

Area of
Focus #7**The IRS's Pre-Refund Wage Verification Program Continues to Incorrectly Flag and Substantially Delay Legitimate Refunds for Hundreds of Thousands of Taxpayers****TAXPAYER RIGHTS IMPACTED¹**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

In an effort to combat refund fraud, the IRS uses the Pre-Refund Wage Verification Program (hereinafter — Income Wage Verification or IWV) to freeze a taxpayer's refund when it detects potentially false wages or withholding. The Return Integrity & Compliance Services (RICS) Integrity & Verification Operation (IVO) — a part of the Wage & Investment (W&I) Division — uses filters, rules, data mining models, and manual reviews to identify potentially false returns, usually through reported wages or withholding, to stop fraudulent refunds before the IRS issues them.² It electronically screens tax returns using three independent systems: the Dependent Database (DDb), the Return Review Program (RRP), and the Electronic Fraud Detection System (EFDS). TAS analysis has shown that the IRS's screening processes in this program are over-inclusive and harm taxpayers with legitimate returns. For example:

- Returns the EFDS selected for review in fiscal year (FY) 2015 had a nearly 35 percent “false positive” rate;³
- When the IRS moved potential identity theft returns identified by EFDS from the IWV to the Taxpayer Protection Program (TPP), the TPP's false positive rate jumped from 19.8⁴ percent in calendar year (CY) 2014 to 36.6 in CY 2015; and⁵
- TAS analysis of the population of taxpayers filing in tax year (TY) 2014 whose returns EFDS selected for review in 2015 (through October), showed that nearly 180,000 taxpayers who eventually received their refunds experienced delays of nearly 18 weeks on average.

The National Taxpayer Advocate has expressed concerns with the IRS's inability to properly identify questionable returns in her 2003, 2005, 2012, and 2015 Annual Reports to Congress, and will continue

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Internal Revenue Manual (IRM) 25.25.2.1(1) (Aug. 20, 2015).

3 A false positive occurs when a system selects a legitimate return and delays the refund past the prescribed review period. See IRS response to TAS information request (Oct. 20, 2015). The IRS now calls false positive rates — false detection rates.

4 IRS, RICS, *Update of the Taxpayer Protection Program (TPP)* 10 (Jan. 7, 2015).

5 IRS, RICS, *Update of the Taxpayer Protection Program (TPP)* 4 (Dec. 30, 2015).

to focus on and advocate for taxpayers whose legitimate refunds have been wrongly selected and unreasonably delayed by over-inclusive filters, rules, and models the IRS uses in the IWV program.⁶

In response to the National Taxpayer Advocate recommendations in the 2015 Annual Report to Congress, the IRS recently notified TAS that in April 2016 it had begun tracking each RRP and EFDS Non-Identity Theft Model False Detection Rate (FDR) separately.⁷ We are pleased the IRS is starting to track the false detection rates for IWV; however, it would be premature to determine statistically valid false positive rates based on the limited amount of data provided, and until the end of the filing season.

The National Taxpayer Advocate understands the need for the IRS to combat refund fraud head-on and that any effective screening method will result in some false positives. However, the National Taxpayer Advocate remains concerned that:

- Until recently the IRS has been reluctant to track the false positive rates for the IWV program, and thus was unable to determine the precise filters or models necessary to exclude legitimate refunds and address the nearly 35 percent false positive rate in the EFDS until after the filing season is completed;⁸
- The IRS reinstated an indefinite freeze on all returns claiming refunds that are selected for IWV at the onset of the screening process. Previously, the IRS would automatically release a return selected for IWV after the 11-week hold unless, after review, the IRS finds the return questionable and takes action to freeze the refund for a longer time. However, the IRS has recently removed this 11-week limitation and all selected refunds are now subject to an indefinite freeze, which harms taxpayers with legitimate refunds that may be delayed for an extended period of time;⁹
- The reinstatement of the indefinite freeze is unnecessary in light of accelerated wage and income reporting, and exposes the IRS to payments of large amounts of interest on returns that are held for more than 45 days; and¹⁰
- Taxpayers whose refunds are frozen cannot directly reach a live assistor in the IVO unit, who possesses the requisite knowledge of a specific taxpayer's account. Taxpayers are left with no choice but to seek TAS assistance, placing undue stress and burden on both taxpayers and TAS employees.

