



*Processes Do Not Always Ensure That
Electronic Filing Identification Numbers
Are Assigned to Qualified Applicants
or Deactivated When Required*

November 15, 2017

Reference Number: 2018-40-003

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Phone Number / 202-622-6500

E-mail Address / TIGTACommunications@tigta.treas.gov

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HIGHLIGHTS

PROCESSES DO NOT ALWAYS ENSURE THAT ELECTRONIC FILING IDENTIFICATION NUMBERS ARE ASSIGNED TO QUALIFIED APPLICANTS OR DEACTIVATED WHEN REQUIRED

Highlights

Final Report issued on November 15, 2017

Highlights of Reference Number: 2018-40-003 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

The IRS's electronic filing (e-file) Provider Program offers taxpayers an alternative to filing a traditional paper tax return. It enables tax returns to be sent to the IRS in an electronic format via an authorized IRS e-file Provider (hereafter referred to as a Provider). A Provider is generally the first point of contact for most taxpayers filing a tax return through the e-file Provider Program.

WHY TIGTA DID THE AUDIT

This audit was initiated to evaluate the controls to prevent the unauthorized use of Electronic Filing Identification Numbers (EFINs).

WHAT TIGTA FOUND

The IRS is still not verifying citizenship status for all individuals on e-file applications. TIGTA's review identified 45 approved applications that listed a Principal or Responsible Official who was not a U.S. citizen or resident alien according to Social Security Administration records at the time of application. The review also identified 1,494 individuals associated with approved applications despite the fact that Social Security Administration records do not show a citizenship status for them.

TIGTA's review of a statistical sample of 34 approved e-file Program partnership applications identified nine (26 percent) that omitted at least one partner with a five percent or greater ownership interest in the partnership. TIGTA estimates that 256 of the 969 partnership applications omitted one or more partners.

In addition, EFINs are not timely deactivated for deceased Principals and Responsible Officials of firms. Of 965 EFINs with deceased Principals and Responsible Officials, 349 were still active, and for 399, the IRS took an average of 1,080 days to deactivate the EFIN.

Lastly, referrals of 328 EFINs used to file potentially fraudulent tax returns were not consistently evaluated or forwarded to the Electronic Products and Services Support organization. The Return Integrity and Compliance Services organization did not evaluate the 328 EFINs for potential fraud, and only 104 were evaluated for identity theft.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division: 1) deactivate EFINs associated with individuals who are not U.S. citizens or resident aliens and verify citizenship status for all prior and current Principals and Responsible Officials for whom Social Security Administration records are blank; 2) develop processes to verify the accuracy of partnership reporting on e-file applications; 3) suspend EFINs associated with the nine partnership applications with omitted partners and request revised applications that accurately report partners; 4) establish time frames for deactivating EFINs for deceased Principals and Responsible Officials; 5) ensure that the 349 EFINs which were still active as of March 24, 2017, are revised or deactivated, as appropriate; 6) finalize procedures for identifying and referring EFINs associated with potentially fraudulent return filings to the Electronic Products and Services Support organization; and 7) ensure that the 286 suspicious EFINs not referred to the Electronic Products and Services Support organization are reviewed for tax return fraud and are deactivated if warranted.

The IRS agreed with six recommendations, partially agreed with one recommendation, and disagreed with the recommendations to suspend EFINs for the nine partnership applications with omitted partners and ensure that the 286 suspicious EFINs are reviewed for fraud. TIGTA believes the lack of corrective action will allow partnerships to circumvent IRS suitability checks and EFINs will continue to be misused.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

November 15, 2017

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Processes Do Not Always Ensure That Electronic Filing Identification Numbers Are Assigned to Qualified Applicants or Deactivated When Required (Audit # 201640011)

This report presents the results of our review to evaluate the controls to prevent unauthorized use of Electronic Filing Identification Numbers. This audit was included in our Fiscal Year 2017 Annual Audit Plan and addresses the major management challenge of Reducing Fraudulent Claims and Improper Payments.

Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services).



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Abbreviations

e-file	Electronic Filing
EFIN	Electronic Filing Identification Number
EPSS	Electronic Products and Services Support
FY	Fiscal Year
IRS	Internal Revenue Service
RICS	Return Integrity and Compliance Services
SB/SE	Small Business/Self-Employed Division
SSA	Social Security Administration
TIGTA	Treasury Inspector General for Tax Administration
U.S.	United States



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Background

The Internal Revenue Service's (IRS) Electronic Filing (e-file) Program offers taxpayers an alternative to filing a traditional paper tax return. The e-file Program enables tax returns to be sent to the IRS in an electronic format via an IRS authorized e-file Provider (hereafter referred to as Provider). A Provider is generally the first point of contact for most taxpayers e-filing a tax return. Figure 1 lists the various types of IRS Providers.

Figure 1: Types of Authorized e-file Providers

e-file Provider Type	Description
Electronic Return Originator	Electronic Return Originators e-file tax returns to the IRS after the taxpayer authorizes the e-filing of their return.
Intermediate Service Provider	These Providers assist with processing tax return information between an Electronic Return Originator (or the taxpayer or tax-exempt organization that e-files) and a Transmitter.
Transmitters	Transmitters e-file tax returns directly to the IRS. Electronic Return Originators may apply to be Transmitters and transmit return data themselves or contract with accepted third-party transmitters that transmit the data for them. Transmitters must have software and computers that can interface with the IRS.
Software Developers	Software Developers write either origination or transmission software according to the IRS e-file specifications.
Reporting Agents	Reporting Agents are accounting services, franchisers, banks, or other entities that originate the electronic submission of certain tax returns for clients or transmit the returns to the IRS in compliance with Revenue Procedures 2012-32 and 2012-34 and I.R.B. 267.
Online Providers	Online Providers allow taxpayers to self-prepare e-filed tax returns by entering return data directly into commercially available software that is downloaded from an Internet site and prepared offline or through an online Internet site. These Providers originate self-prepared returns.

