

Testimony of
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Subcommittee on National Security and
Subcommittee on Health Care, Benefits and Administrative Rules

Hearing on the Fiscal Costs of the President's Executive Actions on Immigration
March 17, 2015

Mr. Chairman, Ranking Member, Members of the Subcommittees: thank you for inviting me to be with you today.

I speak on my own behalf as a private citizen and not on behalf of my firm or partners or clients. I hope to bring to you some of the understanding I have gained during my decades of working with tax administration and enforcement from both within and without the government. This experience includes the six years – 2001~2007 – I was privileged to lead the honorable and dedicated men and women of the Tax Division of the United States Department of Justice.

You have called this hearing to examine the fiscal costs of the President's executive actions on immigration. I will address the likely consequences of those programs to federal tax administration and enforcement.

The Internal Revenue Service is charged with administering and enforcing the internal revenue laws. When enforcing the tax laws requires the involvement of a court other than the United States Tax Court, the 300 plus trial and appellate attorneys of the civil trial and criminal enforcement sections of the Justice Department's Tax Division represent the interests of the United States.

As required by the Inspector General Act, the Department of the Treasury has an Office of Inspector General, established in 1989. And, in accordance with the Internal Revenue Service Restructuring and Reform Act of 1998, Treasury also has another Inspector General, specifically authorized and obligated by law to provide independent oversight of Internal Revenue Service (IRS) activities. The office of the Treasury Inspector General for Tax Administration, most commonly called by its initials, TIGTA, is the one to which I will refer throughout as "Inspector General."

To describe the impact on tax administration and enforcement of the President's "executive actions" on immigration, we need to look at two phenomena: the Individual Tax Identification Number (ITIN), and "refundable credits."

[ITIN](#)

Non-U.S. persons with U.S.-related income are subject to the income tax, but are not eligible for social security numbers. In 1996, the IRS created the Individual Taxpayer Identification Number (ITIN) to enable it to track the tax payments and tax returns of people without social security numbers. And it began issuing these numbers to people in

the United States illegally. This, together with “refundable credits,” has been a gift to criminals intent on raiding the Federal Treasury.

In 1999, the Inspector General issued its first report on IRS’s implementation of ITINs. According to the Report, although IRS developed ITINs to facilitate its processing of the tax returns of non-resident aliens who had U.S.-related income, IRS was issuing them to aliens unlawfully resident in the U.S. The report expressed serious concern about the conflict this created with the obligation of the government to enforce the immigration laws. The Report also highlighted what it referred to as revenue protection issues, noting that “providing illegal aliens with valid TINs . . . increases the potential for fraud.” According to the Report, more than 340,000 ITIN applicants had identified themselves as illegal aliens. For the 1997 tax year 180,662 tax returns were filed using ITINs. By the end of 2003, IRS had issued more than 7 million ITINs. It receives about 2 million new applications for ITINs every year, and issues almost all of them, notwithstanding fraudulent documentation, but more on that later.

“Refundable credits”

The primary source of revenues that fund the operations of our federal government is the income tax. It could be very simple, and, in principle, it is. Everything is taxable and nothing is deductible unless otherwise specified. Everything that is taxable is taxable now and everything that is deductible is deductible later, unless otherwise specified. Having determined your net taxable income (income minus allowable deductions), and applied the appropriate tax rate to reach your tax liability, you then apply any credits for which you are eligible.

Let’s pause for a moment to consider that “credit” and “refund” in the income tax context are often misnomers. When your liability is \$100 and you have already paid \$60 of it, you have a \$60 credit, so only still owe \$40. If you had already paid \$110, you would have a credit of \$110, and be owed a refund of \$10. But the earned income credit, or earned income tax credit, called in our initial- and acronym-happy tax world, the EITC, is a new creature invented by Congress: a “refundable credit.” It does not represent an amount paid in, and it can do more than wipe out your liability. It can create a “refund” of an amount you never paid as income taxes. So you can have a liability before the credit of \$400, have paid in nothing, and, with a refundable earned income tax credit of \$1,000, get a check from Uncle Sam for \$600. The same is true of the additional child tax credit (ACTC).

