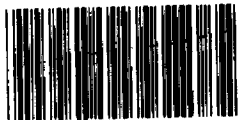


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United States General Accounting Office  
Washington, D.C. 20548



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FOR RELEASE ON DELIVERY  
Expected at 10:00 a.m. EST  
April 24, 1979

STATEMENT OF  
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 BEFORE THE  
 SUBCOMMITTEE ON COMMERCE, CONSUMER  
 AND MONETARY AFFAIRS  
 HOUSE COMMITTEE ON GOVERNMENT OPERATIONS  
 ON  
 THE INTERNAL REVENUE SERVICE'S EFFORTS  
 DIRECTED AT MULTIPLE FALSE FILERS

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to assist the Subcommittee as it begins to look into a question of great concern to all of us-- the extent to which people are filing more than one tax return, getting illegal refunds from the Internal Revenue Service, and not being caught.

At the outset we would like to note that no one knows how many people may be engaged in such schemes. As an IRS official told us, the Government only knows about those it catches. It is the unknown that is of concern, as well as whether IRS has developed an effective system to detect false refund schemes as quickly as possible.

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Our testimony seeks to provide the Subcommittee some answers to these concerns, especially whether IRS has an effective system to detect false filers.

Recognizing the Subcommittee's concern to make recommendations to IRS so its efforts can be as effective as possible, we thought it appropriate to begin by noting the problems we identified with IRS' efforts. To better understand why these problems are significant we will then discuss who the schemers are and how IRS now identifies and tracks down multiple filers.

Before going into detail we would like to point out that one of our concerns in presenting public testimony is to provide the Subcommittee as much information as possible while at the same time not disclosing detailed information that could aid people bent on trying to file false tax returns. It has not always been easy to balance the need to know with the need to protect. We appreciate the Subcommittee's sensitivity to this issue. If the Subcommittee is interested in exploring in more detail some of the sensitive matters we will be discussing, we would be pleased to do so in a closed executive session.

PROBLEMS WITH  
IRS' PROGRAM

Before January 1977, IRS efforts to identify refund schemes consisted of numerous fragmented programs with little or no coordination among them. Working independently, the Internal Audit, Examination, Criminal Investigation, Taxpayer Services, Accounts, and Collection functions in IRS had developed profiles and programs to identify multiple and fraudulent filers. Some of these programs were nationally controlled while others were developed and implemented on a region by region basis. In addition, some of the programs were designed to identify fraudulent schemes after the refunds were issued while others identified fraudulent schemes prior to refund issuance. As a result of this fragmentation, most identified schemes were handled as isolated incidents and corrective measures were taken at the appropriate technical level with little or no dissemination of the findings and action taken to the other groups.

In 1977, as a result of unfavorable publicity about refund schemes, congressional interest, and IRS studies, the Service developed a nationally coordinated detection effort which is now called the Questionable Refund Program.

While that program represents a significant improvement over past efforts, there are many issues and problems that still need to be addressed and solved. The problems can be divided into two categories; those that only affect IRS operations, and those that affect the way IRS coordinates with others.

#### IRS operations

--Not all fraudulent filers detected through the Questionable Refund Program are prosecuted; several are not even investigated by the Criminal Investigation Division. Available statistics indicate that of 512 questionable refund schemes identified during 1978, 287 were rejected by the Criminal Investigation Division.

One factor that can cause a fraudulent filer to go unprosecuted is the Government's inability to determine the filer's true identity. This problem can be occasioned by a filer using fictitious names, addresses, and identification numbers.

A more basic reason why some fraudulent filers go unprosecuted and even uninvestigated is the fact that many fraudulent filers only file one fraudulent return as opposed to multiple filers who file several returns. In 1978, for example, one service center identified 74 questionable refund schemes of which 37 involved the filing of only one return. The Criminal Investigation Division and U.S. attorneys are generally reluctant to work single return cases because they view such cases as having little prosecution potential especially considering other work priorities.

