

GENERAL REPORT
OF THE
INTERNAL REVENUE SERVICE ADVISORY COUNCIL

The Internal Revenue Service Advisory Council (the “IRSAC”), the successor to the Commissioner’s Advisory Group established in 1953, serves as an advisory body to the Commissioner of Internal Revenue. The purpose of the IRSAC is to provide an organized public forum for Internal Revenue Service (the “IRS”) officials and representatives of the public to discuss relevant tax administration issues. The IRSAC reviews existing tax policy and recommends policies regarding both existing and emerging tax administration issues. In addition, the IRSAC suggests operational improvements, conveys the public’s perception of professional standards and best practices for tax professionals and IRS activities, offers constructive observations regarding current or proposed IRS policies, programs, and procedures, and advises the Commissioner and senior IRS executives on substantive tax administration issues.

The IRSAC has 24 members with substantial, disparate experience and diverse backgrounds. The members represent large and small firms from urban and rural settings across all regions of the United States. Members include representatives from the taxpaying public, educators, the tax professional and appraisal community, volunteer income tax community, as well as small and large businesses. In addition to representing different industries and geographic regions of the United States, members also represent several occupations that interact with the IRS in a variety of ways. Current members include accountants, lawyers, enrolled agents, and academics. Each member has a unique

tax policy perspective and is committed to providing meaningful input and feedback to the IRS.

The IRSAC is organized into four subgroups - the Wage and Investment (W&I) Subgroup, the Small Business/Self-Employed (SBSE) Subgroup, the Large Business and International (LB&I) Subgroup, and the Office of Professional Responsibility (OPR) Subgroup. The members recognize the invaluable assistance, dedication and support provided by personnel from the IRS Office of National Public Liaison (NPL) and the operating divisions - Candice Cromling, Director, NPL; Carl Medley, Chief, Liaison Advisory Groups, NPL; Lorenza Wilds, IRSAC Program Manager, NPL; Rose J. Smith, NPL; Anna Millikan, NPL; Maria Jaramillo, NPL; Brian Ward, NPL; Johnnie Beale, W&I; Tonjua Menefee, SB/SE; and Kate Gregg, LB&I. The IRSAC appreciates the invaluable assistance provided by the IRS executives and support personnel throughout the year. We also thank you for the discussions and dialogue that each subgroup held on current and emerging tax policy and procedural issues. The IRSAC members were honored and privileged for the opportunity to be able to work with each of these truly remarkable individuals! Their dedicated service to the IRSAC and IRS should be recognized as truly exemplary.

Issues selected for inclusion in the annual report represent those to which IRSAC members have devoted particular attention during four working sessions and numerous conference calls throughout the year. The issues included in the IRSAC annual report are issues that members consider especially important and include issues that IRS personnel brought to our attention. Nearly all issues involved extensive research efforts.

We acknowledge the many challenges that the IRS has recently experienced and, knowing the demands of the IRS executives and operating division representatives, we sincerely appreciate the time and effort extended to the IRSAC during the year.

The 2012 W&I Subgroup, chaired by Ann Esarco, prepared the attached report that reviews and provides recommendations for: enhancing the promotion of educational opportunities available to practitioners regarding the Earned Income Tax Credit; increasing e-filing of employment tax returns; creating a better awareness of e-services to practitioners; and suggesting formatting and definitional changes to Forms 1099-B and 8949.

The 2012 LB&I Subgroup, chaired by Aameek A. Ponda, prepared the attached report which provides recommendations for streamlining the audit process; focusing audit resources on areas with a permanent tax impact; and developing knowledge management of the newly created Issue Practice Groups and International Practice Networks.

The 2012 SBSE Subgroup, chaired by Madeleine Townes, prepared the attached report that reviews and provides recommendations for reducing taxpayer burden by allowing for efficient Forms 1099 & W-2 corrections; raising awareness of tax filing requirements and outreach to non-filers; and providing illustrations on ways to improve and promote the increased use of technology by the IRS for the benefit of the IRS and the taxpayer.

The 2012 OPR Subgroup, chaired by Charles J. Muller, prepared the attached report that reviews and provides recommendations for the publishing of additional guidance respecting a tax practitioner's ethical and professional obligations under Circular 230; and promulgating proposed amendments to Circular 230 which further

define the competency standard and provide expedited suspension procedures for practitioners who persist in a pattern of willfully failing to file federal tax returns.

The IRSAC also desires to make the point that the IRS must receive consistent, adequate, and appropriate funding to achieve the proper administrative balance between service, compliance, and tax enforcement. With the ever-increasing list of responsibilities, and most notably the implementation and administration of the Affordable Care Act, taxpayers and the tax system will suffer without appropriate levels of funding by Congress.

The following discussion point was not assigned to a specific IRSAC subgroup but is being presented due to its importance throughout our system of tax administration.

**ISSUE: THE IRS MUST CONTINUE TO COMBAT REFUND FRAUD AND
IDENTITY THEFT WHILE CONTINUING TO BALANCE COMPLIANCE AND
TAX ENFORCEMENT**

Executive Summary

The IRS must continue to diligently look for ways to combat identity theft which leads to tax fraud. The IRSAC commends the IRS on its two-pronged effort, but is concerned that both taxpayers and the tax system will suffer if appropriate measures are not taken quickly and effectively to control this fraud.