Source: IRS Publication 3112, IRS e-file Application and Participation. I.R.B. = Internal Revenue Bulletin.



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The Electronic Products and Services Support (EPSS) organization manages the e-file Provider Program

The EPSS organization manages the e-file Provider Program through its application screening and monitoring process. The application screening process is used to ensure that individuals applying for participation in the e-file Provider Program meet required screening and verification standards before they are authorized to participate in the e-file Provider Program. To apply for participation in the e-file Provider Program, applicants have to register for e-Services,¹ complete an online application to participate in the IRS e-file Provider Program, and submit a fingerprint card to the IRS. Individuals with a professional certification can provide proof of certification in lieu of a fingerprint card. Professional certifications include Attorney, Certified Public Accountant, Enrolled Agent, banking official, and officer of a publically held corporation.

Applicants must provide the name, home address, Social Security Number, date of birth, and citizenship status for each Principal² and Responsible Official³ in the organization. The two roles are not mutually exclusive in that a Principal may also serve as the Responsible Official. Applicants must be a U.S. citizen or legal resident alien (lawfully admitted for permanent residence) and 18 years of age as of the date of the application.

In addition to the e-file requirements, suitability checks for applicants may include:

- A criminal background check.
- A tax compliance check to ensure that all required tax returns are filed and paid and to identify fraud and preparer penalties.
- A prior history check for compliance in the e-file Program.

Initial suitability checks for new applicants must be completed within 45 calendar days of the submission of an application unless the IRS notifies the applicant that additional time is needed to process the individual's application.

Electronic Filing Identification Numbers (EFIN) are assigned to e-file Provider Program applicants after the application is complete

After the Provider completes the application and passes initial suitability checks, an acceptance letter is sent to the Provider that includes the EFIN. Providers need an EFIN to e-file tax returns. An EFIN is a six-digit number assigned to Providers to identify businesses that have completed

¹ E-Services are a suite of web-based tools that allows tax professionals and payers to complete certain transactions online with the IRS. These services are available 24 hours a day, seven days a week, via the Internet.

² The Principal is a sole proprietor; each partner who has a 5 percent or more interest in the partnership; the President, Vice-President, Secretary, and Treasurer of a corporation; or an individual authorized to act in legal or tax matters for an entity that is not a sole proprietorship, partnership, or corporation.

³ A Responsible Official is an individual with authority over the IRS e-file operation of a Provider and has authority to sign revised IRS e-file applications.



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the IRS e-file application to become an authorized Provider. For Processing Year⁴ 2016, 278,580 EFINs were used to e-file almost 132 million accepted tax returns.

To further protect EFINs from being misused (*i.e.*, used to file potentially fraudulent tax returns) the EPSS organization encourages Providers to periodically review their e-file statistics on their online EFIN Status Page of the Provider's e-Services account, made available by the EPSS organization, to confirm the number of tax returns they transmitted to the IRS. This weekly report details the number of returns transmitted and the number of tax returns the IRS accepted and rejected. Providers can compare the total number of submitted tax returns shown on the EFIN Status Page to their own records to ensure that the totals match. A discrepancy may be the result of their EFIN having been compromised.

Provider participation in the IRS's e-file Provider Program is based on their continued adherence to program requirements

Authorized Providers must maintain strict adherence to e-file Provider Program requirements to ensure continued participation. These requirements are included in Revenue Procedure 2007-40; Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*; and Publication 3112, *IRS e-file Application and Participation*. Requirements include the need to ensure that:

- Tax returns are accurately transmitted.
- Appropriate documentation is maintained and signed by the taxpayer.
- Security systems are in place to prevent unauthorized access to taxpayer accounts and personal information by third parties.

The EPSS organization has processes to identify potentially high-risk Providers

The monitoring of authorized Providers is conducted by the EPSS organization and the Small Business/Self-Employed Division's (SB/SE) Examination function in an effort to ensure compliance with guidelines that govern the e-file Provider Program. The EPSS organization provides the SB/SE Division with a list of potentially high-risk Providers based on e-file reject rates. These Providers include those that e-filed at least 100 tax returns during the prior calendar year, of which the IRS rejected 25 percent or more of the tax returns. Once the Providers are identified, SB/SE Division revenue agents conduct on-site visits. The number of visits performed is based on available resources. For example, for Fiscal Year⁵ (FY) 2015, the EPSS organization sent a list of 3,049 potentially high-risk Providers to the SB/SE Division to schedule an on-site visit from a revenue agent, but 255 on-site visits were actually performed. Violations

⁴ The calendar year in which the tax return or document is processed by the IRS.

⁵ Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.



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of e-file Provider Program requirements can result in a warning, written reprimand, suspension, or expulsion of the Provider from the program. Figure 2 shows the results of visitations for FYs 2015 and 2016.

Figure 2: Results of Targeted Visitations for FYs 2015 and 2016

Action Taken	FY 2015	FY 2016	Totals
Expulsion	3	2	5
Two-Year Suspension	4	5	9
One-Year Suspension	16	16	32
Written Reprimand	39	51	90
Warning	42	37	79
Inactivation	49	28	77
No Change	102	86	188
Total Visitations	255	225	480

Source: SB/SE Division's Operations Support function.

This review was performed at the EPSS Headquarters in Atlanta, Georgia, and offices in New Carrollton, Maryland, and Andover, Massachusetts, during the period April 2016 through July 2017. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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Results of Review

Verification of Applicants' Citizenship Status Continues to Not Be Performed

Our match of 10,208 Principals and Responsible Officials listed on 16,345 e-file applications, approved between October 1, 2015, and February 28, 2016, to records maintained by the IRS identified:

- 45 Principals or Responsible Officials who were not shown as a U.S. citizen or resident alien on IRS records it receives from the Social Security Administration (SSA). The SSA provides a citizenship status field on the National Account Profile⁶ database it provides the IRS. This field indicates whether an individual is a citizen or legal resident alien.

