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Congress of the United States

House of Representatives

COMMITTEE ON WAYS AND MEANS

WASHINGTON, DC 20515

SUBCOMMITTEE ON OVERSIGHT

August 8, 2012

Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Dear Commissioner Shulman:

As you know, the Committee on Ways and Means Subcommittee on Oversight has held numerous hearings and made inquiries regarding identity theft, the improper payment of tax refunds, and how the Internal Revenue Service (IRS) promotes program integrity. Last week, I wrote to you regarding a Treasury Inspector General for Tax Administration (TIGTA) report finding that the IRS catches only a small portion of fraudulent tax returns and estimating that as much as \$21 billion in fraudulent tax refunds will be issued over the next five years. Earlier today, TIGTA released a report that raises concerns not only about the IRS's ability to catch fraudulent tax returns, but also suggests the Agency has significantly reduced efforts to detect and prevent fraud. The report contains startling examples of IRS management ending practices and procedures that guard against tax fraud and actually discouraging IRS employees from flagging potential fraud. In one case, TIGTA officials confirmed that an IRS official stated that tax fraud was a good thing because it ensured job security for tax examiners.

Today's report specifically draws into question actions surrounding taxpayers with an Individual Taxpayer Identification Number (ITIN). As you know, the law requires individuals to pay taxes on income regardless of immigration status, and the IRS created the ITIN to facilitate tax filing for those not eligible to obtain a Social Security Number. In a July 7, 2011 report, TIGTA found that ITIN filers claimed \$4.2 billion in Additional Child Tax Credits (ACTC) in 2010. Beyond allowing billions of dollars in payments to individuals not authorized to work in the United States, it now appears that the IRS may not be vigilant in detecting blatantly fraudulent ITIN applications.

According to the Inspector General, IRS management has "created an environment which discourages tax examiners responsible for reviewing ITIN applications from identifying questionable applications," and "eliminated successful processes used to identify

questionable ITIN application fraud patterns and schemes.” IRS employees are discouraged from flagging potentially fraudulent ITIN applications. If an examiner flags an application as questionable, but the subsequent reviewer disagrees, the examiner is charged with an error, which affects their performance evaluation and employment opportunities; no errors are charged, however, should the examiner fail to identify a fraudulent application. This incentivizes examiners to approve questionable applications and punishes IRS employees who might err on the side of protecting taxpayer dollars.

Another example of IRS management’s failure to prioritize fraud interdiction is the manner in which it trains examiners. The job of identifying fraudulent ITIN applications falls to examiners, but just over two percent of training for newly hired examiners (one hour out of nearly forty) and just over one percent of refresher training (15 minutes of nearly 19 hours) is spent on questionable documentation identification. Since April 2010, tax examiners have been instructed to flag potentially fraudulent applications based on the *number* of errors it contains, rather than the *significance* of those errors. For instance, someone might apply for an ITIN with an obviously incorrect name or photograph, but so long as that was the only error, the examiner would be barred from flagging the application as potentially fraudulent.

Beyond training and employee incentives, IRS management has chosen to shut down processes and practices with proven success in identifying fraudulent ITIN applications. The IRS had previously found success in identifying and stopping fraudulent ITIN applications through the work of the Questionable Identification Detection Team (QIDT), which succeeded in protecting at least \$43 million against erroneous refunds. In 2010, IRS officials disbanded this group, claiming those resources were better used elsewhere. TIGTA found that, of nine fraudulent schemes the QIDT had identified, seven were still active in Processing Year 2011. These seven schemes involved high numbers of tax refunds sent to individual addresses totaling \$10 million in tax refunds, with 3,565 tax refunds filed, and 36,833 ITIN applications from only seven households. Having disbanded the QIDT, the IRS failed to identify these fraudulent filings and applications or prevent paying out fraudulent refunds. In addition to these followings, TIGTA identified the following cases of ITIN applications, fraudulent tax returns, and fraudulent tax refunds the IRS failed to identify:

- 154 mailing addresses that were used 1,000 or more times on ITIN applications, including:
 - 15,795 ITINs assigned to an address in Phoenix, Arizona;
 - 15,028 ITINs assigned to an address in Dallas, Texas; and
 - 12,345 ITINs assigned to an address in Atlanta, Georgia.
- Ten individual addresses used for filing 53,994 tax returns and receiving \$86.4 million in fraudulent tax refunds, including:
 - 23,994 tax refunds totaling \$46.3 million issued to an address in Atlanta, Georgia; and

- 2,507 tax refunds totaling \$10.4 million issued to an address in Oxnard, California.
- Ten bank accounts which received 23,560 tax refunds totaling over \$16 million, including:
 - 2,706 tax refunds issued to a single account, totaling \$7.3 million; and
 - 1,608 tax refunds issued to a single account, totaling \$4.5 million.
- At one Michigan address where IRS had previously rejected an ITIN application, the agency went on to issue 640 separate refunds totaling \$1.5 million dollars.

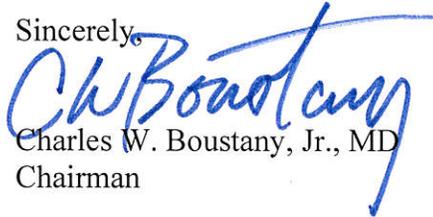
While I understand that IRS struggles to administer an increasingly complex and convoluted tax code, the new TIGTA report suggest that IRS has failed to employ proven strategies to identify potential tax fraud. On the basis of TIGTA's findings, and as part of the Subcommittee's ongoing efforts to protect taxpayer dollars and conduct oversight of IRS, I ask that you provide the following information by no later than August 31, 2012:

1. When did the IRS change its policy regarding consideration of error significance in the ITIN application review process? In your response, include:
 - a. The name and title of the IRS official who made the decision;
 - b. The names and titles of all IRS officials who were aware of the change or proposed change; and
 - c. All documents and correspondence regarding the change.
2. Why did the IRS disband the Questionable Identification Detection Team? In your response, include:
 - a. The name and title of the IRS official who made the decision;
 - b. The names and titles of all IRS officials who were aware of the change or proposed change; and
 - c. All documents and correspondence regarding the change.
3. The IRS has claimed that the disbanding was justified because fraudulent ITIN tax returns would be caught later in the filing process. How would tax return processors identify ITINs that were first issued based on fraudulent applications?
4. Under the QIDT process, questionable applications were logged and tracked. IRS management ended this process, and now merely requires that an orange sticker be placed on the case file. Why did IRS management decide to weaken the questionable application tracking process? In your response, include:
 - a. The name and title of the IRS official who made the decision;
 - b. The names and titles of all IRS officials who were aware of the change or proposed change; and
 - c. All documents and correspondence regarding the change.

5. Under the QIDT process, invalid identification cases were sent to the Austin Fraud Detection Center. What happened to invalid identification cases after the QIDT disbandment?
6. On June 22, 2012, the IRS made interim changes to its ITIN application review process. Are these changes the only modifications the IRS plans to make to its ITIN application review process? Will IRS be reinstating the QIDT process?
7. Will the IRS continue to allow third parties (Certifying Acceptance Agents) to review and verify the identity and foreign status of individuals applying for ITINs?
8. What are the new processing time periods for tax examiners reviewing ITIN applications?
9. In tax examiner training, how much time, both in terms of length and percentage of overall training, will be dedicated to identifying questionable applications?

Thank you in advance for providing this information. If you have any questions, please contact Chris Armstrong at (202) 225-5522.

Sincerely,



Charles W. Boustany, Jr., MD
Chairman