These shortcomings continue to harm a myriad of taxpayers with legitimate refunds. For many, especially low income taxpayers who often rely on refunds for basic living expenses, indefinite IWV freezes

6 See National Taxpayer Advocate 2003 Annual Report to Congress 175-181 (Most Serious Problem: *Criminal Investigation Freezes*); National Taxpayer Advocate 2005 Annual Report to Congress 25-54 (Most Serious Problem: *Criminal Investigation Refund Freezes*); National Taxpayer Advocate 2012 Annual Report to Congress 95-110 (Most Serious Problem: *Despite Some Improvements, the IRS Continues to Harm Taxpayers by Unreasonably Delaying the Processing of Valid Refund Claims That Happen to Trigger Systemic Filters*); National Taxpayer Advocate 2015 Annual Report to Congress 45-55 (Most Serious Problem: *Revenue Protection: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of "False Positives" Within the IRS's Pre-Refund Wage Verification Program*).

7 IDT and IVO Selection Performance Reports, May 4 and June 1, 2016. The IRS defines the FDR as the number of false positives divided by the overall number selected. See National Taxpayer Advocate 2017 Objectives Report to Congress vol. 2 (IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in 2015 Annual Report to Congress; anticipated publication late July 2016, www.TaxpayerAdvocate.irs.gov/2017ObjectivesReport).

8 The IRS provided TAS with a report entitled "IDT and IVO Selection Performance Report" on May 4, 2016. This report indicates that the IRS has begun tracking by model or RRP selection; however, TAS has not been briefed on how this information will be used. TAS looks forward to a discussion regarding how the IRS plans to utilize this information in the future.

9 Information received via email from W&I RICS Program Support (Jan. 11, 2016).

10 IRC § 6611(e) provides that the IRS is required to pay interest on refunds delayed for more than 45 days after the return due date or the date the return is filed, whichever is later.

create dire consequences (*i.e.*, inability to pay rent, utilities, or medical expenses). Not only does the IRS have an obligation to design a tax system that mitigates fraud, but it also has an obligation to design an efficient program that protects taxpayers' rights and promotes future compliance.

The IRS Is Starting to Track the False Positive Rates for the Pre-Refund Verification Program But It Is Unclear How the IRS Intends to Use This Information to Improve the Program

As discussed in the National Taxpayer Advocate's 2015 Annual Report to Congress, the IRS only tracked the false positive rates associated with identity theft.¹¹ However, beginning in April 2016, the IRS began tracking false positive rates for a segment of returns forwarded to the IWV program.¹² While this is a step in the right direction, at this stage TAS is unable to determine if the IRS can properly identify the major factors that are causing one in every three legitimate returns to be caught up by the various filters and models, and the steps the IRS is taking when a problem is identified.

During the first four months of 2015 and 2016 (*i.e.*, January 1 through April 30), TAS provided full or partial relief in about 80 percent of cases for taxpayers who contacted TAS about delayed refunds flagged under the IWV Program. IWV cases constitute about 15 percent of TAS cases received between January 1 and April 30, 2016, which is the second most common reason that taxpayers came to TAS for assistance. During the same time period (January 1 through April 30), TAS received 14,438 IWV cases, a six percent increase compared to cases received by TAS between January 1 and April 30, 2015.¹³ At the same time, the IRS's IWV holds have decreased over 13 percent, as shown in Figure 3.7.1.

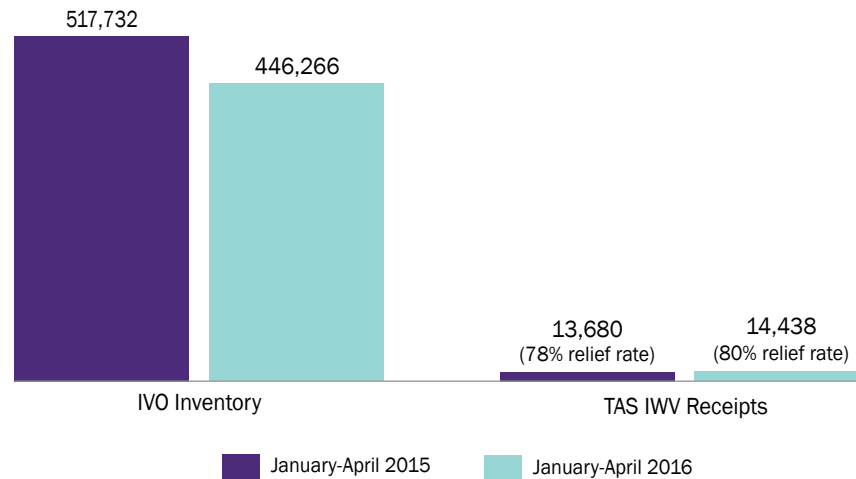
11 This includes programs such as the TPP, EFDS, RRP, Manual Analyst, and DDb. See National Taxpayer Advocate 2015 Annual Report to Congress 49.