When we raised our concerns to EPSS management, they stated that all but one of the 45 individuals passed initial suitability testing based solely on their acceptance in the Preparer Tax Identification Number (PTIN)⁷ Program. If an applicant applied for an EFIN and was previously assigned a PTIN, the IRS considers the applicant as having met the suitability requirements. However, there is no citizen requirement for an individual to obtain a PTIN. Thus, a citizenship verification is not performed. It should be noted that IRS personnel mailed letters to the 45 individuals we identified to obtain documentation supporting their citizenship status. For 33 of these individuals, the IRS received documentation proving they were a U.S. citizen or their tax records were updated to show that they are a U.S. citizen or resident alien. For the remaining 12 individuals, EPSS officials stated that they sent second letters to eight individuals, two individuals were removed as a Principal and/or Responsible Official from the e-file applications, and two individuals could not prove they were a U.S. citizen or resident alien. These last two individuals appealed the EPSS organization's determination.

- 1,494 Principals or Responsible Officials for whom the SSA citizenship status is blank. When we asked EPSS management how they confirmed that these applicants were citizens, they indicated that the SSA informed them that individuals who do not have a citizenship status (*i.e.*, field is blank) may have received their Social Security Number prior to 1981, and the SSA has not needed to update its records since granting the individuals a Social Security Number. EPSS management believes the probability that

⁶ The National Account Profile contains IRS and SSA information for individuals, including date of birth, date of death, and citizenship status.

⁷ The PTIN allows the IRS to administer its preparer program and match preparers to the tax returns they submit to the IRS.



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these individuals are not U.S. citizens is low and the cost of contacting them to verify their citizenship status is not justified. Although we requested documentation supporting EPSS management’s position that these applicants are citizens and the costs that would be incurred to verify these individuals’ citizenship status, they did not provide documentation. EPSS management initially stated that they were researching processes to address blank citizenship issues by using data from other sources. Subsequently, after we completed our fieldwork, management stated that procedures are already in place to address the blank citizenship status issue, and they will focus on processing new applications. Management did not commit to reviewing the 1,494 previously assigned EFINs. Moreover, we found that the IRS’s procedures are silent on how citizenship verification should be confirmed for applicants with a blank/unknown citizenship status.

E-file Provider Program guidelines state that only U.S. citizens and legal resident aliens (lawfully admitted for permanent residence) are allowed to be a Principal or Responsible Official on an application. Internal guidelines require the EPSS organization to complete initial suitability testing on Principals and Responsible Officials, which includes verifying their citizenship. This process is to protect the integrity of the e-file Program and help ensure that only eligible individuals access e-file products and services. Figure 3 shows the number of tax returns filed in Processing Year 2016 by the EFINs associated with the 1,539 individuals who either are not U.S. citizens or resident aliens or have a blank SSA citizenship status, as well as the number of tax returns the IRS accepted and rejected.

Figure 3: Tax Returns Filed in Processing Year 2016 Using EFINs Associated With Potentially Ineligible Individuals

Citizenship Status	Potentially Ineligible Individuals	Taxpayers With a Tax Return Filed Under The EFIN	Accepted Returns	Rejected Returns
Not U.S. Citizens or Legal Resident Aliens	45	5,451	5,328	780
Blank Citizens Status Field	1,494	663,420	659,544	43,307
Totals	1,539	668,871	664,872	44,087

Source: Treasury Inspector General for Tax Administration’s (TIGTA) analysis of 10,208 Principals and Responsible Officials.



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TIGTA previously reported concerns with the IRS not verifying citizenship status

In March 2010, we reported that the citizenship status had not been verified for all Principals and Responsible Officials.⁸ For existing and new applicants, if the citizenship status was blank or unknown on SSA records, the IRS did not request that the applicant provide documentation supporting the individual's citizenship status. We recommended that the Commissioner, Wage and Investment Division, ensure that the citizenship status is verified for all Principals and Responsible Officials who show a blank or unknown citizenship status. The IRS disagreed, stating that it shared our concern of the need to accurately verify information, but recent legislation (at that time) mandating e-filing for most return preparers would probably require it to change the Provider rules with respect to citizenship status. When the EPSS organization does not verify the citizenship status of e-file applicants, EFINs can be issued to ineligible individuals who can use them to file fraudulent tax returns.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Verify the citizenship status of the eight individuals who, per SSA records, were not U.S. citizens or resident aliens and from whom the IRS did not receive a response to its second letter requesting documentation supporting the individuals' citizenship. If documentation is not obtained, deactivate these individuals' EFINs and, if appropriate, deactivate the EFINs for the two individuals who appealed the EPSS's determination that they are not U.S. citizens or resident aliens.

Management's Response: The IRS agreed with this recommendation and has deactivated the EFINs of the eight individuals who did not verify their citizenship. Citizenship has been confirmed for the two individuals appealing the IRS's prior determination.

Recommendation 2: Develop a process to verify citizenship status for all prior and current Principals and Responsible Officials for whom SSA citizenship records are blank, including the 1,494 individuals we identified.

Management's Response: The IRS agreed with this recommendation and plans to develop procedures that will address Principals and Responsible Officials on new applications for whom SSA records do not indicate citizenship. IRS management also plans to initiate a review immediately of those individuals identified in the report who lack the SSA citizenship indicator. However, without any new data sources verifying citizenship status, the IRS must request that individuals provide proof of status. To accomplish this for existing e-file participants, letters requesting proof of citizenship must

⁸ TIGTA, Ref. No. 2010-40-042, *The Screening and Monitoring of E-File Providers Has Improved, but More Work Is Needed to Ensure the Integrity of the E-File Program* (March 2010)



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be created and a reasonable time frame allowed for the individuals to respond. The responses to the almost 1,500 letters will be analyzed, resulting in a report with recommendations on how to proceed with new users and existing users with blank citizenship codes.

