
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Office of Inspections and Evaluations



*The Internal Revenue Service Should
Consider Modifying the Form 1040
to Increase Earned Income Tax Credit
Participation by Eligible Tax Filers*

April 2, 2018

Reference Number: 2018-IE-R004

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

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The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

Highlights

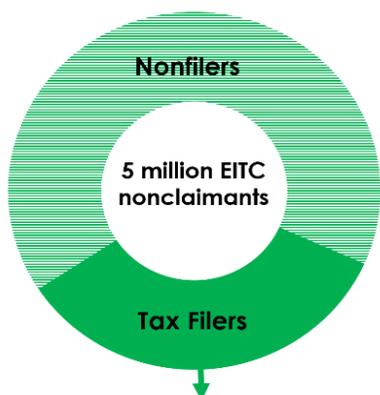
Highlights of Report Number: 2018-IE-004 to the IRS Commissioner, Wage and Investment Division.

WHY TIGTA DID THIS STUDY

The IRS estimates that about 20 percent of eligible taxpayers do not claim \$7.3 billion of Earned Income Tax Credit (EITC) each tax year. This project was initiated to evaluate whether EITC post-filing outreach activities are effective channels to reach eligible taxpayers and increase EITC participation rates.

IMPACT ON TAXPAYERS

The EITC is a refundable tax credit used to encourage employment by low-income working families and individuals. Eligible individuals must file a tax return to receive it. In Tax Year 2015, over 27 million taxpayers received \$67 billion in EITC. The IRS recently estimated that 5 million potentially eligible taxpayers do not claim the credit each year, resulting in \$7.3 billion in unclaimed benefits annually. IRS estimates that over 1.7 million of these taxpayers filed a tax return but did not claim the credit.



The IRS issues reminder notices to certain taxpayers who appear eligible after they have filed their tax returns.



WHAT TIGTA FOUND

In Tax Year 2014, nearly 175,000 taxpayers received \$82 million in EITC after responding to an IRS reminder notice; however, this only increased estimated taxpayer and dollar participation rates by less than one percentage point. Notices have a limited impact because they are issued to a small percentage of potentially eligible tax filers, and half do not respond. Modifying the tax return could increase overall participation and eliminate the need for reminder notices, saving the IRS an estimated \$2 million annually.

Recent versions of the reminder notice sent to taxpayers with children contained erroneous eligibility instructions. The error may have adversely affected a taxpayer's decision to respond or resulted in the credit being incorrectly denied. Although the IRS became aware of the error in July 2015, internal processes delayed the IRS from issuing a revised notice for almost two years. The IRS did not notify taxpayers of the error.

Although the objective of the reminder notices is to increase EITC participation, the IRS has not specified a goal for participation rates in future years. Moreover, improved performance measures are needed to adequately assess program effectiveness.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division, evaluate alternative approaches to increase EITC participation and reduce costs. For example, the IRS should consider eliminating Schedule EIC, *Earned Income Credit*, and modifying Form 1040, *U.S. Individual Income Tax Return*, to collect necessary eligibility information instead of sending reminder notices. TIGTA also recommended that the IRS establish procedures to timely notify taxpayers who have received reminder notices with an error. Finally, TIGTA recommended that the IRS establish a specific objective for increasing EITC participation rates for eligible taxpayers and related performance measures to determine whether the established objectives have been achieved. The IRS agreed with our recommendations.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 2, 2018

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: Gregory D. Kutz
Acting Deputy Inspector General for Inspections and Evaluations

SUBJECT: Final Evaluation Report – The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers (#IE-16-006)

This report presents the results of our evaluation to determine whether Earned Income Tax Credit post-filing outreach activities are effective channels to reach eligible taxpayers and increase participation rates. This evaluation was included in our Treasury Inspector General for Tax Administration Fiscal Year 2018 Program Plan. This review addresses the major management challenges of Providing Quality Taxpayer Service and Achieving Program Efficiencies and Cost Savings.

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

If you have any questions about this report, you may contact me or Phil Shropshire, Director, Office of Inspections and Evaluations.



