



*Improvements Are Needed to Better
Document the Return Preparer Refundable
Credit Compliance Treatment Identification
and Selection Process*

October 19, 2017

Reference Number: 2018-40-001

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 = Law Enforcement Techniques/Procedures and Guidelines for Law Enforcement Investigations or Prosecutions

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HIGHLIGHTS

IMPROVEMENTS ARE NEEDED TO BETTER DOCUMENT THE RETURN PREPARER REFUNDABLE CREDIT COMPLIANCE TREATMENT IDENTIFICATION AND SELECTION PROCESS

Highlights

Final Report issued on October 19, 2017

Highlights of Reference Number: 2018-40-001 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

Refundable credits help low-income individuals reduce their tax burden or provide incentives for specific activities. For example, the Earned Income Tax Credit (EITC), created in 1975, is used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment. Congress later created the Child Tax Credit, which included a refundable component, the Additional Child Tax Credit, to reflect a family's reduced ability to pay taxes as family size increases.

WHY TIGTA DID THE AUDIT

This audit was initiated because return preparers play a significant role in EITC compliance. The IRS estimates that 24 percent or \$16.8 billion in EITC payments were issued improperly in Fiscal Year 2016. The objective of this review was to assess the IRS's strategy and processes for identifying and addressing return preparers' filing returns with erroneous refundable credits such as the EITC.

WHAT TIGTA FOUND

The IRS has completed various compliance treatments to address 24,312 return preparers identified as filing high rates of tax returns with characteristics of an erroneous claim including the IRS issuing a letter to the preparer or visiting the preparer's office.

However, the IRS's scoring and selection model used to develop the FY 2016 Return Preparer Compliance Workplan was not sufficiently

documented. Our analysis found 3,547 return preparers that filed *****2*****, with 30 percent or more of the returns having one or more characteristics of a potentially erroneous EITC claim. These return preparers submitted 337,317 returns with EITC claims totaling more than \$1.1 billion. The IRS did not conduct a compliance treatment for many of these preparers, and documentation did not explain why the IRS excluded these return preparers from treatment.

In addition, TIGTA identified that coordination and referrals among IRS functions could increase the IRS's ability to address return preparers with persistent noncompliance. Analysis of the 1,297 return preparers in the IRS Fiscal Year 2016 Return Preparer Compliance Workplan who received an office visit found that 510 (39 percent) did not improve their compliance with EITC requirements in the following year.

Finally, the IRS excluded 1,686 noncompliant return preparers from the IRS scoring and selection process after including the return preparers in a control group. The control group was used to measure the effectiveness of compliance treatments.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS:

- 1) adequately document the methodology and criteria used in the Refundable Credits Policy and Program Management function's risk-based return preparer scoring and selection model, and
- 2) develop procedures for the Refundable Credits Policy and Program Management function for identifying and referring to other functions egregious preparers who continue to be noncompliant subsequent to an office visit.

IRS agreed with one recommendation and partially agreed with the other recommendation citing that they agreed additional actions were needed when preparers continue to be noncompliant. TIGTA's concern remains that the Refundable Credits Policy and Program Management function does not have written procedures to proactively refer egregious return preparers to other IRS functions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 19, 2017

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Improvements Are Needed to Better Document
the Return Preparer Refundable Credit Compliance Treatment
Identification and Selection Process (Audit # 201640010)

This report presents the results of our review to assess the Internal Revenue Service strategy and processes for identifying and addressing return preparers' filing returns with erroneous refundable credits such as the Earned Income Tax Credit. This audit was included in our Fiscal Year 2017 Annual Audit Plan and addresses the major management challenge of Improving Tax Compliance.

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

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



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Abbreviations

EITC	Earned Income Tax Credit
FY	Fiscal Year
IRS	Internal Revenue Service
PTIN	Preparer Tax Identification Number
PY	Processing Year
RCPPM	Refundable Credits Policy and Program Management



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Background

Refundable credits help low-income individuals reduce their tax burden or provide incentives for specific activities. For example, the Earned Income Tax Credit (EITC),¹ created in 1975,² is used to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment. Congress later created the Child Tax Credit, which included a refundable component, and the Additional Child Tax Credit,³ to reflect a family's reduced ability to pay taxes as family size increases. Other refundable credits provide incentives for specific activities, such as obtaining a college education. For example, the American Opportunity Tax Credit allows individuals to receive a credit for higher education expenses up to \$2,500 per student per year, with up to \$1,000 being refundable.⁴

Although refundable credits provide benefits to individuals, the unintended consequence of these credits is that they can result in the issuance of improper payments and can be the targets of unscrupulous individuals who file erroneous claims. Unlike nonrefundable tax credits, which are limited to the amount of an individual's income tax liability, refundable credits do not have such a limitation. Refundable credits may result in a refund even if there is no tax liability; that is, the portion of the credit that exceeds a taxpayer's tax liability may be refunded to the taxpayer. Consequently, they pose a significant risk as an avenue for those seeking to defraud the Government.

