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United States Senate

COMMITTEE ON THE JUDICIARY

WASHINGTON, DC 20510-6275

April 21, 2014

The Honorable John Koskinen  
Commissioner  
Internal Revenue Service  
U.S. Department of the Treasury  
1111 Constitution Avenue, NW  
Washington, DC 20224

Dear Commissioner Koskinen:

Tax fraud is a serious and rapidly growing problem in the U.S. In recent years, the Internal Revenue Service (IRS) has become a popular target for fraudsters attempting to steal money from the federal government. There are many ways to commit tax fraud, from falsely claiming tax credits to submitting returns under false identities. One of the most serious types of tax fraud is identity theft related tax fraud, where a fraudster uses someone else's identity to file a fraudulent claim. The Treasury Inspector General for Tax Administration (TIGTA) estimates that the IRS is paying out over \$5 billion per year to identity thieves.<sup>1</sup>

Regardless of the type of fraud, one of the most important tools in combating it is a robust fraud detection system. Unfortunately, the IRS's current system is extremely outdated. Implemented in 1994, the Electronic Fraud Detection System (EFDS) remains the IRS's primary frontline system for detecting fraudulent returns even though the IRS itself has said that the system may not even be operable beyond this year.

According to the IRS, EFDS is "too risky to maintain, upgrade, or operate beyond 2014."<sup>2</sup> Alarmingly, the IRS has still not implemented a new system.

In 2006, the IRS attempted to replace the EFDS as its primary fraud detection system. When that initiative failed, the IRS completed the 2006 filing season with no fraud detection system in place.<sup>3</sup> In 2009, the IRS tried to create a more updated system again, commencing development of the Return Review Program (RRP). Successful implementation of the RRP is crucial to ensure fraud detection, especially if the IRS is correct that the EFDS will not be a viable system after this year. In its 2013 audit of the IRS's fraud detection systems, TIGTA said that "A successful RRP system is critical to the IRS mission."<sup>4</sup>

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<sup>1</sup> Treasury Inspector General for Tax Administration (TIGTA), "There are Billions of Dollars in Undetected Tax Refund Fraud Resulting from Identity Theft," July 19, 2012.

<sup>2</sup> Taxpayer Advocate Service, "Fiscal Year 2014 Objectives: Report to Congress," June 30, 2013.

<sup>3</sup> *Id.*

<sup>4</sup> TIGTA, "Improvements Are Needed to Ensure Successful Development and System Integration for the Return Review Program," July 26, 2013.

The IRS estimates that the RRP is expected to enhance revenue by \$28.8 million per year when fully implemented, and that its estimated five-year rate of return is 15,800 percent.<sup>5</sup> Over \$102.9 million has already been spent on the RRP, and Congress approved another \$67.7 million for FY 2014.<sup>6</sup> In spite of these investments by the taxpayer, on January 15, 2013, the IRS reported that it did not have enough resources to bring RRP online by the January 1, 2015 deadline. Furthermore, the Taxpayer Advocate Service reported to Congress that, even with additional resources, the IRS would still need another year (until January 1, 2016) to complete the system, purportedly due to technical challenges.<sup>7</sup> This creates a very real risk for taxpayers, who are more likely to be victims of fraud while the IRS continues to use an inadequate system.

The delay in implementing the RRP is particularly concerning in light of the IRS's responsibilities under the Patient Protection and Affordable Care Act (PPACA). PPACA created premium tax credits to help people pay for health insurance. Americans have the option of estimating their tax credit in advance, and having the payment go directly to the insurer to pay for a health plan. TIGTA has raised serious concerns about the IRS's ability to oversee the premium tax credits, issuing a report in September 2013 finding that the IRS needs to strengthen development controls for the credits.<sup>8</sup> The IRS is also allowing people to claim the premium tax credit as a refundable credit at the end of the year. Refundable tax credits are among the most popular targets for fraudsters. The IRS has noted that refundable credits, especially of significant amounts, attract fraud.<sup>9</sup> In fact, the Earned Income Tax Credit (EITC) has the highest percentage of improper payments of any program in the entire government, 24 percent. In 2013, it is estimated that \$14.5 billion was improperly paid out through EITC.<sup>10</sup>

In addition to the new credits established by PPACA, the healthcare law will also require many people to file tax returns for the first time beginning in 2015. Individuals who enroll in health care through the Health Insurance Marketplace exchanges will be required to file tax returns at the end of the year. This will result in an increase of millions of tax returns in January 2015. If the RRP is not operational by then, the results could be disastrous.

In order to understand the delays in the RRP and how limitations in the EFDS may impact taxpayers, I request that you please provide the following information:

1. What is the cause for the delay in the implementation and completion of the RRP, and when will the system be implemented? When answering, please describe any technical challenges in implementing the RRP.

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<sup>5</sup> Internal Revenue Service (IRS), Wage & Investment Division Summary of Proposed FY 2013 Budget Initiatives (as of Feb. 1, 2011).

<sup>6</sup> IRS, FY 2015 Budget Documents – Congressional Justification, accessed April 11, 2014.

<sup>7</sup> Taxpayer Advocate Service, "Fiscal Year 2014 Objectives: Report to Congress," June 30, 2013.

<sup>8</sup> TIGTA, "Affordable Care Act: Improvements Are Needed to Strengthen Systems Development Controls for the Premium Tax Credit Project," September 27, 2013.

<sup>9</sup> IRS, Initial Report on Earned Income Tax Credit (EITC) Improper Payments, June 14, 2010.

<sup>10</sup> Payment Accuracy, "High-Error Programs," accessed April 8, 2014.

2. How much money has been spent on the RRP to date, and how much in additional funds do you anticipate needing in order to implement the RRP?
3. Has the IRS taken any actions to update the EFDS? If so, please describe the actions taken.
4. What are the current capabilities of the EFDS? Please answer:
  - a. How many returns the EFDS can process at one time;
  - b. how long it takes to review a return through EFDS;
  - c. how often the IRS can incorporate new criteria into EFDS; *and*
  - d. how many components of the EFDS are manual rather than automated.
5. Based upon the continued use of EFDS, do you anticipate any delay in processing tax returns for 2014?
6. Are you incorporating TIGTA's recommendations from its report dated September 27, 2013? If not, which of their recommendations are not being implemented, and why?
7. What are your plans for fraud detection in 2015?
  - a. Will EFDS continue to operate?
  - b. Will any part of RRP be operational?
  - c. How much risk of increased fraud exists for 2015?
  - d. What is the contingency plan to deal with increased fraud should it become a more significant issue in 2015 than it has been in the past?

Thank you for your cooperation and attention in this matter. I would appreciate a response by May 5, 2014. If you have any questions, please do not hesitate to contact Tegan Millspaw of my Judiciary Committee staff at (202) 224-5225.

Sincerely,



Charles E. Grassley  
Ranking Member  
Committee on the Judiciary