

MSP #9

The IRS's Handling of ITIN Applications Imposes an Onerous Burden on ITIN Applicants, Discourages Compliance, and Negatively Affects the IRS's Ability to Detect and Deter Fraud

RESPONSIBLE OFFICIAL

Peggy Bogadi, Commissioner, Wage and Investment Division

DEFINITION OF PROBLEM

Any individual who has a tax return filing obligation but is not eligible to obtain a Social Security number (SSN) must apply to the IRS for an Individual Taxpayer Identification Number (ITIN).¹ ITINs may also appear on credit histories and bank records to meet requirements of backup withholding and the Bank Secrecy Act.² For almost a decade, the National Taxpayer Advocate has raised concerns about ITIN policies and procedures, including the recurring bottlenecks of ITIN applications during the peak tax season and the associated strain on IRS resources, inhibiting an ability to timely detect and deter fraud.

Instead of conducting a comprehensive and strategic analysis of the problems associated with its ITIN program, the IRS has consistently adopted a reactive approach. Thus, on June 22, 2012, in response to a Treasury Inspector General for Tax Administration (TIGTA) report, the IRS abruptly announced interim changes to ITIN procedures, requiring applicants to submit only original documents or documents certified by the issuing agency, and suspending the certifying acceptance agent program.³ This policy change exacerbated long-standing taxpayer service and compliance concerns present in ITIN operations, including:

- The unprecedented burden on ITIN applicants, imperiling their future tax compliance as well as their personal welfare and safety in the U.S. and abroad;
- The bottlenecks caused by seasonal processing of most ITIN applications, contributing to the proliferation of refundable credit schemes;
- The use of outdated processes in ITIN operations;
- The potential abrogation of the U.S. government's commitments under the 1961 Hague Apostille Convention;⁴ and
- The lack of adequate oversight of the certifying acceptance agent program.

¹ Internal Revenue Code (IRC) § 6109; Treas. Reg. § 301.6109-1(d)(3); Instructions to IRS Form W-7, *Application for IRS Individual Taxpayer Identification Number* (Feb. 2012).

² See generally Bank Secrecy Act, 31 U.S.C. §§ 5311-5314, 5316-5322; 12 U.S.C. § 1829(b); USA PATRIOT ACT, § 326, Pub. L. No. 107-56, 115 Stat. 307 (2001); 31 C.F.R. §§ 1010.410, 1010.620, 1022.400.

³ IR-2012-62 (June 22, 2012); TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* 29 (July 16, 2012).

⁴ The 1961 Hague Convention Abolishing the Requirement of Legalization for Foreign Public Documents (Hague Apostille Convention) (entered into force in the United States on Oct. 15, 1981), available at http://www.hcch.net/index_en.php?act=conventions.text&cid=41 (103 signatory countries) (last visited Dec. 20, 2012). See 33 U.S.T. 883, 527 U.N.T.S. 189, T.I.A.S. 10072, 94th Cong. 2d Sess. (1976) (with message and report, and text of Convention). See also Fed. R. Civ. P., Rule 44(a)(2) (notes).

ANALYSIS OF PROBLEM

Background

The IRS established the ITIN program in 1996 to facilitate tax return filing by individuals who have U.S. tax filing obligations and are ineligible for SSNs.⁵ These individuals can fall into one of two categories:

- U.S. resident aliens taxable on their worldwide income; and
- Nonresidents taxable on certain U.S.-source income.⁶

Federal tax law determines a taxpayer's residency status for tax purposes, which may be different from the taxpayer's immigration status. For example, aliens for immigration purposes may be considered residents for tax purposes based on the number of days present in the U.S.⁷ Nonresident alien spouses and dependents of U.S. citizens or residents must furnish ITINs to be able to file joint returns or be included on returns of primary taxpayers. Foreign students and researchers whose employment is not authorized by their immigration status also need ITINs to file returns or claim tax treaty benefits.

Although tax return filing is the most common use for ITINs, certain taxpayers are required to furnish ITINs for other legitimate tax administration purposes. For example, an ITIN may be used to report income associated with a bank account,⁸ for information reporting,⁹ or for withholding on the income of foreign investors.¹⁰ An ITIN does not authorize an alien to work in the United States, grant an immigration status, or qualify the alien for the Earned Income Tax Credit (EITC) or Social Security benefits.¹¹

Of 21 million ITINs assigned from the inception of the program in 1996 through August of processing year (PY) 2012, about 19.8 million (or about *94.4 percent*) showed up on tax returns or information returns (Forms W-2, 1099, W-4, W-8, W-9, 8288, 1042), as shown on Figure 1.9.1 below.¹² For example, between the inception of the ITIN program and February 2009, of all ITINs associated with returns, about 33 percent appeared as primary,

⁵ Certain persons are required to file U.S. income tax returns and pay U.S. income tax regardless of their immigration or residence status. See generally IRC §§ 7701, 864, 871; Treas. Reg. §§ 301.7701(b)-1; 864(c)(1)-(4). To be eligible for an SSN, a taxpayer generally must be a U.S. citizen, legal permanent resident (green card holder), or be in work-authorized immigration status. See U.S. Social Security Administration (SSA), ssa.gov (last visited Dec. 20, 2012). Examples of individuals who need ITINs include non-resident aliens filing a U.S. tax return and not eligible for an SSN, U.S. resident aliens (based on days present in the United States) filing a U.S. tax return and not eligible for an SSN, dependents or spouses of a U.S. citizen/resident alien; and dependents or spouses of non-resident alien visa holders.

⁶ See generally IRC § 7701. See also IRC §§ 1, 11, 61, 861, 862, 864, 871, 881, 882, and 1441-1446.

⁷ To become a resident for tax purposes, an individual must be present in the U.S. on at least 183 days during a three year period that includes the current year. See generally Treas. Reg. § 301.7701(b)-1(c).

⁸ See Form W-9, *Request for Taxpayer Identification Number and Certification*. See also Forms W-8BEN, W-8ECI, W-8EXP, and W-8IMY.

⁹ Forms W-2 and 1099 and its progeny (e.g., 1099-DIV, 1099-INT, and 1099-OID).

¹⁰ See generally IRC §§ 897, 1441-1445. See also, e.g., Forms 8288, 1042, and 1042-S.

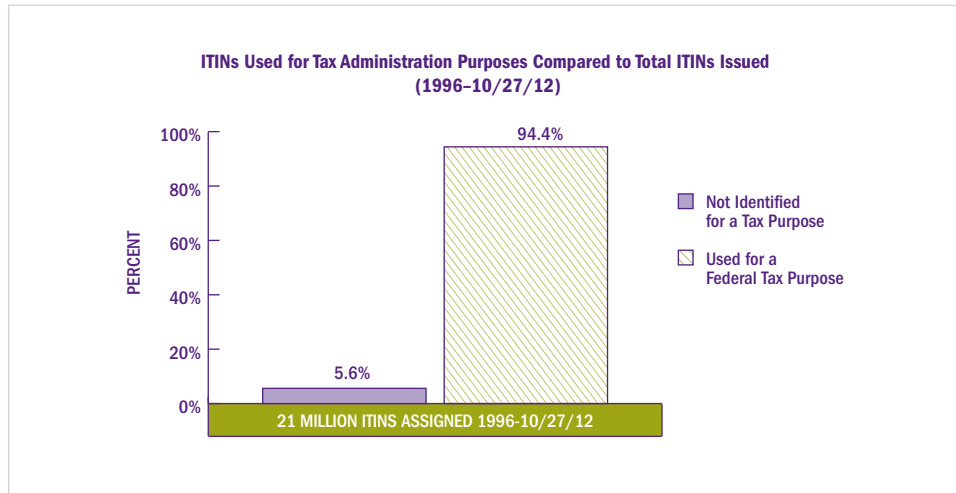
¹¹ IRM 3.21.263.1(6) (Jan. 1, 2011).

¹² IRS, *ITIN Production Reports* (Dec. 31, 2008 – Oct. 27, 2012); National Taxpayer Advocate 2008 Annual Report to Congress 127.

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18 percent as secondary, and 40 percent as those of dependent taxpayers, with the remaining nine percent associated with information returns.¹³

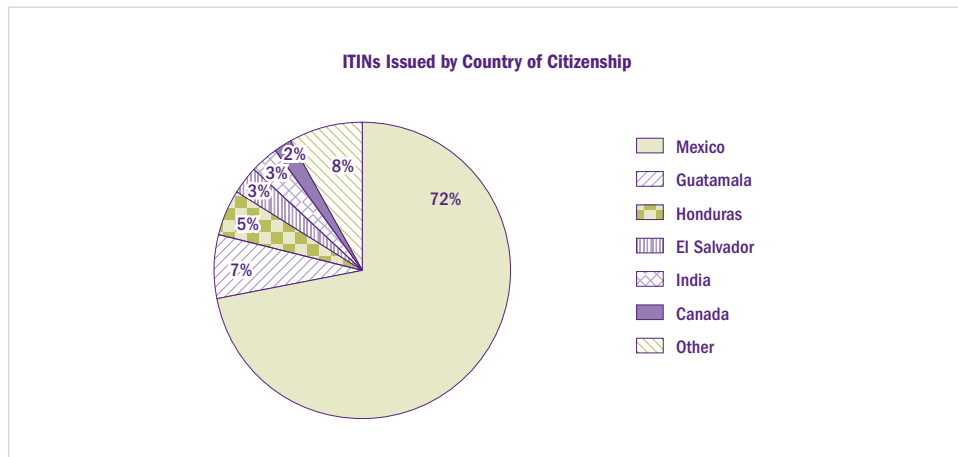
FIGURE 1.9.1, ITINs Used for Tax Administration Purposes Compared to Total ITINs Issued from 1996 through October 27, 2012¹⁴



In PY 2012 (through August 2012), the IRS received about 90 percent of all ITIN applications from nationals of the following countries: Mexico (71.9 percent), Guatemala (7.1 percent), Honduras (4.7 percent), El Salvador (3.4 percent), and India (3.1 percent), as shown in Figure 1.9.2 below.