The Internal Revenue Service (IRS) estimates that 24 percent or \$16.8 billion in EITC payments were issued improperly in Fiscal Year (FY)⁵ 2016. An improper payment is one that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient. The IRS recognizes the role that paid tax return preparers (hereafter referred to as return preparers) play in ensuring compliance with EITC requirements. As such, in Fiscal Year 2009, the IRS developed their Return Preparer Strategy that includes a progressive treatment stream and expanded outreach in an effort to reduce improper EITC payments claimed on tax returns prepared by return preparers. The Refundable Credits Policy and Program Management

¹ The EITC is a refundable tax credit that offsets income tax owed by low-income taxpayers. Refundable tax credits can be used to reduce a taxpayer's tax liability to zero. Any excess of the credit beyond the tax liability can be refunded to the taxpayer.

² Tax Reduction Act of 1975 § 204, 26 U.S.C. § 32.

³ The Additional Child Tax Credit phases out for taxpayers depending upon their income level. Taxpayers with earned income of less than \$3,000 may be eligible for a refundable credit if they have three or more qualifying children and have paid Social Security taxes that exceed their EITC.

⁴ IRS Publication 970, *IRS Tax Benefits for Education*.

⁵ Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.



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(RCPPM) function⁶ within the IRS oversees the Return Preparer Strategy. Its mission is to communicate policy, procedures, and guidance on EITC and other refundable credits and programs. The RCPM also coordinates each year with other functions within the IRS to treat egregious return preparers whose returns show a pattern of noncompliance with refundable credit requirements.

Process to identify return preparers filing high rates of potentially erroneous EITC claims for compliance treatment

At the end of each filing season,⁷ the IRS performs an analysis to identify noncompliant return preparers for a compliance treatment. Compliance treatments include the IRS making calls, sending letters, or conducting face-to-face visits. Wage and Investment Division Strategies and Solutions Research Group analysts perform the following specific steps to identify these noncompliant return preparers:

- Create a data file that includes all EITC returns prepared by return preparers. For Processing Year (PY) 2015, the IRS identified 27.5 million returns with an EITC claim, of which 13 million (47 percent) were prepared by a return preparer.
- Identify return preparer EITC returns identified during processing as having characteristics of a potentially erroneous EITC claim. *****2*****
*****2*****
*****2*****. The nature of the questionable characteristics of the EITC claims ultimately assist the IRS in determining applicable compliance treatments for return preparers in an effort to improve the accuracy of their EITC claims.
- Perform matches from the returns previously identified to identify deceased or incarcerated individuals listed on the tax returns.
- *****2*****. This results in the IRS identifying about 150,000 return preparers each year *****2*****
*****2***** with the characteristics detailed above.
- *****2*****
*****2*****. The return preparers selected comprise the top scoring return preparer list, referred to as the Return Preparer Compliance Workplan in this report. A total of 49,563 return preparers were selected for potential compliance treatments in the FY 2016 workplan. IRS management noted that due to resource

⁶ The RCPM function is in the Wage and Investment Division's Return Integrity and Compliance Services organization.

⁷ The period from January through mid-April when most individual income tax returns are filed.



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limitations, a return preparer's inclusion in the workplan does not guarantee that a return preparer will receive a compliance treatment.

Legislation expanded return preparer due diligence requirements to include other refundable credits

Congress passed the Taxpayer Relief Act of 1997⁸ which requires return preparers to meet due diligence requirements set forth in regulations prescribed by the Secretary of the Treasury. The Act also established a \$100 penalty for each failure to comply with the due diligence requirements. In Calendar Year 2008, the IRS issued expanded regulations clarifying the due diligence rules and established a performance standard requiring return preparers to be knowledgeable about the criteria for EITC eligibility. For example, return preparers whose prepared tax returns claim a refund involving the EITC must meet due diligence requirements in determining the taxpayer's eligibility for, and the amount of, the credit. The return preparer must complete Form 8867, *Paid Preparer's Due Diligence Checklist*. Effective for Tax Year 2011,⁹ Form 8867 must be submitted with electronically filed returns or given to the taxpayer to be included with his or her paper-filed return.¹⁰ Failure to do so could result in a \$510 penalty¹¹ for each failure. Figure 1 provides a summary of the EITC due diligence rules for return preparers.