*The Internal Revenue Service Should Consider Modifying the Form
1040 to Increase Earned Income Tax Credit Participation by
Eligible Tax Filers*

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Abbreviations

CP	Computer Paragraph
EITC	Earned Income Tax Credit
GAO	Government Accountability Office
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration
TY	Tax Year



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Background

The Earned Income Tax Credit (EITC or the credit) is a refundable¹ tax credit that supplements the income of low- to moderate-income working families and individuals. Enacted in 1975,² the EITC encourages employment by supplementing wages and offsetting payroll taxes. The credit is administered by the Internal Revenue Service (IRS), and an income tax return must be filed to claim the EITC. For EITC-eligible taxpayers, the amount of the credit depends on the taxpayer's filing status, earned income, adjusted gross income, and number of qualifying children. The maximum credit amounts for Tax Year (TY)³ 2016 are:

- \$6,269 with three or more qualifying children.
- \$5,572 with two qualifying children.
- \$3,373 with one qualifying child.
- \$506 with no qualifying children.

The IRS wants all eligible taxpayers to claim the credit. In TY 2015, over 27 million taxpayers claimed \$67 billion in EITC. However, the IRS estimates that approximately 24 percent (\$15.6 billion) of EITC payments made in Fiscal Year⁴ 2015 were paid in error. Childless taxpayers claim the credit directly on their *U.S. Individual Income Tax Return* (Form 1040). Taxpayers claiming qualifying children must use Form 1040 (Schedule EIC), *Earned Income Credit*, to report each qualifying child's information. Appendix III provides additional details on EITC eligibility requirements.

The IRS estimates that 79 percent of eligible taxpayers claimed the EITC in TY 2014

The IRS partners with the United States Census Bureau to develop annual estimates of EITC participation.⁵ One estimate reflects the number of eligible taxpayers who claimed the credit (claiming participation), and the other captures the total number of eligible EITC dollars paid (dollar participation). The most recent (TY 2014) estimates show that the claiming participation

¹ Taxpayers can claim refundable tax credits even if they do not have any income tax liability. For example, certain taxpayers whose incomes do not exceed the filing threshold can still receive the EITC if they file a tax return.

² Tax Reduction Act of 1975 § 204, 26 U.S.C. § 32.

³ The 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.

⁴ Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

⁵ The estimation process matches IRS tax return data to the Census Bureau's Current Population Survey Annual Social and Economic Supplement to predict taxpayer eligibility.



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rate is about 79 percent and the dollar participation rate is about 85 percent. Based on these estimates, 5 million potentially eligible taxpayers did not claim approximately \$7.3 billion in EITC refunds. Figure 1 shows the estimated participation statistics.

Figure 1: Estimated TY 2014 EITC Participation Statistics⁶



Source: Center for Administrative Records Research and Applications, U.S. Census Bureau TY 2014 data (numbers and percentages are rounded).⁷

⁶ These statistics only include taxpayers who are estimated to be eligible for the credit; therefore, the statistics exclude improper payments. Historically, the IRS has estimated an EITC improper payment rate of 24 percent.