¹³ IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File (IRTF), TYs 1996-2007, and Information Returns Master File (IRMF), TYs 2000-2006 (data drawn Feb. 2009).

¹⁴ Processing year means the year in which the ITIN application was assigned and is based on a calendar year. Taxable year generally means a calendar year for individuals.

FIGURE 1.9.2, All ITINs Issued by Country of Citizenship in PY 2012 (through August 2012)¹⁵

Dependents residing in Mexico (who account for 53.5 percent of all ITIN applications) can be claimed for the dependency exemption under the “contiguous country” exception.¹⁶ Even though the child tax credit (CTC) and a refundable portion of this credit, known as the Additional CTC (ACTC), generally follow the dependency exemption rules, the IRC provides these credits only for children residing in the U.S.¹⁷ The complexity and inconsistency among these requirements lead to widespread erroneous claims or omissions that cannot be attributable solely to fraud.¹⁸ Requiring taxpayers to understand an exception (*i.e.*, CTC/ACTC) to an exception (*i.e.*, the contiguous country rule) to the general rule (*i.e.*, the dependency exemption) is a sure recipe for error.

In 2011, the last full processing year, the IRS assigned 1.7 million ITINs, of which approximately 270,000 went to non-resident aliens.¹⁹ In PY 2011, an average ITIN filer received a

¹⁵ IRS response to TAS information request (Sept. 17, 2012).

¹⁶ An individual may generally deduct a dependency exemption amount for a child (or younger descendant or that of a sibling or step-sibling) under 19 (24 if a full-time student) sharing his or her home for over half the year who is a U.S. citizen or national, or a resident of the U.S., Canada, or Mexico. See IRC §§ 151(c), 152(b), (c). Different rules apply to dependents residing in Korea and India. See U.S.-Republic of Korea Income Tax Convention, Art. 4(7); U.S. - India Income Tax Convention, Art. 21(2).

¹⁷ See IRC § 24(a), (c), and (d). With income below certain phase-outs, the primary taxpayer may claim a \$1,000 CTC for a child under 17 who is a citizen, national, or resident of the U.S. for tax purposes. If the individual earns income below certain thresholds, ACTC in excess of tax owed is refundable. See also Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children, infra*.

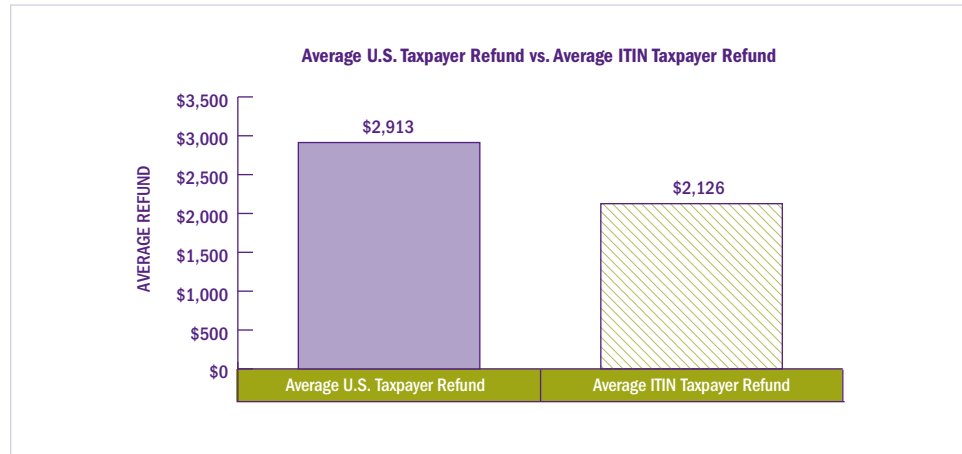
¹⁸ Reports by the Treasury Inspector General for Tax Administration (TIGTA) have attracted headlines with the insinuation that the IRS paid billions of dollars in invalid and fraudulent ACTC claims, *i.e.*, those with ITINs rather than SSNs. See TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the ITIN Program to Detect Fraudulent Applications*, (July 16, 2012); TIGTA, Ref. No. 2009-40-057, *Actions Are Needed to Ensure Proper Use of ITINs and to Verify or Limit Refundable Credit Claims* (Mar. 31, 2009).

¹⁹ IRS, *ITIN Production Report* (Dec. 31, 2011). The IRS assigned 1,740,490 ITINs in 2011. Processing year is the calendar year in which ITIN applications were processed. TAS Research, CDW, IMF_TC150_HISTORY table (data drawn Aug. 27, 2012).

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refund of \$2,126 (including refundable credits) compared to an average of \$2,913 for the general U.S. taxpayer population, as shown below.²⁰

FIGURE 1.9.3, Average ITIN Refunds Are Smaller Than Average U.S. Taxpayer Refunds



In addition, employers withhold Social Security, Medicare, and unemployment taxes from ITIN taxpayers, who are generally ineligible for these benefits. The Social Security Administration (SSA) Earnings Suspense File (ESF) contains data regarding W-2 withholding that was not matched with a valid SSN. Tens of billions of dollars of employment taxes are annually withheld and paid by employers into the ESF on behalf of taxpayers ineligible for SSNs or with SSN mismatches.²¹ In TY 2008 alone, SSA posted 9.4 million wage items, representing \$86 billion, to the ESF.²²

The IRS's Policy Change to Require Applicants to Submit Only Original Documents or Documents Certified by the Issuing Agency Imposes an Onerous Burden on Taxpayers and May Irreversibly Harm Compliance and Endanger Taxpayers.

On June 22, 2012, the IRS abruptly and unilaterally changed ITIN application procedures without discussing these changes with internal and external stakeholders.²³ The IRS eliminated the option of providing a notarized copy of required identification documents, such as passports and birth certificates, with the Form W-7, *Application for IRS Individual Tax Identification Number*. Individuals applying for an ITIN must now either mail their

²⁰ Cf. TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* 29 (July 16, 2012) and IRS, Filing Season Statistics – Dec. 31, 2011, available at <http://www.irs.gov/uac/Filing-Season-Statistics---Dec.-31,-2011> (last visited Sept. 2, 2012).

²¹ See SSA Performance and Accountability Reports (PAR), fiscal years (FYs) 2006-2011. As of October 2010, the ESF had accumulated approximately 305 million wage items and about \$921 billion in wages for TYs 1937-2008. SSA FY 2011 PAR, at 176.

²² SSA FY 2010 PAR, at 176. From TY 2000 to TY 2008, the ESF grew from 3.8 percent of total reported wage items to 4.3 percent of all wages. SSA FY 2010 PAR, at 178.

²³ IR-2012-62 (June 22, 2012). The IRS announced that the procedures were in effect through the end of TY 2012. Although the IRS notified the National Taxpayer Advocate that it would be changing its ITIN procedures, it did not share with her the actual interim procedures prior to publication.

original passports or other acceptable government-issued identification documents (or certified copies of these documents obtained from the original issuing agency) to the IRS Austin Service Center with their Forms W-7. The IRS indicated that it might take *60 days or longer* to return these original documents to the applicant via standard U.S. mail.²⁴ The IRS did not authorize its walk-in sites to verify original documentation presented by ITIN applicants but instead instructed the sites to forward the original documentation to the centralized processing unit in Austin.

The IRS also immediately stopped issuing ITINs for applications submitted through certifying acceptance agents (CAAs) unless they include original documentation or copies of original documents certified by the issuing agency. Prior to this change, ITIN applicants using CAAs could present their original documents to the CAA for verification without having to submit notarized copies to the IRS.²⁵

These changes imposed a significant burden on ITIN applicants. Numerous stakeholders, including Low-Income Taxpayer Clinics (LITCs), colleges and universities, Volunteer Income Tax Assistance (VITA) sites, and tax practitioners complained about the extreme and unnecessary burden of these new interim procedures on taxpayers, and the harm to future compliance and the U.S. economy. Some commented that the policy has such a chilling effect on compliance that the affected taxpayers may stop filing returns altogether.²⁶ One LTC that conducts English as a Second Language (ESL) outreach for low income taxpayers complained that it had to cancel a scheduled workshop in September 2012 for ITIN applicants because no one appeared.²⁷ The clinic believes the applicants are not coming because they are reluctant to give up original identification documents. As the chart below shows, the number of ITIN applications significantly decreased in the months following the June 22, 2012 policy change compared to the same period in PY 2011.²⁸ At the same time, the number of rejected applications significantly increased.

²⁴ IRS, *2012 ITIN Review Frequently Asked Questions*, available at <http://www.irs.gov/uac/2012-ITIN-Review-Frequently-Asked-Questions-1> (last visited Nov. 2, 2012).

²⁵ See Rev. Proc. 2006-10, 2006-1 C.B. 293.

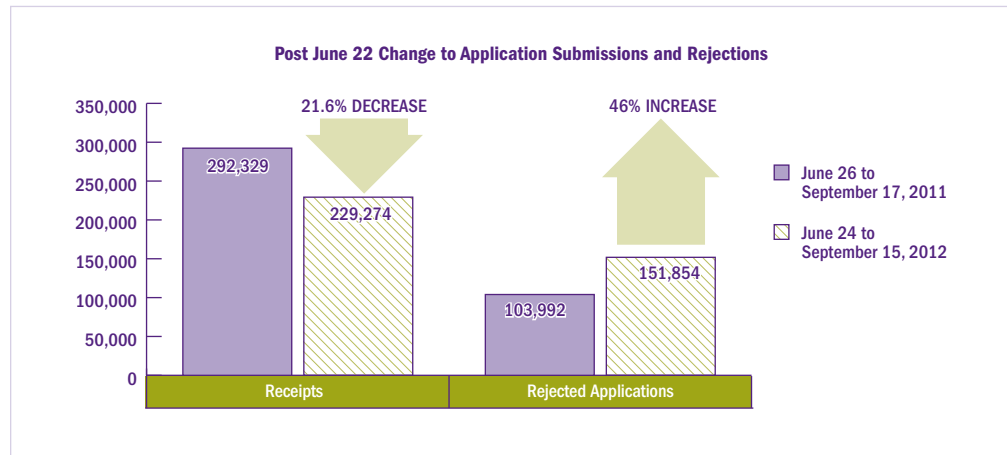
²⁶ TAS Teleconferences with the ABA Commission on Immigration and the Section of Taxation (Aug. 30, 2012); ABA Section of Litigation, Immigration Litigation Committee (Aug. 30, 2012); Low Income Taxpayer Clinics (Aug. 27, 2012); National Community Tax Coalition (Aug. 23, 2012).