IRS Policy

For more than two decades, various government watchdogs have been warning IRS and Congress that refundable credits were the vehicles for massive fraud against the Federal Treasury. Early on, it was the General Accounting Office, reporting to Senator Roth in 1994 that IRS was sending checks to illegal aliens in payment of the earned income credit. Congress addressed this shortly thereafter by making a social security number a requirement of receiving the credit. That has not stopped IRS from paying it, though. And Congress did not institute the same requirement when a few years later, it enacted the

additional child tax credit. So IRS makes no effort to avoid paying the ACTC to unlawful immigrants.

The law makes a social security number a requirement of eligibility to receive the earned income credit. But in 1999, the Chief Counsel's office of IRS ruled that when a person receives a social security number, he can file amended returns to claim the credit for the three preceding years during which he did not. The logic is puzzling: you are not eligible for the credit if you don't have a social security number, but IRS will pay it to you three years during which you did not qualify for it.

Economists estimating the impact on the Federal Treasury of the "executive action" need to keep in mind that IRS will be paying out refundable credits not only for the current year, but also for the three prior years.

They will also want to consider that, in its budget request for 2014, the IRS asked for 440 million dollars to implement the Affordable Care Act, including 306 million dollars for information technology changes required to deliver the associated tax credits. Remember, the Affordable Care Act instituted a credit that is not only refundable, but also transferrable. The person receiving it can designate to whom the IRS should pay it, generally his insurance carrier.

The Tax Gap

There is from time to time, on Capitol Hill and elsewhere in government and in newsrooms, much handwringing about the tax gap, last estimated to be 385 billion dollars per year. The tax gap is the difference between the taxes the IRS should have collected and the amount it did. Note, however, that tax gap computations do not take into account money paid out of the Treasury on fraudulent refund claims. And, as we have seen, the fraud against the Treasury using ITINs and refundable credits amounts to hundreds of billions of dollars.

Refundable credits have given rise to a cottage industry – not the big business - of fraud on the Federal Treasury. Unscrupulous tax return preparers create false Forms W-2, or alter real ones, to create enough income to qualify the person – real or imagined - for the credits. Then they file returns claiming the refunds and take a share – or divert them altogether. Criminals file thousands of ITIN applications, and then thousands of tax returns claiming fraudulent refunds, and, as you will see in the nutshell summaries of Inspector General Reports, the Treasury pays them.

When I was head of the Justice Department's Tax Division, we shut down quite a few fraudulent return preparation operations, and the effort continues. But after-the-fact law enforcement cannot redress these crimes or recover the lost billions. The money should not be paid out of the Federal Treasury in the first place. And it is the responsibility of the Internal Revenue Service to see that it is not. But it invariably and repeatedly fails to do so.

Oath

Every state or federal employee or lawmaker swears an oath of allegiance to the Constitution of the United States of America. Article VI, Clause 3, of the Constitution requires as much. And the requirement is codified in 5 USC §3331, which provides the language of the oath.

The allegiance every government employee swears is to the Constitution, not to any person or office. Perhaps it was with their oaths in mind that, in the Spring of 2012, eleven current and former IRS employees responsible for processing ITIN applications contacted WTHR Eyewitness News in Indianapolis to report that their supervisors were requiring them to simply approve even the most suspect applications, thus creating a “massive loophole for illegal immigrants.”

Apparently some of these troubled IRS employees also wrote to Congress. At the request of members of Congress, the Inspector General investigated the allegations, and determined them to be well-founded. In a July 2012 report, the Inspector General identified numerous deficiencies in IRS procedures for processing of ITIN applications, leaving the door open for widespread fraud.

This was not the first time rampant ITIN-enabled raids on the Federal Treasury had been investigated. In 2002, IRS itself established a task force to review the problem and recommend ways to stem the tide. In July 2011, the Inspector General reported that in the previous year, Treasury had paid 4.2 billion dollars in refundable credits to people not authorized to work in the United States.

Inspector General Reports

Let's take a quick look at some of the Inspector General's reports over the years, along with a couple of other relevant items:

In 2004, the General Accounting Office reported that ITINs could easily be obtained using bogus documents and used for illegal purposes.

In 2009, the Inspector General reported an increase in the use of ITINs from 530,000 in 2001 to more than 1.8 million in 2007. The report highlights also note that for 2007, “1.2 million ITIN filers received Additional Child Tax Credits of **1.8 billion dollars**,” and recommended that Congress pass legislation requiring a person claiming the ACTC to have a social security number. For 2000 to 2007 inclusive, ACTC totaling nearly

5.25 billion dollars had been paid on ITIN returns, likely with little or no verification of eligibility – i.e., the existence or U.S. residence of a qualifying child - even assuming unlawful immigrants are not ineligible.

