



*Further Efforts Are Needed to Ensure  
the Internal Revenue Service Prisoner File  
Is Accurate and Complete*

**December 18, 2012**

**Reference Number: 2013-40-011**

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

**Redaction Legend:**

2(f) = Risk Circumvention of Agency Regulation or Statute

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# HIGHLIGHTS

## FURTHER EFFORTS ARE NEEDED TO ENSURE THE INTERNAL REVENUE SERVICE PRISONER FILE IS ACCURATE AND COMPLETE

### Highlights

Final Report issued on December 18, 2012

Highlights of Reference Number: 2013-40-011 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

#### IMPACT ON TAXPAYERS

The number of fraudulent tax returns filed by prisoners and identified by the IRS has increased from more than 18,000 tax returns in Calendar Year 2004 to more than 91,000 tax returns in Calendar Year 2010. The refunds claimed on these returns increased from \$68 million to \$757 million. The accuracy and reliability of the Prisoner File affects the IRS's ability to stop fraudulent refunds.

#### WHY TIGTA DID THE AUDIT

Refund fraud committed by prisoners remains a significant problem for tax administration. The overall objective of the audit was to assess the reliability of the IRS Prisoner File.

#### WHAT TIGTA FOUND

Despite increased efforts by the IRS to improve the accuracy of the Prisoner File, some prisoner information contained in the file is inaccurate, the file contains incomplete records, and not all facilities that house prisoners reported prisoners. As such, controls used to ensure the IRS identifies fraudulent refunds on tax returns prepared by prisoners are not fully effective.

The majority of the inaccuracies identified are due to misinformation and (b) (6). The Federal Bureau of Prisons and State Departments of Corrections collect and record the information on prisoners, (b) (6). Further, the IRS does not have the authority to disclose to the prisons information related to prisoner-filed

fraudulent tax returns or prisoner identity issues. This limits the ability of prison officials to curtail prisoners' continued abuse of the tax system.

Of the 2.8 million records on the 2012 Prisoner File, 2.3 million (82 percent) matched identifying information on Social Security Administration records, but there is no assurance that (b) (6). More than 260,000 (9 percent) records did not (b) (6). About 240,000 (9 percent) records did not match the Social Security Administration's records.

In addition, records may be inaccurate or incomplete on the Prisoner File. Most issues are beyond the control of the IRS. Nonetheless, the IRS can take steps to improve its validation and verification processes.

#### WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS conduct a (b) (6) and compare the Institution and Prisoner Files to ensure all facilities that house prisoners reported them. Legislation is also needed to permanently authorize the IRS to share data with the prisons.

IRS management agreed to continue to assess the effectiveness of the validation activities performed on the Prisoner File and agreed that legislation is needed. However, management stated that new programming and procedures to detect the (b) (6) will be deployed in Calendar Year 2013 and building a process to check for (b) (6) in the Prisoner File would be a duplication of effort.

TIGTA does not believe the new programming and procedures will ensure the reliability and accuracy of the Prisoner File. They are unrelated to the Prisoner File validation process and are intended to detect (b) (6).

Other IRS offices use the Prisoner File and would be unaware that the (b) (6) on the Prisoner File included (b) (6).



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

December 18, 2012

**MEMORANDUM FOR** COMMISSIONER, WAGE AND INVESTMENT DIVISION

**FROM:** Michael E. McKenney  
Acting Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Further Efforts Are Needed to Ensure  
the Internal Revenue Service Prisoner File Is Accurate and  
Complete (Audit #201240036)

This report presents the results of our assessment of the reliability of the Internal Revenue Service (IRS) Prisoner File. This was a follow-up review to a prior Treasury Inspector General for Tax Administration audit and was added to our Fiscal Year 2012 Annual Audit Plan coverage.<sup>1</sup> This review addresses the major management challenge of Fraudulent Claims and Improper Payments.

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

Copies of this report are also being sent to the IRS managers affected by the report recommendations. If you have any questions, please contact me or Augusta R. Cook, Acting Assistant Inspector General for Audit (Returns Processing and Account Services).

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<sup>1</sup> Treasury Inspector General for Tax Administration, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Dec. 2010).



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## *Abbreviations*

AMTAP	Accounts Management Taxpayer Assurance Program
IRS	Internal Revenue Service
PTIN	Preparer Tax Identification Number
TIGTA	Treasury Inspector General for Tax Administration



*Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete*

## *Background*

Refund fraud committed by prisoners remains a significant problem for tax administration. The number of fraudulent tax returns filed by prisoners and identified by the Internal Revenue Service (IRS) has increased from more than 18,000 tax returns in Calendar Year 2004 to more than 91,000 tax returns in Calendar Year 2010. The refunds claimed on these tax returns increased from \$68 million to \$757 million. Although the IRS prevented the issuance of \$722 million in fraudulent tax refunds during Calendar Year 2010, it released more than \$35 million. Figure 1 shows the number of fraudulent tax returns identified by the IRS as filed by prisoners in Calendar Years 2004 through 2010 and the related refund information.