12 See National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress vol. 2 (IRS Responses and National Taxpayer Advocate's Comments Regarding Most Serious Problems Identified in 2015 Annual Report to Congress; anticipated publication late July 2016, www.TaxpayerAdvocate.irs.gov/2017ObjectivesReport).

13 Data obtained from Taxpayer Advocate Management Information System (TAMIS) (Jan. 1, 2015; May 1, 2015; Jan. 1, 2016; May 1, 2016). TAS received 14,438 cases in 2016 (January through April) and 13,680 cases in 2015 for the same period. The IRS identified 446,266 in 2016 (January through April) and 517,732 cases in IVO for 2015 for the same period.

FIGURE 3.7.1¹⁴

IVO Inventory vs. TAS IWV Case Receipts, January-April 2015 & 2016



The increasing flow of taxpayers seeking TAS assistance with IWV holds, combined with the associated high relief rates, is a strong indicator of a serious, continuing problem within the IWV program. The IRS IWV program has significantly delayed legitimate refunds to taxpayers because of over-inclusive filters or cross-competing rules, thereby creating a significant hardship that qualifies taxpayers for TAS assistance.

Investing in the tracking of the IWV false positive rates by model or filter during the filing season, performing regular global reviews, and quickly adapting filters, rules, and models based on levels of confidence in each, would result in a more efficient use of resources and fewer delays for taxpayers with legitimate returns — thereby reducing taxpayer burden. False positive data, if monitored and analyzed in real-time, can be used by the IRS to improve its fraud prevention and IWV programs, minimize harm to taxpayers making legitimate refund claims, and preserve IRS and TAS resources.

The National Taxpayer Advocate applauds the IRS's recent efforts to revisit a series of filters known as "business rules." The IRS first implemented the business rules in January 2009 as the original system to combat identity theft. Over time, due to the creation of additional systems with more complex and productive filters, the false positive rate associated with these rules has increased considerably. RICS executives are recognizing that such a high false positive rate is not acceptable and that either a complete elimination of the rules (to allow the more complex filters and models to pull a more selective group of

¹⁴ *Refund Fraud & ID Theft Global Report* (Apr. 30, 2016). This decrease in IRS IVO volume is significant because it may be an indicator that the IRS is not clearing cases in a timely manner.

returns) or an effective update is necessary to shield taxpayers with legitimate refunds from the arduous verification process.¹⁵

The Reinstatement of the Indefinite Refund Hold Creates the Likelihood That Numerous Taxpayer Refunds Will Be Held Indefinitely

In her 2005 Annual Report to Congress, the National Taxpayer Advocate raised concerns with the Questionable Return Program (QRP), which was managed by the IRS Criminal Investigation (CI) Unit at that time.¹⁶ In response to the National Taxpayer Advocate's concerns expressed in the report, the IRS created the Pre-Refund Program Executive Steering Committee (ESC) consisting of members of TAS, W&I, CI, Information Technology (IT), and the Small Business/Self Employed (SB/SE) Division. Following negotiations between the National Taxpayer Advocate and the Commissioner's staff, the committee decided that refunds would be held no longer than 11 weeks to allow the Accounts Management Taxpayer Assurance Program (AMTAP), now referred to as IVO, to review the returns and make a determination on whether a return was valid.

In October 2015, TAS learned that RICS was in the process of reinstating an indefinite freeze on all returns claiming refunds at the onset of processing. RICS executives personally assured the National Taxpayer Advocate that the process would not go forward without consulting TAS regarding possible alternatives that would not impede taxpayer rights. Despite this agreement, TAS later discovered that the change had already been implemented prior to the meeting between RICS executives and the National Taxpayer Advocate.

We strongly believe that reinstatement of the indefinite freeze will reproduce the same taxpayer rights violations that precipitated the original change to a temporary freeze, undermining taxpayers' *rights to be informed* and *to quality service*.¹⁷

The Indefinite Freeze Is Unnecessary in the Light of Accelerated Deadline for Wage and Income Reporting, and May Result in the IRS Potentially Paying Large Amounts of Interest on Returns That Are Held for More Than 45 Days

IRC § 6611(e) provides that the IRS is not required to pay interest on held refunds for the first 45 days after the return due date or the date the return is filed, whichever is later. If refunds selected by the IWV Program are now indefinitely held, the IRS may be responsible for interest on any tax refund held for more than 45 days. TAS analysis of taxpayer data for TY 2014 showed that on average, of the nearly 180,000 taxpayers whose returns were flagged as potentially fraudulent, taxpayers were forced to wait