From another 2009 report of the Inspector General, “Individual Taxpayer Identification Numbers Are Being Issued Without Sufficient Documentation” we learn that tens of thousands of ITINS had been used multiple times in the same year, resulting in hundreds

of millions of dollars in refunds paid. In 2008, more than 72,000 ITINs were used on multiple tax returns that resulted in the payment of **176 million dollars** in refunds.

In 2011, the Inspector General reported that individuals not authorized to work in the United States were paid **4.2 billion dollars** in refundable credits in 2010 alone. IRS did not agree to TIGTA's recommendation that it require additional documentation to support claims of child tax credits, notwithstanding that, for 91% of ITIN returns claiming ACTC, an examination resulted in an adjustment. But the refunds had already been issued. Additional child tax credits totaling nearly **14.25 billion dollars** were paid to illegal aliens in 2008, 2009, and 2010. IRS does not agree that this credit is not available to unlawful immigrants, and takes no steps to confirm that the child about whom the credit is claimed exists at all, or lives in the ITIN filer's household and not in another country.

Drawing upon data in several Inspector General Reports, the Center for Immigration Studies concluded in 2011 that for the six years 2005 – 2010, inclusive, illegal immigrants collected about **7.3 billion dollars** more from the Federal Treasury than they contributed to it.

Perhaps the most damaging of all the studies of IRS's handling of ITINs and tax returns filed using them is the Inspector General's July 2012 report, entitled, and concluding, with the understatement typical of the TIGTA, that "Substantial Changes Are Needed To The Individual Taxpayer Identification Number Program To Detect Fraudulent Applications." The Report concludes that IRS does not have controls over the issuance of ITINs sufficient to prevent or deter fraud. According to the Report: "In Processing Year 2011, the IRS processed more than 2.9 million ITIN tax returns resulting in tax refunds of **6.8 billion dollars**."

The report had been undertaken at the request of members of Congress, who forwarded complaints they had received from IRS employees. The employees complained that their supervisors pressured them not to carefully consider ITIN applications, but rather just to issue as many ITINs as possible as fast as possible. The Inspector General's audit confirmed the veracity of these complaints. It discovered that IRS approved tens of thousands of ITIN applications submitted using the same address. TIGTA found 154 addresses across the U.S. for which more than 1,000 ITINs had been issued.

In 2011, IRS sent 24,000 refunds totaling **46 million dollars** to a single address in Atlanta. It paid more than **9 million dollars** in refunds to filers of nearly 3,600 refund claims from 7 addresses. Among the charts in the Report is one showing the 10 addresses most commonly used for ITIN tax refunds. For 2011, these 10 addresses accounted for

- nearly 54,000 ITIN returns claiming refunds,
- totaling more than **86 million dollars** THAT WERE ISSUED.

TIGTA found that, notwithstanding that IRS had rejected prior ITIN applications using certain addresses, it approved dozens, and in one case more than 600, ITIN applications from five addresses, and issued 739 refunds totaling **1.8 million dollars** to those addresses. TIGTA's research also confirmed that ITINs were being used for purposes other

than tax reporting. It found them listed in property and vehicle ownership records and in traffic violations histories.

Later that year, then Deputy Commissioner Steve Miller responded to Rep. Boustany's inquiry following up on the Inspector General's July report about ITINs, saying steps were being taken to address the deficiencies.

In 2013, the Inspector General reported that the IRS had not complied with an Executive Order to reduce improper payments. The Report concludes that from 2003 –2012, inclusive, IRS paid **122 billion dollars**, give or take 11 billion dollars in EITC in error. (Remember, this does not include ACTC paid in error.) Later that year, Sen. Sessions proposed an amendment to the budget bill to bar payment of ACTC on a tax return using an ITIN. Sen. Reid killed it.

Last year, 2014, the Inspector General issued a report entitled "Existing Compliance Processes Will Not Reduce The Billions Of Dollars In Improper Earned Income Tax Credit And Additional Child Tax Credit Payments." IRS is required by law to identify programs that present a high risk of fraud and to take action to prevent it. IRS identifies only EITC, and not ACTC, as high risk. The Inspector General concluded the two programs have similar risks of fraud, and estimated that between 25.2 and 30.5 percent – or **6.5 billion dollars**, give or take half a billion dollars - of the ACTC payments made for 2013 should not have been made. Similarly, **14.5 billion dollars** of EITC payments in 2013 were in error. For 2012, IRS paid out **63 billion dollars** in EITC and **26.6 billion dollars** in refundable ACTC.