**Figure 1: Fraudulent Tax Returns Filed by Prisoners for Calendar Years 2004–2010<sup>1</sup>**

<b>Calendar Year</b>	<b>Fraudulent Tax Returns</b>	<b>Refunds Claimed<sup>2</sup> (Millions)</b>	<b>Refunds Prevented (Millions)</b>	<b>Refunds Issued (Millions)</b>
2004	18,103	\$68.1	\$54.6	\$13.4
2005	21,254	\$80.4	\$67.5	\$12.8
2006*	N/A	N/A	N/A	N/A
2007	37,447	\$165.9	\$136.6	\$29.2
2008	47,898	\$190.4	\$162.1	\$28.3
2009	44,944	\$295.1	\$256.0	\$39.1
2010	91,434	\$757.6	\$722.4	\$35.2

*Source: IRS Criminal Investigation for data through 2009. Refund Tax Compliance Office for 2010 data. \*Data were unavailable in Calendar Year 2006.*

To combat this growing problem, the IRS compiles a list of prisoners (Prisoner File) from the Federal Bureau of Prisons and State Departments of Corrections. Various IRS offices and functions use the Prisoner File to prevent and detect fraud committed by prisoners, including the filing of fraudulent tax returns.

<sup>1</sup> Calendar Year data is compiled from a separate analysis of Fiscal Year reports. As of October 2012, the IRS stated that data for Calendar Years 2011 and 2012 (year to date) were not available. See Figure 3 for Fiscal Years 2010 through 2012 data.

<sup>2</sup> Refunds Prevented and Refunds Issued may not total the Refunds Claimed for Calendar Years 2004 through 2010 because Refunds Claimed did not include adjustments made during tax return processing in those years.



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**Laws and regulations relating to prisoners and tax administration**

**The Inmate Tax Fraud Prevention Act of 2008.**<sup>3</sup> This Act was signed October 15, 2008. It stated that the Secretary of the Treasury could disclose to the head of the Federal Bureau of Prisons any return information with respect to individuals incarcerated in Federal prisons who the Secretary has determined may have filed or facilitated the filing of a fraudulent return to the extent that the Secretary determines that such disclosure is necessary to permit effective Federal tax administration.

Congress amended the Act<sup>4</sup> in July 2010 to allow the IRS to share prisoner tax data with the State Departments of Corrections<sup>5</sup> as well. Provisions included in the act also require the Secretary of the Treasury to provide an annual report to Congress on the filing of false or fraudulent tax returns by Federal and State prisoners. The act allowing the IRS to disclose false prisoner tax return information to the prisons expired on December 31, 2011. The Prisoner Fraud Reduction Act of 2011 was introduced in July 2011 to make the authority permanent, but no further action was taken on this act. In August 2012, the Family and Business Tax Cut Certainty Act of 2012 was introduced. This act included a section to improve and make permanent the provision authorizing the IRS to disclose certain return and return information to certain prison officials.

**Executive Order 13250.**<sup>6</sup> In November 2009, in Executive Order 13250, *Reducing Improper Payments and Eliminating Waste in Federal Programs*, the President directed Federal agencies to identify “ways in which information sharing may improve eligibility verification and prepayment scrutiny.” The President further reinforced the importance of reducing payment errors, and recovering improperly paid amounts, in a memorandum issued in March 2010 on *Finding and Recapturing Improper Payments*. Building on these initiatives, in June 2010, the President issued a memorandum on *Enhancing Payment Accuracy Through a “Do Not Pay List,”* in which he underscored that:

*While identifying and recapturing improper payments is important, prevention of payment errors before they occur should be the first priority in protecting taxpayer resources from waste, fraud, and abuse. In those cases where data available to agencies clearly shows that a potential recipient of a Federal payment is ineligible for it, subsequent payment to that recipient is unacceptable. We must ensure that such payments are not made.*

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<sup>3</sup> Pub. L. No. 110-428, 122 Stat. 4839.

<sup>4</sup> *Homebuyer Assistance and Improvement Act of 2010*, Pub. L. No. 111-198, 124 Stat. 1356.

<sup>5</sup> State Departments of Corrections is the term we use for various State agencies that oversee State prisons.

<sup>6</sup> Exec. Order No. 13250, 3 C.F.R. 274 (2010).



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**United States-Korea Free Trade Agreement Implementation Act.**<sup>7</sup> On October 21, 2011, the President signed into law the United States-Korea Free Trade Agreement Implementation Act. The law states that not later than September 15, 2012, and annually thereafter, the head of the Federal Bureau of Prisons and the head of any State agency charged with the responsibility for the administration of prisons shall provide to the Secretary of the Treasury, in electronic format, a list of all the prisoners incarcerated within the prison system for any part of the prior two calendar years or the current calendar year through August 31.<sup>8</sup> Although the prisons were providing data to the IRS voluntarily, this law made the exchange of prisoner data with the IRS mandatory.

**The Prisoner File is the cornerstone of the IRS's efforts to prevent the issuance of fraudulent refunds to prisoners**

For the 2012 Prisoner File, the IRS instructed prison officials to send information for currently incarcerated prisoners<sup>9</sup> as well as prisoners released between January 1, 2009, and August 31, 2011. The requested fields and maximum character lengths were explained in the instructions sent to the prisons. The 2012 Prisoner File consists of 2.8 million records.