If IRS handles single refund schemes properly, it could still take civil action against the taxpayer. The question is whether IRS is doing this to effectively deter such people from attempting to try to get fraudulent refunds in the future.

We did not have sufficient time to assess IRS' efforts in this regard, but will do so as quickly as possible so the Committee and Subcommittee can have our analysis before they issue their report.

- Information available to us indicates that IRS' computerized system for scoring the fraud potential of refund returns is not very effective in identifying those returns with the most fraud potential. Some field offices have commented that they get more productivity out of low-scored returns, and an IRS study in this regard showed that 46 percent of the known fraudulent refund returns had low fraud scores. While this demonstrates the value of a redundant detection program, it also demonstrates weaknesses in the scoring system. IRS is collecting data during this year's program that it hopes to use in improving the scoring system.
- Because of the risk of current or former employees becoming involved in multiple filer schemes, it is imperative that IRS strictly limit access to the details of its efforts directed at identifying fraudulent refunds. Our review of correspondence files and discussions with field personnel indicated that such was not the case. It appears that the details are known to more people than is really necessary. We would compare this to the details of IRS' system for scoring a return's audit potential--known as the discriminant function or DIF system--which are known to very few persons.
- The Information Returns Program is a vital part of IRS' detection efforts because it enables IRS to identify fraudulent W-2s by matching them with W-2s filed by employers. The success of that program has been affected, however, by the fact that not all wage documents have been matched and that the matching process actually occurs many months after the return is filed. Of about 168 million W-2s filed by employers for tax year 1976, for example, no more than 25 percent were matched to information provided on tax returns.

The importance of this effort is further justification for the need for IRS to implement this Committee's recommendations to more fully match appropriate documents. IRS says that the Combined Annual Wage Reporting System, which has been implemented this year, will enable it to start matching virtually all wage information. Only time will tell if that expectation is realized. There is no reason to expect that the timing of the matching process will improve under the new system.

- The Questionable Refund Program is basically a filing season effort. Most team members return to their regular assignments around the end of May each year. Certain team members, however, retain year-round responsibility for the Questionable Refund Program as part of their everyday duties. One way IRS might improve the program would involve retaining several additional team members during part of the post-filing season. The team members could analyze samples of refund returns they did not review during the filing season. Such analyses would provide valuable insight into the validity of the scoring system and would serve as a way of identifying schemes that somehow escaped detection through existing checks.
- There are other specific weaknesses in IRS' system but discussing them in a public hearing would only serve to help potential schemers.

#### Coordination problems

- One aspect of IRS' detection efforts could be jeopardized by recent actions taken by the Bureau of Prisons to revise its computerized inmate data system. In that regard, the Bureau has decided to discontinue collecting prisoner social security numbers even though it knew that IRS has been using that information as part of its Questionable Refund Program. Although the Bureau has said that it is designing another information system that will include prisoner social security numbers, current estimates indicate that the system may not be operational in time for the 1980 filing season. We understand that IRS is searching for alternate ways to get the prisoner social security numbers.

- Another prison-related matter is the fact that IRS has no national effort directed at obtaining cooperation and/or information from State prison authorities. Such liaison is left to local initiative with the result that only some IRS field offices are working with the States.
- IRS personnel have indicated that it takes from 4 to 8 weeks to get information, such as earnings data, from the Social Security Administration. This is much too long when dealing with multiple filer cases. Another Social Security Administration-related aspect of this program is the apparent ease with which persons have been able to obtain social security numbers.
- IRS and the Social Security Administration need to start advising each other of fictitious social security numbers that have been identified during the Questionable Refund Program or during various fraud investigations by Social Security. Because they don't now do that, a social security number may still be considered valid by the Social Security Administration even though IRS has identified it as invalid or vice versa.
- Another area where IRS and Social Security should coordinate is in exchanging information on a regular basis on similar type schemes involving false refund claims and fraudulent welfare claims. In some cases the same types of factors are used in both schemes: fictitious names and valid social security numbers belonging to innocent third parties. The same people may be using the same names and numbers when trying to defraud Social Security and IRS.
- IRS is unable to work as closely as it would like with the Postal Service in investigating questionable refund cases because of disclosure restrictions resulting from the Tax Reform Act of 1976. For example, IRS cannot request Postal Inspectors to assist in investigating a fraudulent refund scheme for mail fraud purposes because IRS' Chief Counsel has ruled that information from fictitious tax returns may not be disclosed to Postal Inspectors. In Chief Counsel's opinion, although a fictitious name may have been used on the return, a real person filed it and therefore would be protected under the disclosure provisions.

