

**The Internal Revenue Service's Individual
Taxpayer Identification Number Program
Was Not Implemented in Accordance
with Internal Revenue Code Regulations**

September 1999

Reference Number: 094505

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

2a = Law Enforcement Criteria

2b = Law Enforcement Guideline(s)

2e = Law Enforcement Procedure(s)



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 28, 1999

MEMORANDUM FOR COMMISSIONER ROSSOTTI

A handwritten signature in cursive script that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Internal Revenue Service’s Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations

This report presents the results of the subject audit report. In summary, the Internal Revenue Service (IRS) Tax Identification Number (ITIN) program implementation was reviewed for conflicts with laws and regulations; impact on other IRS programs; and operational effectiveness. 2a, 2b, 2e----- Over 340,000 of the ITINs were issued to self-documented illegal aliens. Our concerns are whether: the information on illegal aliens should be shared with the Immigration and Naturalization Service; illegal aliens should be treated as residents for tax purposes; ITIN causes revenue protection issues; and, whether operational problems during the implementation were corrected.

Recommendations were made to: bring legal issues to the attention of the Joint Committee on Taxation for the Confidentiality of Tax Information Study; bring to your attention the taxation of illegal aliens; implement revenue protection controls; and correct operational conditions.

The IRS generally agrees with the report recommendations. The disclosure issue will be forwarded to the Joint Committee on Taxation. Likewise, the Assistant Commissioner (International) will discuss with you the taxation of illegal aliens as United States residents. However, the revenue protection actions are seen as needing legislative remedy. The Office of Audit disagrees that the IRS should not take any action on this recommendation. Subsequent to the issuance of the draft report, the

Office of Audit determined that there were 180,662 Tax Year 1997 Form 1040 returns filed with the ITIN as the identifying number.

The IRS needs to examine the overall Revenue Protection Strategy to ensure that returns with ITINs 2a, 2b, 2e-----
2a, 2b, 2e----- This could be done on a sample basis. The operational conditions are being addressed.

Management's comments have been incorporated into the report, where appropriate, and the full text of their comments is included as an appendix.

Copies of this report are also being sent to IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Parker Pearson, Acting Associate Inspector General for Audit (Small Business & Corporate Programs), at (202) 622-5955.

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**The Internal Revenue Service's Individual Taxpayer Identification Number Program
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Executive Summary

The Internal Revenue Service (IRS) made a policy decision to issue IRS Individual Taxpayer Identification Numbers (ITINs) to illegal aliens so tax filing obligations could be met. This IRS policy, to “legalize” illegal aliens, seems counter-productive to the Immigration and Naturalization Service (INS) mission to identify illegal aliens and prevent unlawful alien entry. The ITIN Program was designed to improve nonresident alien compliance with tax laws.

In 1994, the IRS conducted a study, based on the audit report entitled *Review of Nonresident Alien Information Documents* (Reference Number 041403, dated January 21, 1994), which showed significant compliance concerns with the \$80 billion annual nonresident alien United States (U.S.) investment income. The ITIN Program permanently assigns a U.S. Tax Identification Number (TIN) to nonresident aliens. Information documents, showing individual taxpayers as recipients of dividends, interest, and other income, can then be matched to tax returns.

Results

The IRS established ITIN regulations that require an alien person to provide sufficient documentation to prove both identity and foreign status. The ITIN Program, as implemented, 2a, 2b, 2e-----

2a, 2b, 2e----- We concluded that the majority of these persons were illegal aliens.

Illegal alien presence in the U.S. is a congressional concern. Legislation in the Welfare Reform Act and the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 requires:

- Curtailing and/or eliminating welfare benefits.
- Cooperating among federal, state and local governments on illegal alien identification.
- Increasing border patrols to prevent unlawful alien entry.

The ITIN Program adversely affects effective and efficient tax administration. Providing illegal aliens with valid TINs allows for certain tax advantages and increases the potential for fraud. Fraudulent or invalid dependent claims on tax returns provide additional tax deductions and access to certain tax credits. This will become an increasingly important factor with the addition of the child tax and education credits provided for in the

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Taxpayer Relief Act of 1997. The potential for fraud is further increased because of costly examination resources required to determine compliance. 2a, 2b, 2e-----
2a, 2b, 2e-----

The ITIN Program raises a range of concerns from tax policy to operational implementation.

Tax policy concerns include:

- Conflict between the IRS' disclosure policy, which does not provide for information sharing with the INS, and federal statutes requiring cooperation between federal agencies and the INS.
- Tax treatment of illegal aliens as residents, which allows tax benefits not available to nonresident aliens.

Operational concerns include:

- Management controls did not ensure effective implementation of the Internal Revenue Service's ITIN Program.
- 2a, 2b, 2e-----

- Ineffective returns processing controls for taxpayers affected by the ITIN Program requirement.

Summary of Recommendations

To address tax policy and operational issues, the IRS needs to request input from appropriate external authorities and take internal actions to determine whether:

- The ITIN Program disclosure policy is in conformance with current Immigration laws.
- The Privacy Act Notification should be included on the ITIN application form. The Privacy Act Notification provides the warning that information can be provided to the Department of Justice within the parameters of disclosure law.
- The Administration wants to continue affording illegal aliens tax treatment similar to legal resident aliens.

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- The role of the Acceptance Agent in facilitating the application process should be re-examined.
- Necessary information should be included in the ITIN database for future computer matching initiatives.

Management's Response: IRS management generally concurs with the recommendations in this report.

In response to Tax Policy Issues:

The IRS will request that the study groups for the Joint Committee on Taxation and the Secretary of the Treasury address the interrelationship of taxpayer confidentiality provisions under the Internal Revenue Code (IRC) with provisions of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.

A Privacy Act Notice will be added to the Application for IRS Individual Taxpayer Identification Number (Form W-7), and a determination will be made as to whether the Form W-7 will require a disclosure statement under the definition of an "individual federal income tax return form."

The Commissioner will be informed of the concern that certain illegal aliens may be receiving tax benefits under the IRC. Currently, the IRS does not have authority to act on the related recommendation.

In response to Operational Issues:

2a, 2b, 2e-----

2a, 2b, 2e----- Using information from the ITIN database, checks to measure compliance with the terms of Acceptance Agent Agreements will be initiated by the IRS Foreign Payments Branch.

A Request for Information Services will be prepared and submitted to request updates to the ITIN database screen display to permit the display of cross-reference information.

Management's complete response to the draft report is included in Appendix IX.

Office of Audit Comment: 2a, 2b, 2e-----
2a, 2b, 2e-----

2a, 2b The IRS needs to examine the overall Revenue Protection Strategy to ensure that returns with ITINs 2a, 2b, 2e-----

2a, 2b, 2e----- This could be conducted on a sample basis. Subsequent to the issuance of the draft report, the Office of Audit determined that there were 180,662 Tax Year 1997 Form 1040 returns filed with the ITIN as the identifying number.

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Objective and Scope

The objective of the audit was to evaluate the implementation of the ITIN Program.

The objective of this review was to determine whether the Internal Revenue Service (IRS) effectively and timely implemented the Individual Taxpayer Identification Number (ITIN) Program. This implementation included processing applications for ITINs and individual income tax returns filed with ITINs.

The review was conducted in the Offices of the Assistant Commissioner (International), (Submission Processing), and (Customer Service). Audit work was also conducted in the Philadelphia Service Center (PSC) with support from the Fresno Service Center (FSC). Collateral support was received from other service centers as needed.

The audit was conducted from July 1996 through March 1998. The delay in issuance of this report was due to the management response being delayed until March 17, 1999, and our subsequent efforts to ensure the final report continued to be relevant. Appendix I contains the detailed objective, scope, and methodology for our review. Appendix II contains a listing of major contributors to this report.

Background

IRC Section 6109 Regulations require submission of the Form W-7 for individuals to obtain ITINs.

Internal Revenue Code (IRC) Section 6109 Regulations provide for the ITIN. Effective for tax returns filed after December 31, 1996, foreign individuals are required to furnish either a Social Security Number (SSN) or an ITIN. Foreign individuals, not eligible for a SSN, should use the ITIN.

The IRS expected 1.25 million Forms W-7 to be filed.

