Successfully Executing IRS Form 4506-C and Reverifying Tax Transcripts

Obtaining and reconciling tax transcripts is a critical component of the quality control (QC) reverification process. This important control begins with properly executing Form 4506-C in a timely manner. By having an effective process in place to obtain tax transcripts, your QC function will be positioned to identify potential income/ employment discrepancies and enhance loan quality.

To reduce loan quality risk and operational risk to your organization, consider:

- Discrepancies identified during the reconciliation of tax transcripts versus the income data used to qualify the borrowers can reveal both income and employment misrepresentation. Such discoveries have contributed to some of our recent industry-wide fraud alerts.
- Fannie Mae's external auditing function (Mortgage Origination Risk Assessment) frequently finds that lenders have inadequate processes in place to effectively execute Form 4506-C, resulting in weaker risk controls and wasted expenses.

Ask yourself:

Given the critical nature of this control, what due diligence should you perform to ensure a successful execution of Form 4506-C to obtain the transcripts needed to adequately reverify the borrower's income?

> **NOTE:** *Form 4506-C replaces Form 4506-T and must be used effective* **May 1, 2021** *for the IRS's Income Verification Express Service (IVES). See IRS website for details.*

Tips on transitioning to Form 4506-C

- Notify correspondents of the requirement to transition to Form 4506-C immediately.
- If technology (loan origination system) or other constraints impact the ability to obtain Form 4506-C, consider the following:
    - Implement a manual process to have Form 4506-C signed by borrower(s) at closing.
    - Leverage upcoming prefunding samples to identify any loans utilizing Form 4506-T and add a condition to get an updated Form 4506-C at closing.
    - *After* closing, attempt to get Form 4506-C signed by the borrower(s) IF the loan is selected for post-closing QC.
    - Note: If post-closing QC is unable to obtain tax transcripts due to an incorrect form, cite a defect.

## Common reasons for IRS rejection of Form 4506-C

Because borrower data on the form is non-public information, the IRS aggressively reviews all lender-completed fields to prevent unauthorized access to taxpayer information. Therefore, be on the lookout for these common defects during the origination cycle:

Line 5A *(IVES participant name)* not completed correctly. Often caused by confusion from third-party originators over which entity to add to this line.	Code 10 Rejection: Indication of possible identity theft/fraud. **NOTE:** *This rejection code is a red flag that should trigger further review.*
An important signature is missing.	A box is left unchecked.
The tax year information was omitted.	Elements of the form are filled out inconsistently.
Information entered on the form isn't legible.	The form appears manually altered.
Information such as name, address, mailbox, or TIN is missing.	Inconsistent dates or signature date is 120 days outside of IRS request window.

Tips for a successful 4506-C/tax transcript process

- Add checks in pre-funding QC, pre-purchase QC, and closing package reviews to analyze the signed Form 4506-C to ensure it is completed correctly.
  - Compare income documents and information (e.g., borrower's name and address against W-2s) to Form 4506-C to prevent common reasons for rejection from occurring.
- Confirm that the Tax Form Number (1040, W-2, 1065, 1120, etc.) entered in the "Transcript requested" section of Form 4506-C supports the income documentation and any Desktop Underwriter ® (automated underwriting system) recommendation used for qualification.
  - *Ask yourself:* Do you know when tax return (1040) transcripts should be requested versus when to request W-2 transcripts? See the scenario chart in Guidelines Related to IRS Form 4506-C.
- Order transcripts as early as possible during the post-closing QC cycle to allow adequate time to receive them prior to the start of the QC review.
- If using a QC vendor, consider pulling transcripts in-house and send to the vendor. Alternatively, if the QC vendor's attempt to obtain transcripts fails, ask the vendor to refer the loans back to your QC team for review and a re-attempt.
- Track attempts to obtain transcripts and the IRS rejection reasons (e.g., sent date, receipt date, rejections; by branch, originator, third-party originator).
  - When transcripts are *not* received, it's important to document the attempt and the rejection reason in the QC file.
  - If a trend of failed attempts is identified, pull an upcoming component discretionary QC sample using the trend characteristics to target. Focus reviews on income only and obtain tax transcripts.
- Upon receipt, reconcile transcripts with the income documents used to qualify the borrower(s) and look for discrepancies.
- Ensure QC cites a defect when Form 4506-C can't be executed.
- Investigate the root cause of all rejections and implement a corrective action plan, when necessary.
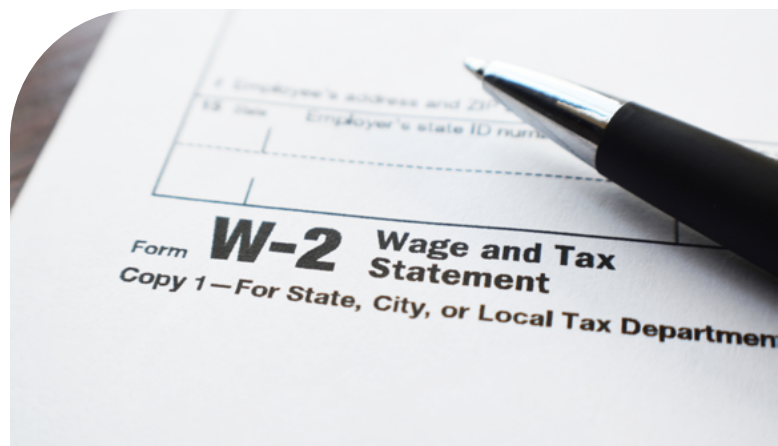
Next steps

Complete a thorough review of your end-to-end Form 4506-C execution and tax transcript reverification processes and look for areas where you can improve your success rate. Obtaining tax transcripts and reconciling the income is a *Selling Guide* requirement and is critical to your QC and risk management functions.

Ask yourself: Is this critical risk control process being efficiently managed to bring the most value to your organization?

Look for future *Quality Insider* articles about reverification best practices!

Resources:

- Guidelines Related to the IRS Form 4506-C and Tax Return Transcripts
- *Selling Guide*: D1-3-02, Lender Post-Closing QC Review of Approval Conditions, Underwriting Decisions, and Documentation
- *Selling Guide*: B3-3.1-06, Requirements and Uses of IRS IVES Request for Transcript of Tax Return Form 4506-C

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