[Additional Relevant Data](#)

On February 2 of this year, the Center for Immigration Studies, with information obtained under the Freedom of Information Act, reported that "more than 5.5 million new work permits were issued to aliens from 2009 to 2014, above and beyond the number of new green card and temporary worker admissions in those years."

At a Senate [hearing](#) on March 3, officials of the United States Citizenship and Immigration Services (USCIS) testified that their agency processed nearly seven million immigration-related applications during fiscal year 2014 alone. Daniel Renaud, Associate Director of USCIS Field Operations, also testified that people applying under the executive orders will receive even less scrutiny than the seven million rushed through the process last year.

Last week, the Inspector General for the Social Security Administration revealed that, notwithstanding that it has the mechanisms and a system for doing so, the agency has not removed from its active rolls the numbers assigned to at least 6.5 million people who were born more than 112 years ago. (As the oldest living American is 112 years old, the SSA IG supposes anyone born before that has died by now.) Just under 70,000 of these were reportedly used in income tax returns from 2006 to 2011.

SSA has issued 450 million numbers since the start of the program. Death apparently is the only event for which SSA will retire a social security number. SSA has no mechanism or

system for revoking, terminating, or retiring the numbers it assigns to people who are only temporarily eligible for them, as is the case with persons in the U.S. with temporary work authorization. The DACA and DAPA actions are also supposed to be temporary, but will apparently result in a social security number permanently entitling its holder to various types of financial assistance courtesy of U.S. taxpayers.

Conclusion

The “deferred action” eligibility requirements do not include government confirmation that the applicant has neither filed for nor received, nor been party to requesting or receiving, tax or other federal benefits for which he is not eligible.

We know from experience that the actions upon which the Administration embarks are guaranteed to inflict substantial damage on tax administration and enforcement, and to drain even more billions of hard-earned dollars from the Federal Treasury than past follies are already costing, and continue to cost.

It is incumbent upon Congress to take all available steps to minimize what could otherwise be a raid on the Federal Treasury. Congress should clarify that refundable credits are not available to persons who entered the country illegally, or who entered legally, but overstayed. And it should require the Social Security Administration to keep track of, and to communicate with other relevant agencies concerning, social security numbers granted on the basis of temporary work permits.

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Lee O'Connor is a partner in the law firm's federal tax controversy and tax policy group and located in the Washington, DC office. Ms. O'Connor represents clients in civil and criminal federal tax investigations, and in disputes with other government agencies, and formulates and advises on regulatory and legislative solutions to government disputes. She has presented oral arguments in the United States Supreme Court and in the United States Courts of Appeals.

Ms. O'Connor joined Pillsbury in July 2007 after serving for six years as the Assistant Attorney General for the Tax Division of the United States Department of Justice. While at the Department of Justice, she was a member of the President's Corporate Fraud Task Force.

As Assistant Attorney General, Ms. O'Connor headed a division of more than 600 people, supervising the litigation in federal courts - civil and criminal, trial and appellate – of its 350 attorneys. Significant cases during her tenure involved corporate and individual abusive tax shelters and offshore tax evasion. She created and implemented continuing programs to coordinate parallel civil and criminal investigations and judicial proceedings with the Internal Revenue Service and United States Attorneys Offices throughout the country. In recognition of her outstanding contributions to the accomplishment of the Justice Department's mission, Ms. O'Connor received the Edmund J. Randolph Award for Outstanding Service. And for her contributions to federal tax administration and enforcement, the Commissioner of the Internal Revenue Service and the IRS Chief Counsel awarded her their highest honors.

Early in her career, Ms. O'Connor was a Corporate Tax Law Specialist in the National Office of the Internal Revenue Service. She is also a CPA and, for more than 20 years, was a national tax consultant with top national accounting firms.

Ms. O'Connor has taught in the graduate tax law program of Georgetown University School of Law, and was Distinguished Adjunct Professor of Tax Policy at the George Mason University School of Law, and has long been a frequent speaker at bar conferences and business seminars.