²⁷ National Taxpayer Advocate and IRS teleconference with LITCs (Sept. 27, 2012).

²⁸ IRS, Real-Time System (RTS) reports (Sept. 22, 2012). The decline in ITIN receipts before June 22, 2012 constitutes 0.6 percent compared to the same period of TY 2011, while the decline in ITIN receipts after June 22 is 21.6 percent.

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FIGURE 1.9.4, Received and Rejected ITIN Applications in Second Quarters of Processing Years 2011 and 2012



The IRS's Policy Change Harmed Foreign Taxpayers.

The requirement to provide original documents or copies certified by the issuing agency imposed a significant burden on many groups of taxpayers, including foreign students and businesspeople:

- **Foreign students**²⁹: Hundreds of thousands of foreign students bring more than \$20 billion into the U.S. economy every year.³⁰ In FY 2011, the United States granted about 850,000 visas in student visa categories.³¹ As of April 2, 2012, there were about 1.2 million students, exchange visitors, and their dependents in active visa status.³² All these students are in the country legally under the Student and Exchange Visitor Program (SEVP).³³ The Department of Homeland Security (DHS) has authorized Designated School Officials (DSOs) of the 9,888 SEVP-member schools and Responsible Officers (ROs) of the 1,426 exchange visitor program sponsors to verify students' or visitors' documentation and certify extensions of visas on Forms I-20 and DS-2019.³⁴
- **Foreign businesspeople and investors**: Foreign individuals who have a U.S. filing obligation need ITINs to file a return, to make an election, claim an exemption from withholding, or submit a form to a partnership or a corporation that conducts business

²⁹ See e.g., Community Colleges for International Development, Inc. letter to the National Taxpayer Advocate (July 23, 2012).

³⁰ USA Today, *More foreign students studying in USA*, Nov. 14, 2011, available at <http://www.usatoday.com/news/education/story/2011-11-13/foreign-students-boost-usa-economy/51188560/1> (last visited on Sept. 19, 2012). While some of these taxpayers who are authorized to work in the United States are eligible for an SSN, many others have taxable income and need an ITIN to comply with their U.S. tax filing requirements.

³¹ U.S. Dept. of State, *Nonimmigrant Visas Issued FY 2011*.

³² U.S. Dept. of Homeland Security, *The Student and Exchange Visitor Program (SEVP) Quarterly Review* (Apr. 2, 2012). Since the inception of the program in 2003, the number of visa holders increased to approximately 9.5 million.

³³ SEVIS, <http://www.ice.gov/sevis/>. This web-based system collects real-time information on nonimmigrant students, exchange visitors, approved schools, and program sponsors.

³⁴ U.S. Dept. of Homeland Security, *The Student and Exchange Visitor Program (SEVP) Quarterly Review* (Apr. 2, 2012).

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in the United States. These taxpayers are considered nonresidents for tax purposes and generally cannot claim exemptions or refundable credits.³⁵ While the IRS has no reliable estimate of the number of nonresident alien taxpayers who may have filing obligations, it receives between 600,000 and 700,000 returns from these taxpayers each year.³⁶

The IRS's policy change created a tremendous burden on these taxpayers, including:

- The extended time (from one to three months, not including the IRS processing time of at least 60 days) without a passport. For students, this limited their ability to timely leave the country after the authorized period of stay or to travel in emergencies. For businesspeople, this can cause substantial damage to their business activities, preventing travel until the IRS returns their passports.
- The inability to submit documents certified by an apostille, which violates the U.S. government's obligations under the Hague Convention.³⁷
- Violation of prohibitions against sending original passports by mail in certain countries.³⁸
- The inability to obtain a certified copy from certain country embassies or a copy of a U.S. visa certified by the Department of State.³⁹
- The extended period of time (often many months) and associated costs required to obtain a duplicate, if the passport is lost.
- The inability to apply for required driver's licenses for taxpayers who are considered temporary state residents.⁴⁰

³⁵ For a taxpayer to be considered a U.S. resident for tax purposes, he or she must meet either the green card or the substantial presence test for the calendar year. Under the substantial presence test, a taxpayer should be physically present in the United States on at least 31 days during the current year, and 183 days during the past three years, calculated according to a special formula. For a detailed discussion of the contiguous country rule for dependency exemptions, see Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children, infra*.

³⁶ IRS Office of Research, Forecasting and Statistics, Document 6187 (Sept. 2010 and July 2012), Tables 1B. See also National Taxpayer Advocate 2011 Annual Report to Congress 137-150.

³⁷ As a signatory to the Hague Convention, the United States agreed to recognize public (including notarized) documents issued by other signatory countries if those public documents are authenticated by the attachment of an internationally recognized form of authentication known as an apostille. See Hague Apostille Convention, available at http://www.hcch.net/index_en.php?act=conventions.text&cid=41 (103 signatory countries) (last visited Dec. 20, 2012).

³⁸ For example, Algeria, India, Lithuania, Russia, Tunisia, and Ukraine prohibit mailing passports across borders. See, e.g., Indian Embassy in the United States, available at http://www.indianembassy.org/index.php?option=com_faq&task=detail&id=2 (last visited Dec. 20, 2012); FedEx web site, available at http://www.fedex.com/ru_english/shippingguide/exportguidelines/ (last visited Dec. 20, 2012); United States Postal Service (USPS), available at http://pe.usps.com/text/imm/tz_016.htm (last visited Dec. 20, 2012). Interestingly, the U.S. consulate in Nogales, Mexico does not permit the mailing of documents of citizenship, see U.S. Consulate in Nogales, Mexico, available at http://spanish.nogales.usconsulate.gov/non_em_svcs2.html ("El Consulado Estadounidense en Nogales, Sonora no permite el envío/recibo por correo de documentos de Ciudadanía.") (last visited Sept. 25, 2012).

³⁹ AICPA Comments Regarding the Internal Revenue Service's (IRS's or Service's) June 22, 2012 Interim Policy Changes Involving the Individual Taxpayer Identification Number (ITIN) Application Process to the National Taxpayer Advocate (Oct. 16, 2012); TAS and IRS teleconferences with U.S. college and university representatives (Aug. 23, 2012 and Sept. 13, 2012).

⁴⁰ Community Colleges for International Development, Inc. letter to the National Taxpayer Advocate (July 23, 2012); TAS and IRS teleconferences with U.S. college and university representatives (Aug. 23, 2012 and Sept. 13, 2012); National Taxpayer Advocate email to the Deputy IRS Commissioner for Services and Enforcement (July 25, 2012).

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The policy change may also prevent foreign businesspeople or investors from filing for an election or to apply for a withholding certificate under the Foreign Investment in Real Property Tax Act (FIRPTA).⁴¹ As a result, the IRS may be preventing or discouraging foreign investment into the U.S. economy.⁴² The following example provided to TAS by a practitioner describes the harm the new ITIN rules created:

EXAMPLE: Two potential investors in real estate in Florida, which is trying to attract foreign investments in foreclosed real estate, are no longer interested in applying for ITINs and have abandoned the idea of investing in the U.S. One investor was a Canadian who just got a notarized copy of his identification documents. The other investor, who is from India, travels the world for business, but under Indian law cannot mail his passport. If he sent it to the IRS, he could not travel. His passport is actually nine passports stapled together, containing over 500 pages with visas from 50 countries. In India, he would have to wait six months to get new passports. Thus, because of the new IRS policy, the businessman chose not to invest in the U.S.⁴³

The Policy Change Imposed Onerous Burdens on Individual Taxpayers in the United States and Their Dependents Abroad.

Outside stakeholders, LITCs and TAS case advocates have reported the policy change will cause foreign individuals who are U.S. residents for tax purposes to experience the following burdens, which may irreversibly harm them and their filing compliance:⁴⁴

- Taxpayers in several states risk being detained for an extended time (for example, incident to a routine traffic stop) for not having identification documents that they sent to the IRS.⁴⁵ As a result, some taxpayers, whether in the U.S. legally or not, who may feel threatened by the “show me your papers” laws, could choose a path of least resistance and decide not to file taxes at all, costing the government reductions in voluntary compliance and tax revenue.⁴⁶

⁴¹ See, e.g., IRC § 83(b); Treas. Reg. § 1.83-2(e)(1) (a taxpayer identifying number (TIN) is required to make an election to treat the receipt of stock as income when received; the election must be made within 30 days of the transfer of property; no extensions are permitted); IRC § 7701(b); Treas. Reg. § 301.7701-3 (to obtain an EIN for a foreign entity in order to make an entity classification election, its principal officer must have a TIN); IRC § 1445 (a TIN is required on Form 8288-B, *Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests*).

⁴² See, e.g., Systemic Advocacy Management System (SAMS) submissions No. 25328, 25401, and 24891; TAS Teleconferences with the ABA Commission on Immigration and the Section of Taxation (Aug. 30, 2012); ABA Section of Litigation, Immigration Litigation Committee (Aug. 30, 2012); AICPA letter to the IRS Commissioner (Aug. 28, 2012).

⁴³ SAMS Issue No. 24891 (July 6, 2012) (Consent for Disclosure of Tax Information is on file with the National Taxpayer Advocate).