Processes Have Not Been Established to Ensure That Partnerships Comply With e-file Application Requirements

Our comparison of partners listed on a statistically valid sample⁹ of 34 approved e-file Provider Program partnership applications to IRS information and selected Secretary of State websites identified nine (26 percent) partnership e-file applications that omitted at least one partner with a 5 percent or greater ownership interest in the partnership. Based on the results of our statistical sample, we estimate that 256 of the 969 partnership e-file applications may have a similar condition.¹⁰

When we discussed our audit results with IRS management, they stated that the failure to disclose a partner on the application does not represent an inherent risk to the e-file Program. In addition, management disagreed that all partners are required to be listed on the application and stated that ongoing EFIN monitoring by the EPSS and the Return Integrity and Compliance Services (RICS) organizations and the SB/SE Division should identify EFINs used to file potentially fraudulent tax returns.

The IRS's position is contrary to its own e-file Program Provider guidance. Specifically, IRS Publication 3112 states, "Each partner who has a 5 percent or more interest in the partnership is a Principal." IRS guidance also states that e-Services products can be accessed by five categories of authorized users, one of which is a Principal, including a partner who has a 5 percent or more interest in a partnership. In addition, IRS guidance requires that suitability checks be performed on an organization's Principals and Responsible Officials for the initial and continuous participation in the IRS e-file Provider Program.

We also disagree with management's assertion that it is not important to ensure that all applicable partners are listed on the application and that omitting them does not present a risk to the e-file Program. Below are examples of partnership applications that we identified in which a partner may have been knowingly omitted from the application due to concerns as to their ability to pass the IRS's suitability requirements.

- Two partnerships applications would have been identified as not meeting suitability requirements because the IRS would have identified the omitted partners as having an

⁹ To select our statistically valid sample, we used an expected error rate of 5 percent, a precision rate of 6 percent, and a confidence level of 90 percent. Our sample was selected from a universe of 969 partnership applications approved by the IRS from January 2015 to February 2016.

¹⁰ The point estimate projection is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the point estimate is between 139 and 374 partnerships that omitted at least one partner on the application.



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outstanding tax debt without an installment agreement.¹¹ In addition, as of June 2017, one of the partners omitted from the application had not filed a tax return for Tax Years¹² 2014 or 2015. Program requirements include filing all business and personal tax returns.

- One partnership application would have been identified as not meeting continuous suitability requirements because two of the partners omitted from the application had outstanding tax debt without an installment agreement. It should be noted that two partners omitted from the application held a combined interest of 100 percent in the partnership. The sole individual listed on the application had zero interest in the partnership.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 3: Develop processes to verify the accuracy of partnership reporting on prior e-file applications as well as new partnership e-file applications to ensure compliance with program requirements.

Management's Response: The IRS partially agreed with this recommendation. IRS management determined that Publication 3112 instructions and guidelines can be clarified and will be revised to explain that a Key Person would correctly be listed in the place of a Principal (partner) with an interest of 5 percent or greater when that partner does not substantially participate in the e-filing operations of the firm. Procedures will also be established by which organizations will identify when the Key Person exception is applicable and being used. IRS management believes the update to the publication can be accomplished in a short time frame. However, the update to procedures will require programming changes to allow the online application to reflect the selection of the Key Person election.

Office of Audit Comment: The IRS did not agree to review prior e-file applications from partnerships to ensure that the applications list all partners with a 5 percent or greater ownership interest. Moreover, changing Publication 3112 to allow Key Persons to be listed on the e-file application as a Principal in lieu of one or more partners would allow partnerships to circumvent initial and continuous suitability checks by purposely excluding partners with criminal backgrounds, past due taxes, *etc.*

¹¹ Had these partners been included on the application, they could have appealed a failed suitability test and would have been given the opportunity to satisfy their tax debts.

¹² A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.



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Recommendation 4: Suspend the EFINs associated with the nine partnership applications with omitted partners that we identified and request revised applications that accurately report partners to ensure that these partners meet program suitability requirements.

Management's Response: The IRS disagreed with this recommendation. IRS management responded that there were no violations of the e-file Provider Program warranting suspension. Partnerships that choose to identify Key Persons instead of including all partners with 5 percent or greater ownership interest in the partnership have complied with the program requirements.

Office of Audit Comment: The nine partnerships did not list all partners who have a 5 percent or greater ownership on their e-file applications as required by Publication 3112. As we detailed in this report, some of the partners omitted would not have passed IRS suitability requirements.

Electronic Filing Identification Numbers Continue to Not Be Timely Deactivated for Deceased Principals and Responsible Officials

Our review identified 965 EFINs associated with Principals or Responsible Officials who were deceased on or before December 31, 2015, but their names are listed on e-file applications approved between October 1, 2015, and February 28, 2016. For 217 (22 percent) applications, the deceased individual was properly removed from the application, and the EFIN was allowed to remain active because the deceased was not the sole Principal or Responsible Official. However, for the remaining 748 EFINs, we determined that:

- 399 (41 percent) of the EFINs associated with deceased individuals were deactivated, as required, but the time frame to deactivate these EFINs ranged from 117 to 3,775 days. The average was 1,080 days.
- 349 (36 percent) of the EFINs associated with deceased individuals were still active as of March 24, 2017. These EFINs continued to be used subsequent to the individuals' deaths to transmit 45,468 tax returns in Calendar Year 2016. It should be noted that 109 (31 percent) of the 349 EFINs involved decedents who were Principals or Responsible Officials associated with large taxpayers and volunteer organizations. The EPSS organization does not require EPSS assistants to conduct suitability checks for these individuals during application screening or continuous monitoring of Providers.