Honors & Awards

- *Legal 500 US*, Tax Controversy (2011-2012)
- Nation's Top 50 IRS Representation Practitioners, *CPA Magazine* (2008)
- Washington's Top Lawyers, Tax, *Washingtonian* (2007)

Affiliations



Chairman, Administrative Law Group of the Federalist Society for Law and Public Policy Studies

Vice-Chairman, Board of Directors, Americans United for Life

Advisory Council, Republican National Lawyers Association

Fellow, American College of Tax Counsel

Member, National Association of Former United States Attorneys

Member, American, Federal and District of Columbia Bar Associations

Former member, Tax Executive Committee, American Institute of Certified Public Accountants

Courts

United States Supreme Court

United States Court of Appeals for the Fifth Circuit

United States Court of Appeals for the Federal Circuit

District of Columbia Court of Appeals

United States Court of Federal Claims

United States Tax Court

Recent Speaking Engagements

"Economic Liberty: Promoting the Freedom to Work, To Grow and To Prosper in America," Speaker, Republican National Lawyers Association 15th Annual National Policy Conference, Washington, DC, March 21, 2014

"Drones and Presidential Authority," Moderator, Federalist Society National Student Symposium, University of Florida, Gainesville, Florida, March 8, 2014

"Is the Obama Administration Conducting a Serious Investigation of IRS Targeting?" Testimony before the House Oversight and Government Reform Subcommittee on Economic Growth, Job Creation & Regulatory Affairs, February 26, 2014

"What, if any, is the Proper Role of the IRS in the Administration of Social Welfare Programs?" ABA Tax Section Mid-Year Meeting, January 24, 2014

"Executive Branch Gone Wild? Checks and Balances in the 21st Century," Moderator, Federalist Society's National Lawyers Convention, November 16, 2013

Teleforum with Peter Schweizer about this book "Extortion: How Politicians Extract Your Money, Buy Votes, and Line Their Own Pockets," November 7, 2013

Teleforum with Clark Neily about his book "Terms of Engagement: How Our Courts Should Enforce the Constitution's Promise of Limited Government," October 10, 2013



Teleforum with Christopher deMuth about his essay, "The Bucks Start Here," October 3, 2013

"The Use and Abuse of the Internal Revenue Code - The Chances for Meaningful Tax Reform in 2013." National Black Chamber of Commerce's 21st Annual Convention - Innovation: Growth, Profit & Prosperity, Palm Beach, FL, July 25, 2013

"A Stewardship Challenge: Harmonizing Ecology, Prosperity and Liberty," Foundation for Research on Economics & the Environment Conference, Three Forks, Montana, July 15-19, 2013.

"*City of Arlington* – How Much Deference?" Moderator, Federalist Society Administrative Law and Regulation Practice Group Teleforum, May 20, 2013

"Prospects for Meaningful Tax Reform in 2013." Republican National Lawyers Association 14th Annual National Policy Conference, Washington, DC, April 25, 2013

"The Use and Abuse of the Internal Revenue Code, and Chances for Tax Reform," Ave Maria Law School, Naples, Florida, April 18, 2013

"Hot Issues Appellate Tax Litigation," Moderator, Federal Bar Association 36th Annual Tax Law Conference, Washington, D.C., March 2, 2012

"The Use and Abuse of the Internal Revenue Code," University of Washington School of Law, Seattle, WA, May 13, 2011

"What Today's Lawmakers Could Learn from President Reagan's Tax Policy," Republican National Lawyers Association's 12th Annual National Policy Conference, Washington, D.C., May 6, 2011

"U.S. Tax Reform and International Trends: Implications for Global Business and U.S. Competitiveness," Council on Foreign Relations Corporate Meeting, Washington, D.C., June 18, 2010

"Federal and State Tax Laws in 2010 and Thereafter," Republican National Lawyers Association's 11th Anniversary National Policy Conference, Washington, D.C., April 16, 2010

"What Tax Law Can Tell Us About How 'Health Care Reform' Will Work," Presentation to Harvard Law School Federalist Society with Abigail Adams Society, Cambridge, MA, March 25, 2010

Publications

IRS Will Scrutinize Fringe Benefits During Employment Tax Audits, 8/3/2010

Supreme Court to Decide Application of Six-Year Limitations Statute to Tax Refund Claim, 12/21/2007