In those instructions, the IRS asked the prisons to provide:

- \*\*\*\*\*2(f)\*\*\*\*\*, if available.
- A list of institutions for the IRS Institution File with one record for each institution within its purview. The IRS instructions state the institution code included in the prisoner data provided by prisons must correspond to one of the institution codes in the Institution File.
- All possible addresses for each institution.

**A prior Treasury Inspector General for Tax Administration (TIGTA) review reported the Prisoner File was inaccurate and incomplete**

In December 2010, the TIGTA reported that:<sup>10</sup>

- Approximately 12 percent (360,540 records) of almost three million records on the 2009 Prisoner File were either missing information and/or had inaccurate information. For example, the file contained records \*\*\*\*\*2(f)\*\*\*\*\*and questionable release dates.

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<sup>7</sup> Pub. L. No. 112-41, §502.

<sup>8</sup> The Fiscal Year 2011 IRS letter requested information for currently incarcerated prisoners as well as prisoners released between January 1, 2009, and August 31, 2011.

<sup>9</sup> A prisoner may be reported under the Federal Bureau of Prisons or a State Department of Corrections facility or another facility, such as a halfway house, the prisoner's home address due to house arrest, a parole office, or a work address due to participation in a work release program.

<sup>10</sup> TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Dec. 2010).





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- The IRS had not compiled a master list of Federal and State prisons at that time to evaluate the completeness of the data provided. Therefore, the IRS was unable to determine if it had received prisoner data from all facilities and, consequently, contact could not be made with the nonreporting facilities.

The TIGTA recommended that the IRS develop a process to assess the reliability (accuracy and completeness) of data received from Federal and State prisons and to communicate with the prison facilities that provide missing or inaccurate information.

This review was performed at the Wage and Investment Division's Return Integrity and Correspondence Services, Earned Income Tax Credit, Refund Tax Compliance's Planning and Policy Development Office in Atlanta, Georgia; the Federal Bureau of Prisons in Grand Prairie, Texas, and Washington, D.C.; and the Departments of Corrections in California, Florida, Georgia, Massachusetts, and Texas from April through August 2012. In addition, employees were interviewed from the Accounts Management Taxpayer Assurance Program (AMTAP), Criminal Investigation's Refund Crimes Office, the Return Preparer Office, and the Information Technology function's Dependent Database and Electronic Fraud Detection System. 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 finding 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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- Prisoners were reported under institutions that were closed, and numerous prisons reported only one prisoner each.
- The Institution File contained records with blank institution codes and included institutions that are closed.

Most of these issues are beyond the control of the IRS. The IRS has to rely on information provided by the prisons to identify prisoner-filed tax returns, and the IRS does not have the authority to disclose information to the prisons related to prisoner-filed fraudulent tax returns or prisoner identity issues. Nonetheless, the IRS can do a better job of ensuring the Prisoner File is accurate and complete by taking further steps to improve its validation and verification processes.

**The IRS is taking steps to improve the Prisoner File data**

After the TIGTA reported issues with the Prisoner File in Fiscal Years<sup>14</sup> 2005 and 2011,<sup>15</sup> the IRS took steps to obtain more accurate data, including developing a cross-functional team to investigate standardizing and improving the accuracy of data received from the prisons and reaching out to leaders of the Federal Bureau of Prisons and State Departments of Corrections to develop a greater understanding of the issues related to tax compliance in the prison community.

After receiving information from prisons for the 2012 Prisoner File, the IRS took the following steps to validate and verify the accuracy of the 2.8 million records:

- Attempted to identify structural errors (e.g., \*\*\*\*\*2(f)\*\*\*\*\*, missing release dates, entry dates later than the release date), formatting errors, duplicate records, and inconsistencies with prior year's data.
- Compared its listing of institutions (Institution File) to the institution codes on the 2012 Prisoner File and attempted to correct any inaccuracies with the States and the Federal Bureau of Prisons.
- Followed up with the technical contacts in the various correctional systems to resolve identified errors and issues. Working with the State systems, the IRS sought explanations or corrections for errors. Ten of the 52 prison systems<sup>16</sup> provided corrected data to the IRS once they were informed of missing data or data errors. The other 42 did not send in corrected data.

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<sup>14</sup> A 12-consecutive-month period ending on the last day of any month, except December. The Federal Government's fiscal year begins on October 1 and ends on September 30.

<sup>15</sup> TIGTA, Ref. No. 2005-10-164, *The Internal Revenue Service Needs to Do More to Stop the Millions of Dollars in Fraudulent Refunds Paid to Prisoners* (Sept. 2005); TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Dec. 2010).

<sup>16</sup> The 52 prison systems include the 50 State Departments of Corrections, the District of Columbia, and the Federal Bureau of Prisons.



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In addition, during the validation process, the IRS marks records that have identifying information that matches the Social Security Administration data. However, it does not attempt to rectify the records that do not match because the IRS does not have the authority to share this information with the prisons.

The number of records reported on the 2012 Prisoner File increased by 15 percent over the 2011 Prisoner File. IRS management stated some of this increase was a result of their increased communication with the State prisons.