Once a deceased Principal or Responsible Official is identified, internal guidelines require EPSS assistants to take the following steps to deactivate the EFIN:

- If the decedent is not the sole Principal or Responsible Official on the e-file application, the EPSS assistant should request that the Provider remove the deceased individual from



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the application. If the Provider does not remove the decedent from the application within 30 days, the assistor should deactivate the EFIN.

- If the decedent is the only individual on the application, the assistor should deactivate the EFIN. Guidelines do not specify a time frame for deactivating these EFINS.

According to EPSS management, most of the decedents' EFINS remained active because the majority of the cases were not worked by EPSS assistors as required. For the other decedent cases that were untimely worked, management stated that EPSS systems show assistors initiating those cases, but they did not always complete the removal process.

We notified IRS management, in April 2017, of the 349 EFINS that still remained active. Management stated that those cases were currently being reviewed and worked. Management also stated that in April 2017, the IRS's Information Technology organization performed another match of Tax Identification Numbers to its active e-file applications, including Principals and Responsible Officials associated with large taxpayers and volunteer organizations. According to EPSS management, the resulting query identified 39 additional decedent cases that are being worked. EPSS management stated that they will perform this interim decedent identification process until funding becomes available to upgrade IRS system requirements to perform this check systemically, which they anticipate will take place by Fall 2018.

TIGTA previously reported concerns with the IRS not ensuring that EFINS associated with deceased applicants were deactivated

In March 2011, we reported that the IRS did not perform periodic checks to ensure that the EFINS associated with deceased individuals were deactivated.¹³ In response, the IRS implemented a new procedure that identified deceased Principals and Responsible Officials by comparing Taxpayer Identification Numbers from existing e-file applications to SSA information to identify records containing a date of death. The IRS stated that it would then deactivate the EFINS of any deceased individuals identified during this match, as warranted. In addition, the IRS stated that these procedures were implemented in February 2012 and are performed twice per year. However, the results of our current review indicate that these corrective actions are not sufficient because EPSS assistors are still not timely deactivating deceased individuals' EFINS.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 5: Establish time frames and a process for ensuring timely inactivation of EFINS for which the sole Principal or Responsible Official is deceased.

¹³ TIGTA, Ref. No. 2011-40-031, *Review of the Use of the Electronic Filing Identification Number* (Mar. 2011).



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Management's Response: The IRS agreed with this recommendation. IRS management plans to update procedures to include a required time frame for taking action to deactivate the EFINs associated with Principals or Responsible Officers who are deceased.

Recommendation 6: Ensure that the 349 EFINs that were still active as of March 24, 2017, are deactivated or the e-file application is revised, as appropriate.

Management's Response: The IRS agreed with this recommendation and is taking action to address the identified EFINs.

Referrals of Electronic Filing Identification Numbers Used to File Potentially Fraudulent Tax Returns Were Not Consistently Evaluated or Forwarded to the Electronic Products and Services Support Organization

Our review determined that referrals of the EFINs used to file potentially fraudulent tax returns were not consistently evaluated or forwarded to the EPSS organization. *****3***** contacted us with concerns about 328 EFINs *****3***** that were used to file potentially fraudulent tax returns. Despite the identification of the questionable filings associated with these EFINs, information regarding these EFINs was not reviewed for fraud or forwarded to the EPSS organization for evaluation. *****3***** identified the EFINs in Calendar Years 2014 and 2015 and *****3***** to RICS management. It should be noted that although this process identified EFINs potentially used to file fraudulent tax returns, *****3***** was instructed to discontinue *****3***** . RICS personnel stated that *****3***** *****3***** .

We contacted RICS management to discuss their response to *****3***** . Management stated that they reviewed the referrals to determine if the EFINs were used to submit identity theft tax returns. RICS management reviewed 104 (32 percent) of the 328 EFINs and determined that the majority did not meet their criteria for a referral. Specifically, at least 90 percent of the returns submitted using the EFIN did not have identity theft characteristics. For the 104 referrals reviewed, RICS officials submitted 42 to the EPSS organization, which deactivated all 42 EFINs. Management indicated that they performed a cursory review for the remaining 224 (68 percent) EFINs; however, they were unable to provide support documenting their review.

When we discussed with RICS management the 286 EFINs that they did not refer to the EPSS organization, they stated that the e-mail box *****3***** used to refer the EFINs to the RICS organization was not created to receive these types of referrals. The 286 EFINs that were not referred were used to file 365,382 tax returns for 258,199 taxpayers in Processing Years 2015 through 2017. The IRS placed an identity theft marker or a marker indicating potential fraud on



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the tax accounts associated with 72,038 (28 percent) of the returns filed during this period. In addition, the IRS rejected an average of 22 percent of the e-filed returns submitted using the referred EFINs. RICS management did note that as a result of our audit, they are working with the Lead Development Center to create procedures for handling referrals for which potential fraud is involved.

In February 2017, the IRS reported that the EPSS organization has partnered with the RICS organization, Criminal Investigation, the Lead Development Center, and other internal and external partners to combat fraud and identity theft related to EFINs. The EPSS organization receives referrals from external partners involving the misuse of EFINs. In addition, the EPSS organization works with the Research, Applied Analytics, and Statistics organization and performs its own analysis to identify possible compromised EFINs. If compromised EFINs are identified, they are deactivated. If fraudulent returns are being filed, the information is forwarded to one of the IRS's compliance partners for the necessary actions.

Recommendations

The Commissioner, Wage and Investment Division, should:

Recommendation 7: Finalize procedures for identifying and referring EFINs associated with potentially fraudulent return filings to the EPSS organization.