Figure 1: Summary of EITC Due Diligence Rules for Return Preparers

Requirement	Explanation of Requirement
Complete and Submit Form 8867	Return preparers must complete Form 8867 based on information provided by the taxpayer and submit it to the IRS with the prepared tax return.
Compute the Credit	Complete the Earned Income Credit worksheet from the Form 1040, <i>U.S. Individual Income Tax Return</i> , instructions, or Publication 596, <i>Earned Income Credit</i> , or a form with the same information.

⁸ Pub. L. No. 105-34, 111 Stat. 788.

⁹ A tax year is 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.

¹⁰ Treasury Regulation § 1.6695-2.

¹¹ Pub. L. No. 112-41. Section 501 increased the EITC due diligence penalty from \$100 to \$500. For returns or claims filed after December 31, 2014, the penalty is indexed for inflation. The \$510 penalty is for Tax Year 2016.



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Requirement	Explanation of Requirement
Knowledge	The return preparer should: 1) not have reason to know that information used to determine the client’s eligibility for the EITC or the EITC amount is incorrect, inconsistent, or incomplete; 2) make additional inquiries if a reasonable and well-informed return preparer would know the information is incomplete, inconsistent, or incorrect; 3) use knowledge of the law to ensure that the client is asked the right questions to get all relevant facts; and 4) document any additional questions asked and the client’s answers at the time of the interview.
Record Retention	Return preparers must maintain Form 8867 and the EITC worksheet, or the equivalent; a record of how and when the information used to complete the form was obtained and the identity of the person furnishing the information; documentation of any additional questions asked to meet the knowledge requirement and the taxpayer’s answers; and copies of taxpayer-provided documents relied upon to complete the forms. This information must be maintained for three years after the original due date of the tax return, the date the return or claim for refund is filed, or the date the EITC claim was presented for signature.

Source: IRS public website, IRS.gov.

The Protecting Americans from Tax Hikes Act of 2015¹² Section 207 enacted December 18, 2015, expanded the above due diligence requirements to include tax returns with Child Tax Credit, Additional Child Tax Credit, and American Opportunity Tax Credit claims.

This review was performed at the RCPPE function headquarters in Atlanta, Georgia, during the period April 2016 through June 2017. 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.

¹² Pub. L. No. 114-113, 129 Stat. 2242.



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Results of Review

In FY 2016, the IRS completed various compliance treatments to address 24,312 return preparers identified as filing high rates of tax returns with characteristics of an erroneous EITC claim. Return preparers may receive more than one treatment type. Figure 2 provides key compliance treatments completed in an effort to increase EITC return preparer compliance.

Figure 2: Completed Key Compliance Treatments for the FY 2016 Workplan

Compliance Treatment	Number Completed
Post-Refund Client Audits	23,575
Compliance Letters 5025	7,961
Letter 4858, <i>EITC Due Diligence Requirements For Return Preparers</i> (Filing Season)	5,386
Warning Letters 4833-A, <i>EITC Tax Return Preparer Alert</i>	3,754
Letter 4858, Issued to New Return Preparers (Filing Season)	3,524
Warning Telephone Calls (Filing Season)	1,647
Audit Letter 5138, Compliance Letter 5025 ¹³	1,435
Due Diligence Visits (Pre-Filing Season)	807
Follow-up Telephone Calls (Pre-Filing Season)	684
Due Diligence Visits (Filing Season)	321
Knock and Talk Visits ¹⁴	164
Letter 1125, <i>Preparer Penalty 30-Day Letter</i> , Penalty Package	132

Source: IRS Return Preparer Delivery Tool.

In addition to conducting the above compliance treatments, each year the RCPDM function evaluates the effect these treatments have on addressing noncompliant return preparers. For example, the IRS's September 2016 *EITC Return Preparer Analysis* document included the

¹³ Compliance Letter 5025, *You May Have Prepared Inaccurate Returns with Questionable Qualifying Children and Self-Employment Income*, was mailed in the same envelope as the Audit Letter 5138, *Return Preparer EITC Client Audit Notification*, for post-refund audits.

¹⁴ Knock and Talk Visits are pre-filing season educational visits for return preparers typically conducted by Small Business/Self-Employed Division field agents, while also accompanied by an armed Criminal Investigation agent.