This type of ruling makes it difficult to secure the type of coordination needed to effectively identify and prosecute some false filers.

--There has also been concern that the disclosure provisions of the 1976 Tax Reform Act may have hindered cooperation between IRS and U.S. attorneys in prosecuting fraudulent refund cases. Our discussions with 10 assistant U.S. attorneys who have prosecuted fraudulent refund cases indicated that they had all the information needed to prosecute effectively.

--Some delays in the exchange of information between IRS service centers is apparently being occasioned by an inability to transmit taxpayer-identifiable data over the Treasury Enforcement Communications System. IRS and Customs (which has operational responsibility for the Treasury communications system) are working on that problem. Because an important objective of the Questionable Refund Program is to stop a fraudulent return before it is paid, any delay in exchanging information on identified schemes could be critical.

The following explanation of the characteristics of multiple filers and IRS' program to detect them should help provide an understanding of why it is important to address the problems we have just discussed.



CHARACTERISTICS OF MULTIPLE  
FILERS AND THEIR SCHEMES

The most remarkable characteristic of a multiple filer is that he or she generally is not particularly remarkable. Almost anyone--automobile dealers, waitresses, salesmen, laborers, machinists, students--can become a multiple filer. All it takes is minimal knowledge of how to prepare a tax return, access to certain forms which for the most part are readily available to the public, and the nerve to follow through on a scheme aimed at defrauding the Government.

While certain specific segments of the population can be expected to produce several multiple filers each year, it is the general public which produces most of them. In calendar year 1977, for example, the general public accounted for 389, or 75 percent, of the 515 potential defendants in fraudulent refund cases. Prisoners, former prisoners, and their associates accounted for 19 percent; tax return preparers for 5 percent; and former IRS employees for the remaining 1 percent.

Although these statistics indicate that prisoners account for a large percentage of the fraudulent filers, we should point out that this may be due to IRS emphasis on detecting prisoner refund schemes. The statistics, in effect, may reflect that IRS is more successful in detecting prisoner schemes than other schemes. Nevertheless, the large number of prisoners demonstrates why IRS must have effective coordination with Federal and State prison authorities.

Besides prisoners, return preparers, and IRS employees, one might expect to see computer programmers or operators involved in refund schemes. While there have been some schemes detected involving such persons, available information indicates that persons having data processing knowledge are no more likely to perpetrate a refund scheme than persons in other occupations. It is possible, however, that such persons are simply evading detection.

In discussing how multiple filing schemes work, the key elements are how the filer obtained and used social security numbers and W-2s. In general, multiple filers will either obtain social security numbers from the Social Security Administration by using fictitious names and/or use valid social security numbers belonging to innocent third parties. The perpetrators may, for example, obtain and use the social security numbers of persons who would have no reason to file their own returns such as derelicts, students, or prisoners serving lengthy sentences. Closer coordination between IRS and Social Security may prevent such misuse.

As for W-2s, the fraudulent filer will usually obtain blank forms, which are easily accessible, and just fill in the appropriate data. One piece of data the schemer has to include on the W-2 is an employer identification number. Schemers generally either use a valid company name and identification number; apply for their own identification numbers; or just make a number up.

The following examples, which were taken from public records, demonstrate the various ways multiple filers obtain and use social security numbers and W-2s.