Management's Response: The IRS agreed with this recommendation. IRS management plans to update procedures to clarify the referral process and improve the awareness of referral criteria for those organizations making recommendations to impose e-file sanctions.

Recommendation 8: Ensure that all 286 of the suspicious EFINs not referred to the EPSS organization are reviewed for evidence of tax return fraud and deactivate them if warranted.

Management's Response: The IRS disagreed with this recommendation. IRS management responded that the tax returns associated with the 286 EFINs were evaluated for fraud and identity theft potential at the time they were processed and were treated accordingly if fraud or identity theft was suspected. IRS processes are designed to deactivate EFINs immediately when evidence indicates that an EFIN has been misappropriated for use in filing identity theft returns. Of the 328 EFINs referred for consideration, 104 were reviewed and 42 meeting identity theft criteria were deactivated. Sanctions intended to address non-identity theft fraudulent or questionable return preparation are subject to due process and cannot be initially addressed through EFIN deactivation procedures. It is incorrect to conclude, based simply on volume of returns filed, that an EFIN holder is responsible for the preparation of suspect returns.

Office of Audit Comment: Our recommendation is not based "simply on volume of returns filed." The volume of tax returns filed using these EFINs was provided to show



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the high percentage (28 percent) of tax accounts on which the IRS placed an identity theft marker or a marker indicating potential fraud associated with the returns filed. We also provided the high percentage (22 percent) of IRS-rejected e-filed returns that were submitted using the referred EFINs. The high percentage of accounts with an identity theft marker and rejected returns warrants IRS review of these EFINs to ensure that they are not being used to file fraudulent tax returns.



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the controls to prevent unauthorized use of EFINs. To accomplish this objective, we:

- I. Determined if the EFIN suitability controls ensured that EFINs were activated for only those applicants who met e-file requirements for acquiring an EFIN.
 - A. Determined if current controls ensured that all individuals with 5 percent or greater ownership in a partnership were listed on the e-file applications.
 1. From the universe of 521 completed partnership e-file applications created between October 1, 2015, and February 28, 2016, we selected a statistically valid sample of 33 partnerships. The sample used a 90 percent confidence level, a 5 percent projected error rate, and a 6 percent precision rate. A statistically valid sample was used to allow the results to be projected across the population of partnership applications meeting our criteria.
 2. Identified all partners of the partnerships from the sampled applications by using the yK1 tool,¹ the Employee User Portal,² and selected Secretary of State websites and compared the partners to those listed on the e-file application to identify partners who were not listed on the application.
 3. Conducted suitability checks on the partners who were not listed on the e-file application to determine if the application would have been approved (passed suitability checks) if the suitability checks had been completed.
 - B. Determined if the lack of second-level reviews of approved e-file applicants resulted in unsuitable Providers obtaining an EFIN.
 1. From the universe of 16,345 completed e-file applications in the EFIN database created between October 1, 2015, and February 28, 2016, matched the Principals and Responsible Officials on the applications to the most current version of the National Account Profile³ database to identify instances in which an incorrect

¹ The yK1 is an interactive link analysis tool developed by the IRS to discover and explore tax entities and their relationships.

² The Employee User Portal is a web-hosting infrastructure that provides access to electronically filed tax returns.

³ The National Account Profile contains IRS and SSA information for individuals, including date of birth, date of death, and citizenship status.



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determination was made regarding a Principal or Responsible Official's U.S. citizenship status.

2. For individuals who should not have passed the citizenship test, identified tax returns that were e-filed using the firms' EFINs.
- II. Reviewed monitoring procedures to determine if controls are in place to identify unauthorized use of EFINs.
- A. For the 328 EFINs identified by the *****3**** who submitted a suggestion to the RICS organization regarding fraudulent tax return preparers, interviewed RICS management to determine what they did when they received the information and why they did not notify the EPSS organization of potential EFIN misuse.
 - B. Compared the 328 EFINs identified by the *****3***** to the EFIN database to determine if and when the EFINs were deactivated.
 1. For the 286 EFINs that were not referred, quantified the number of tax returns submitted.
 2. Determined if any of these tax returns were marked by the IRS as identity theft or potentially fraudulent tax returns.
- III. Evaluated the effectiveness of inactivating EFINs when the EPSS organization received notification of a deceased Principal or Responsible Official from its various sources, including the Preparer Tax Identification Number Program or SSA.⁴
- A. Matched the identifying information for Principals and Responsible Officials for firms with an active EFIN in Calendar Year 2016 to SSA records (the National Account Profile database) to determine if deceased individuals have an active EFIN.
 - B. For instances in which a deceased Principle or Responsible Official was identified, determined the type of firm.
 - C. For sole proprietorships, determined if the EFIN was used in Processing Year 2016.⁵
 - D. For other types of firms, determined if the application was updated, as required, to replace the deceased individual with a new Principal or Responsible Official.
 - E. Quantified the number of tax returns filed using EFINs with deceased individuals still listed on the e-file application.
 - F. Identified the reasons the EFINs were not deactivated.

⁴ This objective is a follow-up on the IRS's corrective action to the first recommendation in TIGTA, Ref. No. 2011-40-031, *Review of the Use of the Electronic Filing Identification Number* (Mar. 2011).

⁵ The calendar year in which the tax return or document is processed by the IRS.



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G. For deactivated EFINs, evaluated the timeliness of the deactivation.

Data validation methodology

During this review, we were able to rely on an IRS data extract of e-file applications as well as data extracted from the IRS Individual Masterfile⁶ and the SSA's National Account Profile. Before relying on the e-file application data, we ensured that IRS data extract contained the specific data elements that we needed. In addition, throughout our testing, we reviewed random samples of all data extracted and verified that the data in the extracts were the same as the data captured in the IRS's Integrated Data Retrieval System⁷ and/or the source from which they were extracted to ensure that they were an accurate reflection of the original data.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: suitability check controls for ensuring that applicants meet EFIN requirements, periodic and continuous monitoring controls to identify unauthorized use of EFINs, controls to ensure that referrals are properly addressed, and the process for inactivating EFINs that were stolen or abused or should no longer be active.