⁴⁴ AICPA letter to the IRS Commissioner (Aug. 28, 2012); National Community Tax Coalition (NCTC) letter to the IRS Commissioner (Aug. 20, 2012).

⁴⁵ See Ariz. Rev. Stat. Ann. § 11-1051(B) (passed as a part of Arizona S.B. 1070 law); *Arizona v. U.S.*, 132 S.Ct. 2492 (2012) (officer conducting stop, detention, or arrest can verify individual's immigration status with federal government if officer had suspicion that the person was unlawfully in the U.S.). Similar statutes were passed in Georgia, Alabama, Indiana, South Carolina, and Utah. The New York Times, *Arizona Immigration Law* (SB 1070) (June 25, 2012), available at <http://topics.nytimes.com/top/reference/timestopics/subjects/i/immigration-and-emigration/arizona-immigration-law-sb-1070/index.html> (last visited Dec. 20, 2012).

⁴⁶ SAMS Issue No. 25007 (July 9, 2012). See also AICPA letter to the IRS Commissioner (Aug. 28, 2012); National Community Tax Coalition (NCTC) letter to the IRS Commissioner (Aug. 20, 2012) (NCTC is a membership coalition of community-based organizations offering free tax and financial services to low- and moderate-income, working families through Volunteer Income Tax Assistance (VITA) programs).

- Some countries require citizens to carry identification documents at all times. The IRS's interim rule puts taxpayers' spouses and dependents who are not even present in the U.S. at risk of detention in those countries.⁴⁷
- Depending upon the taxpayer's location in the U.S., it may not be possible or practical to appear in person at the consular office.
- Some prospective ITIN applicants have been advised by their home countries' consulates that they do not issue certified copies of passports.⁴⁸
- Some countries, e.g., the United Kingdom and the Commonwealth countries, will not issue a certified copy of a passport at all — even if the applicant is present in the home country. The only way to have the government stamp a copy is via the apostille process.⁴⁹
- Some countries do not provide any type of certification process for these documents, making it impossible for taxpayers to secure an ITIN.⁵⁰
- In order to file timely returns, some taxpayers must forego a joint return and any exemptions because their spouses and dependents cannot obtain ITINs before the return filing date. As a result, they could be made to pay more in taxes than they legally owe.⁵¹
- Some unbanked taxpayers, many of whom are low income, cannot cash checks until their original documents are returned.⁵²
- Taxpayers who are low income and therefore transient are at greater risk of losing their documents in the mail or at the IRS, and of becoming victims of identity theft and associated fraud.

Original Documents are Often Lost, Imposing Significant Hardship on Applicants.

TAS case advocates and LITCs note that the original documents sent by regular mail to applicants are often lost.⁵³ The IRS normally returns originals by regular mail within 60 days

⁴⁷ For example, all Belgians from the age of fifteen are required to carry electronic identity cards at all times. See *Electronic Identity Documents*, Belgian Official eID web site, available at http://eid.belgium.be/en/find_out_more_about_the_eid/the_electronic_identity_documents/ (last visited Oct. 20, 2012). In Turkey, locals have compulsory ID cards, which they must carry with them at all times. See Turkey's Official Travel Portal, available at <http://www.goturkey.com/content.php?cid=51533&typ=c&lng=en> (last visited Oct. 20, 2012).

⁴⁸ AICPA letter to the National Taxpayer Advocate (Oct. 16, 2012).

⁴⁹ TAS teleconferences with LITCs (Aug. 27, 2012); TAS Teleconferences with the ABA Commission on Immigration and the Section of Taxation (Aug. 30, 2012); National Community Tax Coalition (Aug. 23, 2012); TAS attorney advisor and Systemic Advocacy analyst meeting with case advocates at Austin campus (Sept. 19, 2012); TAS call to the Embassy of Ukraine in Washington, D.C. (Sept. 27, 2012). For a detailed discussion of the apostille certification process, see Hague Apostille Convention available at <http://www.hcch.net> (last visited Dec. 20, 2012).

⁵⁰ TAS teleconferences with Low Income Taxpayer Clinics (Aug. 27, 2012); TAS teleconferences with the ABA Commission on Immigration and the Section of Taxation (Aug. 30, 2012); NCTC (Aug. 23, 2012); TAS attorney advisor and Systemic Advocacy analyst meeting with case advocates at Austin campus (Sept. 19, 2012).

⁵¹ E.g., a TIN is required to claim a Child Tax Credit (CTC) or a dependency exemption. IRC §§ 24(e); 151(e). If a return is filed without a TIN, the IRS may disallow credits and exemptions and assess any resulting deficiency under procedures for mathematical or clerical errors. IRC § 6213(g)(2).

⁵² National Taxpayer Advocate and IRS teleconference with LITCs (Sept. 27, 2012).

⁵³ Teleconferences with TAS case advocates (Aug. 24, 2012); LITCs (Aug. 27, 2012).

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of receipt.⁵⁴ If these documents are returned to the IRS as undeliverable, IRS procedures do not require a personal contact with the taxpayer over the phone.⁵⁵ Instead, if the IRS does not detect a better address, it mails the original passports to embassies of issuing countries and destroys other items.⁵⁶ Many ITIN applicants are low income and transient.⁵⁷ However, given the high percentage of cell phone usage in this country, most applicants probably do have a contact phone number that they retain for a long time.⁵⁸ The IRS should change the Internal Revenue Manual (IRM) to require ITIN employees to contact the applicant if a document is returned as undeliverable. The IRS should also send the original documents by trackable mail service, such as certified, registered, or priority mail, and allow applicants who need their documents back more quickly the option of including a prepaid Express Mail or Courier envelope.⁵⁹ In addition, we recommend the IRS revise its Form W-7 to allow applicants to provide contact information of a third party designee for limited purposes of discussing Form W-7 processing issues with the designated third party, similar to a third party designee box on a tax return.⁶⁰

The IRS Should Have Focused Specifically on Refund Schemes Instead of Establishing Prohibitive Requirements for the Entire ITIN Population.

The IRS changed its procedures in response to a recent TIGTA report that identified certain tax refund fraud connected to refundable credits and exemptions.⁶¹ However, it is unclear how receipt of an original passport or other identification provides the IRS with any more certainty that the applicant is actually the owner of the document or shows that the applicant is eligible for any refundable credits claimed. For example, for the taxpayer to claim a CTC or Additional CTC, his or her child must satisfy certain requirements not substantiated by the claimant's documents.⁶²

Generally, to claim exemptions for spouses and dependents, the ITIN taxpayer must be a U.S. resident alien for tax purposes, a resident of Canada or Mexico, or a resident of India

⁵⁴ IRM 3.21.263.5.2.10 (Jan. 1, 2011).

⁵⁵ Over 19 million pieces of mail each year, or ten percent of all correspondence the IRS sends to taxpayers, are returned as "undeliverable as addressed." The documents may also be lost within the IRS. For a more detailed discussion, see Status Update: *Underfunding IRS Initiatives to Modernize its Taxpayer Address Correspondence Systems Undermines Taxpayers' Statutory Rights and Impedes Efficient Resource Allocation*, *infra*.

⁵⁶ SERP IRM 3.21.263.5.2.11 (5) (June 27, 2012) and IRM 3.21.263.5.10.4 (11) and (12) (Sept. 24, 2012).

⁵⁷ Randy Capps *et al.*, *A Profile of Low-Income Working Immigrant Families 2*, The Urban Institute (June 2005), http://www.urban.org/UploadedPDF/311206_B-67.pdf (last visited Nov. 2, 2012). See also American College of Emergency Physicians, *Illegal Immigrant Care in the Emergency Department*, <http://www.acep.org/content.aspx?id=25206> (last visited Nov. 2, 2012).

⁵⁸ About 92 percent of all adults in the United States have a cell phone. Forrester Research, Inc., North American Technographics Online Benchmark Survey (Part 2), Q3 2012. However, the lack of paid minutes for some low income taxpayers may limit reliability of cell phone access.

⁵⁹ See National Taxpayer Advocate 2010 Annual Report to Congress 221-234 (Most Serious Problem: *The IRS has not Studied or Addressed the Impact of the Large Volume of Undelivered Mail on Taxpayers*).

⁶⁰ See Form 1040, U.S. Individual Tax Return (2011) which contains a third party designee box on page 2 of the return. It allows a preparer, a friend, a family member, or any other person to discuss tax return with the IRS over the phone and answer any questions that may arise during processing. The designee may also provide the IRS any information missing from the return, call the IRS for information about the processing of the return or the status of any refund or payment, receive copies of IRS notices and provide responses to such notices. See Form 1040 Instructions (2011), at 72.

⁶¹ TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* (July 2012). The report identified erroneous Child Tax Credit refunds and thousands of returns filed from a few addresses.

⁶² See generally IRC §§ 24 and 151.

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or the Republic of Korea meeting certain requirements.⁶³ While the IRS may have a legitimate reason to scrutinize ITIN applications from nationals of these countries, it does not have justification for imposing undue burden on all ITIN applicants.⁶⁴ Its one-size-fits-all approach to documents does not resolve concerns about dependency exemptions and the CTC and harms generally compliant taxpayer groups.

Seasonal Processing of Most ITIN Applications and the Absence of Revocation Procedures Exacerbates the IRS's Inability to Timely Detect and Deter Fraud.

For several years, the National Taxpayer Advocate has criticized the IRS policy of processing ITIN applications only with paper tax returns during the filing season, on the grounds that it creates seasonal bottlenecks affecting over one million tax returns and associated refunds annually.⁶⁵ The policy is in response to the fear that the bulk of ITIN applications are submitted by resident aliens employed in the U.S. illegally who seek ITINs for non-tax purposes, such as for obtaining a driver's license.⁶⁶ However, as discussed above, over 94.4 percent of issued ITINs appear on tax returns.⁶⁷ In addition, most states do not require an applicant for a driver's license or a state ID card to provide an SSN, removing an incentive for ITIN holders to use ITINs for non-tax purposes.⁶⁸

The requirement that ITIN applications be submitted along with tax returns strains IRS resources during the filing season, condensing a 12-month ITIN workload into four months. This process does not allocate sufficient time or resources to verify the existence of wage income or the tax filing need for those claiming exemptions and credits.