15 The Unpostable Code 147 "business rules" are part of the Accounts Management (AM) Identity Protection Strategic Oversight (IPSO), and were developed as an original system to combat identity theft. While there is considerable overlap, these business rules are not a pre-refund wage verification program. RICS recently approached the IDT Re-engineering team to elevate the UPC 147 process as an agenda item with the specific proposal that the TPP filters, instead of the business rules, be used to flag the returns. TPP, while under RICS, is also an identity theft program. This is a step in the right direction; however, the persistent intersection between identity theft and refund fraud models, rules, and filters is another reason to employ a committee presence to improve communication and implement real-time modifications to screening rules and filters, which will allow for a quicker resolution of systemic issues and minimization of taxpayer harm. For a more detailed discussion on the IDT Re-engineering team, see Area of Focus: *The IRS Re-Engineering of Its Identity Theft Victim Assistance Procedures Is a Step in the Right Direction But Does Not Go Far Enough*, *supra*.

16 This report addressed how CI permanently froze accounts with no notice to the taxpayer. See National Taxpayer Advocate 2005 Annual Report to Congress 25-54 (Most Serious Problem: *Criminal Investigation Refund Freezes*).

17 See TBOR, www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

nearly 18 weeks (or 126 days) until they received their refund.¹⁸ TAS anticipates that the hold time will substantially increase due to the IRS's decision to again impose indefinite freezes on all tax refund returns selected for IWV at the onset of the screening process. As a result, the IRS will be required to pay an increased amount in interest to affected taxpayers.

However, the recent change in law consistent with prior National Taxpayer Advocate recommendations¹⁹ now requires Forms W-2 and W-3 and returns or statements that report non-employee compensation (e.g. Forms 1099-MISC) to be filed on or before January 31 of the year following the calendar year to which the returns relate.²⁰ By moving the deadline up from the end of February and the end of March for electronic filers, the IRS will have more time to match the wage and tax information reported on the taxpayer's return against the information submitted by employer. This capability should reduce the need to contact an employer for verification and suggests that the recently reinstated indefinite freeze is no longer necessary.²¹

The National Taxpayer Advocate is pleased the IRS is working on posting wage and tax information faster so the information can be used to verify income and withholding upfront, thereby reducing refund delays and taxpayer burden. The National Taxpayer Advocate looks forward to discussing the first year results with the IRS and collaborating in the future to discuss proposed improvements and implement additional process efficiencies.

Taxpayers Whose Refunds Are Indefinitely Frozen by the IWV Program Still Cannot Reach a Live Assistor in IVO

Despite a decade of TAS advocating for improved telephone service for taxpayers, unlike the TPP, the IWV Program still does not have a dedicated phone number for taxpayers to call. As a result, taxpayers whose refunds are indefinitely frozen face lengthy hold times and courtesy disconnects trying to reach IRS Customer Service Representatives (CSRs) on an already over-burdened general line.²²

18 See National Taxpayer Advocate 2015 Annual Report to Congress 45-55 (Most Serious Problem: *Revenue Protection: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of "False Positives" Within the IRS's Pre-Refund Wage Verification Program*).

19 See National Taxpayer Advocate 2015 Annual Report to Congress 45-55 (Most Serious Problem: *Revenue Protection: Hundreds of Thousands of Taxpayers File Legitimate Tax Returns That Are Incorrectly Flagged and Experience Substantial Delays in Receiving Their Refunds Because of an Increasing Rate of "False Positives" Within the IRS's Pre-Refund Wage Verification Program*); National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86-8 (*Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*); National Taxpayer Advocate 2012 Annual Report to Congress 180-91 (Most Serious Problem: *The Preservation of Fundamental Taxpayer Rights Is Critical as the IRS Develops a Real-Time Tax System*); National Taxpayer Advocate 2011 Annual Report to Congress 284-95 (Most Serious Problem: *Accelerated Third-Party Information Reporting and Pre-Populated Returns Would Reduce Taxpayer Burden and Benefit Tax Administration But Taxpayer Protections Must Be Addressed*); National Taxpayer Advocate 2009 Annual Report to Congress 338-45 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing*).

20 Section 201 of the PATH Act amended IRC § 6071 to require that certain information returns be filed by January 31, generally the same date as the due date for employee and payee statements, and are no longer eligible for the extended filing date for electronically filed returns under section 6071(b). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 201 (2015).

21 For a more detailed discussion on the impact of the accelerated deadline, See *Review of the 2016 Filing Season, supra*.