- A taxpayer ran advertisements in various newspapers soliciting resumes for alleged position openings. Individuals responding to the advertisements received follow-up letters from the taxpayer seeking the applicants' W-2 forms, social security numbers, and other information. The taxpayer, who was sentenced in February 1979, then used the information to prepare tax returns using various addresses.
- A former IRS auditor filed false tax returns using names of recently deceased individuals. The names were obtained from the obituary columns of newspapers and social security numbers were obtained from voter registration files. The schemer was convicted in March 1979. (This example illustrates the need for IRS to adequately protect the details of its detection efforts.)
- An individual, posing as an IRS courier, obtained employees' social security numbers from the owner of a business, prepared false W-2s, and filed 195 false returns claiming \$368,000 in refunds. The individual was sentenced to a two year prison term in September 1978.
- Twenty four individuals, including three bank tellers responsible for cashing checks quickly without arousing the suspicion of bank officials, used false names to obtain social security numbers, then filed 521 false returns under their own and fictitious names, thereby defrauding IRS of more than \$250,000. The twenty four were indicted in September 1977.
- An inmate of a State prison obtained other inmates' social security numbers and filed 70 false tax returns based on fictitious W-2s. The inmate and his accomplices received over \$55,000 in refunds from IRS before the scheme was detected. In May

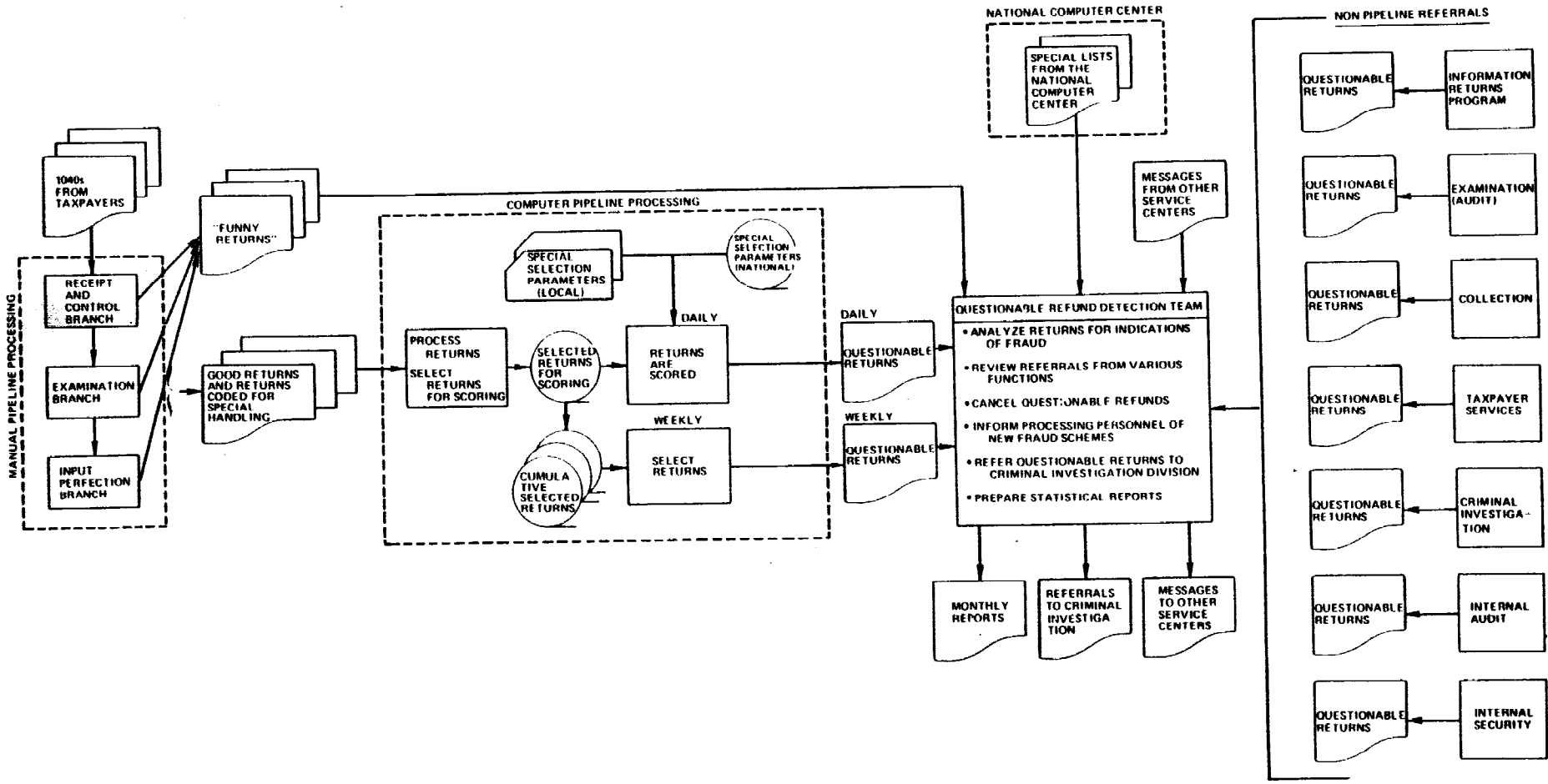
1977, the alleged mastermind of the scheme was indicted along with nine other inmates and three accomplices outside the prison who assisted in cashing the checks and investing the proceeds.