To improve the reliability of the 2013 Prisoner File, in April 2012 the IRS issued a letter to prison officials informing them of its pending request for prisoner data. The IRS sent a follow-up letter to the prisons in July 2012 that included specifics for formatting data and lessons learned from previous experiences. The IRS also assigned IRS liaisons for each State so that contact information could be included in e-mails sent to the technical contacts for each prison system. As of August 2012, the IRS was in the process of developing procedures to validate and verify the 2013 Prisoner File.

In addition, the IRS plans to schedule a Prisoner File process meeting with all users of the 2013 Prisoner File, including the Information Technology function (for the Electronic Fraud Detection System and the Dependent Database) and the Return Preparer Office. It also plans to consult with the Wage and Investment Division Research and Analysis function to compile a list of known formatting errors to assist the States in compiling their data and performing validation checks prior to submission.

**The 2012 Prisoner File contains inaccurate identifying data on individual prisoners**

Test results showed that approximately 240,000 (9 percent) \*\*\*\*\*2(f)\*\*\*\*\* \*\*2(f)\*\* did not match information provided by the Social Security Administration.

Inconsistencies included:

- \*\*\*\*\*2(f)\*\*\*\*\*
- \*\*\*\*\*2(f)\*\*\*\*\*<sup>17</sup> \*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*

Additionally, the 2012 Prisoner File does not identify prisoners \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*. More than 700 records on the Prisoner File were \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*.

<sup>17</sup> \*\*\*\*\*2(f)\*\*\*\*\*



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**The 2012 Prisoner and Institution Files are incomplete and may contain inaccurate data**

The 2012 Prisoner File contains blank fields, prisoners were not reported on the Prisoner File for each prison listed on the Institution File, and in some cases prisoners were reported on the Prisoner File for institutions that are closed. In addition, prisons on the Institution File contained blank institution codes and several prisons reported only one prisoner each.

\*\*\*\*\*2(f)\*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\*.



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**Incomplete records on the 2012 Prisoner File**

Almost 160,000 (6 percent) of the 2.8 million records contain blank release dates and more than 8,300 (0.3 percent) records show blank incarceration dates. The IRS uses the release and incarceration dates to help determine if an individual was incarcerated during the time period he or she was claiming wages, withholding, and credits on a tax return. The IRS stated that it worked with the prisons to determine the reasons for the blank release dates. Some explanations provided were that the individual was awaiting trial and had not been convicted yet or the prisoner was an escapee.

In addition, more than 260,000 (9 percent) of the 2.8 million records \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*. The TIGTA and the IRS are unable to determine how many of those records are for prisoners \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*.

**Incomplete and inaccurate data on the 2012 Prisoner and Institution Files**

Of the 4,192 prisons listed on the 2012 Institution File, 574 (14 percent) institutions had a blank institution code, 1,328 (32 percent) institutions used an institution code on the Institution File that did not match an institution code on the Prisoner File, and 181 (4 percent) institutions reported only one prisoner each.

The IRS did not compare the 2012 Institution File to the 2012 Prisoner File to identify nonreporting institutions. It also did not perform additional research to determine if prisoners for these institutions were reported under other institutions or if the institutions should be reporting prisoners at all. This makes it difficult for the IRS to ensure it has a complete list of prisons and prisoners.

A test of a random sample of 25 of the 1,328 institutions on the Institution File that did not match an institution code on the Prisoner File showed:

- 10 (40 percent) institutions were not listed on the State Departments of Corrections websites.
- 6 (24 percent) institutions were administrative offices and without the IRS contacting the facility, it cannot be determined if they should have reported prisoners.
- 5 (20 percent) institutions should have reported prisoners.
- 4 (16 percent) institutions used a truncated institution code on the Institution File but reported prisoners under the complete institution code on the Prisoner File.

TIGTA also performed a search for closed prisons. Two states, Michigan and North Carolina, had lists of closed prisons on their Department of Corrections websites. TIGTA compared the closed prisons for these States to the 2012 Institution File and determined that 12 closed prisons for Michigan and 10 closed prisons for North Carolina were listed on the 2012 Institution File.



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- Of the 12 closed Michigan prisons listed on the 2012 Institution File, six reported prisoners.
- Of the 10 closed North Carolina prisons listed on the 2012 Institution File, prisoners were reported for all 10 closed prisons.

For the 16 closed prisons that reported prisoners, 168 prisoners were reported on the Prisoner File.

Some institutions on the Institution File appear to have only administrative functions and therefore would not house prisoners. For example, the Federal Bureau of Prisons included the Accounting Operations, Security Background Investigations, Centralized Records Office, and Sacramento Intelligence Unit as prisons on the 2012 Institution File. Additionally, a prisoner may be reported under the Federal Bureau of Prisons or a State Department of Corrections facility or another facility, such as a halfway house, the prisoner’s home address due to house arrest, a parole office, or a work address due to participation in a work release program. Without additional research, the IRS cannot determine if these facilities should have reported prisoners.