Background

Identity thieves continue to become more proficient in devising schemes to steal identities in their attempt to file fraudulent refund claims. The thief uses stolen social security numbers to prepare fraudulent Form W-2s, file tax returns and obtain refunds based on the fraudulently prepared Forms W-2 and 1040, generally very early during the

filing season. Populations that have no tax filing requirements such as the elderly, children and the deceased are often the targets, making this particularly difficult to identify as an accurate return is often never required to be filed. Thieves may obtain jobs with hospitals, schools or nursing homes in order to acquire thousands of SSNs and market this information or use it themselves. Despite the fact that these thieves steal the information from sources outside of the tax system, the IRS is sometimes the first to inform an individual that identity theft has occurred, and in some cases the IRS and the individual are never aware of the fraud, leading to multiple years of fraudulent returns being filed.

The IRS has the goal of preventing identity theft and detecting refund fraud prior to its occurrence, as well as assisting taxpayers who are victims. A number of enhanced fraud protection processes for the 2012 filing season were implemented, including filters developed to stop suspect returns and contact the taxpayer before the return is processed, new tools to identify taxpayers with changed circumstances (e.g. a new job, a new bank account or debit card for the refund deposit), and enhanced use of the functionality of the Identity Protection Personal Identification Numbers (IP PINs). The IRS also developed procedures for handling taxpayer personal information that law enforcement officials discover in the course of investigating identity theft schemes or other criminal activity and is accelerating the matching of information returns to identify mismatches earlier.

In 2011, the IRS identified and prevented the issuance of over \$14 billion in fraudulent returns. Identity theft is a subset of this total. From 2008 through the middle of 2012, the IRS has identified more than 600,000 taxpayers who have been affected by identity theft. With respect to these taxpayers, during 2011 the IRS protected \$1.4 billion

in refunds from being erroneously sent to identity thieves. Through mid-April 2012, the IRS had stopped over 325,000 questionable returns with \$1.75 billion in claimed refunds using filters specifically targeting refund fraud.

IRSAC applauds the continued efforts to assist individuals who have been impacted by identity theft. The IP PIN program began as a pilot in 2010, and was expanded in 2011. Under this program, a six-digit number is assigned to many taxpayers who are identified as identity theft victims, and had their account issues resolved. In addition, the IRS has trained 35,000 public contact employees to be able to help taxpayers who are victims of identity theft to speed up their case resolution. Taxpayers can also self-report that they are victims before their tax accounts are affected by contacting the Identity Protection Specialized Unit.

Taxpayer outreach has continued with a new section on IRS.gov dedicated to identity theft matters, outreach to educate return preparers about the IP PIN and identity theft, as well as working with software developers on inclusion of the IP PIN on the tax form.

Recommendations

1. The IRS should strongly consider delaying refunds until after verification of the taxpayer's identity. For taxpayers that rely on an early refund in January, the IRS should consider a process under which 25 percent of the refund is issued prior to verification, and the remaining 75 percent issued after verification. The increased use of refund anticipation loans needs to be considered if refunds are delayed.
2. The IRS should continue to work with the banking industry to find and prosecute the perpetrators who use debit cards.

3. Authentication procedures should continue to be studied so that refunds can be processed more quickly for those taxpayers whose identity is authenticated. It may be possible to allow authentication to be made by a third party. Consideration should be given to requiring fingerprints or other unique identifiers that can be associated with the social security number on the income tax return as authentication. This could be done by local police or other approved groups and included by the taxpayer on the signature line of the return.
4. It may be possible to publicize the protections that the IRS has in place and the need to slow down refunds until information returns can be matched or verification can occur. This could be used in conjunction with requiring Form W-2s and Form 1099s to be filed with the IRS by January 31, the same date that forms are furnished to taxpayers. In addition, the IRS can publicize the importance of properly estimating taxes payable each year to avoid significant overpayments that may be delayed due to a verification process.
5. The IRS should consider continued expansion of the IP PIN for taxpayers who have had their identity stolen, and perhaps for all taxpayers who request refunds before verification. There also needs to be a method of connecting a child's identity to their parent's return to protect the child's SSN from identity theft.
6. The IRS needs to continue its Criminal Investigation Division work with and prosecution by the Justice Department, making results public so that the consequences of identity theft are understood by the public.

Identity theft is an ongoing issue, which the IRS must deal with in order to protect the tax system. With the landscape continuously changing, identity thieves continue to create

new ways of stealing personal information and using it for their gain. The IRS must continue to look for ways to improve its return processing to ensure potentially false returns are screened out at the earliest possible stages of processing. With the integrity of the tax system at stake and budgets struggling, it appears that the easiest way to combat identity theft tax fraud is to delay refunds until verification of identity can be made. While the cost of this will be taxpayer frustration with delayed refunds, the gains achieved by stopping fraudulent returns from being filed and fraudulent refunds from being issued far outweigh this frustration. By aggressively controlling this risk now, the integrity of the tax system will be less of a target in the future.

Conclusion

The IRSAC members are grateful for the opportunity to serve the Internal Revenue Service and taxpayers. It is readily apparent that the IRS is continually required to “do more with less” resources while operating in a complex, ever changing environment throughout the world. The IRS is to be highly commended for its historical and continued efforts, and vast accomplishments, on behalf of tax administration.