Allowing taxpayers to obtain ITINs throughout the year would enable the IRS to build in additional time for analyzing trends and verifying wage and withholding amounts before

⁶³ See generally IRC §§ 152(b)(3)(A); 873(b)(3). See also U.S. – Republic of Korea Tax Convention, Art. 4(7) and U.S. – India Tax Convention, Art. 21(2). These restrictions do not apply if the ITIN applicant is a nonresident alien married to a U. S. citizen or resident alien and has chosen to be treated as a resident of the United States. For a more detailed discussion of the contiguous country rule for dependency exemptions, see Legislative Recommendation: *Simplify the National Status and Related Requirements for Qualifying Children*, *infra*.

⁶⁴ In PY 2012 (through August 2012), the IRS received about 90 percent of all ITIN applications from the nationals of the following countries: Mexico – 71.9 percent; Guatemala – 7.1 percent; Honduras – 4.7 percent; El Salvador – 3.4 percent; and India – 3.1 percent. IRS response to TAS information request (Sept. 17, 2012).

⁶⁵ See, e.g., National Taxpayer Advocate 2010 Annual Report to Congress 319-34 (Status Update: *Despite Program Improvements, the IRS Policy of Processing Most ITIN Applications with Paper Returns During Peak Filing Season Continues to Strain IRS Resources and Unduly Burden Taxpayers*), National Taxpayer Advocate 2009 Annual Report to Congress 520-22; National Taxpayer Advocate 2008 Annual Report to Congress 126-40 (Most Serious Problem: *IRS Handling of ITIN Applications Significantly Delays Taxpayer Returns and Refunds*); Taxpayer Advocate Directive (TAD) 2009-1 (Processing of Forms W-7/Filing of ITIN Applications and Associated Tax Returns) (Feb. 25, 2009).

⁶⁶ National Taxpayer Advocate 2010 Annual Report to Congress 327-28. See also Government Accountability Office (GAO), Ref. No. GAO-04-529T, *Individual Taxpayer Identification Numbers Can Be Improperly Obtained and Used* (Mar. 10, 2004); TIGTA, Ref. No. 2004-30-023, *The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration* (Jan. 2004).

⁶⁷ See Figure 1.9.1, ITINs Used for Tax Administration Purposes Compared to Total ITINs Issued From 1996 Through August 31, 2012, *supra*.

⁶⁸ U.S. Immigration and Customs Enforcement, Factsheet, *Applying for a Driver's License or State Identification Card* (Jan. 17, 2012). In most states, however, the nonimmigrant alien needs to apply for an SSN and present a Form SSA-L676, *Refusal to Process SSN Application*, when applying at the Department of Motor Vehicles.

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the filing season begins.⁶⁹ To reduce the improper use of ITINs, the IRS should develop a process to revoke the numbers that are no longer used for tax purposes, after notifying the taxpayer; for example, in situations when the taxpayer leaves the country (as would a student) or receives an SSN.

The IRS Should Apply Existing Processes to Timely Identify and Prevent Potential Fraud Schemes Involving ITIN Applicants.

Unlike the Questionable Refund Program (QRP) and its successor, the Accounts Management Taxpayer Assurance Program (AMTAP), the ITIN program was not designed to select and examine returns suspected of fraud. The ITIN program does not have electronic applications or filters to screen, score, and select returns for review.⁷⁰ The inability of the ITIN operation to screen returns is exacerbated by the IRS's insistence on processing the bulk of ITIN applications attached to paper returns during the peak filing season as discussed above. Thus, efforts to detect fraud when processing ITIN applications are necessarily unwieldy, ineffective, and subjective. If ITINs were assigned before the filing season, the returns associated with them would be subject to all fraud detection filters the IRS uses for all other returns claiming refunds. As further illustration of the ITIN program's deficiencies, the IRS has identified multiple fraud schemes, *e.g.*, thousands of returns filed from the same address, same return information, same CAA, etc.⁷¹ However, it failed to take timely enforcement actions against perpetrators. Yet these returns have precisely the kind of characteristics that the IRS's regular return processing routinely catches and stops.

The IRS also misses the opportunity to use the recently adopted Preparer Tax Identification Number (PTIN) regulations to address potential ITIN-related fraud by tax preparers.⁷² If it requires preparers to provide a PTIN on an ITIN application (Form W-7) the IRS will be able to link questionable or potentially fraudulent applications to a preparer and take appropriate action, including a referral to the IRS Criminal Investigation (CI) division, the Return Preparer Office, or the Office of Professional Responsibility, and a referral to the U.S. Department of Justice for a court injunction against the preparer.⁷³

⁶⁹ Acting on TAS's recommendation, the IRS now accepts pay stubs, letters from the employer on the employer's letterhead, earnings statements, and other corroborating documents such as employee benefits forms as a proof of wage income and tax filing need. See IRM 4.19.15.38.4 (Sept. 6, 2012). See also National Taxpayer Advocate Fiscal Year 2013 Objectives Report to Congress 54.

⁷⁰ AMTAP uses the Electronic Fraud Detection System (EFDS) for these purposes. EFDS employs "data mining" computer scoring models for detecting fraud. Returns that are flagged are diverted into a workload for further inspection before any refund is issued. For a detailed discussion, see 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*, *supra*.

⁷¹ TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* (July 2012).

⁷² Treas. Reg. § 31.6109-2. IRS Notice 2011-6, 2011-3 I.R.B. 315, specifically excludes the Form W-7 from the list of forms requiring a PTIN.

⁷³ See, *e.g.*, Circular 230, *Regulations Governing Practice before the Internal Revenue Service*; IRC § 7402(a).

TAS Visit to ITIN Operation Confirmed the Need for Modernization of the Technologically Obsolete Paper Process.

On September 18 and 19, 2012, TAS representatives visited the ITIN unit in Austin, TX. The visit showed that the employees do not use modern technology to process applications and detect potential fraud, instead manually verifying and processing a large number of paper files. Most ITIN examiners do not even have access to a telephone or IRS systems, other than the Real-Time System (RTS) for entering information about ITIN applications. The RTS itself is an outdated system that does not have fields for numbers, countries of issuance, and types of taxpayer documents proving identity, foreign status, or U.S. residency for tax purposes. For example, an ITIN examiner cannot enter the number or the date and the country of issuance of a passport for electronic screening of subsequent applications. Nor can he or she use face recognition software to identify multiple applications using the same photo identification. Further, RTS is an offline system that cannot communicate with other federal and state government databases to verify the taxpayer's identity.

To detect and deter fraud in the ITIN program, the IRS should modernize its processing technology to permit:

- Scanning and barcoding of incoming applications for future reference;
- Use of face recognition software and matching technology for screening applications, pictures, and signatures and comparing them with applications already in the database; and
- Automatic electronic verification with other federal, state, and foreign government agencies.⁷⁴

If the IRS can electronically verify the validity of submitted documents, it would not need to require originals from applicants.

The IRS Should Address Unique Characteristics of Different Groups of ITIN Filers in Drafting New ITIN Rules.

As discussed above, the IRS's sweeping policy change based on a one-size-fits-all approach has imposed an unnecessary burden on different groups of ITIN applicants and may have had a chilling effect on filing compliance, as well as putting taxpayers at personal risk. Many taxpayer groups are not eligible for child tax credit and dependency exemptions and pose little or no risk of noncompliance. The IRS should take the demographics of taxpayer return claims into account and craft discrete exceptions for different groups of ITIN filers.

⁷⁴ For example, the United States Citizenship and Immigration Services (USCIS) E-Verify System verifies a foreign person's identity and status using its own, United States Department of State, and SSA data electronically. E-Verify now requires the foreign individual's passport number and the country of issuance. USCIS also administers a similar electronic Systematic Alien Verification for Entitlements (SAVE) program. SSA has a special arrangement for direct electronic access to state records (called SASPRO) such as those for human services (TANF/Medicaid/Food Stamps), wage, unemployment, vital statistics (birth/death records), and workers' compensation. The IRS should explore the availability of systems for electronic verification of documents submitted with ITIN applications.

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Foreign Students, Researchers, Trainees, and Exchange Visitors

This group of taxpayers should be able to file W-7 applications throughout the year for themselves, their spouses, and dependents by attaching copies of identity and foreign status documents certified by a SEVP-approved school or organization. The National Taxpayer Advocate is pleased with the collaboration between TAS and the IRS on this issue. On October 2, 2012, in response to the National Taxpayer Advocate's and stakeholders' concerns, the IRS stated that taxpayers with a SEVIS record can submit copies of their documents proving identity and foreign status when certified by a SEVP-designated official.⁷⁵ However, ITIN applications from these taxpayers must still accompany a paper return unless they meet an exception.⁷⁶ Because these taxpayers pose little or no risk of using ITINs for a non-tax purpose, they should be allowed to apply for and obtain ITINs throughout the year, in advance of the filing season. This would allow them to file electronically and therefore significantly reduce their burden. It would also enable their returns to run through the IRS's regular refund fraud detection procedures, further mitigating risk of tax fraud.

Alien Taxpayers Submitting Copies of Public Documents Certified by an Apostille.

