRONEOUS REFUND AND CREDIT CLAIMS WAS NOT PROPERLY IMPLEMENTED

Issued on September 26, 2013

Highlights

Highlights of Report Number: 2013-40-123 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

Congress enacted the erroneous claim for refund or credit penalty (referred to as the erroneous refund penalty) to enhance the IRS's ability to address the growing number of erroneous tax credit and refund claims filed. Taxpayers who claim excessive tax credits or refunds may be penalized up to 20 percent of the erroneous tax credit or refund claim. Refund or credit claims that have no reasonable basis in law create unnecessary burden on both taxpayers and the IRS by straining resources and impeding effective tax administration.

WHY TIGTA DID THE AUDIT

The Small Business and Work Opportunity Tax Act of 2007 amended the Internal Revenue Code to allow for a monetary penalty for erroneous tax refund or tax credit claims. This audit was initiated to determine whether the IRS is properly assessing the erroneous claim for refund or credit penalty on individual tax accounts.

WHAT TIGTA FOUND

The IRS incorrectly interpreted the erroneous refund penalty law, which significantly limited the types of erroneous tax refund or credit claims to which the penalty would apply. The IRS assessed only 84 erroneous refund penalties totaling \$1.9 million between May 2007 and May 2012.

In response to concerns raised from various IRS functions, the IRS Office of Chief Counsel subsequently revised its interpretation of the law as to when the erroneous refund penalty could be assessed, and issued an updated memorandum in May 2012.

Although the IRS revised its interpretation of the law, it has not developed processes and procedures to enable those functions (Campus Operations) that disallow the majority of individual tax credits to assess the penalty.

For example, in the year after the IRS revised its interpretation of the law (June 3, 2012 through May 25, 2013), there were 709,123 individual tax credits disallowed by these functional areas for which the IRS could have potentially assessed erroneous refund penalties totaling more than \$1.5 billion.

IRS management raised concerns about the costs and benefits of establishing processes and procedures for the Campus Operations to assess erroneous refund penalties. However, the IRS has not provided any documentation and/or analysis to support the validity of these concerns. In view of the significant problem of erroneous claims for credits and refunds and the related costs to the Government, TIGTA believes that the IRS should reexamine its decision and put appropriate procedures and processes in place to comply with this section of law.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS develop processes and procedures to enable Campus Operations to assess the erroneous refund penalty for disallowed credit claims that are excessive and do not have a reasonable basis.

The IRS agreed with the recommendation and stated that a cross-functional team of affected stakeholders will determine the operational and procedural changes needed to integrate assessment of the erroneous refund penalty into the Campus Operations.

READ THE FULL REPORT

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

<http://www.treas.gov/tigta/auditreports/2013reports/201340123fr.pdf>

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