⁶ The IRS database that maintains transactions or records of individual tax accounts.

⁷ IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records.



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Appendix II

Major Contributors to This Report

Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services)
W. Allen Gray, Director
Janelle Pruden, Audit Manager
Ken Carlson, Lead Auditor
Jerome Antoine, Auditor
Kamelia Phillips, Auditor



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Appendix III

Report Distribution List

Commissioner
Office of the Commissioner – Attn: Chief of Staff
Deputy Commissioner for Services and Enforcement
Deputy Commissioner, Wage and Investment Division
Director, Customer Account Services, Wage and Investment Division
Director, Identity Theft Victim Assistance
Director, Office of Audit Coordination



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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 1,539 individuals who, per SSA records, were not shown as being a U.S. citizen or resident alien (see page 5).

Methodology Used to Measure the Reported Benefit:

We compared a listing of 10,208 Principals and Responsible Officials associated with 16,345 approved e-file applications completed between October 2015 and February 2016 to SSA records and identified:

- 45 individuals who were not U.S. citizens or resident aliens according to SSA records.
- 1,494 individuals for whom the SSA did not have a citizenship status.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 256 e-file partnership applications¹ for which partners are not accurately included as Principals (see page 7).

Methodology Used to Measure the Reported Benefit:

We selected a statistically valid random sample² of 34 partnership e-file applications from a population of 969 e-file applications submitted by partnerships and approved by the IRS between January 2015 and March 2016. We manually reviewed the 34 partnership e-file applications using the IRS's yK1³ application, Employee User Portal,⁴ and selected Secretary of State websites and determined that nine did not properly list all partners as a Principal. Based on the

¹ The point estimate projection is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the point estimate is between 139 and 374 partnership e-file applications.

² To select our statistically valid sample, we used an expected error rate of 5 percent, a precision rate of 6 percent, and a confidence level of 90 percent. Our sample was selected from a universe of 969 partnership applications approved by the IRS from January 2015 to February 2016.

³ The yK1 is an interactive link analysis tool developed by the IRS to discover and explore tax entities and their relationships.

⁴ The Employee User Portal is a web-hosting infrastructure that provides access to electronically filed tax returns.



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results of our sample, we project that 256 partnership e-file applications, from the population of 969, did not include at least one partner on the application.⁵

⁵ The point estimate projection is based on a two-sided 90 percent confidence interval. We are 90 percent confident that the point estimate is between 139 and 374 partnerships that omitted at least one partner on the application.



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Appendix V

Management's Response to the Draft Report

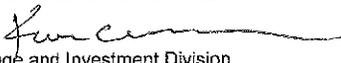


COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

OCT 10 2017

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kenneth C. Corbin 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Processes Do Not Always Ensure That
Electronic Filing Identification Numbers Are Assigned to
Qualified Applicants or Deactivated When Required
(Audit # 201640011)

Thank you for the opportunity to review and comment on the subject draft report. The IRS electronic filing (*e-file*) program offers taxpayers an efficient, quick way to meet their filing obligations. The e-file program is made possible through the efforts of electronic return originators and other participants in the e-file Provider program. The integrity of the e-file Provider program is an important aspect of IRS' monitoring of the electronic tax return submission process. To obtain an Electronic Filing Identification Number (EFIN) and participate in the e-file Provider program, tax professionals must submit an e-file application, are subject to suitability checks that may include professional credential validation, criminal background checks and tax compliance checks. For the 2016 filing season, there were more than 132 million electronic returns, filed by 278,500 active EFINs, that were accepted.

We are addressing findings raised in the report, related to individuals for whom available Social Security Administration data is silent regarding their citizenship status and EFINs listing deceased individuals as Principals or Responsible Officials. Procedures are being revised to ensure appropriate follow-up inquiries are made with those individuals whose citizenship status cannot be determined from available information. This process will also be augmented by planned upgrades, expected in late 2017, to the automated systems supporting the EFIN application program. We are also establishing timeliness standards for the resolution of EFIN assignments to individuals who are now deceased.

The report indicates partners are not being included on an e-file Application as is required. This is not a correct conclusion as the IRS established, in 2007, an exception



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for Principals listed on the e-file Application.¹ The exception allows Key Persons who participate substantially in the firm's e-file operation to be provided on the application in lieu of corporate officers, partners, etc. Therefore, it is not necessary for partnerships to include all partners with a five percent or greater ownership interest in the partnership as Principals on the application. The rules governing application and participation in the e-file provider program are provided in Publication 3112, *IRS e-file Application and Participation*. The partnerships that identified key persons on their applications have complied with the e-file requirements and will not be deactivated. However, based on the concerns raised in the report, we will clarify the Key Person rule in that publication.

In the past five years, we have taken steps to strengthen expulsion policies for the e-file Provider program. Identity theft (IDT) policy and procedures have been implemented that have enhanced monitoring of program participants, identification of potential fraud, and improved external communication and education. We continue to improve internal communication and the sharing of information among the multiple IRS functions whose actions contribute to the integrity of the program. Referral procedures have also been strengthened to ensure the Electronic Products and Services Support function is notified in a timely manner when suspicious activity related to an EFIN has occurred.