Foreign individuals, their spouses and dependents apply for the ITIN using the Application for IRS Individual Taxpayer Identification Number (Form W-7). The IRS began processing Forms W-7 in July 1996. The IRS estimated that by September 30, 1997, 1.25 million applications would have been submitted.

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The intent of the ITIN Program was to improve tax compliance by nonresident aliens.

The ITIN Program was implemented to facilitate return filing, improve compliance on tax returns and other documents filed by nonresident aliens, and reduce taxpayer burden.

Results

Overall, the ITIN Program was timely implemented. The IRS was successful in meeting the July 1, 1996, target date for processing Forms W-7. The IRS began issuing ITINs in July 1996.

The IRS will face tax administration difficulties as a result of how the ITIN Program was implemented.

However, the ITIN Program, as implemented, may cause tax administration difficulties. This conclusion is based on 2a, 2b, 2e-----
2a, 2b, 2e-----
2a, 2b, In fact, over 340,000 applicants identified themselves as illegal aliens.

The ITIN regulations require that both identity and foreign status be verified. 2a, 2b, 2e-----
2a, 2b, 2e-----

2a, 2b, 2e----- The ITIN allows a person to file an Individual Income Tax Return (Form 1040). This condition complicates efficient tax law administration because providing illegal aliens with valid TINs allows for certain tax advantages and increases the potential for fraud. This potential is increased because of costly examination resources required to determine compliance. 2a, 2b, 2e-----

2a, 2b, 2e-----

The IRS needs to address tax policy and operational issues resulting from the ITIN Program implementation.

Several conditions from both the ITIN regulations and program implementation require action. These range from tax policy decisions to operational changes. Tax policy concerns include:

- Conflict between IRS regulations and the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.

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- Tax treatment of illegal aliens as United States (U.S.) residents.

The operational concerns include:

- Management controls did not ensure effective implementation of the Internal Revenue Service's ITIN Program.
 - Publicity efforts were not effective in notifying potential taxpayers of ITIN requirements.
 - The Acceptance Agent Program implementation has gone beyond its regulatory purpose.
- Taxpayer identification controls for cross-referencing information were not effective over the assignment of ITINs. Information needed to ensure compliance did not appear in the database.
- Returns processing controls were not effective for taxpayers affected by the ITIN requirement.
 - Prior year tax returns were processed for refunds without required ITINs.
 - Tax returns and payments from taxpayers submitted with ITINs were not accepted as filed by the IRS' main computer system.

We identified three additional areas where PSC management has already taken action. (The issues and management's response can be found in Appendices VI-VIII.)

- Customer service needed to be improved on the telephone number dedicated to inquiries about ITINs.
- Adequate physical security was not provided over original documents submitted by persons applying for the ITIN.
- Processing of Forms W-7 during implementation of the ITIN Program needed improvement.

IRS management was very cooperative in taking certain recommended corrective actions when necessary. This

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was especially important because actions needed to be taken on-line during the processing phase.

The Internal Revenue Service's Individual Taxpayer Identification Number Program Needs to Consider the Effect of Illegal Aliens on Disclosure and Tax Policy Issues

We identified two issues that relate to the effect of illegal aliens on the ITIN Program:

- Conflict between IRS regulations and the Illegal Immigration Reform and Immigrant Responsibility Act of 1996.
- Tax treatment of illegal aliens as residents.

These issues take on greater significance as the IRS comes under scrutiny by the Congress and with the passage of the Taxpayer Relief Act of 1997. Illegal alien presence in the U.S. is a congressional concern which is addressed by legislation in the Welfare Reform Act and the Illegal Immigration Reform and Immigrant Responsibility Act of 1996. In addition, the Taxpayer Relief Act of 1997 provides for additional tax advantages, which could increase the risk of fraud.

Conflict between IRS Regulations and the Illegal Immigration Reform and Immigrant Responsibility Act of 1996

The IRS needs to resolve a conflict between its internal regulations and a federal statute that affects illegal alien applicants for ITINs.

The IRS provides disclosure protection to illegal alien applicants. The Congress has clearly stated how the federal government is to communicate between agencies concerning illegal aliens. The Illegal Immigration Reform and Immigrant Responsibility Act of 1996 (the Illegal Immigration Reform Act) states that information concerning illegal alien status should be provided to the Immigration and Naturalization Service (INS) **notwithstanding** any other law. However, in the ITIN

IRC Section 6103 prevents the IRS from providing illegal immigrant information to the INS.

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The Immigration Act of 1996 was not considered when drafting ITIN regulations.

The IRS intentionally does not provide the INS with alien information.

regulations issued on May 29, 1996, the IRS states, “Generally, tax return and tax return information are confidential, as required by 26 USC 6103.” Therefore, the IRS assurance of anonymity seems to be in conflict with a federal statute.

We determined that the IRS did not consider provisions of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 due to the timing of its passage in September 1996. However, the Illegal Immigration Reform Act provisions were introduced to both the House and Senate as early as 1995. Therefore, the IRS’ ITIN regulations were drafted when the INS Act provisions were in bills before the Congress.

IRS management and the Office of Disclosure Litigation indicated that the IRS intentionally will not provide information to the INS. The rationale for this policy is that the Illegal Immigrant Statute is a “general” statute and does not change IRC Section 6103. The IRS requires that IRC Section 6103 be changed before providing the information to the INS.

However, based on other IRS action, even current IRC Section 6103 provisions have not been followed. For example, the Form W-7 does not contain the Privacy Act statement, which in part, provides notification that information can be provided to the Department of Justice (DOJ) within the parameters set by IRC Section 6103.

Tax Treatment of Illegal Aliens as Residents

The IRS continues to consider illegal aliens as residents for tax purposes. We have the following concerns with this current policy:

- The alien makes the determination of residency.
- Tax benefits are being afforded to aliens.
- Revenue Protection concerns involving fraudulent refund issues are present on illegal alien tax returns.

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The ITIN Program allows illegal aliens to receive the same tax benefits as resident aliens.

The Alien Makes the Determination of Residency

IRC Section 7701 outlines the legal requirements for residency for tax purposes. This allows illegal aliens to file Forms 1040. Thus, illegal aliens are receiving tax benefits beyond nonresident alien taxpayers (who file U.S. Nonresident Alien Income Tax Returns (Form 1040NR)), who are in compliance with U.S. immigration laws.

Tax Benefits Are Being Afforded to Aliens

Some of the tax advantages that are being realized by illegal aliens treated as residents include receiving spousal exemptions, standard deductions, and even some erroneous earned income credits. These tax advantages are not available to 1040NR filers.

Revenue Protection Involving Fraudulent Refund Issues Are also Present on Illegal Alien Tax Returns

Appendix IV of this report contains specific information about returns processing control weaknesses on returns with ITINs. Public disclosure of this information could provide taxpayers with information that could be used to defraud the government.

Recommendations

1. The IRS' policy toward illegal aliens needs to reflect stated administrative policy and be in concert with federal statutes.
 - 1.1. The IRS needs to bring the conflict between the general and specific statutes to the attention of the Confidentiality of Tax Return Information study groups established by the IRS Restructuring and Reform Act of 1998. The independent studies are to be conducted by the Joint Committee on Taxation and the Secretary of the Treasury.

Management's Response: Management concurs with this recommendation. Section 3802 of the IRS Restructuring and Reform Act of 1998 directs the Joint Committee on Taxation and the Secretary of the

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Treasury to conduct separate studies of the scope and use of provisions regarding taxpayer confidentiality. The IRS will request that the study groups address the interrelationship of taxpayer confidentiality provisions under the IRC with provisions of the Illegal Immigration Reform and Immigration Responsibility Act of 1996.

- 1.2. The IRS needs to include a Privacy Act statement on the Form W-7 application form. The Privacy Act notification provides the warning that information can be provided to the DOJ within the parameters set by IRC Section 6103.

Management's Response: Management concurs with this recommendation. A Privacy Act Notice will be added to the Form W-7. Also, Section 3508 of the IRS Restructuring and Reform Act of 1996 requires that any instruction booklet accompanying an individual federal income tax return form shall include a description of the conditions under which return information may be disclosed to any party outside the IRS. The IRS will determine if Form W-7 meets the definition of an "individual federal income tax return form" and, if so, include a disclosure statement.