As a signatory to the Hague Convention, the United States agreed to recognize public (including notarized) documents issued by other signatory countries if those public documents are authenticated by the attachment of an internationally recognized form of authentication known as an apostille.⁷⁷ The apostille procedure allows public documents issued in one signatory country to be recognized as valid in another.⁷⁸ Apostilles may be issued only by a designated Competent Authority of a signatory country. Each Competent Authority is required to keep a register of apostilles it has issued that *any* interested person can access as an essential tool to combat fraud and verify the origin of an apostille in case of doubt.⁷⁹

In January 2012, the Hague Conference on Private International Law (HCCH) and the National Notary Association of the United States of America (NNA) officially adopted the electronic Apostille Program (e-APP), a secure software that provides for the issuance of electronic apostilles (e-Apostilles) and verification of paper and electronic apostilles (e-Registers).⁸⁰ The e-APP (the e-Apostille and/or e-Register component) has been implemented in at least 14 countries, including the United States and Mexico, with other countries actively pursuing or considering implementation.⁸¹ The IRS should immediately rescind

⁷⁵ IRS, *IRS Clarifies Temporary ITIN Application Requirements for Noncitizens with Tax Extensions and Many Foreign Students* (Oct. 2, 2012).

⁷⁶ See Instructions for Form W-7, *Application for IRS Individual Taxpayer Identification Number* (Jan. 2012).

⁷⁷ Hague Conference on Private International Law (HCCH), Outline, *Hague Apostille Convention available at* http://www.hcch.net/index_en.php?act=publications.details&pid=3121&dtid=2 (last visited on Sept. 24, 2012).

⁷⁸ The main examples of public documents for which apostilles are issued in practice include birth, marriage and death certificates; extracts from commercial registries and other registers; patents; court rulings; notarial acts and notarial attestations of signatures; and academic diplomas issued by public institutions. HCCH, Outline, *Hague Apostille Convention*.

⁷⁹ *Id.*

⁸⁰ An e-Register under the e-APP allows for easy online verification that a presented Apostille has really been issued by the Competent Authority. HCCH, *Operational E-Registers by State, available at* http://www.hcch.net/index_en.php?act=text.display&tid=146 (last visited Sept. 24, 2012). HCCH and NNA successfully piloted the program since April 2006.

⁸¹ HCCH, *Operational E-Registers by State, available at* http://www.hcch.net/index_en.php?act=text.display&tid=146 (last visited Sept. 24, 2012).

its ITIN policy change, which effectively denies recognition of copies of public documents certified by an apostille (and violates the U.S. obligations under the Hague Convention), and find a way to routinely verify the validity of apostilles. With the majority of ITIN applications submitted by Mexican nationals, the IRS may be interested in developing an electronic tool to systemically verify the validity of Mexican apostilles through the e-APP process.⁸²

Proper Oversight of the Certified Acceptance Agent Program Would Ensure the Validity of Foreign Documents and Alleviate Burden for ITIN Applicants.

According to Treasury Regulations and the controlling revenue procedure, other federal agencies, financial institutions, colleges and universities, and other authorized persons (including foreign persons) can certify copies of documents for ITIN applications.⁸³ As stated above, on June 22, 2012, the IRS stopped accepting copies of documents certified by CAAs, reacting to evidence of fraud by several “bad actors” identified in the TIGTA report.⁸⁴ Many stakeholders complained that instead of taking a timely enforcement action against unscrupulous CAAs, the IRS essentially ended the CAA program, creating undue burdens for honest taxpayers and compliant CAAs.⁸⁵

The following persons, if authorized as CAAs, pose little or no risk for the integrity of the ITIN program:

- Colleges and universities (as described above);
- Other federal agencies, *e.g.*, the Social Security Administration or the United States Postal Service (which currently accepts U.S. passport applications);
- Financial institutions (broadly defined to include securities dealers, money services businesses, telegraph companies, etc.) that are required by law to verify and record the identity (name and address) and the TIN of the customer, *e.g.*, the passport number and the country of issuance for a foreign national;⁸⁶
- Low Income Taxpayer Clinics;⁸⁷
- Volunteer Income Tax Assistance sites that provide free services and lack a financial incentive to commit or aid and abet fraud;

⁸² About 72 percent of all ITIN applications came from nationals of Mexico in PY 2012. IRS response to TAS information request (Sept. 27, 2012).

⁸³ Treas. Reg. § 301.6109-1(d)(3)(iv)(B); Rev. Proc. 2006-10, 2006-1 C.B. 293, § 4.02(1).

⁸⁴ TIGTA, Ref. No. 2012-42-081, *Substantial Changes Are Needed to the Individual Taxpayer Identification Number Program to Detect Fraudulent Applications* (July 2012).

⁸⁵ See, *e.g.*, NCTC letter to the IRS Commissioner (Aug. 20, 2012); IRS and TAS teleconference with the members of the NCTC (Aug. 23, 2012).

⁸⁶ See *generally* Bank Secrecy Act, 31 U.S.C. §§ 5311-5314, 5316-5322; 12 U.S.C. § 1829(b); USA PATRIOT ACT, § 326, Pub. L. No. 107-56, 115 Stat. 307 (2001); 31 C.F.R. §§ 1010.410, 1010.620, 1022.400. See also IRM 4.26.5.6 and IRM 4.26.5.6.1 (Oct. 3, 2012) (these requirements apply for a funds transmittal of \$3,000 or more, and for any bank transaction over \$100).

⁸⁷ IRC § 7526; IRM 21.3.4.21.1 (Oct. 1, 2008). LITCs receive federal funding to provide education and outreach on the rights and responsibilities of U.S. taxpayers to individuals who speak English as a second language (ESL) and provide free or nominal fee legal assistance to low income taxpayers in resolving controversies with the IRS.

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- Attorneys and Certified Public Accountants (CPAs) who are governed by their state licensing authorities and bound by ethical standards;⁸⁸
- Enrolled Agents;⁸⁹ and
- Certain state government agencies, *e.g.*, Departments of Motor Vehicles, Departments of Social Services, and Boards of Education that have substantial experience in verifying the foreign persons' identity for state purposes.⁹⁰

The ITIN program office (IPO) does not provide accurate or timely information to CAAs.⁹¹ For example, in June 2009, IPO provided inaccurate information about CTC eligibility to CAAs on at least one occasion. In an IPO newsletter, CAAs were informed that the definition of qualifying child could also include "...other eligible person who lived with you all year as a member of your household."⁹² Apparently, IPO paraphrased the qualifying relative relationship test and erroneously added it to the qualifying child relationship test in the context of explaining who could claim the child tax credit.⁹³ Even though a CAA pointed out the error, the IPO did not print a correction.⁹⁴

The IRS should significantly revamp its CAA program to provide accurate and periodic training to CAAs, require all CAAs to take an annual competency examination like the return preparation exam administered to VITA volunteers, and require a due diligence statement regarding the accuracy of the ITIN application as well as any claims for the dependency exemption and CTC similar to IRS Form 8867, *Paid Preparer's Earned Income Credit Checklist*.⁹⁵ The IRS should also expand the program to include attorneys, CPAs, LITCs, VITA sites, and state government agencies. The program also would benefit from a process for electronic verification of CAA certifications where possible, and increased enforcement efforts against "bad actors."

CONCLUSION

Regardless of a taxpayer's immigration status or country of origin or residence, an efficient and equitable tax system does not distinguish between alien and other taxpayers with respect to taxpayer protection or customer service. The IRS should use a proactive approach to the ITIN application process, facilitating voluntary compliance and taking timely

⁸⁸ These tax professionals are also subject to Circular 230 rules and the jurisdiction of the IRS Office of Professional Responsibility. It is highly unlikely that they will actively pursue ITIN application fraud.

⁸⁹ An enrolled agent is a person who has earned the privilege of representing taxpayers before the IRS by either passing a three-part comprehensive IRS test covering individual and business tax returns, or through experience as a former IRS employee. See Treasury Department Circular No. 230, §§ 10.4-10.6, 31 C.F.R. §§ 10.4-10.6.

⁹⁰ Certification of documents by state school boards may be particularly useful for verification of eligibility for a dependency exemption and CTC.

⁹¹ The IRS does not provide periodic trainings to CAAs.

⁹² IPO News 7 (June 2009).

⁹³ See IRC § 152 (d)(2)(H).

⁹⁴ Email from LITC Director to TAS (Oct. 3, 2012).

⁹⁵ IRC § 6695(g) imposes a \$500 penalty for the failure to comply with the EITC due diligence requirements. While the IRS may require CAAs to provide a due diligence checklist, it cannot impose penalties absent legislative change.

enforcement actions against perpetrators of fraud. While the National Taxpayer Advocate is pleased that the IRS now actively collaborates with TAS on ITIN issues, the IRS should consider inside and outside stakeholders' perspectives *before* significantly changing ITIN application procedures. Instead of employing a one-size-fits-all approach that harms future compliance by ITIN taxpayers, the IRS should specifically address refundable credit issues and CAA schemes identified in the TIGTA report.

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Immediately rescind the June 22, 2012 requirement that ITIN applicants submit only original documents or documents certified by the issuing agency.
2. Accept copies of documents certified by an apostille in conformance with the U.S. obligations under the Hague Convention.
3. Accept copies of original documents certified by a SEVP-approved institution or an LITC.
4. Improve oversight of the CAA program, including periodic trainings to CAAs, an annual competency examination similar to the exam for VITA volunteers, and a requirement to provide a due diligence statement regarding the accuracy of the ITIN application, dependency exemption, and CTC claims, similar to EITC due diligence requirements.
5. Expand the CAA program to include attorneys, CPAs, LITCs, VITA sites, enrolled agents, and federal and state government agencies that have substantial experience in verifying foreign persons' identities.
6. Allow filing of ITIN applications throughout the taxable year with proof of taxable income and a filing need.
7. Develop a process to retire ITINs that are no longer used for tax purposes; for example, in situations when the taxpayer leaves the country (as would a student) or receives an SSN, after communicating with the taxpayer.
8. Require ITIN employees to contact the ITIN applicant if a document is returned as undeliverable.
9. Amend the Form W-7 to allow applicants to provide alternative contact information of a third party designee for limited Form W-7 processing questions, similar to a field on a tax return.
10. Return the original documents by trackable mail service, such as certified, registered, or priority mail, and allow applicants who need their documents back faster an option to include a prepaid Express Mail or courier envelope.
11. Invest in modernization of the ITIN operation, including an update of the RTS software to include the document number and the country of issuance of a foreign document, a process for scanning and barcoding submitted documentation, and electronic

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verification of documents with federal, state, and foreign (if possible) government databases and CAAs.