Several IRS functions rely on the Prisoner and Institution Files to identify fraudulent tax returns filed by prisoners, revoke Preparer Tax Identification Numbers (PTIN) held by prisoners, and assist in tax scheme detections. Without accurate or complete information, these functions are unable to consistently identify tax returns filed by prisoners, \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*2(f)\*\*\*\*\*. In addition, the IRS may be unable to accurately determine whether a tax return filer was capable of earning the income and withholding claimed or if they were entitled to claim credits during a specific tax period.

**The IRS’s ability to resolve discrepancies in prisoner records is limited**

\*\*\*\*\*2(f)\*\*\*\*\*  
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\*\*\*\*\*2(f)\*\*\*\*\*. However, when the IRS identifies records that do not match Social Security Administration records, it does not have the authority to contact prison officials to try to resolve the discrepancies.

IRS Counsel has determined that the IRS does not have the authority to disclose information to the prisons \*\*\*\*\*2(f)\*\*\*\*\* does not match Social Security Administration records. IRS Counsel stated that once the data are received by the IRS, Internal Revenue Code (IRC) Section 6103 applies. This section of the law states that tax returns and return information shall be confidential. Return information is defined as:

*... a taxpayer’s identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments, whether the taxpayer’s return was, is being, or will be examined or subject to other investigation or processing, or any other*





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*data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense, ...*<sup>19</sup>

The IRS began discussions with the Social Security Administration in June 2011 to identify  
\*\*\*\*\*2(f)\*\*\*\*\*  
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\*\*\*\*\*2(f)\*\*\*\*\*.

In Fiscal Year 2012, the Office of Management and Budget coordinated a meeting between the IRS, the Social Security Administration, the Federal Bureau of Prisons, and other agencies interested in the prisoner data to identify the most efficient way for different agencies to obtain prisoner information. However, disclosure issues exist for both the Social Security Administration and the IRS due to the lack of statutory authority to exchange any prisoner information they maintain.

**A prior law gave the IRS authority to inform prison officials about prisoners who filed fraudulent tax returns, but the law expired**

The Inmate Tax Fraud Prevention Act of 2008<sup>20</sup> and the amendment in July 2010<sup>21</sup> gave the IRS the authority to disclose prisoner tax return information to the Federal Bureau of Prisons and the State Departments of Corrections if the prisoner filed or facilitated the filing of a fraudulent tax return. However, this authority expired on December 31, 2011.

In a previous audit report,<sup>22</sup> the TIGTA recommended that the IRS work with the Department of the Treasury to seek legislation to extend the authority to disclose prisoner tax return data to the Federal Bureau of Prisons and State prison officials. This would have allowed adequate time for the exchange of information and to determine the benefits of the exchange. On December 15, 2010, the IRS agreed with the recommendation and stated that it would work with the Department of the Treasury to seek legislation that would provide an extension of the time allowed to disclose prisoner tax return data to the State and Federal prison officials.

The Prisoner Fraud Reduction Act of 2011 was introduced in July 2011 to make the authority permanent, but no further action was taken on this act. In August 2012, the Family and Business Tax Cut Certainty Act of 2012 was introduced which included a section to improve and make permanent the provision authorizing the IRS to disclose certain return information to certain prison officials.

<sup>19</sup> Internal Revenue Code § 6103 (b)(2)(A).

<sup>20</sup> Pub. L. No. 110-428, 122 Stat. 4839.

<sup>21</sup> Pub. L. No. 111-198, 124 Stat. 1356.

<sup>22</sup> TIGTA, Ref. No. 2011-40-009, *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Dec. 2010).





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In early August 2011, the IRS established the Refund Tax Compliance Office to combat the increase in prisoner tax fraud and conduct fraud detection work. The team worked with prison authorities to set up Memorandums of Understanding that would allow them to share fraudulent tax return activities in an effort to reduce prisoner tax fraud. Before the authority to share this information expired on December 31, 2011, the IRS had set up Memorandums of Understanding with 22 of the State Departments of Corrections and with the Federal Bureau of Prisons.

The President's Revenue Proposals<sup>23</sup> for Fiscal Year 2013 contained a legislative proposal<sup>24</sup> to reinstate the IRS's authority to disclose return information with respect to individuals incarcerated in Federal or State prisons who the IRS determines may have filed or facilitated the filing of a fraudulent return. The proposal also includes the following additions to the prior provision:

- Make the authorization for disclosure permanent.
- Authorize the disclosure of actual returns (and not just return information).
- Allow disclosure directly to officers and employees of the Federal or State prison agency.
- Allow re-disclosure of return information to contractors that operate prisons.
- Clarify the authority for the re-disclosure to, and use of return information by, legal representatives to defend against inmate claims.

**IRS functions are negatively affected by inaccurate and incomplete prisoner information**

Various IRS offices and functions use the Prisoner File, for example, to identify a fraudulent tax return or screen tax return preparers. Inaccurate and incomplete data can affect the performance of these functions and hinder their ability to efficiently fulfill their program goals. Figure 2 shows the IRS functions that use the Prisoner File.

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<sup>23</sup> General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals, Department of the Treasury.

<sup>24</sup> The legislative proposal would revise Internal Revenue Code § 6103(k)(10).