2. The IRS needs to bring the illegal alien tax issue to the attention of the Commissioner. A decision needs to be made by the Administration whether a tax law change should address returns filed with an ITIN that have a Wage and Tax Statement (Form W-2), with a SSN. We recommend that these returns be treated as Forms 1040NR to eliminate certain tax advantages.

Management's Response: The Commissioner will be informed of Treasury Inspector General for Tax Administration's concern that certain illegal aliens may be receiving tax benefits under the IRC. The IRS does not have the authority, under the IRC and Regulations, to implement the recommendation.

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2.1. Administratively, consideration should be given to freezing the account from refunding until the discrepancy is resolved.

Management's Response: 2a, 2b, 2e-----

Office of Audit Comment: The IRS needs to examine the overall Revenue Protection Strategy to ensure that returns with ITINs are 2a, 2b, 2e-----
2a, 2b, 2e-----

2a, 2b, 2e---- This could be done on a sample basis. Subsequent to the issuance of the draft report, the Office of Audit determined that there were 180,662 Tax Year 1997 Form 1040 returns filed with the ITIN as the identifying number.

Management Controls Did Not Ensure Effective Implementation of the Internal Revenue Service's Individual Taxpayer Identification Number Program

The implementation of the ITIN Program could be improved in the following areas:

- Publicity efforts were not effective in notifying potential taxpayers of ITIN requirements.
- The Acceptance Agent Program implementation has gone beyond its regulatory purpose.

Publicity Efforts Were Not Effective in Notifying Potential Taxpayers of ITIN Requirements

In October 1996, we issued an Audit Memorandum reporting that the IRS did not timely or comprehensively publicize the requirement to obtain an ITIN. A publicity

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Publicity of the ITIN requirement needed to be targeted at potential applicants.

strategy was not in place to coincide with the inauguration of the ITIN Program in July 1996.

Publicity included press releases, news articles, and presentations to practitioners. However, these efforts were not adequately targeted at the taxpayers likely to use the ITIN.

In addition, we reported that the publicity level may have contributed to a lower than expected number of ITIN applications. The IRS expected that 250,000 applications would be filed from July 1 through September 30, 1996. Our results showed the IRS received only 17,787 (7 percent) of the expected filings as of late September 1996.

We further concluded that the low publicity level would affect taxpayer burden and the IRS' resources. Taxpayer burden would be increased because, without an awareness of the ITIN requirement, tax returns filed by these individuals would not be processed. In addition, the IRS' resources would be strained when the imminent volume of ITIN applications from taxpayers was received. The IRS did not have a publicity strategy in place because efforts were directed toward ensuring readiness for ITIN processing at PSC.

IRS policy provides for timely informing taxpayers on the laws and regulations. Efforts should be made to meet taxpayers' needs. We recommended that the IRS immediately increase publicity to educate taxpayers on ITIN requirements. Actions to accomplish this included: providing ITIN applications to taxpayers assigned temporary TINs in Calendar Year 1996, and identifying the countries where publicity would be most effective. In addition, we recommended the IRS continue to process tax returns in the same manner as 1996, and send an application to those taxpayers that file without a required ITIN.

IRS management took appropriate actions to better publicize the ITIN requirement.

Some of the actions taken by IRS management in response to our memorandum included a mail-out conducted on December 9, 1996, for approximately 308,000 individuals who had previously been assigned temporary "900" numbers. A "900" number is the

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prefix used for temporary numbers assigned to facilitate returns processing. Other IRS actions included: 1) sending an extensive Question and Answer package to all IRS field offices, 2) sending an ITIN package to 11 national organizations, and 3) analyzing the individual nonresident alien population.

In addition, 1997 returns with a missing primary or secondary TIN were processed in a manner similar to the process used in 1996. (A TIN is required to process a tax return.) For all other returns, correspondence was issued, which included the toll-free telephone number needed to obtain information.

The Acceptance Agent Program Implementation Has Gone Beyond its Regulatory Purpose

Effective May 29, 1996, authority for the Acceptance Agent Program was included in the IRC Section 6109 Regulations. To facilitate the process of allowing foreign individuals to obtain ITINs, the Section 6109 Regulations were amended to include authority for the IRS to “accept” persons to act as agents *on behalf of taxpayers*.

We identified two issues concerning the implementation of the Acceptance Agent Program:

- The program has provided an extended service to domestic applicants.
- Acceptance Agents are acting in a dual-agent role.

As a result, the Acceptance Agent Program has not met the regulatory requirement of serving foreign applicants.

The Acceptance Agent Program Has Provided an Extended Service to Domestic Applicants

Initially, the IRS intended to limit the Acceptance Agent Program to persons authorized to practice before the IRS. These enrolled agents were required to provide their Employer Identification Number (EIN) on submitted Forms W-7 so the IRS could identify them as authorized Acceptance Agents.

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The Acceptance Agent Program has gone beyond the IRC Section 6109 regulatory purpose.

However, some tax preparation agency employees do not have EINs. In order to process Forms W-7 submitted by Agents not having EINs, it was necessary for the IRS to allow Electronic Filing Identification Numbers (EFINs) as Acceptance Agent identification (using the EFIN required special approval from IRS Chief Counsel). Further, the Office of Refund Fraud advised that they discouraged EFINs as Acceptance Agent criteria because of identified risk factors.

Overall, the nine-month delay in executing the Acceptance Agent agreements affected PSC resources designated for the ITIN Program. The Request for Information Services (RIS) was not submitted timely to allow the ITIN database to accept EFINs. As a result, PSC had to develop a manual system to process the Forms W-7 filed by Acceptance Agents without EINs. The manual system was converted to an automated system in January 1998.

The Acceptance Agents Are Acting in a Dual-Agent Role

The role of the Acceptance Agent has been extended beyond the original intent.

In addition to Acceptance Agents acting on behalf of taxpayers as established in IRC 6109 regulations, the role of the Acceptance Agent has been extended to act on behalf of the IRS.

Acceptance Agents are required to enter codes in the box designated “For IRS Use Only” on the Form W-7 after validating the identity and foreign status of the ITIN applicant.

2a, 2b, 2e-----

Recommendation

3. The IRS needs to ensure Acceptance Agents are in complete compliance with the signed agreement. The IRS needs to develop a compliance system to ensure Acceptance Agents are acting on behalf of

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the taxpayer. This could include a plan, compliance checks, and a measurement system for Acceptance Agents located abroad.

Management's Response: Management concurs with this recommendation. Using information from the ITIN database, the IRS Foreign Payments Branch will initiate checks to measure compliance with the terms of Acceptance Agent agreements. The compliance checks will include Acceptance Agents located in the U.S. and abroad. Due to laws in some foreign countries, compliance checks of Acceptance Agents located abroad may be limited to correspondence audits.

Taxpayer Identification Controls for Cross-Referencing Information Were Not Effective Over the Assignment of the Internal Revenue Service's Individual Taxpayer Identification Numbers

The following issues concern the Revenue Protection Strategy and require management's attention:

Information Needed to Ensure Compliance Did Not Appear in the Database

In June 1997, we briefed IRS management about not "computer displaying" the SSN of U.S. persons who are spouses or parents to individuals being assigned ITINs. The U.S. person's SSN information was requested by the Office of Refund Fraud as required information for conducting future computer matching initiatives. These initiatives usually involve matching of similar fields from separate computer-based files for the purpose of data analyses.

National Office Information Systems (IS) management advised us that the information was not available for display because the ITIN database was designed using a version of Form W-7, as provided by the Office of the Assistant Commissioner (International). This version did not include the required field for the cross-reference (spouse or parent) SSN because input from the Office of Refund Fraud was not received in time.

Information necessary for providing the IRS a means of ensuring compliance did not appear in the ITIN database.

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IS did begin capturing information even though it could not be displayed. However, to view information relating to parent or spouse SSNs, the database must be downloaded using utility programs available only to PSC. -----
2a, 2b, 2e-----

Information being captured in the cross-reference TIN field may be inconsistent with the original intent.

The IRS' use of this information may be further impeded. The data now has two possible meanings since two types of data are now input to the same data field. Information related to the original data is input, and, information related to an SSN issued after an ITIN has already been assigned, is also input. It is now difficult to distinguish between the two uses.