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following conclusions based on the return preparer compliance treatments performed in FY 2016:

- Return preparers who received Due Diligence Visits, in which the IRS limited its review to only 75 returns, performed no worse in the next filing season than return preparers who received a visit in which the IRS reviewed 150 returns.
- Knock and Talk Visits with Criminal Investigation agents were much more effective in changing return preparer behavior than visits performed without a Criminal Investigation agent.
- Compliance Letter 5025 had a minimal effect on return preparers that prepare high volumes of returns. Letter 4858 was more effective for new return preparers than experienced return preparers.

Finally, RCPPEM function officials stated that the IRS expanded the Return Preparer Strategy for FY 2017 to include noncompliant return preparers filing returns with potentially erroneous refundable credit claims. The strategy now identifies return preparers filing returns with erroneous Additional Child Tax Credit and American Opportunity Tax Credit claims in addition to EITC claims. The scoring and selection model was updated to reflect these credits and the IRS updated Form 8867 to include return preparer due diligence requirements for claiming these credits. These actions were taken to address legislative provisions in the Protecting Americans from Tax Hikes Act.

The Return Preparer Scoring and Selection Model Was Not Sufficiently Documented

The RCPPEM function’s scoring and selection model used to develop the FY 2016 Return Preparer Compliance Workplan was not sufficiently documented. The methodology the IRS uses to ultimately select return preparers for a compliance treatment involves multiple steps in which the IRS applies exclusionary criteria. When we discussed 3,547 untreated preparers that we identified as filing a high percentage of returns with one or more characteristics of a potentially erroneous EITC claim, the IRS provided a list of reasons for many of the preparers who were not given a compliance treatment. However, the documentation provided did not explain why the IRS excluded these return preparers from treatment. For example, the IRS provided a list of 296 noncompliant return preparers who were not treated because another function was examining the preparer, but the documentation did not identify the function, issue under examination, time frame, or whether the issue was resolved.

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*****2*****. The 3,547 return preparers include:



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- 1,362 return preparers who were not included in the FY 2016 workplan and, thus, not considered for a treatment. The IRS scoring and selection model used returns processed as of May 27, 2015. We conducted our analysis on the same data file that the IRS used, but we included returns processed as of October 28, 2016. Additional returns may have been processed during this period that may partially explain why the scoring model did not identify some preparers.
- 2,185 return preparers with high rates of noncompliance that were not treated. IRS management stated that budget constraints prevented the IRS from treating all identified noncompliant return preparers listed in the workplan.

Overall, the 3,547 return preparers filed 337,317 returns with EITC claims totaling more than \$1.1 billion. When we raised our concerns to management that documentation detailing the specific methodology for scoring and selection of return preparers is not adequate, they indicated that key staff meet before the scoring process begins each year and discuss changes that will be made to score return preparers. IRS management noted that meeting minutes are maintained. However, our review of the minutes identified that criteria decisions were not always documented. For example, several criteria explored during the meetings are labeled “to be determined” but no decision on the final criteria was documented.

IRS management also stated that the 3,547 return preparers generally did not score high enough to receive a treatment. However, our analysis of the scores the IRS assigned to these preparers does not support this assertion.

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IRS management stated that some return preparers with low scores are treated if they belong to a network with another preparer with a high score, and the low-scored preparer filed *****2*****. Another reason for treating a preparer with a low score is if the preparer is identified as a new preparer. New preparers are issued a Letter 4858. *****2*****



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*****15 *****2*****
*****2*****
*****2*****. However, the IRS can identify the return preparer to whom a legitimate PTIN is assigned to alert them of the potential misuse of their PTIN. These are cases in which the return preparer’s PTIN is likely being used by unauthorized individuals to prepare tax returns, either with or without the preparer’s consent.

Recommendation

Recommendation 1: The Commissioner, Wage and Investment Division, should adequately document each year the methodology and criteria used in the RCPDM function risk-based return preparer scoring and selection model.

Management’s Response: The IRS agreed with this recommendation and will ensure that the risk-based return preparer scoring and selection model methodology is adequately documented as part of the Fiscal Year 2018 strategy.

