

#11 AUTHORIZE THE IRS TO WORK WITH FINANCIAL INSTITUTIONS TO REVERSE MISDIRECTED DEPOSITS

Present Law

Title 12, United States Code, § 3402 generally bars government authorities from accessing financial information of any customer from a financial institution unless the records are reasonably described and are disclosed as enumerated in 12 U.S.C. §§ 3404 through 3408, which include customer authorizations, administrative subpoena or summons, search warrants, judicial subpoenas, or formal written requests. Section 3402 also provides for limited exceptions, one of which includes 12 U.S.C. § 3413. Section 3413(c) provides that “[n]othing in this chapter prohibits disclosure of financial records in accordance with procedures authorized by [the IRC].” The IRC does not currently include procedures through which the IRS can obtain information about an account holder who receives a misdirected direct deposit refund.

The IRS has erroneous refund procedures to recover a direct deposit that has been applied to the wrong taxpayer’s bank account due to IRS error.⁶⁹ An erroneous refund is defined as “the receipt of any money from the Service to which the recipient is not entitled.”⁷⁰ However, the IRS may not use its erroneous refund procedures to recover the refund (assess and collect it) if it does not know the identity of the account owner.

Reasons for Change

Every year, some taxpayers who request that their tax refunds be paid through direct deposit place the wrong bank account or routing number on their tax returns. As a result, the refund is sometimes deposited into the account of an unrelated third party. In a small number of cases, dishonest tax return preparers change the routing information on a return and the taxpayer’s refund is deposited into the preparer’s account.

There currently are no procedures that allow the IRS to recover a misdirected direct deposit. Existing regulations provide the general rule that when federal payments (other than vendor payments) are deposited, the account at the financial institution shall be in the name of the recipient.⁷¹ However, financial institutions are not required to verify whether the name on the designated account matches the name of the depositor/taxpayer,⁷² and the IRS has no authority to take money out of the incorrect account or receive confidential information from the financial institution regarding the owner of the incorrect account.

The IRS can do little more than contact the financial institution and ask that it attempt to persuade the incorrect account owner to return the misdirected funds. While the financial institution is required to take corrective action when the mistake is its own, it is generally not required to take action if the mistake is made by the taxpayer.⁷³ As a result, a taxpayer who enters a wrong digit may lose his tax refund in entirety.

For this reason, a taxpayer has greater recourse if he requests that his refund be paid by paper check. If a taxpayer elects to receive his refund by check and the check does not arrive, the taxpayer may notify the

69 See IRM 21.4.5.5.5, *Overview of Category D Erroneous Refunds* (Oct. 1, 2016).

70 See IRM 21.4.5.2, *Erroneous Refunds Overview* (Oct. 9, 2015).

71 31 C.F.R. § 210.5(a).

72 “It is important to note that [a financial institution] is not required to manually verify that the name on the [Automated Clearing House] entry matches the name on the account at the time the payment is posted.” Bureau of the Fiscal Service (BFS) Green Book: *A Guide to Federal Government ACH Payments 2-6* (Rev. May 2013), <https://www.fiscal.treasury.gov/fsreports/ref/greenBook/pdf/greenbookchapter2.pdf>.

73 See 31 CFR § 210.8(d) (providing that if a financial institution becomes aware that an agency has originated an Automated Clearing House credit entry to an account that is not owned by the payee whose name appears in the ACH payment information, the financial institution shall promptly notify the agency).

IRS, and the Treasury Department's Bureau of the Fiscal Service (BFS, formerly Financial Management Service) will determine whether the check has been negotiated. If it has not been negotiated, BFS will issue a replacement check to the taxpayer. If BFS finds the paper check has been negotiated, it will conduct additional research, and if it determines the taxpayer was not involved in negotiation of the check, it will issue a replacement to the taxpayer and charge the Check Forgery Insurance Fund.⁷⁴

By contrast, taxpayers who elect to receive their refunds by direct deposit have no such support. BFS guidelines state, in part: "If the taxpayer or the taxpayer's agent gave incorrect account information, neither Fiscal Service nor IRS will assist the taxpayer with recovering the funds, and the taxpayer is free to pursue civil action."⁷⁵

Despite its efforts to persuade taxpayers to elect to receive their refunds via direct deposit, the IRS has insufficient procedures for replacing misdirected direct deposit refunds. As a result, taxpayers who elect to receive their refunds electronically have no backstop if they make a mistake (or if their preparer redirects the refund). As compared with the ability to obtain a replacement check, the current procedures undermine the IRS's goals by providing a strong incentive for taxpayers to elect to receive their refunds by check.

Recommendation

Amend the IRC to require the IRS to create a process through which the IRS can work with financial institutions to identify the account holder of a misdirected tax refund deposit. In addition, amend Title 31 of the United States Code to require the return of misdirected funds by the account holder of the account that incorrectly received the funds.

74 See 31 U.S.C. § 3343. Once it is determined a refund check has been cashed and the BFS determines whether or not the payee endorsed the check, BFS may issue a replacement check, or when appropriate, issues denial letters. IRM 21.4.2.4.13 (Jan. 13, 2016).

75 BFS Green Book, *A Guide to Federal Government ACH Payments 1-9* (Rev. May 2013), <https://fiscal.treasury.gov/fsreports/ref/greenBook/pdf/greenbookchapter1.pdf>.