Recommendations

4. The IRS needs to determine the information to be captured in the "cross-reference" SSN field within the ITIN database to eliminate confusion.

Management's Response: A RIS will be prepared and submitted to request updates to the ITIN database screen display to permit display of cross-reference information. The requested implementation date will be January 1, 2000. For data posted to the ITIN database prior to January 1, 2000, modifications will be reconfigured to meet updated database specifications, permitting the display of stored "cross-reference" TINs for all applications processed. With RIS implementation, this additional information will be available upon manual research of individual applicant files using Command Codes specifically designed to access the ITIN database from IRS locations worldwide. Implementation is dependent on acceptance and execution of the RIS by IS.

5. The IRS should draft a RIS to explain the intent of the information captured when determined. At a minimum, the RIS should outline the source of information, the information to be captured, and the manner in which it is to be entered and displayed.

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Management's Response: A RIS will be prepared and submitted to request updates to the ITIN database screen display to permit the display of cross-reference information. The requested implementation date will be January 1, 2000, and is dependent on acceptance and execution of the RIS by IS.

Returns Processing Controls Were Not Effective for Taxpayers Affected by the Internal Revenue Service's Individual Taxpayer Identification Number Requirement

The following areas were identified where returns processing controls needed improvement:

- Prior year tax returns were processed for refunds without required ITINs.
- Tax returns and payments from taxpayers submitted with ITINs were not accepted as filed by the IRS' main computer system.

Prior Year Tax Returns Were Processed for Refunds Without Required ITINs

In January 1997, we orally advised IRS management on an issue where prior year returns may be processed without required ITINs.

IRC Section 6109 Regulations established after December 31, 1996, as the effective date for tax returns to have an ITIN. A prior year return is a return from a past year due date being filed in the current year. In this case, these would be tax returns filed after December 31, 1996, to satisfy a prior year tax module. The IRS was not clear on how to handle these returns. An informal opinion by IRS Chief Counsel stated that tax returns requiring a primary taxpayer to file with an ITIN would require an ITIN before it could be processed.

The IRS had not considered the issue of prior year returns when the draft and final ITIN regulations were written. As a result, the IRS issued over 850 refunds

The IRS was not administering the ITIN regulations for prior year returns.

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totaling nearly \$3 million for prior year returns received after December 31, 1996.

We recommended that the IRS request an opinion from IRS Chief Counsel to determine whether prior year tax returns received after December 31, 1996, should require ITINs. We also recommended stopping the processing of these returns until it was determined whether correspondence for ITINs was necessary.

The IRS took appropriate action for consistently administering ITIN regulations.

The IRS was responsive to our recommendations and it was determined that prior year tax returns filed after December 31, 1996, did require ITINs. The IRS issued procedures to clarify this issue.

Tax Returns and Payments from Taxpayers Submitted with ITINs Were Not Accepted as Filed by the IRS' Main Computer System

During the ITIN implementation, two computer programming conditions occurred that affected tax return and payment processing. First, in February 1997, we issued an Audit Memorandum that advised that approximately 50,000 taxpayers granted ITINs did not have accounts established on the Masterfile. The Masterfile is the IRS' database that stores various types of taxpayer account information.

Accounts for ITIN taxpayers were not properly established on the Masterfile.

Without an established account, the tax transactions processed for these taxpayers were unpostable. An unpostable is caused by any transaction that does not meet Masterfile criteria. The unpostable transaction is returned to the service center as an error to be corrected. Service center personnel had not been provided any error correction procedures for correcting this type of ITIN unpostable transaction. As a result, refunds can be delayed and payments cannot be immediately credited.

Miscommunication within IRS management caused unexpected unpostable conditions to arise.

IS personnel advised us that they had planned to have the ITIN accounts available in February 1997. However, communication was not effective between IS and some ITIN Program stakeholders. For example, PSC was not advised of the IS decision not to establish the Masterfile accounts as ITINs were issued.

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Management took appropriate corrective action to avoid further unpostable conditions.

We recommended developing procedures for correcting this type of unpostable condition. The IRS responded by issuing procedures to correct the problem.

Second, we identified a problem, which resulted from the IRS not appropriately establishing accounts on the Masterfile for taxpayers granted ITINs.

A computer programming error may have caused an additional 750,000 unpostable conditions.

A computer programming error may have caused up to 750,000 unpostable conditions throughout the 1997 filing season. These would cost over \$907,312 to correct. These conditions were caused by errors involving identification data for taxpayers receiving ITINs from January 1, 1997, through April 14, 1997. IS corrected the programming error.

Office of Audit Comment:

IRS management took on-line actions to correct these conditions. Therefore, a recommendation is not included in this audit report.

Conclusion

The IRS' implementation of the ITIN Program will adversely affect effective and efficient tax administration. The program raises a range of concerns from tax policy to operational implementation.

The implementation resulted in conflict between the IRS' disclosure policy and the Illegal Immigrant Reform Act, and gives illegal aliens U.S. residency status for virtually all taxation. In addition, Form W-7 application, entity and returns processing controls did not ensure effective implementation of the ITIN Program.

The IRS should refer disclosure issues to the congressional committees studying IRC Section 6103. The IRS needs to re-examine the role of the Acceptance Agent in facilitating the ITIN Program. In addition, the IRS needs to ensure that information is available to perform computer matching initiatives for compliance purposes.

The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective was to determine whether the Internal Revenue Service (IRS) effectively and timely implemented the Individual Taxpayer Identification Number (ITIN) Program. This implementation included processing applications for ITINs and individual income tax returns filed with ITINs. The specific objectives and related audit tests follow.

- I. To determine whether the IRS effectively processed individual income tax returns submitted by taxpayers using an ITIN as the primary identification number, we:
 - A. Determined whether any coding and editing related to the ITIN was accurate and effective by:
 1. Reviewing Internal Revenue Code Section 6109 Regulations, which established procedures for requiring ITINs.
 2. Interviewing personnel to determine effective date of ITIN requirement.
 3. Sampling 50 cases to determine whether returns were correctly processed with respect to ITIN requirement.
 - B. Determined whether data transcription of information was accurate and accepted by the computer system by:
 1. Sampling 100 cases to determine whether information provided by ITIN applicants was input correctly.
 2. Reviewing Integrated Data Retrieval System (IDRS) for all 100 cases to compare information provided and information input.
 - C. Determined whether the taxpayer filed the return with a valid ITIN by:
 1. Determining the effectiveness of the IRS methodology for validating the authenticity of the ITIN by:
 - a) Interviewing personnel and gathering validity information.
 - b) Determining whether a validity process was in place.

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2. Determining whether the IDRS provided accurate information for researching ITIN accounts by sampling 100 cases and validating the information on source documents and input to IDRS.
- D. Determined whether any ITIN-specific error conditions were effectively resolved by:
1. Identifying adverse trends in error conditions and resolution.
 2. Reviewing inventories to determine types of ITIN errors requiring resolution.
 3. Interviewing personnel to determine whether there were problems with ITIN case resolution.
 4. Reviewing cases in the Unpostables and Remittance Processing Sections to determine resolution.
- E. Determined whether returns with a primary ITIN posted to the Masterfile, and whether the information posted to the correct account by:
1. Interviewing personnel to determine procedures for establishing accounts on the Masterfile.
 2. Researching IDRS to determine whether ITIN recipients had accounts established on the Masterfile.
- F. Determined whether ITIN-related unpostable conditions were effectively resolved by:
1. Identifying adverse trends.
 2. Reviewing reports and interviewing personnel to determine Unpostable Codes occurring.
 3. Gathering unpostable reports from three service centers.
 4. Analyzing unpostable inventory levels.
 5. Interviewing management personnel to determine resolution.

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- G. Determined whether service centers receiving applications attached to returns were controlling the documents and physically securing any original documents supporting the application by:
 - 1. Interviewing personnel responsible for processing the information.
 - 2. Reviewing processing procedures to identify inconsistencies.

- H. Determined whether controls were adequate over shipping the returns and applications from the receiving service center to the Philadelphia Service Center (PSC) and ensuring that the PSC received returns and applications by:
 - 1. Interviewing personnel responsible for processing the information.
 - 2. Gathering information from one other service center to determine whether procedures were being followed.