Referrals to Other Functions Could Assist in Addressing Return Preparers With Continued Noncompliance

Our analysis of the 1,297 return preparers in the FY 2016 workplan who received a Due Diligence Visit or a Knock and Talk Visit found that 510 (39 percent) did not improve their compliance with EITC requirements in the following year. Return preparers who receive a Due Diligence Visit or a Knock and Talk Visit are those that the IRS identifies as the most egregious in their potential noncompliance with EITC filing requirements. The RCPDM function is limited in the actions it can take to address return preparers whose behavior does not improve subsequent to one of these compliance treatments. However, other functional areas within the IRS could further address these return preparers such as Criminal Investigation¹⁶ or the Electronic Products and Services Support function.¹⁷ For example, Criminal Investigation can initiate an investigation of tax fraud on the return preparer, or the Electronic Products and Services Support function can research the preparer and take action to address the potential misuse of the preparer’s Electronic Filing Identification Number.¹⁸

¹⁵ A PTIN is a number issued by the IRS to return preparers and is used as the return preparers and is used as the return preparer’s identification number. When applicable, the PTIN must be placed in the Paid Preparer section of a tax return that the return preparer prepared for compensation.

¹⁶ Criminal Investigation investigates potential criminal violations of the Internal Revenue Code and related financial crimes.

¹⁷ The Electronic Products and Services Support function supports third-party electronic filers and provides online tools for tax and information return filers.

¹⁸ Providers use an IRS-assigned Electronic Filing Identification Number to electronically file tax returns.



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When we discussed the referral of continued noncompliant return preparers to other IRS functional areas, RCPDM function management stated that they have not developed written procedures for referring return preparers to other IRS functions. IRS management stated that they do, in fact, provide information to other functional areas. Those functions make their own determinations on how to use the information provided. For example, the RCPDM function provided information to the Return Preparer Office related to 159 return preparers in FY 2016. This information included misused PTINs and was provided because the RCPDM function could not identify the name of the person misusing the PTIN. We contacted the Return Preparer Office and found that they were able to identify 32 names of individuals misusing the PTINs provided.

Recommendation

Recommendation 2: The Commissioner, Wage and Investment Division, should develop procedures for the RCPDM function to identify and refer to other IRS functions the egregious return preparers who continue to be noncompliant subsequent to a Due Diligence Visit or a Knock and Talk Visit.

Management's Response: The IRS partially agreed with this recommendation. IRS management agrees that additional actions should be taken when return preparers continue with their noncompliant behavior after receiving a Due Diligence Visit or a Knock and Talk Visit. However, IRS management does not believe additional procedures within the RCPDM function will accomplish that result. The Refundable Credits Return Preparer Strategy is a treatment program that shares information with the Criminal Investigation Division and the Small Business/Self-Employed Division's Examination function to initiate face-to-face visits with noncompliant return preparers. Both functions have procedures for referring preparers with continued egregious behavior for sanctions under Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service*,¹⁹ as well as civil and criminal procedures applicable under the Internal Revenue Code.

Office of Audit Comment: Our concern remains that the RCPDM function does not have written procedures to proactively refer egregious return preparers to either the Criminal Investigation Division or the Small Business/Self-Employed Division's Examination function. Thus, these return preparers are not considered for sanctions that could change their behavior.

¹⁹ Department of the Treasury, Treasury Department Circular No. 230 (Rev 6-2014), *Regulations Governing Practice before the Internal Revenue Service* (June 2014).



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**Noncompliant Return Preparers Used to Measure the Effectiveness of
Compliance Treatments Were Excluded From Future Years' Scoring
and Selection Methodology**

Our review identified 1,686 noncompliant return preparers who were excluded from the scoring and selection process in FY 2014 and FY 2015 after being assigned to a FY 2013 control group. Return preparers selected for the control group are not subjected to compliance treatments and are used to compare their filings with those return preparers who received treatments to evaluate the effectiveness of the compliance treatments. For example, the IRS compares the future compliance behavior of return preparers that receive a letter or visit to that of the control group return preparers.

In September 2010,²⁰ we reported that risk factors used in FY 2010 did not include return preparers identified as high risk in the prior year that had not received a Due Diligence Visit. This meant that a return preparer could be identified as noncompliant and be included in the control group year after year, thus never receiving a Due Diligence Visit. We recommended that the IRS include a risk factor in its computation of the probability score for return preparers placed in the control group. The IRS agreed with our recommendation and reported that it assigned a “*control group risk factor*” to all return preparers in the FY 2010 control group.

However, in FY 2013, the IRS once again selected return preparers for a control group but did not assign a control group risk factor to the return preparers placed in the group to ensure that this factor was used in computing the risk score for return preparers selected for treatment in the subsequent year. Our analysis of 1,867 return preparers in the FY 2013 control group identified that 1,686 continued to prepare EITC returns in FYs 2014 and 2015. These return preparers filed an estimated 368,936 returns with erroneous EITC, according to the IRS’s own analysis. The total erroneous EITCs claimed on the returns was \$1.5 billion.