The report recommends the IRS sanction 286 potentially suspicious EFINs; however, the returns filed by those EFINs went through fraud and IDT filtering when processed and were treated accordingly. Tax return preparers are regulated under the authority of Treasury Department Circular 230, *Regulations Governing Practice before the Internal Revenue Service*. The standards established by Circular 230 do not create a nexus between return preparation and the transmittal of electronic returns. Further, returns may be prepared by tax professionals who are not EFIN holders and do not transmit their own returns. Conversely, EFIN holders may transmit returns that were prepared by others. Deactivation of EFINs based on the suspicion of inept or intentional preparer actions is not a correct conclusion. In such cases, disciplinary actions must adhere to the standards of Circular 230 and the due process afforded therein. Determinations of fraud would require further investigation by our compliance operations. If it is determined that the EFIN holder was directly involved in the transmission of fraudulent or abusive returns, EFIN sanctions would then be imposed.

Attached are our comments and proposed actions to your recommendations. If you have any questions, please contact me, or a member of your staff may contact James P. Clifford, Director, Customer Account Services, Wage and Investment Division, at (470) 639-2716.

Attachment

¹ Rev. Proc. 2007-40; 2007-1 C.B. 1488; 2007-26 I.R.B. 1488



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Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1

Verify the citizenship status of the eight individuals who, per SSA records, were not U.S. citizens or resident aliens and, from whom, the IRS did not receive a response to its second letter requesting documentation supporting the individuals' citizenship. If documentation is not obtained, deactivate these individuals' EFINs, and if appropriate, deactivate the EFINs for the two individuals who appealed the EPSS's determination that they are not U.S. citizens or resident aliens.

CORRECTIVE ACTION

We agree with this recommendation. The Electronic Filing Identification Numbers (EFINs) associated with the eight individuals who did not verify their citizenship have been deactivated. Citizenship has been confirmed for the two individuals appealing our prior determination.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

Director, Electronic Products and Services Support, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 2

Develop a process to verify citizenship status for all prior and current Principals and Responsible Officials for whom SSA citizenship records are blank, including the 1,494 individuals we identified.

CORRECTIVE ACTION

We agree with this recommendation and will develop procedures that will address Principals and Responsible Officials on new applications for whom Social Security Administration records do not indicate citizenship. We will immediately initiate a review of those individuals identified in the report who lack the SSA citizenship indicator. However, without any new data sources verifying citizenship status, IRS must request individuals provide proof of status. To accomplish this for existing e-file participants, letters requesting proof of citizenship must be created, and a reasonable timeframe allowed for the individuals to respond. The responses to the almost 1,500 letters will be analyzed, resulting in a report with recommendations on how to proceed with new users and existing users with blank citizenship codes.



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IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Electronic Products and Services Support, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 3

Develop processes to verify the accuracy of partnership reporting on prior e-file applications as well as new partnership e-file applications to ensure compliance with program requirements.

CORRECTIVE ACTION

We partially agree with this recommendation. Upon review of the audit findings, we have determined instructions and guidelines provided to applicants by Publication 3112, *IRS e-file Application and Participation*, can be clarified to explain when a Key Person would correctly be listed in the place of a Principal (partner) with an interest of five percent or greater, when that partner does not substantially participate in the electronic filing operations of the firm.

Publication 3112 will be revised as soon as practical under its publication schedule and procedures will be established by which organizations will identify when the Key Person exception is applicable and being used. While the update to the publication can be accomplished in short timeframe, the update to the procedures will require programming changes to allow the online application to reflect the selection of the Key Person election.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Electronic Products and Services Support, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.



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RECOMMENDATION 4

Suspend the EFINs associated with the nine partnership applications we identified and request revised applications that accurately report partners to ensure that these partners meet program suitability requirements.

CORRECTIVE ACTION

We disagree with this recommendation as there were no violations of the e-file provider program warranting suspension. Partnerships that choose to identify key persons, instead of including all partners with five percent or greater ownership interest in the partnership, have complied with the program requirements.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A

RECOMMENDATION 5

Establish time frames and a process for ensuring timely inactivation of EFINs for which the sole Principal or Responsible Official is deceased.

CORRECTIVE ACTION

We agree with this recommendation. Procedures will be updated to include a required timeframe for taking action to deactivate the EFINs associated with Principals or Responsible Officials who are deceased.

IMPLEMENTATION DATE

March 15, 2018

RESPONSIBLE OFFICIAL

Director, Electronic Products and Services Support, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 6

Ensure that the 349 EFINs that were still active as of March 24, 2017, are deactivated or the e-file application is revised, as appropriate.



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CORRECTIVE ACTION

We agree with this recommendation. Actions are being taken to address the identified EFINs.

IMPLEMENTATION DATE

January 15, 2018

RESPONSIBLE OFFICIAL

Director, Electronic Products and Services Support, Customer Account Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 7

Finalize procedures for identifying and referring EFINs associated with potentially fraudulent return filings to the EPSS organization.

CORRECTIVE ACTION

We agree with this recommendation. Procedures will be updated to clarify the referral process and improve the awareness of referral criteria for those organizations making recommendations to impose e-file sanctions.

IMPLEMENTATION DATE

June 15, 2018

RESPONSIBLE OFFICIAL

Director, Electronic Products and Services Support, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 8

Ensure that all 286 of the suspicious EFINs not referred to the EPSS organization are reviewed for evidence of tax return fraud, and deactivate them if warranted.

CORRECTIVE ACTION

We disagree with this recommendation. The tax returns associated with the 286 EFINS were evaluated for fraud and identity theft (IDT) potential at the time they were processed, and were treated accordingly if fraud or IDT was suspected. When evidence indicates an EFIN has been misappropriated for use in filing IDT returns, our processes are designed to deactivate it immediately. Of the 328 EFINs referred for consideration,



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104 were reviewed and 42, meeting IDT referral criteria, were deactivated. Sanctions intended to address non-IDT fraudulent or questionable return preparation are subject to due process and cannot be initially addressed through EFIN deactivation procedures. It is incorrect to conclude, based simply on volume of returns filed, that an EFIN holder is responsible for the preparation of suspect returns.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A