- I. Determined whether the PSC processed those applications received from other service centers by:
 - 1. Observing inventories of documents being received by the PSC from other service centers.
 - 2. Interviewing personnel to determine whether instructions were clear for processing these documents.

- J. Determined whether the PSC made the appropriate decision on granting an ITIN within the prescribed 72-hour time frame by:
 - 1. Reviewing procedures for processing applications.
 - 2. Interviewing personnel in the PSC ITIN processing section.
 - 3. Observing, on various days, application inventory levels.

- K. Determined whether the IRS had initiatives to detect taxpayer fraud for both the applications for the ITIN and returns processed with the ITIN by:
 - 1. Interviewing PSC personnel to determine whether controls were in place to detect fraud.

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2. Interviewing Criminal Investigation personnel to determine its initiatives and input.
 3. Reviewing ITIN database components to determine whether information existed to identify fraud.
 4. Interviewing Information Systems personnel to determine whether systems controls were in place.
- L. Determined how the IRS measured and quantified the ITIN Program effect on revenue protection by:
1. Reviewing the Revenue Protection Strategy.
 2. Determining whether the IRS had appropriate controls in place to ensure revenue protection.
- II. To determine the effectiveness and timeliness of processing applications for the ITIN, we:
- A. Determined whether the PSC processed applications accurately and timely by:
1. Determining whether PSC resources were sufficient for determining whether an ITIN was granted within the prescribed 72-hour time frame. We:
 - a) Interviewed management personnel to determine procedures.
 - b) Reviewed procedures established to process the ITIN-related documents.
 - c) Observed on various occasions application inventory levels.
- B. Determined the accuracy and reliability of data from applications for ITINs kept in the IDRS and ITIN application databases by:
1. Selecting 100 applications mailed to the IRS.
 2. Reviewing information provided by applicants.

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3. Researching IDRS to determine whether information provided was consistent with information input to the IDRS.
- C. Determined whether the Acceptance Agent Program was effectively and timely implemented to provide service to foreign individuals for the filing season and minimize the taxpayer burden of applying for the ITIN by:
1. Interviewing management personnel to determine the implementation schedule.
 2. Reviewing documentation to determine whether controls were in place.
 3. Reviewing agent agreements to determine completeness.
 4. Interviewing PSC personnel to determine readiness.
 5. Identifying initial applications submitted by Acceptance Agents.
- D. Determined whether the IRS provided adequate service to taxpayers using the telephone number dedicated to inquiries about ITINs (215-516-ITIN) by:
1. Determining whether employees assisting taxpayers calling the main customer service number were trained to refer the taxpayers to the ITIN number for specific questions about ITIN applications. (We coordinated with the audit team conducting the National Audit of Telephone Customer Service for supporting evidence.)
 2. Determining whether the IRS was effectively monitoring the quality and timeliness of service on the ITIN dedicated telephone number. (We coordinated with the audit team conducting the National Audit of Telephone Customer Service for supporting evidence.)
 3. Interviewing PSC personnel to determine call capacity.
 4. Analyzing statistics on telephone usage, capacity, and performance.
- E. Determined the adequacy of physical security over original documents sent with applications by:

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1. Interviewing personnel to determine procedures.
 2. Reviewing procedures to determine adequacy.
 3. Observing ITIN section security on multiple occasions via secured walk-throughs after hours.
- III. To determine whether the implementation of the ITIN Program was in compliance with laws and regulations, we:
- A. Determined whether illegal aliens were receiving ITINs against the Administration's policy by:
1. Reviewing legislative history for intent of the ITIN issuance.
 2. Interviewing management at various levels of the IRS for input on the issuance of ITINs to illegal aliens.
 3. Analyzing data in the ITIN database establishing statistics on ITINs issued to illegal aliens.
 4. Reviewing regulations establishing ITIN requirements.
 5. Researching laws and regulations involving the ITIN issuance.
 6. Researching disclosure laws and the IRS' commitment to the Immigration Naturalization Service.
- B. Determined whether illegal alien taxpayers were being treated favorably by:
1. Reviewing tax laws and regulations involving alien tax situations.
 2. Reviewing the Taxpayer Relief Act of 1997 to determine new laws being affected by the ITIN requirement.
 3. Interviewing personnel to determine the rationale for different tax treatment.
 4. Analyzing the ITIN database to determine statistics and extent of illegal alien tax benefits.

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Appendix II

Major Contributors to This Report

Parker Pearson, Acting, Assistant Inspector General for Audit (Small Business and Corporate Programs)

Kerry Kilpatrick, Director

Phil Shropshire, Deputy Director

Phil Peyser, Senior Auditor

Richard J. Viscusi, Senior Auditor

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John T. Quartapella, Auditor

**The Internal Revenue Service's Individual Taxpayer Identification Number Program
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Appendix III

Report Distribution List

Chief Operations Officer OP
Assistant Commissioner (International) OP:IN
Assistant Commissioner (Forms and Submission Processing) OP:FS
Assistant Commissioner (Program Evaluation and Risk Analysis) M:OP
Associate Chief Counsel (International) CC:INTL
Associate Chief Counsel (Enforcement Litigation) CC:EL
National Director, Submission Processing OP:FS:S
Chief, Paper Processing Branch OP:FS:S:P
National Director for Legislative Affairs CL:LA
Office of Management Controls M:CFO:A:M

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Appendix IV

2a, 2b, 2e-----

2a, 2b, 2e-----

**The Internal Revenue Service's Individual Taxpayer Identification Number Program
Was Not Implemented in Accordance with Internal Revenue Code Regulations**

2a, 2b, 2e-----

**The Internal Revenue Service's Individual Taxpayer Identification Number Program
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Appendix V

Glossary of Terms

1. Acceptance Agent – A person, accepted by the Internal Revenue Service (IRS), authorized to act on behalf of taxpayers seeking to obtain a Taxpayer Identification Number from the IRS.
2. Administration – The Executive and the Legislative Branches of the United States government.
3. Employer Identification Number – (EIN) A unique nine-digit number used to identify a taxpayer's business account.
4. Foreign Individual – An individual who is not a citizen or national of the United States (U.S.).
5. Foreign Status – Required to be proven by individual upon application for an Individual Taxpayer Identification Number (ITIN) on Form W-7. One example of supporting documentation can include an individual's passport.
6. Form 1040 – U.S. Individual Income Tax Return.
7. Form 1040NR – U.S. Nonresident Alien Income Tax Return.
8. Form W-7 – Application for IRS Individual Taxpayer Identification Number.
9. Illegal Aliens – Foreign nationals who are residing in the U.S. without legal entry. Also defined as individuals who cannot provide proof of foreign status, such as a passport.
10. IRC Section 6109 Regulations – Generally provide that, when required by regulations, a person must furnish a Taxpayer Identification Number (TIN) for securing proper identification of that person on any return, statement, or other document under the Internal Revenue Code (IRC). These regulations set forth procedures for requesting a TIN for certain alien individuals for whom a Social Security number is not available. These regulations also require foreign persons to furnish a TIN on their tax returns.
11. Individual Taxpayer Identification Number – (ITIN) A taxpayer identifying number issued to an alien individual by the IRS, upon application, for use in connection with filing requirements.

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12. Integrated Data Retrieval System – (IDRS) IRS computer system capable of retrieving or updating stored information; works in conjunction with a taxpayer's account records.
13. Masterfile - The IRS' database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.
14. Nonresident alien – all non-U.S. citizens who have not been admitted as permanent residents who are physically present in the United States for 31 days in any year must test their residency status to determine whether there was a substantial presence in the United States. If in the current year and the previous two years the nonresident has been physically in the United States for a total of 183 days or more, they are considered U.S. residents for tax purposes. (Formulas are used to determine the ratable number of days that count for residency status.) If the person is determined to be a U.S. resident for tax purposes, then the person is taxed on his/her worldwide income.
15. Request for Information Services – Narrative request issued by customer organizations in the IRS, which propose new system requirements or modifications to existing processing systems.
16. Social Security Number – (SSN) A nine-digit number used to identify the record of earnings an individual has in employment or self employment covered by Social Security. An applicant for a number must provide evidence of age, identity and United States citizenship or alien status. Penalties are imposed for falsely obtaining or improperly using a SSN.
17. Taxpayer Identification Number – (TIN) A nine-digit number assigned to taxpayers for identification purposes. Depending on the nature of the taxpayer, the TIN is either an Employer Identification Number (EIN), a Social Security Number (SSN), or an Individual TIN.