When we discussed with IRS management the reason for reverting back to not assigning a control group risk factor to those preparers selected for the FY 2013 control group, they indicated that they decided to retain return preparers in the control group for multiple years. As such, these high-risk preparers were excluded from inclusion in FY 2014 and FY 2015 scoring and selection. However, management noted that, starting with the FY 2016 workplan, return preparers in the previous year’s control group are included in the subsequent years’ scoring and selection methodology. Thus, we are not making a recommendation.

²⁰ Treasury Inspector General Tax Administration, Ref. No. 2010-40-116, *Actions Can Be Taken to Improve the Identification of Tax Return Preparers Who Submit Improper Earned Income Tax Credit Claims* (Sept. 2010).



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to assess the IRS strategy and processes for identifying and addressing return preparers' filing returns with erroneous refundable credits such as the EITC. To accomplish this objective, we:

- I. Evaluated the PY 2015 return preparer strategy and scoring model to determine if it properly assessed the risks of return preparers for appropriate treatments.
 - A. Assessed the sufficiency of the processes, guidelines, models, and other methodology used to implement the Due Diligence Visits and compliance treatments for the return preparers identified as high risk for noncompliance.
 - B. Assessed the risk-based scoring and selection process to determine whether the most egregious return preparers are identified for each treatment in accordance with the RCPPM function's criteria.
 - C. Interviewed Wage and Investment Division's Strategies and Solutions, Research Group analysts about the risk-based scoring and selection methodology and documented the process for the Treasury Inspector General for Tax Administration's contract statistician to evaluate whether the formula and calculations used are adequate for selecting the highest risk return preparers in accordance with the RCPPM function's criteria.
 - D. Assessed the process for incorporating return preparer referrals from other business units for assessment and possible treatment.
 - E. Evaluated the risk-based scoring and selection methodology to determine whether the most egregious return preparers are identified for each treatment in accordance with the RCPPM function's criteria.
 1. Determined if the RCPPM function's criteria and calculations were correctly programmed to identify return preparers for the Return Preparer Strategy's PY 2015 Workplan.
 - a. Obtained the PY 2015 Individual Return Transaction File¹ Preparer Subset file and identified the universe of return preparers who submitted tax returns claiming the EITC. We identified the number of returns each return preparer submitted claiming the EITC. For these tax returns, we matched the taxpayer

¹ Contains data transcribed from initial input of the original individual tax returns during return processing.



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records to the *****,²*****,³
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*****2*****.

b. Determined the following characteristics from the population of return preparers identified in Step I.E.1.a.:

1. *****,²*****.
2. For each return preparer identified in Step I.E.1.b.1.:
 - a. *****,²*****
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 - b. Sorted these returns so that only unique tax returns were counted, then grouped by return preparer.
 - c. For each return preparer, calculated the percentage of potentially erroneous tax returns to total EITC tax returns.
 - d. Sorted these return preparers in order of egregiousness (percentage of errors).
3. Matched the results of Step I.E.1.b.2 to the return preparers the IRS identified as noncompliant in its scoring methodology for PY 2015.
4. For return preparers that the IRS did not identify, calculated the IRS-adjusted EITC amounts. We quantified the number of return preparers that should have been identified for a treatment in PY 2015 and the total amount of adjusted EITC amounts for these return preparers.
5. For return preparers that do not match the IRS list of noncompliant return preparers, provided a list to the IRS for it to analyze why the return preparers were not identified as high risk.

F. Determined if the RCPPEM function updated its annual workplan for FY 2017 to address the new Protecting Americans from Tax Hikes Act⁴ requirements.

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⁴ Pub. L. No. 114-113, 129 Stat. 2242.



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- II. Determined if the IRS properly measures whether its Return Preparer Strategy treatments improve return preparers' compliance.
 - A. Obtained PYs 2015 and 2016 tax return data for each return preparer that was provided a treatment (letter, call, or visit).
 - B. Determined if the treatment had a positive effect on the accuracy of tax returns prepared by the return preparer.
 - 1. Calculated the percentage of tax returns considered erroneous for each year.
 - 2. Compared PY 2015 erroneous returns to PY 2016 erroneous returns to determine if the percentage of erroneous returns increased, decreased, or stayed the same.
 - C. Determined the dollar amount of the assessed penalties for PY 2015.
 - D. Determined if the IRS properly measures whether its return preparer treatments and education efforts improve return preparers' compliance with refundable credit requirements.
- III. Determined if the RCPPM function completed required treatments according to its annual workplan.