22 A courtesy disconnect is when the IRS phone line is overloaded and the caller is disconnected after a certain amount of time. For a full discussion of the National Taxpayer Advocate's concerns regarding taxpayer account access, see National Taxpayer Advocate 2015 Annual Report to Congress 56-63 (Most Serious Problem: *Taxpayer Access to Online Account System: As the IRS Develops an Online Account System, It May Do Less to Address the Service Needs of Taxpayers Who Wish to Speak With an IRS Employee Due to Preference or Lack of Internet Access or Who Have Issues That Are Not Conducive to Resolution Online*).

If an IWV taxpayer attempts to get information from *Where's My Refund*, he or she will receive a generic message prompting a call to the IRS, creating a vicious cycle of futility. Even if the taxpayer does reach a CSR, he or she will find the CSR does not have access to the IWV history or information, and cannot give specific responses to taxpayer inquiries.²³ CSRs take down information and route it to the IWV group in IVO. IVO, however, does not call back or correspond with a taxpayer based on the referral from a CSR. If the information forwarded by the CSR is not verifiable, IVO will simply close out the referral on the Account Management Services (AMS) application.²⁴ The indefinite freezes will exacerbate this situation and more taxpayers will resort to contacting TAS to resolve their issues regarding their legitimate refunds.

TAS Acknowledges the Improvement of Collaboration With RICS on Resolving IWV Holds Through the Streamlined Operation Assistance Request (OAR) Processing

A common type of IWV cases in TAS involves taxpayers whose refunds remain frozen despite matching data from the Information Returns Program (IRP).²⁵ Often the refund remains frozen until TAS sends an Operation Assistance Request (OAR) for priority handling. In an effort to prioritize the release of legitimate refunds and to reduce taxpayer burden, IVO and TAS agreed to use a Bulk OAR process between March 21 and June 30, 2016. Under this process TAS provides IVO a weekly report of Taxpayer Identifying Numbers (TINs) that have had income and withholding verified through IRP. IVO then sends a report back to TAS reflecting the accounts that have been adjusted. By eliminating the need for individual OARs for each taxpayer, the Bulk OAR process has reduced the number of taxpayers affected by delays, allowing both TAS and IVO employees to direct more time and resources to complex cases requiring additional verification. TAS and IVO's agreement to streamline OAR processing is a step in the right direction and an indication of IVO's willingness to assist taxpayers experiencing significant hardship and to partially alleviate burden on IRS and TAS resources. TAS will continue to assist taxpayers with legitimate refunds, monitor the current conditions, and measure the effectiveness of the Bulk OAR process to determine if it should be continued in FY 2017.

FOCUS FOR FISCAL YEAR 2017

In Fiscal Year 2017, TAS will continue to:

- Advocate for the IRS to continue tracking the false positive rates for the Pre-Refund Wage Verification Program and provide a mechanism for prompt adjustment of filters and models based on filter or model performance;
- Advocate for reinstating the Pre-Refund ESC as a servicewide forum to coordinate policy and other business results related to revenue protection and include TAS as a charter member;
- As data becomes available, quantify the impact of indefinite refund freezes on taxpayers whose refunds have been held, its impact on both IRS and TAS resources, including the potential increase in the amount of interest payments;

23 IRM 21.5.6.4.35.3 (Nov. 2, 2015).

24 IVO does not correspond with a taxpayer based on a referral from a CSR. To the contrary, if it is just a refund status inquiry not associated with any verifiable information, IVO employees will just close out the referral on AMS. IRM 25.25.5.2 (July 27, 2015); IRM 25.25.5.4 (July 27, 2015); IRM 25.25.5.4.1 (July 27, 2015).

25 The IRS can use information returns (e.g., Forms W-2 and 1099) filed by employers, banks, and other third parties to report various types of payments to individuals. These payments include wages, interest, and dividends, as well as payments to self-employed taxpayers for services rendered. The IRS collects and maintains this information through the IRP.

- In light of the new accelerated information reporting deadlines, advocate for the IRS to reform its IWV processes, eliminate the indefinite refund freeze, and reevaluate whether an 11-week freeze needs to be reinstated or the freeze duration may be shortened;
- Advocate for creating a function within the IVO unit where trained assistors will answer incoming calls from taxpayers and respond to written inquiries to provide information regarding the status of an account, to verify income and withholding, and to release incorrectly held refunds, as appropriate; and
- Review the Bulk OAR process and advocate for its continuation in FY 2017 if it is determined that the agreement effectively reduces taxpayer burden and redirects IRS and TAS resources to more complex cases.