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Appendix VI

**Audit Memorandum
Individual Taxpayer Identification Numbers:
Telephone Service Can Be Improved**

Internal Revenue Service

memorandum

date: March 25, 1997

to: Director D
Philadelphia Service Center

from: Regional Inspector *William F. Hill III*
Northeast Region

subject: **Internal Audit Memorandum - Individual Taxpayer Identification
Numbers: Telephone Service Can Be Improved**

During our National Audit on the Individual Taxpayer Identification Number (ITIN) Program, we identified issues concerning telephone service which warrant your attention. This memorandum is being issued for information purposes only; no response required. The issues may appear in a future Internal Audit Report. These issues have been discussed with the Chief, Information Systems and Accounting Division.

If you have any questions or comments, please contact Deputy Assistant Regional Inspector (Internal Audit) Philip Shropshire at 212-466-4996, or Senior Auditor, Rick Viscusi at 215-516-3124.

Results

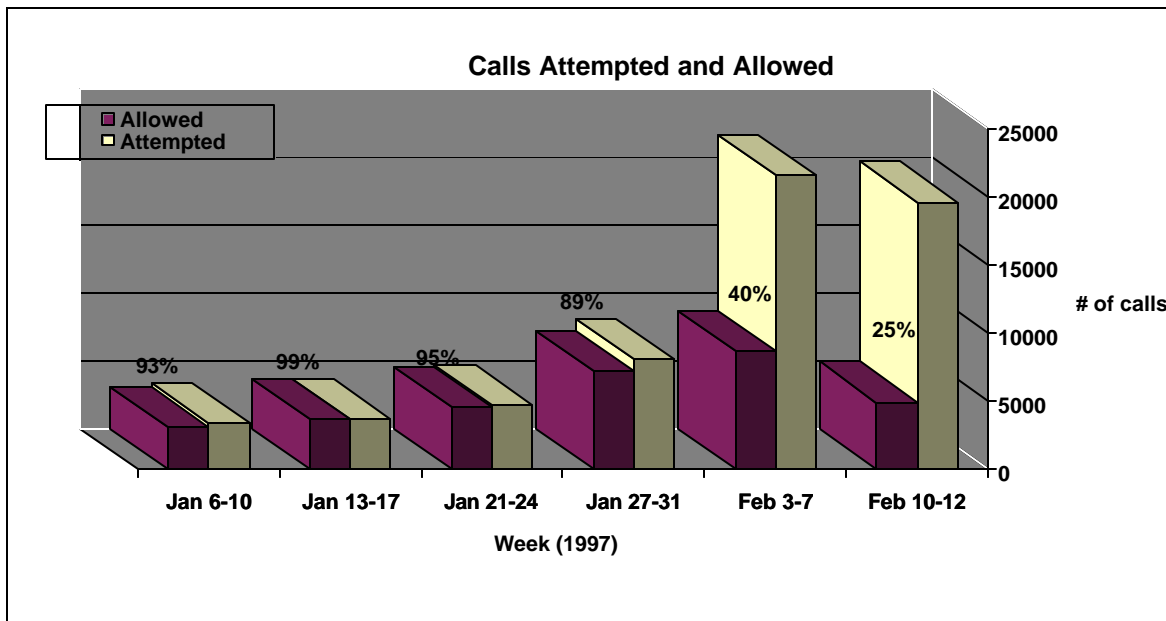
Customer service needs to be improved on the telephone number dedicated to inquiries about Individual Taxpayer Identification Numbers. The Accounting Branch, ITIN Unit, provides telephone assistance to persons who have specific questions about ITINs and ITIN applications.

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The ITIN telephone number, 215-516-ITIN, is publicized in the instruction package for ITIN applications; in responses to ITIN applications which the IRS sends to the applicants; and in at least one IRS ITIN publication. Telephone usage statistics show that over 71,000 calls had been attempted from the beginning of the ITIN program through February 12, 1997.

The ITIN Unit could improve customer service for the ITIN telephone number. Taxpayers may be receiving improper information or may not be receiving any information at all. We identified five issues:

1. The percentage of calls allowed into the system has decreased dramatically beginning February 3, 1997. In January, 89 to 99 percent of the calls attempted were allowed into the telephone system each week. The percentage of calls allowed decreased during the first week of February. This decrease coincided with a sharp increase in the number of calls attempted (refer to the chart below).



Source: ASPECT ACD

The increase in demand was not recognized because management may not be regularly analyzing all of the potentially useful statistical information available from the telephone system. During the months of operation, the number of assistants answering calls and the number of available telephone lines remained constant.

2. A toll-free number for better customer service was not established. We were advised that the majority of calls would be from international customers and that these

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customers cannot reach the United States using a toll-free number. However, management determined as early as November 1996 that the majority of persons who may require ITINs had domestic addresses. The IRS could have relieved these taxpayers of toll-calls for customer service.

Management provided the following additional reasons for not pursuing a toll-free number:

- The cost per call (eight cents per minute) may have been high.
 - ITIN call volumes could not be projected.
 - The majority of calls would be in the first year of the program.
 - TELETIN does not have a toll-free number.
3. The telephone hours may not correspond to hours of high call volume from most domestic customers. The hours of service are currently 4:00 PM through 11:00 PM. Management advised us that the hours of service were intended to accommodate international taxpayers and because of relatively low daily volume of calls in prior months.
 4. Spanish-speaking customers may not be receiving adequate service. Management observed that up to 75 percent of calls are from persons who primarily speak Spanish. Management is attempting to hire Spanish-speaking personnel. In addition, prerecorded messages that customers hear when they are connected to IRS are available only in English. The messages include information on how to obtain a Form W-7, Application for Individual Taxpayer Identification Number, through a faxed request.
 5. There is no method to ensure whether customers are receiving the most accurate or useful information. Management has not conducted reviews of the quality of the service provided to customers. Management advised us that quality reviews were not conducted due to the low volume of calls in prior months. In addition, we were also advised that management is in the process of hiring a phone manager, who would be conducting the reviews.

Management Response to Memorandum

1. The ASPECT ACD analyst will generate reports by time of day/day of week and redial attempts. These reports will be available for PSC ISA Division management beginning in mid-March. These reports will be analyzed on a daily basis, and decisions will be made on changing hours of telephone availability and/or adding more personnel to the telephones.

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2. Headquarters and PSC management made a decision *not* to establish ITIN as a toll-free number. Management approached the ITIN telephone calls with the philosophy that the "800 Normal Toll-Free Sites" would handle the general ITIN inquiries. The PSC ITIN telephone service was planned as a very limited operation. PSC management continues to believe that a toll-free number is not currently needed.
3. The PSC ITIN Telephone hours will be expanded on March 10 from 2:00pm to midnight. The initial 4:00pm to 11:00pm hours of operation were decided upon with the rationale that these hours were better than an 8:00am to 5:00pm timeframe because most ITIN applicants work and could better contact us during their non-work hours.
4. Spanish speaking calls were referred to a Spanish speaking ITIN employee who called these taxpayers back. Effective March 3, there are now three Spanish speaking ITIN employees.
5. Telephone quality reviews by the Quality Assurance Branch will commence the week of March 10.

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Appendix VII

**Management Briefing #1
Adequate Physical Security Was Not Provided over
Original Documents Submitted by Persons Applying for the
Individual Taxpayer Identification Number**

Internal Revenue Service

memorandum

date: February 19, 1997

to: Director
Philadelphia Service Center

from: Audit Manager
Internal Audit, Northeast Region

subject: Adequate physical security was not provided over original documents submitted
by persons applying for the Individual Taxpayer Identification Number

A person can request an Individual Taxpayer Identification Number (ITIN) by mailing to the Philadelphia Service Center an application form with one or more *original* documents. These documents could include a passport, birth certificate and driver's license.

The documents are considered evidence of a person's identity and alien status. This evidence is needed to grant an ITIN. The Accounting Branch ITIN Unit processes the applications.