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Figure 2: Functions Using the IRS Prisoner File

Refund Tax Compliance Office – Planning and Policy Development Team

The Blue Bag Program is conducted by State and Federal prison officials. They monitor prisoners’ tax returns and tax-related correspondence. When they identify potential fraud, the prisons forward the tax return or correspondence to the Refund Tax Compliance Office for further review. More than 500 prisons participate in this program.

The Automated Questionable Credit Program reviews tax returns with questionable refunds or issues identified through TIGTA findings. These could include tax returns marked with a prisoner indicator.

Return Preparer Office

The IRS uses the Prisoner File to identify individuals, who already have PTINs to determine if they may be a prisoner. The Return Preparer Office sent 35 letters to PTIN owners who had a Social Security Number, full name, date of birth, and name control that matched information on the Prisoner File. Based on responses to the letters, the IRS revoked nine (26 percent) PTINs and plans to revoke four (11 percent) more. In addition, three (9 percent) PTINs expired during the verification process.

Information Technology – The Dependent Database

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Criminal Investigation

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\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*

Source: IRS management for each of the offices listed.

After the Refund Tax Compliance Office compiles the Prisoner File, the Information Technology, Electronic Fraud Detection System function inputs it into an existing database and creates extracts for other functions and systems. Its primary function related to the Prisoner File is to identify tax returns filed by prisoners. \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*.

Other IRS functions and offices analyze the prisoner tax returns to determine if the claim for refunds and credits are accurate. For example, the AMTAP verifies \*\*\*\*\*2(f)\*\*\*\*\* ,  
\*\*\*\*\*2(f)\*\*\*\*\* ,  
\*\*\*\*\*2(f)\*\*\*\*\* ,  
\*\*\*\*\*2(f)\*\*\*\*\*



*Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete*

For Fiscal Year 2012 through June 30, 2012, the AMTAP identified more than 170,000 fraudulent tax returns from prisoners and prevented the IRS from issuing \$2.1 billion in fraudulent refunds. Figure 3 shows the total number of prisoner returns and the related fraudulent refunds detected and stopped by the AMTAP.

**Figure 3: Accounts Management Taxpayer Assurance Program Prisoner Returns and Refunds Detected and Stopped**

Number of Returns and Refunds	Fiscal Year 2010	Fiscal Year 2011	Fiscal Year 2012*
Returns Detected	77,563	168,703	173,106
Returns Stopped	69,461	157,949	156,482
Refunds Detected	\$384M	\$2.8B <sup>25</sup>	\$2.1B <sup>26</sup>
Refunds Stopped	\$350M	\$2.7B	\$2.1B

*Source: Accounts Management Taxpayer Assurance Program management.  
\*As of June 30, 2012.*

## **Recommendation**

**Recommendation 1:** The Commissioner, Wage and Investment Division, should ensure that the validation and verification of future IRS Prisoner Files includes: 1) \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\* 2) a comparison of the Institution and Prisoner Files to ensure all facilities that house prisoners reported them.

**Management's Response:** IRS management agreed to continue to assess the effectiveness of the validation activities performed on the Prisoner File. The IRS's assessment is an ongoing process that is an integral part of the annual construction of the Prisoner File. Programming and procedures to be deployed for the 2013 Filing Season<sup>27</sup> are intended to detect the \*\*\*\*\*2(f)\*\*\*\*\*  
immediately stop the processing of the returns, and elevate them for review to ascertain if the use is legitimate. Because these procedures will apply to all returns, building that process into the Prisoner

<sup>25</sup> The increase in refunds detected from Fiscal Year 2010 to 2011 was a result of improved data models, increased staff resources, and working approximately 91,000 more tax returns. In addition, eight prisoner tax returns that totaled approximately \$1 billion in refunds were detected and stopped in Fiscal Year 2011.

<sup>26</sup> The amount of refunds detected and stopped in Fiscal Year 2012 includes two prisoner tax returns that totaled \$1.1 billion in refunds.

<sup>27</sup> The period from January through mid-April when most individual income tax returns are filed.



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*Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete*

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File will be a duplication of effort. By April 15, 2014, the IRS will review the performance of the new programming and procedures and ascertain if additional actions should be taken regarding the Prisoner File validation process.

The IRS will also continue to work with the stakeholders in the prisoner information reporting process, including other Federal and State agencies, to evaluate the effectiveness of data provided to the IRS and its use in preventing refund fraud by the prisoner population. The evaluation will include the effectiveness of prisoner housing information and how it is used. This is an ongoing process.

**Office of Audit Comment:** TIGTA believes the new programming and procedures are unrelated to the Prisoner File validation process and will not ensure the reliability and accuracy of the Prisoner File. The new programming and procedures to be deployed for the 2013 Filing Season are intended to detect the use of \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*. The IRS will not identify records of prisoners  
\*\*\*\*\*2(f)\*\*\*\*\*.

Other IRS offices also use the Prisoner File and will not be aware that the information on the Prisoner File includes \*\*\*\*\*2(f)\*\*\*\*\*.

### ***Legislative Recommendation***

**Recommendation 2:** To reduce the risk of prisoners \*\*\*\*2(f)\*\*\*\*\* to file fraudulent tax returns, legislation is needed that would permanently authorize the IRS to share data with the prisons when it determines that \*\*\*\*\*2(f)\*\*\*\*\*.