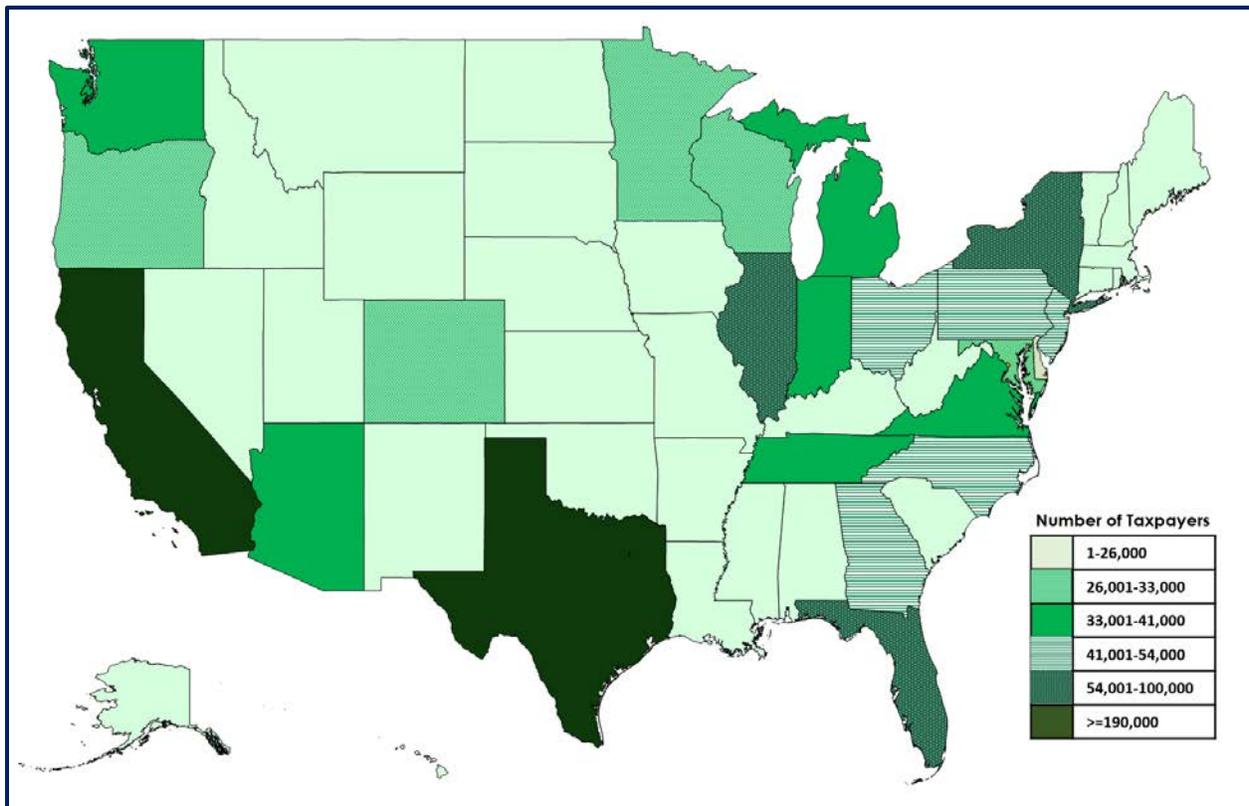
⁷ The U.S. Census Bureau's Current Population Survey Annual Social and Economic Supplement is matched with IRS administrative records to produce the official estimate of EITC participation.



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Approximately 1.7 million potentially eligible taxpayers filed a tax return but did not claim the credit. Figure 2 shows this population by State. Appendix VII has more detailed State-level data on potentially eligible tax filers who did not claim EITC in TY 2014.

Figure 2: Population of Potentially Eligible Taxpayers (Point Estimates) Who Filed a Tax Return but Did Not Claim the EITC in TY 2014⁸



Source: IRS/Census Bureau American Community Survey Match, TY 2014.⁹

Academic research shows that there are many factors which affect whether a taxpayer claims the EITC. Some factors include unawareness of the credit, fear of being audited, stigma, tax preparation costs, and complexity of eligibility rules and forms. The IRS has outreach programs and tools to address some of these factors. For example, the Volunteer Income Tax Assistance

⁸ These figures are based on point estimates and are rounded to the nearest thousand. Each estimate has a margin of error associated with it ranging from 0.5 to 5.4 percent.

⁹ The American Community Survey is a nationwide survey designed to provide communities with reliable and timely demographic, social, economic, and housing data every year. While the Current Population Survey Annual Social and Economic Supplement survey is used to produce the official estimate of EITC participation, the American Community Survey is used to provide estimates by geography.



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

program provides free tax return preparation for low-income taxpayers. The web-based *EITC Assistant* tool helps taxpayers navigate through complex eligibility rules. The IRS also hosts an EITC Awareness Day, an annual nationwide campaign aimed at generating media coverage at the beginning of the filing season.¹⁰ Most of these outreach efforts occur during the filing season because taxpayers must file a tax return to claim the credit. However, the IRS also performs outreach activities after tax returns have been filed (hereafter referred to as “post-filing” outreach).