Original documents included in undeliverable mail and mail scheduled to be sent to the applicants were not adequately secured. As a result, the potential for the loss or theft of an alien's property was not minimized. We have no evidence that documents were lost or stolen.

The ITIN Unit is located in an unrestricted area that would be accessible to personnel in the service center during non-duty hours. Mail that contains original documents should be locked in cabinets during those hours.

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Undeliverable mail was stored on exposed shelving. On November 8, 1996, we counted 144 pieces of undeliverable mail stored on the shelves. Of the 144 pieces of mail, 46 (32 percent) contained original documents.

Subsequent to our review, the mail was placed in a lockable cabinet. However, we observed that the cabinet had not been locked when we conducted an unannounced non-duty hour review of physical security on December 5, 1996.

In addition, we determined that original documentation being prepared for return to applicants was also unsecured. We observed these documents during an unannounced non-duty hour review on February 5, 1997.

We counted approximately 35 containers of mail. We identified original documents in seven of the containers:

Five of the containers had mail apparently awaiting envelopes

Two other containers had mail in addressed, unsealed envelopes.

The remaining containers had addressed, sealed envelopes. These envelopes may have also included original documents.

The documents were not properly safeguarded because the importance of protecting taxpayers' property was not sufficiently and effectively communicated to the employees in the ITIN Unit.

Management Response to Briefing

Calendar year 1997 receipts were much higher than expected. In order to assist with security requirements, a closet was transformed into a *safe*. All work related to *back-up documentation* will be secured in the *safe* or locked cabinets during non-work hours.

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Appendix VIII

**Management Briefing #2
Processing of Forms W-7 During Implementation of the
Individual Taxpayer Identification Number Program Needed Improvement**

Internal Revenue Service

memorandum

date: January 23, 1997

to: Director
Philadelphia Service Center

from: Audit Manager
Internal Audit, Northeast Region

subject: Processing of Forms W-7 during Implementation of the ITIN Program needed
Improvement

Initially, the PSC ITIN Unit was staffed with 60 employees. Due to low volumes of work through September 1996, resulting in part from the limited publicity strategy, a number of employees were furloughed or detailed to other functions.

In December 1996, the volume of Forms W-7 began increasing. This was due in part to the approaching filing season and the direct mailout to 308,000 potential applicants for ITINs.

The ITIN Unit was not able to effectively process the increasing volume of Forms W-7, and management was unable to recapture lost resources from the initial reduction of staff in September 1996. As a result, Forms W-7 were not being processed and the Unit was not returning original documentation to taxpayers within the stated 72-hour timeframe.

In addition, ITIN Unit technicians were forced to pre-screen applications to determine whether they would result in "accepted" or "rejected" forms for processing. This process

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created the need to photocopy "rejected" Forms W-7 for entry into the SEQUENT system at later date. At one time, the inventory level for entry reached 10,000 applications.

The Form W-7 volume caused the ITIN Unit to detail-in employees from the Receipt and Control Branch to assist with extracting mail intended for the ITIN Unit. In addition, employees were detailed-in from the Code and Edit function to assist with coding Forms W-7 for processing.

The Receipt and Control Branch employees received conflicting instructions as to executing the additional responsibilities. This confusion resulted in 1) tax returns and Forms W-7 to be improperly detached and separately forwarded to incorrect locations, 2) current tax returns to be improperly date-stamped and 3) forms to be inappropriately stapled together.

We briefed management and recommended that the ITIN Unit draft instructions detailing respective duties. Management quickly resolved the confusion by establishing stated procedures for the duties to be carried out by the detailed employees.

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Appendix IX

Management's Response to the Draft Report



CHIEF OPERATIONS OFFICER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

March 17, 1999

OFFICE OF TREASURY
INSPECTOR GENERAL
RECEIVED
199903-463429 DH
MAR 17 P 5 28

FOR TAX ADMINISTRATION

MEMORANDUM FOR ACTING TREASURY INSPECTOR GENERAL FOR
TAX ADMINISTRATION

FROM:

John M. Dalrymple
John M. Dalrymple
Chief Operations Officer

SUBJECT:

Draft Internal Audit Report - Review of the Individual
Taxpayer Identification Number (ITIN) Program
(Internal Audit Project #960084)

Thank you for the opportunity to respond to the draft report covering Internal Audit's review of the ITIN Program. This response was prepared with input from the staffs of the Assistant Commissioner (International), the Assistant Commissioner (Forms and Submission Processing), the Associate Chief Counsel (International), and the Associate Chief Counsel (Enforcement Litigation).

IDENTITY OF RECOMMENDATION 1.1

The Internal Revenue Service (IRS) needs to bring the conflict between the general and specific statutes to the attention of the Confidentiality of Tax Return Information Study Groups established by the IRS Restructuring and Reform Act of 1998. The independent studies are to be conducted by the Joint Committee on Taxation and the Secretary of the Treasury.

ASSESSMENT OF CAUSE(S)

In general, we concur with this recommendation. In the draft report, Internal Audit states that the reference to section 6103 of the Code in the preamble to the ITIN regulations provides "the Service's assurance of anonymity" that "seems to be in conflict with federal statutes" (namely, to provide information to the Immigration and Naturalization Service (INS) as required under provisions of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996). Internal Audit was informed that each regulation promulgated by the IRS and Treasury that is subject to the Paperwork Reduction Act (PRA) contains a reference to section 6103.

The reference ("Generally, tax returns and tax return information are confidential, as required by 26 USC 6103") is part of the standard language included in every preamble of each regulation that is required to have a PRA section. The use of the word "generally" in the standard language and the universal use of the statement indicates that it represents the general rule regarding confidentiality of tax returns and return

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information that is afforded to all taxpayers under Title 26. As such, the ITIN regulations give no greater or lesser assurances of confidentiality than any other IRS regulation subject to the PRA.

On January 14, 1998, Internal Audit met with representatives of the Associate Chief Counsel (Enforcement Litigation) to discuss the propriety of the IRS regularly sharing information reported on Form W-7 with the INS. Internal Audit was informed that Form W-7 information was covered by section 6103 and that section 6103(i) permits, in certain instances, disclosure of tax return information to federal officers or employees for administration of federal laws not relating to tax administration. After discussing the provisions of section 6103(i), it was determined that the statute would not permit the implementation of Internal Audit's recommendation that the IRS regularly disclose Form W-7 information to the INS. Internal Audit was also informed that section 6103 of the Code was not amended by the Illegal Immigration Reform and Immigration Responsibility Act of 1996. It should be mentioned that the IRS has been in contact with INS regarding other ITIN matters. To date, that agency has not requested or expressed an interest in receiving information from the ITIN database.

CORRECTIVE ACTIONS

Section 3802 of the IRS Restructuring and Reform Act of 1998 directs the Joint Committee on Taxation and the Secretary of the Treasury to conduct separate studies of the scope and use of provisions regarding taxpayer confidentiality. The IRS will request that the study groups address the interrelationship of taxpayer confidentiality provisions under the Code with provisions of the Illegal Immigration Reform and Immigration Responsibility Act of 1996.

IMPLEMENTATION DATE

The recommendation was presented to the Treasury study group on February 3, 1999.

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (International) OP:IN

IDENTITY OF RECOMMENDATION 1.2

The IRS needs to include Privacy Act notification on the Form W-7 application form. The Privacy Act notification provides the warning that information can be provided to the Department of Justice within the parameters set by IRC 6103.

ASSESSMENT OF CAUSE(S)

In general, we concur with this recommendation. Form W-7 does not contain a Privacy Act Notice. The notice was not included on Form W-7 since the form does not apply to U.S. persons.

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CORRECTIVE ACTIONS

A Privacy Act Notice will be added to Form W-7. Also, section 3508 of the IRS Restructuring and Reform Act of 1998 requires that any instructions booklet accompanying an individual federal income tax return form shall include a description of the conditions under which return information may be disclosed to any party outside the IRS. The IRS will determine if Form W-7 meets the definition of an "individual Federal income tax return form" and, if so, include a disclosure statement.

IMPLEMENTATION DATE

Next printing of Form W-7. Estimated Revision Date of August 31, 1999.