**Management's Response:** IRS management agreed with this recommendation, as having the ability to share data with the prisons would be beneficial to both the IRS and the prisons. Implementation of this recommendation is dependent on legislative action.



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*Further Efforts Are Needed to Ensure the Internal Revenue  
Service Prisoner File Is Accurate and Complete*

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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

Our overall objective was to assess the reliability of the IRS Prisoner File. We determined whether the Prisoner File is accurate and complete. We also assessed the steps the IRS takes and the controls the IRS has in place to ensure the data in the Prisoner File are accurate and complete, including the steps the IRS takes to obtain and validate the data on the Prisoner File. To accomplish our objective, we:

- I. Determined whether the data the IRS receives from the prisons are complete.
  - A. Determined what information the prisons are required by law to share with the IRS.
  - B. Determined what data the IRS requests from the prisons.
  - C. Analyzed the Prisoner File to determine whether data are received in accordance with the law.
- II. Determined whether the IRS has coordinated with Federal and State Government agencies to receive prisoner information.
  - A. Interviewed IRS management to determine whether they have coordinated with other agencies about the prisoner data.
  - B. Interviewed the Social Security Administration to determine what information it has on prisoners and whether they share information with the prisons when the data do not match their records.
- III. Determined what steps the prisons take to ensure the Prisoner File data are complete and accurate.
  - A. Selected a judgmental sample<sup>1</sup> of six prison systems and officials to visit/interview. We visited prisons and interviewed prison officials in the top five States and the Federal Bureau of Prisons with the most prisoners and the highest amount of fraudulent tax return refunds, as reported by the IRS in the 2009 report to Congress (Federal Bureau of Prisons, California, Florida, Georgia, and Texas) and a local prison in Massachusetts. We did not select a statistical sample of prison systems and officials to visit/interview due to time, resource, and travel budget constraints, and because we did not plan to project the results.

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<sup>1</sup> A judgmental sample is a nonstatistical sample, the results of which cannot be used to project to the population.



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*Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete*

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- B. Determined how the prisoner information is entered into the prison system and whether any validations are performed on the data.
- C. Determined who extracts the prisoner data to provide it to the IRS and whether any validations are performed on the data.
- IV. Determined the IRS's procedures to ensure the data on the Prisoner File are complete and accurate.
  - A. Interviewed IRS management to determine the steps they take to ensure the Prisoner File is complete.
  - B. Interviewed IRS management to determine the steps they take to ensure the Prisoner File is accurate.
  - C. Tested a random sample of 25 of the 1,328 institutions on the Institution File that did not report prisoners on the Prisoner File. We did not select a statistical sample because we did not plan to project the results.
- V. Determined which IRS programs rely on the data in the Prisoner File and how incomplete or inaccurate data affect them.
  - A. Interviewed IRS management to determine which IRS programs use the Prisoner File and how the File is used.
  - B. Determined the effect on the programs' use of the File for any issue identified with the accuracy or completeness of the Prisoner File.
- VI. Determined the accuracy of the IRS's Processing Year 2012 Prisoner File by comparing the file to the Social Security Administration's 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 the following internal controls were relevant to our audit objective: processing of the prisoner data to build the Prisoner File, coordination efforts with Federal and State Government agencies to receive prisoner information, validation of the Prisoner File data for completeness and accuracy, and the effect of data anomalies on users of the Prisoner File. We evaluated these controls by interviewing IRS management and select Federal and State Government agency officials, evaluating the data the IRS receives from the prisons for completeness, and analyzing the IRS's Processing Year 2012 Prisoner File by comparing the file to the Social Security Administration's data.



*Further Efforts Are Needed to Ensure the Internal Revenue  
Service Prisoner File Is Accurate and Complete*

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**Appendix II**

*Major Contributors to This Report*

Randee Cook, Acting Assistant Inspector General for Audit (Returns Processing and Account Services)  
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*Further Efforts Are Needed to Ensure the Internal Revenue  
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**Appendix III**

*Report Distribution List*

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Office of the Commissioner - Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Chief Technology Officer OS:CTO  
Deputy Commissioner, Services and Operations, Wage and Investment Division SE:W  
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Audit Liaison: Chief, Program Evaluation and Improvement, Wage and Investment Division  
SE:W:S:PEI  
Assistant Secretary of the Treasury for Tax Policy





*Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete*

**Appendix IV**

*Management's Response to the Draft Report*



COMMISSIONER  
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

November 27, 2012

MEMORANDUM FOR MICHAEL E. MCKENNEY  
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Peggy Bogadi   
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete (Audit # 201240036)

Tax refund fraud perpetrated by prisoners constitutes a serious threat to the integrity of the United States tax system, and the IRS is firmly committed to identifying and stopping it at the earliest possible opportunity. One tool used to accomplish this task is the prisoner file, which is a compilation of data received from the Federal Bureau of Prisons (FBOP), the various State Departments of Corrections, and the District of Columbia Department of Corrections. The prisoner file, used during initial tax return processing, complements our other fraud detection measures by identifying those returns filed by individuals reported to be incarcerated and subjects those returns to additional scrutiny.