Validity and reliability of data from computer-based systems

We validated the data from the Individual Return Transaction File, National Account Profile,⁵ Dependent Database, Prisoner File, Individual Master File,⁶ and the Business Master File⁷ by: 1) reviewing the data for obvious errors in accuracy and completeness and 2) selecting a random sample of records from each extract to verify that the data elements extracted matched the taxpayer account information in the Integrated Data Retrieval System.⁸ The contracted statistician assisted with the review of the control group assessment. We determined that the data were valid and sufficiently reliable for the purposes of this report.

⁵ The National Account Profile is an application used for to resolve inconsistent information on taxpayers' tax returns such as transposed Social Security numbers or incorrect addresses.

⁶ The IRS database that maintains transactions or records of individual tax accounts.

⁷ 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.

⁸ 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 that the following internal controls were relevant to our audit objective: the IRS processes for scoring and selecting return preparers for compliance treatments, the IRS processes for measuring whether compliance treatments improve return preparers' compliance, and the processes for ensuring treatments in its workplan are completed. We evaluated these controls by interviewing IRS personnel, evaluating documentation, and analyzing return preparer data.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Services and Enforcement
Chief Information Officer
National Taxpayer Advocate
Deputy Commissioner, Wage and Investment Division
Director, Office of Program Evaluation and Risk Analysis
Director, Refundable Credits Exam Operations, Wage and Investment Division
Director, Refundable Credits Policy and Program Management, Wage and Investment Division
Director, Return Integrity and Compliance Services, Wage and Investment Division
Director, Strategies and Solutions, Wage and Investment Division
Senior Operations Advisor, Wage and Investment Division
Chief, Program Evaluation and Improvement, Wage and Investment Division
Director, Office of Audit Coordination



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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 28, 2017

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kenneth C. Corbin /s/ Kenneth C. Corbin
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report - Improvements Are Needed to Better Document the
Return Preparer Refundable Credit Compliance Treatment Identification
and Selection Process (Audit# 201640010)

Thank you for the opportunity to review and comment on the subject draft report. We appreciate the report's recognition of the Refundable Credits Return Preparer Strategy (RPS) being an important part of IRS' overall strategy to reduce Earned Income Tax Credit noncompliance. The primary goal of the RPS is to improve both the accuracy of claims for refundable tax credits and the rate of voluntary compliance with the eligibility requirements for those credits. This is achieved by educating tax return preparers about the credits and the due diligence requirements for which they are responsible as tax professionals. To that end, the IRS provides resources, such as an on-line due diligence preparer toolkit that links to an interactive on-line due diligence training module. Additionally, in 2017, we delivered Due Diligence Webinars to tax professionals, published eNews for Tax Professionals, and continued our annual presentations at the 2017 National Tax Forums.

To supplement its educational outreach activities, the RPS also employs a risk-based scoring and selection process that detects trends and other questionable characteristics of preparers' client returns. The scoring and selection process identifies those preparers who continually do not meet their due diligence requirements and selects them for consideration by our compliance processes. The model considers multiple factors, including the *****2***** and *****2***** , when selecting candidates for the various treatment streams. As summarized in the report, treatments used to promote improvements in return preparation include letters, phone calls, educational visits, client audits, and due diligence audits.



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We agree that the documentation outlining the return preparer scoring and selection model can be improved; however, we disagree with the finding that the Treasury Inspector General for Tax Administration's (TIGTA) identified that there were 3,547 untreated return preparers. Preparers are identified using a dynamic data driven set of criteria that had been updated over the course of the 17 months between the time our selections were made and the time the TIGTA analysis identifying the 3,547 preparers was done. The data had changed and would not be expected to provide the same results. The report notes that 1,362 of the 3,547 identified preparers could be associated with returns filed after the date of our analysis. We reviewed the list of preparers identified and concluded that the remaining 2,185 did not meet selection criteria for reasons such as not having prepared the ***2*** of returns established by the selection criteria; not meeting minimum scoring thresholds; or having been addressed by another treatment process. The results of our review were discussed with the auditors and we appreciate the acknowledgement in the report of the length of time that had passed between the two analyses and its contributory effect on the finding. The Return Preparer Refundable Credit Program was designed to supplement other compliance treatments already in existence and utilize diminishing enforcement resources more cost effectively. Due to resource reductions, it is not possible to treat 100 percent of all non-compliant populations. A refundable credit operational strategy is currently underway to evaluate all treatments and determine which mix of treatments will be most effective in achieving a desired result.