Another key aspect of any multiple filing scheme is the technique the filer uses to actually obtain the refund checks. Some schemers use a post office box or a general delivery address, others use several different addresses and then file change of address cards at the various post offices to funnel the checks to one location, and still others use various answering service mail drops. Since addresses play such an important part in false filing schemes, it is vital that IRS be able to coordinate investigations with the Postal Service.

#### HOW THE QUESTIONABLE REFUND PROGRAM WORKS

The Questionable Refund Program involves many different checks directed at identifying potentially fraudulent refunds. The program appears sufficiently sophisticated to catch most multiple filers, but there is no assurance that some do not go undetected. IRS has continued to refine its program on the basis of schemes it knows about. To the extent people have come up with ingenious schemes that somehow involve different procedures or approaches than IRS' system is geared to detect, those people will not be caught. Unfortunately, we are not aware of a way to get a handle on the number of such undetected filers.

As shown in the flow chart now before you, the Questionable Refund Program provides IRS with three basic avenues for detecting fraudulent filers:



- Manual detection as the returns are processed through the service center "pipeline".
- Computerized detection as returns are processed at the service centers through the "pipeline".
- Referrals from "non-pipeline" activities such as audit and collection.

The heart of the detection process is the Questionable Refund Detection Team at each of IRS' ten service centers, a multifunctional group of specialists including representatives from IRS' Criminal Investigation, Examination, and Collection functions. These teams evaluate potential fraudulent returns referred to them by the three detection methods, recommend adjustments to fraud criteria, implement refund cancellation procedures when appropriate, and turn over suspected fraudulent returns to the Criminal Investigation Division.

IRS begins checking a refund return for fraud potential as soon as the return is received from the taxpayer at the service center. Service center personnel who process returns are alerted to look for suspicious characteristics. Any suspicious returns are then removed from the processing pipeline and put directly into "funny boxes" where they are investigated by the fraud detection team. Certain characteristics can cause a return to be specially coded by pipeline personnel. These codes are used during subsequent computer processing and can affect a return's chance of being investigated by the refund fraud detection team.

Computerized detection of fraudulent filers begins after the manual pipeline processing. At this point, all returns which had not been selected by the team from the "funny boxes," including those with the special codes just discussed, are processed.

Daily, returns are "scored" based on their characteristics with certain characteristics causing points to be added to a return's score. The system operates on the premise that the higher a return's score, the greater its potential for involving a fraudulent refund. IRS uses a cutoff score to determine which returns will be forwarded to the refund detection team for detailed review. As we noted earlier, this scoring system needs to be improved. The computer program also gives each service center the option of searching returns for schemes peculiar to that locality.

The detection teams also use various computer listings, generated periodically by the service centers and IRS' National Computer Center, to identify certain type schemes including those that cross service center boundaries.