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (International) OP:IN

IDENTITY OF RECOMMENDATION 2

The IRS needs to bring the illegal alien tax issue to the attention of the Commissioner. A decision needs to be made whether a tax law change should address returns filed with an ITIN that have a Form W-2 with a Social Security Number (SSN). We recommend that these returns be treated as Form 1040NRs to eliminate certain tax advantages.

ASSESSMENT OF CAUSE(S)

Currently, taxpayers and the IRS are required to follow the standards contained in section 7701(b) of the Code to determine whether an alien individual is a resident or a nonresident for U.S. tax purposes. Under section 7701(b), individuals who are not U.S. citizens are treated as residents of the U.S. for "tax" purposes if they hold immigrant visas (also known as green cards) or they meet the "substantial presence test" (being present in the U.S. on at least 183 days during a 3-year period that includes the current year) set forth in section 7701(b)(3)(A) of the Code. Section 7701(b) ("Definition of Resident Alien and Nonresident Alien") was added to the Code by the Deficit Reduction Act of 1984. The substantial presence test does not address immigration status.

Internal Audit believes that the issuance of ITINs to certain illegal aliens allows those illegal aliens to receive tax benefits, particularly the Child Tax Credit and Education Incentives contained in the Taxpayer Relief Act of 1997. Internal Audit believes that Congress did not intend to afford tax benefits to illegal aliens. It should be noted Internal Audit was informed that the congressional staff member who drafted legislation denying the Earned Income Tax Credit to taxpayers without SSNs (section 32(m) of the Code) also drafted the portions of the Taxpayer Relief Act of 1997 pertaining to the Child Tax Credit and Education Incentives.

The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations

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In summary, the IRS does not have the authority, under the Code and Regulations, to implement Internal Audit's recommendation to treat individuals who are not U.S. citizens or legal residents as nonresident aliens for tax purposes if those individuals meet the substantial presence test of section 7701(b) of the Code.

CORRECTIVE ACTIONS

The Commissioner will be informed of Internal Audit's concern that certain illegal aliens may be receiving tax benefits under the Code.

IMPLEMENTATION DATE

Within 30 days of the issuance of Internal Audit's final report.

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (International) OP:IN

IDENTITY OF RECOMMENDATION 2.1

Administratively, consideration should be given to freezing the account from refunding until the discrepancy is resolved.

ASSESSMENT OF CAUSE(S)

Internal Audit's review of Forms W-2 attached to tax returns filed by illegal aliens indicated that 2a, 2b, 2c

2a, 2b, 2c

Audit's report did not indicate whether any instances of fraudulent return filings were found during the course of their review.

2a, 2b, 2e

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (Forms and Submission Processing) OP:FS

IDENTITY OF RECOMMENDATION 3

The IRS needs to ensure acceptance agents are in complete compliance with the provisions of the agreements. The IRS needs to develop a compliance system to ensure acceptance agents are acting on behalf of the taxpayer. This could include a plan, compliance checks, and a measurement system for acceptance agents located abroad.

The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations

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ASSESSMENT OF CAUSE(S)

In general, we concur with this recommendation. On May 6, 1997, Internal Audit met with representatives of the Assistant Commissioner (International) to discuss their concerns about the status of the Acceptance Agent Program. One of the concerns raised at the meeting was the relationship between the acceptance agent and the ITIN applicant and the relationship between the acceptance agent and the IRS. Internal Audit was directed to the regulations and Revenue Procedure 96-52 which state that acceptance agents act on behalf of taxpayers seeking to obtain taxpayer identifying numbers from the IRS. The definition of an "acceptance agent" contained in Revenue Procedure 96-52 states "An acceptance agent acting in its capacity as an acceptance agent does not act as an agent of the IRS, nor is it authorized to hold itself out as an agent of the IRS." This language is included in every agreement between acceptance agents and the IRS. The draft Internal Audit report expresses concern that "The role of the acceptance agent has been extended beyond original intent . . ." since the IRS mails ITIN cards and correspondence to the acceptance agent rather than to the taxpayer. Please be aware that by signing the Form W-7, the taxpayer authorizes the IRS to disclose return information to the acceptance agent regarding ITIN matters.

Another concern expressed at the May 6, 1997, meeting was the issue of compliance checks of acceptance agents. It was explained that compliance checks of acceptance agents were being planned in coordination with Examination, Collection, and EP/EO. Since the Acceptance Agent Program had just been implemented and relatively few ITINs had been issued to that date (May 1997), compliance checks were not planned until after January 1998, when Information Systems would be able to provide acceptance agent information from the ITIN database. Due to programming problems, the acceptance agent ITIN database information was not available until July 1, 1998.

CORRECTIVE ACTIONS

Using information from the ITIN database, checks to measure compliance with the terms of acceptance agent agreements will be initiated by the Foreign Payments Branch. The compliance checks will include acceptance agents located in the U.S. and abroad. Due to laws in some foreign countries, compliance checks of acceptance agents located abroad may be limited to correspondence audits.

IMPLEMENTATION DATE

Compliance checks of acceptance agents were initiated in October 1998.

RESPONSIBLE OFFICIAL(S)

Assistant Commissioner (International) OP:IN

The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations

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IDENTITY OF RECOMMENDATION 4

The IRS needs to determine the information to be captured in the "cross-reference" SSN field within the ITIN database, in order to eliminate confusion as to the representation of the number displayed.

ASSESSMENT OF CAUSE(S)

The failure of the ITIN Program's research feature to display "cross-reference" TIN data led Internal Audit staff to conclude that such data was not present in the ITIN database. All information provided by the applicant on Form W-7, including the name and TIN (SSN or ITIN) of the U.S. person on whose return the applicant's ITIN will appear, has been transcribed and stored in the ITIN database since the program was implemented in July 1996.

CORRECTIVE ACTIONS

A Request for Information Services (RIS) will be prepared and submitted to request updates to the ITIN database screen display to permit the display of cross-reference information. The requested implementation date will be January 1, 2000. Data posted to the ITIN database prior to the January 1, 2000, modifications will be reconfigured to meet updated database specifications, permitting the display of stored "cross-reference" TINs for all applications processed. With RIS implementation, this additional information will be available upon manual research of individual applicant files using Command Codes specifically designed to access the ITIN database from IRS locations worldwide. Should an automated research process or general data extract be required in support of specific stakeholder initiatives, research or extract specifications must be developed and included in the January 1, 2000, Submission Processing RIS or presented in separate RIS' developed by the impacted stakeholder(s). Implementation of this corrective action is dependent on acceptance and execution of the RIS by Information Systems.

IMPLEMENTATION DATE

January 1, 2000

RESPONSIBLE OFFICIAL(S)

Chief, Paper Processing Branch OP:FS:S:P
National Director, Submission Processing OP:FS:S
Assistant Commissioner (Forms and Submission Processing) OP:FS

IDENTITY OF RECOMMENDATION 5

The IRS should draft a RIS to explain the intent of the information captured when determined. At a minimum, the RIS should outline the source of information, the information to be captured, and the manner in which it is to be entered and displayed.

The Internal Revenue Service's Individual Taxpayer Identification Number Program Was Not Implemented in Accordance with Internal Revenue Code Regulations

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ASSESSMENT OF CAUSE(S)

The ITIN Program's research feature does not currently display cross-reference TIN data.

CORRECTIVE ACTIONS

A RIS will be prepared and submitted to request updates to the ITIN database screen display to permit the display of cross-reference information. The requested implementation date will be January 1, 2000. Implementation of this corrective action is dependent on acceptance and execution of the RIS by Information Systems.

IMPLEMENTATION DATE

January 1, 2000

RESPONSIBLE OFFICIAL(S)

Chief, Paper Processing Branch OP:FS:S:P
National Director, Submission Processing OP:FS:S
Assistant Commissioner (Forms and Submission Processing) OP:FS

If you have any questions concerning this matter, please contact me or have a member of your staff contact John Manton of the Office of the Assistant Commissioner (International) at (202) 874-1621.

cc: Acting Assistant Inspector for Audit
cc: Assistant Commissioner (International)
cc: Assistant Commissioner (Forms and Submission Processing)
cc: Associate Chief Counsel (International)
cc: Associate Chief Counsel (Enforcement Litigation)