Optimal program effectiveness is achieved when preparers of questionable returns are addressed as quickly as possible. Early intervention can influence future returns and reduce the number of improper claims. Without the authority to establish minimum qualifications for paid return preparers, issuing compliance letters, warning notices, and making telephone contacts permits the RPS to leverage limited resources and maximize the number of preparers that can be addressed. In some cases, when egregious behavior remains unchanged, preparers may be subject to personal visits by IRS compliance or enforcement personnel. Personal visits are effective treatments. As reported, in the year after a Due Diligence or Knock and Talk visit, 61 percent of the preparers did improve. While effective, personal visits are among the most costly treatment options and compete with other compliance and enforcement programs for limited resources.

Further challenging our ability to more fully use personal visits to improve compliance with EITC requirements is the cumulative effect decreased budgetary resources has had on staffing. Since 2010, the IRS' budget has been cut by more than \$1 billion in real dollars and the effect of those cuts has directly impacted our ability to retain and replace the staff needed to perform this work. We agree with the TIGTA's conclusion that referrals to other functions can assist in addressing return preparers with continued noncompliance; however, we disagree that additional procedures are needed within the Refundable Credits Policy and Program Management (RCPPM) function. The RCPMP provides oversight to the RPS, which identifies and refers those preparers whose



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noncompliance is most egregious to the appropriate enforcement functions. Operationally, these referrals are part of the RPS process. Additional procedures will not provide the staff needed to work those referrals. It should also be noted that the Electronic Products and Services Support (EPSS) function, mentioned in the report, does not have compliance oversight over the Electronic Filing Identification Numbers (EFIN) assigned to noncompliant return preparers. When an EFIN has been misused, such as when it was fraudulently obtained or is being improperly used by another individual, it may be deactivated by the EPSS function to prevent future electronic submissions of tax returns. Sanctions against noncompliant return preparers fall under the scope of Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service*, as well as civil and criminal penalties applicable under the Internal Revenue Code. Procedures already exist under these provisions for addressing return preparer noncompliance.

The performance of the RPS is evaluated annually and its strategies are revised to incorporate lessons learned, address new compliance concerns affecting refundable credits and test new treatments. The use of control groups in evaluating performance results is imperative in measuring the impact of program actions and its ability to influence change in treated preparers' behavior. In fiscal year 2017, as a result of the expansion of the preparer due diligence requirements under the Protecting Americans Against Tax Hikes Act of 2015¹, two additional tax credits, the Additional Child Tax Credit and the American Opportunity Tax Credit, were integrated into the RPS. This was accomplished without additional resources or funding.

Attached are our comments and responses to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Michael Beebe, Director, Return Integrity and Compliance Services, Wage and Investment Division, at (470) 639-3250.

Attachment

¹ Pub. L. No. 114-113, 129 Stat. 2242.



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Attachment

Recommendations

Recommendation 1

The Commissioner, Wage and Investment Division, should adequately document each year the methodology and criteria used in the RCPDM function risk-based return preparer scoring and selection model.

CORRECTIVE ACTION

We agree with this recommendation and will ensure the risk-based return preparer scoring and selection model methodology is adequately documented as part of the Fiscal Year 2018 strategy.

IMPLEMENTATION DATE

April 15, 2018

RESPONSIBLE OFFICIAL

Director, Refundable Credits Policy and Program Management, Return Integrity and Compliance 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

The Commissioner, Wage and Investment Division, should develop procedures for the RCPDM function to identify and refer to other IRS functions the egregious return preparers who continue to be noncompliant subsequent to a Due Diligence Visit or a Knock and Talk Visit.

CORRECTIVE ACTION

We agree with the intent of this recommendation, that additional actions should be taken when return preparers continue with their noncompliant behavior after receiving a Due Diligence Visit or a Knock and Talk Visit; however, additional procedures within the Refundable Credits Policy and Program Management function will not accomplish that result. The Refundable Credits Return Preparer Strategy is a treatment program that shares information with the Criminal Investigation Division and the Small Business/Self-Employed Division's examination function to initiate face-to-face visits with noncompliant return preparers. Both functions have procedures for referring preparers with continued egregious behavior for sanctions under Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service*, as well as civil and criminal penalties applicable under the Internal Revenue Code.

IMPLEMENTATION DATE

N/A



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RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A