The teams also receive referrals from nonpipeline activities such as the Examination, Collection, Taxpayer Services, Internal Security, and Internal Audit Divisions. These referrals involve possible fraudulent situations that were detected after the refunds had been issued. Referrals

from these sources are sent directly to the detection teams. Another nonpipeline activity is the Information Returns Program. Under that program, IRS has initiated a procedure whereby it attempts to match the W-2 filed by the taxpayer with a corresponding W-2 filed by the employer. A situation involving a taxpayer-filed W-2 with no corresponding employer-filed W-2 could indicate a fraudulently filed return. As we noted earlier, this program must function properly to help IRS detect false filers.

A basic objective of the Questionable Refund Program is to identify a potentially fraudulent refund and put a freeze on it before it is paid. But about 64.4 million, or 75 percent, of the 86.1 million individual income tax returns filed in the first 6 months of 1978 involved refunds. Since the overwhelming majority of these refund returns are not fraudulent, IRS tries to conduct its Questionable Refund Program activities without affecting the overall timeliness of its refund process. Thus, the Questionable Refund Detection Teams are given about 2 weeks after receiving a return to determine whether a potentially fraudulent refund is involved.

When a service center detection team identifies a multiple filing scheme, it feeds data into an information system at that service center and forwards the information to other IRS service centers. If IRS used Treasury's



Enforcement Communications System, the information would be exchanged faster. The team that identified the scheme then forwards the involved returns to the Criminal Investigation Division at the appropriate IRS district office which investigates the suspected multiple filer and, when appropriate, recommends prosecution.

Upon receipt by the district office, tax returns involved in suspected refund schemes are directed to the Questionable Refund Program Coordinator. The coordinator, a Criminal Investigation Division special agent, has 10 days in which to evaluate the returns to determine whether a criminal tax case can be developed. Once the special agent and his supervisor agree that a refund scheme has criminal potential, a detailed investigation is initiated on a priority basis. Either the program coordinator or another special agent then begins conducting interviews, checking Federal, State, and local records, checking with employers, and conducting surveillances as necessary. These investigative activities are directed toward identifying the multiple filer and gathering evidence in support of a prosecution recommendation. In many instances, special agents ultimately conclude these investigations with an arrest of a suspected multiple filer--often as he or she picks up a refund check at the post office or other mail drop.

IRS district offices are authorized to refer multiple filer cases directly to the local U.S. attorney for prosecution. According to IRS personnel we spoke to in Washington and the field, U.S. attorneys are generally very cooperative in multiple filer cases although we were told that IRS often has to stay on top of a case to insure rapid indictment. A Justice Department official told us that the priority U.S. attorneys give multiple filer cases can vary from place to place but that he has received no feedback from IRS about any problems in that regard. We saw no evidence of any real problems in that regard either based on our discussions with IRS personnel and assistant U.S. attorneys.

Periodically, each service center prepares cumulative summaries showing identified refund schemes and sends those summaries, along with copies of related tax returns, to the national office. The national office mails consolidated summary statements to the regions and appropriate management; it analyzes the various tax returns to get a better fix on the characteristics of questionable refund returns so as to improve its detection efforts.

The Questionable Refund Program has several positive features:

- It is a redundant program meaning that each refund return is looked at many times even before the refund is mailed out. Each service center employee in the processing pipeline is giving the return a critical look and then the return is subjected to several computer checks.

- Unlike most IRS efforts, the Questionable Refund Program is controlled and directed by a multi-functional committee operating out of the national office. This facilitates a more effective interchange of information between service centers than is normally possible in IRS.
- The program is evaluated each year with extensive field input and revised accordingly. This enables IRS to keep on top of the most currently identified schemes and scheme characteristics and to correct program deficiencies.
- IRS district offices are permitted to refer multiple filer cases directly to U.S. attorneys for prosecution. As such, multiple filer cases are processed more quickly than regular criminal tax cases which have to flow through IRS attorneys and the Tax Division of the Department of Justice before reaching the U.S. attorney.

By effectively addressing the problems we mentioned earlier, IRS' program could even be better.

This concludes our prepared statement. We would be pleased to respond to any questions.