IRS COMMENTS

The IRS issued interim changes on June 22, 2012 to strengthen the procedures for issuing ITINs. Designed specifically for tax administration purposes, ITINs are only issued to people who are not eligible to obtain a Social Security number. After careful consideration, the IRS implemented these changes to protect the integrity of the application process while minimizing burden for applicants.

During the interim period, the IRS only issued ITINs when applications included original documentation, such as passports and birth certificates, or certified copies of these documents from the issuing agency. ITINs were not issued based on applications supported by notarized copies of documents. In addition, ITINs were not issued based on applications submitted through certifying acceptance agents unless they attached original documentation or copies of original documents certified by the issuing agency.

Some categories of applicants were not impacted by the interim changes including military spouses/dependents and nonresident aliens applying for ITINs for the purpose of claiming tax treaty benefits. The IRS also established exceptions to the interim procedures for certain types of applicants. On October 2, 2012, the IRS announced special instructions for the Student and Exchange Visitor Program (SEVP) and non-citizens with approved TY 2011 extensions. The original document requirement did not apply to these groups of taxpayers.

During the summer and fall of 2012, the IRS gathered feedback from stakeholders and interested groups on how to best safeguard the integrity of the ITIN program and improve applicant procedures.

Based on an extensive review of the ITIN application process along with feedback gathered from a variety of stakeholders, the IRS developed procedures for the 2013 filing season that will strengthen controls over the ITIN process. The IRS is also continuing this dialogue as we move forward in implementing these procedures. The IRS will maintain its new and stronger standard for issuing ITINs. ITIN applications will require original documentation, such as passports, birth certificates, or certified copies of these documents from the issuing agency. In addition, the IRS finalized its earlier decision of no longer accepting notarized copies of documents for ITINs to protect the integrity of the application process. The IRS recognizes the burden this may cause taxpayers and has identified exceptions and alternate methods to secure an ITIN without sending original documentation to the IRS. Though many of the interim guidelines from the summer were made permanent, others were modified based on feedback from key stakeholders. The changes will provide additional flexibility for people seeking ITINs while maintaining the stronger protection measures.

The IRS acknowledges there may be some additional burden with the IRS's policy change to require applicants to submit only original documents or documents certified by the issuing agency. The IRS is taking steps to relieve taxpayer burden while maintaining the integrity of the ITIN process. In addition to direct submission of documents to the IRS ITIN centralized site or use of Certifying Acceptance Agents, ITIN applicants will have several other avenues for verification of their documents. These options include providing full-service assistance for primary and dependent taxpayers at some key IRS Taxpayer Assistance Centers and our U.S. Tax Attachés in London, Paris, Beijing, and Frankfurt. In addition, Certifying Acceptance Agents, including those at the Low Income Taxpayer Clinics (LITCs) and Volunteer Income Tax Assistance (VITA) centers, may certify the original documentation of primary and secondary taxpayers. We have also retained the exception announced on October 2, 2012 for foreign students at educational institutions to be certified through the SEVP.

The Most Serious Problem suggests that the IRS is in violation of the Hague convention by requiring original documents. The IRS disagrees with this assertion. If the IRS generally accepted notarized copies of documents, then the IRS would be bound to accept notarized apostille copies from international sources under the Hague convention. Since the IRS no longer accepts notarized copies of documents, there is no requirement to accept apostille copies from international sources under the Hague convention.

Certified Acceptance Agents are an important intermediary in the ITIN application process. For processing year 2013, CAAs will be able to review original or certified copies from the issuing agency of identification documents from applicants and certify to the IRS that they verified the authenticity of the documents supporting the ITIN application. These face-to-face interviews of the primary and secondary applicants will help improve the integrity of the program while minimizing burden for applicants. ITIN applications for dependents submitted to the IRS by CAAs will continue to require original documents or copies certified by the issuing agency.

The application process for CAAs and AAs remains unchanged; however, there are new eligibility requirements for CAAs. The acceptance agent must be a U.S. or foreign person covered under Circular 230, and not under suspension or disbarment from practice before the IRS. This will include individuals who are attorneys admitted to the practice before the bar, Certified Public Accountants (CPA), Enrolled Agent (EA) and registered tax return preparers. The IRS recognizes that there are unique situations where it is not necessary to require a person to meet the Circular 230 eligibility requirements. IRS has granted exceptions to approved financial institutions, colleges, and universities, gaming industry, LITCs, and VITA centers.

As part of the application process, CAAs are required to complete an online course. Additionally, CAAs are required to successfully complete a forensic document identification training course. The IRS will increase compliance reviews using risk-based selection

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criteria. Infractions are identified and classified as minor and major. Stricter penalties will apply to major infractions, and CAAs will be removed from the program for one year.

The IRS recognizes there is a need to keep tighter control over ITINs to prevent misuse of the numbers once assigned. Changes were made to ensure they are being used for legitimate tax purposes. A key change is that, for the first time, new ITINs will expire after five years. Taxpayers who still need an ITIN will be able to reapply at the end of the expiration period. This step will provide additional safeguards to the ITIN program to help ensure only people with legitimate tax purposes are using the numbers. In addition, the IRS will explore options, through engagement with interested stakeholder groups, for deactivating or refreshing the information relating to previously issued ITINs. The IRS agrees with the recommendation of the National Taxpayer Advocate that the IRS should develop a process to retire ITINs that are no longer used for tax purposes.

In addition to changes in the ITIN program, there will be further compliance checks on claims for credits including the Additional Child Tax Credit. For PY 2013, there will be a requirement to attach Form 8812, *Additional Child Tax Credit*, to the Form 1040 tax return. The Form 8812 will include statements about the residency of dependent children with ITINs. The IRS is also adding pre-refund compliance checks based on referrals from the ITIN employees and additional filters to identify fraud. There are steps in place during tax return processing to identify fraud, such as “funny box” procedures, the Electronic Fraud Detection System (EFDS), Accounts Management Taxpayer Assurance Program (AMTAP), and Dependent Database (DDb) filters. The IRS efforts to prevent fraud and ID theft within the ITIN program are balanced with the accessibility of an obtaining an ITIN for those taxpayers filing tax returns.

With respect to the recommendation that the IRS allow filing of ITIN applications throughout the taxable year with proof of taxable income and a filing need, the IRS position remains unchanged. As mentioned in response to Most Serious Problem #8 in the 2010 Annual Report, the procedure of requiring a valid tax return with the Form W-7 application was designed to ensure that the ITIN assigned is used for its proper tax administration purpose. Associating the issuance of the ITIN with the filing of a tax return is still the only reliable method for the IRS to verify the number is being requested and properly used for tax administration purposes. As a result, ITINs are no longer issued solely based upon a statement that an applicant requires an ITIN in order to file a return without proof that the individual in fact needs the number to do so.

The IRS plans to make improvements in the following three areas noted in the draft Most Serious Problem: 1) making telephone contact with ITIN applicants, 2) returning documents by other than regular mail and 3) upgrading the RTS system. These are detailed more specifically in the following paragraphs.

With respect to the recommendation that ITIN employees contact the ITIN applicant if a document is returned undeliverable, the IRS agrees to do a study on undelivered ITIN

mail. Under consideration is a procedure requiring ITIN Tax Examiners to research the Integrated Data Retrieval System (IDRS) for a good mailing address. If none is found, the employee will send an email to the Entity function in Austin with the taxpayer's telephone number. An Entity employee will then call the taxpayer to identify a good mailing address. The study will track how many applications do not have telephone numbers and the successful and unsuccessful attempts by the Entity to reach the taxpayer by telephone. At the end of six months, the IRS will evaluate the results and determine whether to continue the procedure.

The IRS appreciates the recommendation of the National Taxpayer Advocate regarding the use of certified, registered, or priority mail to return original documents. The Form W-7 instructions will be updated with a note that applicants are permitted to include a prepaid Express Mail or courier envelope for faster return delivery of their documents. The IRS would then return the documents in the envelope provided by the taxpayer. This option will permit applicants to obtain an expedited level of mail service provided they are willing to bear the associated cost.

The National Taxpayer Advocate has also recommended that the IRS invest in modernization of the ITIN operation, including an update of the RTS software. The RTS is a web-based application designed as an inventory system. It currently captures the document number and country of issuance of documents submitted with Form W-7. The IRS agrees to evaluate the feasibility of an automated process to scan and electronically verify documents. If feasible, the IRS will take the necessary steps to request the required system architecture. System upgrades and enhancements are subject to funding and resource prioritization processes.

The IRS will continue to elevate the feedback of National Taxpayer Advocate, as well as all other stakeholders, as we determine if additional program improvements are needed in the future.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate is pleased that the IRS has acknowledged the burden imposed on ITIN applicants by the interim ITIN application rules. We applaud the IRS's efforts to increase and improve its compliance checks on questionable claims for tax credits, including the Additional Child Tax Credit, recognizing that these return issues are separate and distinct from the application for the ITIN. We also appreciate the IRS's efforts to strengthen and improve the oversight of the Certifying Acceptance Agent program, including the requirement (with exceptions) for the CAA to be a regulated Circular 230 practitioner, to complete an online course, and to complete forensic training. Nonetheless, we encourage the IRS to provide periodic training to CAAs and develop and administer an annual competency examination for these agents.