In past years, relationships were developed with the FBOP and state facilities to obtain from those institutions, annually, the information on their prisoner populations needed to construct the prisoner file. While all parties were committed to the goal of stopping refund fraud committed by incarcerated individuals, there were challenges in obtaining accurate and complete data. The number of jurisdictions involved contributed to a general lack of uniformity in the data reported by the institutions, and the voluntary nature of its provision did not always promote timely or complete data. Last year, with the passage of the United States - Korea Free Trade Agreement Implementation Act<sup>1</sup> (KFTA), formal requirements were established for the annual provision of prisoner data by the FBOP and state agencies responsible for administering prisons. To prepare for implementation of the Act, we corresponded with the heads of office of each correctional agency, with a reporting requirement, explaining the provisions of the new law and providing technical specifications to help them understand their reporting

<sup>1</sup> Pub. L. No. 112-41, §502



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obligations. We are pleased to report that for Calendar Year 2012 every agency required to report under the provisions of the KFTA did so.

While the formal reporting requirements under the KFTA represent a substantial step forward in refining and improving the accuracy of the prisoner file, there are still significant challenges presented by the multiple jurisdictions involved and differences in the solutions the various state agencies have implemented to address their respective needs. Not all prisoners under the jurisdiction of reporting correctional agencies are housed in conventional prison facilities. For example, reports on the prisoner population can also include individuals under the supervision of parole offices, medical facilities, or the reporting offices for inmates serving their sentences under home confinement. Furthermore, some states contract with county and city jails to house inmates, which can contribute to wide fluctuations in the populations and prisoner movement among locations.

Data cleansing and validation activities are performed on the information we receive from the reporting entities. This is done to perfect the data to the greatest extent possible and maximize the effectiveness of the prisoner file as a fraud detection tool.

As noted in the report, prisons do not always maintain records  
\*\*\*\*\*2(f)\*\*\*\*\* (SSN) associated with prisoners.

\*\*\*\*\*2(f)\*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\* Consequently, we recognize that the prisoner file will contain incomplete information for some prisoners; however, we believe that any risks associated with incomplete records are mitigated by the matching activities we perform on all returns against information obtained from the Social Security Administration (SSA). We also follow up with the correctional agencies to request corrected data. Last year, ten agencies provided additional information,

\*\*\*2(f)\*\*\*\*\* We are committed to maintaining good working relationships with the correctional agencies and ensuring they understand our need for accurate data. We believe these efforts will continue to improve the accuracy and reliability of the prisoner file. With regard to long-term improvements in the availability of reliable information on the prisoner population, the IRS, as the report notes, is working with the Office of Management and Budget, the SSA, the FBOP, and other federal agencies to identify actions necessary to promote the efficient and effective sharing of prisoner data within government.

Attached are our comments on your recommendations. If you have any questions, please contact me, or a member of your staff may contact Jodi L. Patterson, Director, Return Integrity and Correspondence Services, at (202) 283-7673.

Attachment



*Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete*

Attachment

**RECOMMENDATION**

**RECOMMENDATION 1**

The Commissioner, Wage and Investment Division, should ensure the validation and verification of future IRS Prisoner Files includes: 1)\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\* 2) a comparison of the Institution and Prisoner Files to ensure all facilities that house prisoners reported them.

**CORRECTIVE ACTION**

We will continue to assess the effectiveness of the validation activities performed on the Prisoner File. Our assessment is an ongoing process that is an integral part of the annual construction of the Prisoner File. Programming and procedures to be deployed for the Calendar Year 2013 Filing Season are intended to detect the \*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*, immediately stop the processing of the returns, and elevate them for review to ascertain if the use is legitimate. Since these procedures will apply to all returns, building that process into the Prisoner File will be a duplication of efforts. By April 15, 2014, we will review the performance of the new programming and procedures and ascertain if additional actions should be taken regarding the Prisoner File validation process.

We will also continue to work with the stakeholders in the prisoner information reporting process, including other Federal and State agencies, to evaluate the effectiveness of data provided to the IRS and its use in preventing refund fraud by the prisoner population. The evaluation will include the effectiveness of prisoner housing information and how it is used. This is an ongoing process.

**IMPLEMENTATION DATE**

Assessment of decedent identity protection measures: April 15, 2014  
Assessment of data use and validation: Implemented and ongoing

**RESPONSIBLE OFFICIAL**

Director, Return Integrity and Correspondence Services, Wage and Investment Division

**CORRECTIVE ACTION MONITORING PLAN**

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

**LEGISLATIVE RECOMMENDATION:**

**RECOMMENDATION 2**

To reduce the risk of prisoners \*\*\*\*\*2(f)\*\*\*\*\* to file fraudulent tax returns, legislation is needed that would permanently authorize the IRS to share data with the prisons  
\*\*\*\*\*2(f)\*\*\*\*\*.



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*Further Efforts Are Needed to Ensure the Internal Revenue Service Prisoner File Is Accurate and Complete*

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**CORRECTIVE ACTION**

We agree with this recommendation, as having the ability to share data with the prisons would be beneficial to both the IRS and the prisons. Implementation of this recommendation is dependent on legislative action.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A