The National Taxpayer Advocate remains concerned about the disproportionate burden imposed on families with dependents applying for ITINs. The new permanent ITIN rules issued on November 30, 2012 provide limited alternatives to the requirement to submit either original documents or copies certified by the issuing agency to the ITIN processing operation in Austin.⁹⁶ While the IRS has allowed CAAs to certify primary and secondary ITIN applicants' documents after an in-person appearance by the applicant, this option is not available for dependent applicants, as CAAs must collect and mail originals or copies certified by the issuing agency. For dependents, the only alternative to mailing original documents is to appear at "participating IRS Taxpayer Assistance Centers (TACs)," which are only authorized to certify copies of passports or national identification cards.⁹⁷ This is impossible for taxpayers with dependents residing abroad, while taxpayers in the United States with young children may be required to travel extensively if there is no TAC in their area.⁹⁸ In addition, many TACs require a valid U.S.-issued ID just to enter the building, which makes this option unavailable for many.⁹⁹ For taxpayers with dependents residing abroad, whose only option for presenting original documents in person is to appear at one of four U.S. tax attaché offices, there is simply no alternative but to mail documents to the IRS.

As discussed above, the requirement to submit original documents or copies certified by the issuing agency imposes a significant burden on families with dependents, who now comprise more than two thirds of all ITIN applicants, while at the same time reducing

⁹⁶ IRS, *IRS Strengthens Integrity of ITIN System; Revised Application Procedures in Effect for Upcoming Filing Season*, IR-2012-98 (Nov. 29, 2012).

⁹⁷ See IRS, *ITIN Policy Change Summary for 2013*, available at <http://www.irs.gov/Individuals/ITIN-Policy-Change-Summary-for-2013>. (last visited Dec. 7, 2012).

⁹⁸ See Most Serious Problem: *The IRS Lacks a Servicewide Strategy That Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*, *infra*.

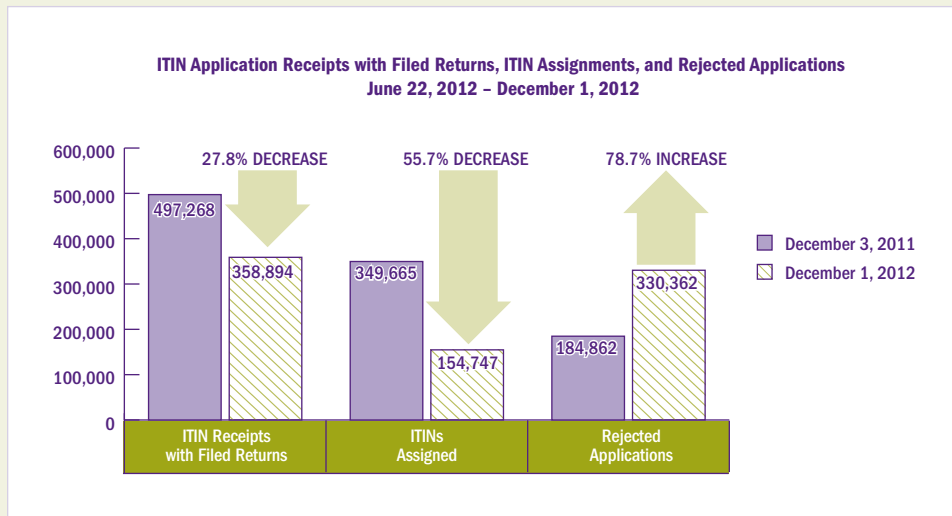
⁹⁹ Representatives of Low Income Taxpayer Clinics raised concerns about the requirement of many TACs or federal buildings in which some TACs are located to produce a valid, U.S.-issued ID to enter the building. 2013 Annual Low Income Taxpayer Clinic Grantee Conference, *Recent Developments in IRS Policies and Procedures Related to ITIN Applications*, panel discussion (Dec. 6, 2012).

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filing compliance.¹⁰⁰ Because of these new permanent rules, many dependents cannot travel with their families, as they wait more than two months — according to the IRS's own estimates — for the IRS to return their passports. As Figure 1.9.5 below shows, the volume of ITIN applications submitted with tax returns and the number of assigned ITINs substantially decreased from June 22, 2012, when the IRS announced the policy change, through December 1, 2012, compared to the same period in processing year 2011.¹⁰¹ At the same time, the number of rejected applications increased significantly.

FIGURE 1.9.5, ITIN Application Receipts, Assignments, and Rejects



The IRS needs a workable solution that will not burden applicants or hinder filing compliance. One such option would be to allow CAAs, U.S. embassies and consulates, federal and state government agencies, and U.S. financial institutions to certify copies of a dependent's foreign documents by verifying that the original documents are authentic and the copies are exact copies of the originals. The CAA could send in the certified copies and allow the taxpayer to retain the original documents.

In addition, the IRS could accept copies of foreign documents certified by an apostille. The IRS does not acknowledge its responsibility to accept apostilles as valid certifications of original documents under the Hague Convention, rationalizing that the apostille is a mere notarization. This interpretation is both inaccurate and unproductive for the IRS's own purposes, because it ignores the definition and purpose of the apostille as a state certification of authenticity.¹⁰² We submit that the state that issued the document is in the best

¹⁰⁰ IRS response to TAS information request (Sept. 28, 2012). As of mid-2012, of the 906,848 total ITINs assigned, 614,714 were issued to dependents.

¹⁰¹ IRS, Real-Time System (RTS) reports (Dec. 1, 2012).

¹⁰² See Hague Apostille Convention; see also HCCH, *The ABCs of Apostilles, How to Ensure That Your Public Documents Will be Recognized Abroad*, Q&A 10, available at <http://www.hcch.net/upload/abc12e.pdf> (last visited Dec. 7, 2012).

position to authenticate its validity. The validity of an apostille can be easily verified by *any* interested person by accessing the apostille register maintained by a competent authority of each signatory country. Thus we recommend that the IRS reconsider its responsibilities regarding apostilles under the Hague Convention.¹⁰³

While the National Taxpayer Advocate is pleased by the IRS's commitment to develop a process to retire ITINs not used for tax purposes, she is disappointed with the IRS's refusal to accept and process ITIN applications throughout a taxable year with proof of earned income. In addition to the automatic five-year expiration rule for newly assigned ITINs, the IRS should be able, after communicating with the taxpayer, to retire numbers that are no longer used for tax purposes, for example, where the taxpayer leaves the country (as would a student) or receives an SSN. If the IRS can deactivate an ITIN not used for a valid tax administration purpose, it has no basis for requiring concurrent filing of paper tax returns with paper ITIN applications.

More importantly, the IRS mischaracterizes the National Taxpayer Advocate's position with respect to accepting ITIN applications throughout the year. The National Taxpayer Advocate is not recommending that the IRS issue ITINs "solely based upon a statement that an applicant requires an ITIN in order to file a return without proof that the individual in fact needs the number to do so." Rather, the National Taxpayer Advocate has consistently recommended that the IRS allow taxpayers to submit ITIN applications throughout the year so long as they are accompanied by proof that the taxpayer has a filing requirement.¹⁰⁴ This proof can consist of multiple paystubs showing withholdings, an employment agreement, or other such documents. The IRS's refusal to eliminate procedures that create a bottleneck and prevent e-filing is also inconsistent with the IRS's own plans to consider the Form W-7 as a "candidate" for electronic filing.¹⁰⁵ The IRS should reconsider its position and allow filing of ITIN applications throughout the taxable year with proof of taxable income and a filing need. We note that when ITIN returns are e-filed, they pass through IRS screens for identity theft and fraud protection. Thus, under our recommendation there would be no need for manual work-arounds.

We commend the IRS for initiating a study of undelivered mail to ITIN applicants and for its plans to revise procedures for telephone contact with applicants and return of documents by trackable mail service. We are also pleased that the IRS plans to enhance the RTS system, including an automated process to scan and electronically verify documents. We are looking forward to the IRS establishing a timeline for these changes. The IRS should

¹⁰³ HCCH, Outline, Hague Apostille Convention.

¹⁰⁴ See e.g., National Taxpayer Advocate 2010 Annual Report to Congress 334, National Taxpayer Advocate 2008 Annual Report to Congress 140, National Taxpayer Advocate 2004 Annual Report to Congress 162, Taxpayer Advocate Directive (TAD) 2009-1 (Processing of Forms W-7/Filing of ITIN Applications and Associated Tax Returns) (Feb. 25, 2009).

¹⁰⁵ See IRS Comments to the Most Serious Problem: *Challenges Persist for International Taxpayers as the IRS Moves Slowly to Address Their Needs* (stating "Forms 1040NR, U.S Nonresident Alien Income Tax Return, and W-7, Application for IRS Individual Taxpayer Identification Number, have been identified as candidate forms for electronic filing"), *infra/supra*.

not limit its provision of verifiable document returns to situations where taxpayers provide prepaid courier envelopes. It should return all documents via trackable mail service such as certified, registered, or priority mail. The IRS also should revise Form W-7 to include a field for contact information of a third party for limited processing questions, similar to a field on a tax return, and a PTIN of the paid preparer (if any).

Recommendations

The National Taxpayer Advocate recommends that the IRS:

1. Permit CAAs, federal and state government agencies, and U.S. financial institutions to certify identity documents for dependent ITIN applicants, similar to current rules for CAA certification of documents for primary and secondary taxpayers.
2. Accept copies of documents certified by an apostille in conformance with the U.S. obligations under the Hague Convention.
3. Improve oversight of the CAA program, including periodic trainings to CAAs and an annual competency examination.
4. Allow filing of ITIN applications throughout the taxable year with proof of taxable income and a filing need.
5. In addition to the automatic five-year expiration rule for newly assigned ITINs, develop a process to retire ITINs that are no longer used for tax purposes, for example, where the taxpayer leaves the country (as would a student) or receives an SSN, after communicating with the taxpayer.
6. Require ITIN employees to contact the ITIN applicant if a document is returned as undeliverable.
7. Amend Form W-7 to allow applicants to provide contact information for a third party for limited Form W-7 processing questions, similar to a field on a tax return.
8. Return original documents by trackable mail service, such as certified, registered, or priority mail.
9. Modernize the ITIN operation, including an update of the RTS software to include the document number and country of issuance of a foreign document, a process for scanning and barcoding submitted documentation, and electronic verification of documents with federal, state, and foreign (if possible) government databases and CAAs.