Some eligible taxpayers who filed a tax return and did not claim an EITC received reminder notices

The IRS/Census Bureau study estimated that 20.2 million taxpayers who filed a tax return were eligible to claim the EITC in TY 2014. An estimated 18.5 million taxpayers claimed the credit, resulting in a claiming participation rate for tax filers of 92 percent. However, an estimated 1.7 million (8 percent) eligible tax filers did not claim the credit. The IRS sends notices to some of these tax filers reminding them of their potential eligibility for the credit.¹¹ Each notice explains the credit and requires the taxpayer to answer a series of eligibility questions. For taxpayers with children, the information requested replicates information that would have been reported on Schedule EIC. For childless taxpayers, the notices are used primarily to verify if the taxpayer lived in the United States for more than half of the year. Potentially eligible taxpayers with children receive a Computer Paragraph (CP) 09 notice, and childless taxpayers receive a CP 27 notice. The IRS issued over 361,000 reminder notices in TY 2014 (95,000 notices to taxpayers with children and 266,000 notices to childless taxpayers). Figure 3 shows an example of the notice sent to taxpayers with children.

¹⁰ The period from January through mid-April when most individual income tax returns are filed.

¹¹ The IRS uses a series of computer filters to identify families and individuals who are apparently eligible for the EITC based on tax return information but who did not claim the credit on their tax return. The filters prevent some potentially eligible filing nonclaimants from receiving a notice due to past compliance issues or difficulty in determining eligibility. For example, taxpayers with children older than 18 years of age are not sent a notice because the IRS cannot determine if the child is a full-time student.



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Figure 3: EITC Reminder Notice (CP 09) Sent to Taxpayers with Children

Important information about the Earned Income Credit	
You may be eligible for a refund of up to \$ 6,269	
<p>Our records show that you may be eligible for the Earned Income Credit (EIC), but didn't claim it on your 2016 tax form. Depending on your earnings and eligibility, your benefit can be up to \$6,269.</p> <p>Do not discard or overlook this notice because you may be entitled to some additional money.</p>	<hr/> <p>Summary</p> <p>The credit, which can be up to \$6,269, is for certain people who have worked and earned income. Please complete the worksheet on Page 3 to determine if you're eligible for the credit.</p> <hr/>
<p>What you need to do</p>	<p>Complete the Earned Income Credit Worksheet on page 3.</p> <p>If the worksheet confirms that you're eligible for the credit</p> <ul style="list-style-type: none">• Sign and date the attached worksheet, and mail it to us in the enclosed envelope. <p>If the worksheet indicates that you're not eligible for the credit</p> <ul style="list-style-type: none">• Please do not return the worksheet to us.

Source: Example of TY 2016 CP 09 notice obtained by Treasury Inspector General for Tax Administration (TIGTA) from IRS Wage and Investment Division.

Taxpayers must complete, sign, and return the notice with the attached worksheet to receive the credit. IRS employees in the Wage and Investment Division handle taxpayer responses and either issue a refund or a letter to the taxpayer denying the credit.



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Results of Review

EITC reminder notices have a limited effect on increasing overall EITC participation. For example, in TY 2014 (the latest year for which data are available), the reminder notices increased participation by around 175,000 taxpayers, increasing overall claiming participation from the estimated 78 percent to 78.7 percent. Although several alternative options exist that could reduce costs and increase EITC participation, the IRS has not fundamentally modified its approach in over 25 years.

We also found that recent versions of the notice sent to taxpayers with children had erroneous eligibility instructions. Unfortunately, the error may have affected a taxpayer's decision to respond or resulted in IRS employees incorrectly denying the credit. Although the IRS became aware of the error in July 2015, internal processes delayed issuing a revised notice for almost two years. Furthermore, the IRS did not notify taxpayers of the error.

Although the objective of the reminder notices is to increase EITC participation, the IRS has not specified a participation rate target. Moreover, improved performance measures are needed to adequately assess program effectiveness because some of the current measures do not provide meaningful data about the quality and effect of the notices.

More Effective and Efficient Options May Exist to Increase EITC Participation Among Eligible Tax Filers

In TY 2014, approximately 175,000 taxpayers received \$82 million in EITC refunds after responding to the notice.¹² While this is positive in terms of raw figures, it increased estimated claiming and dollar participation rates by less than one percentage point. Notices have a limited impact because they are issued to a small percentage of potentially eligible tax filers, and half do not respond. The IRS did not adopt a previous recommendation by the Government Accountability Office (GAO) to put additional eligibility information on the tax return mainly because of concerns about space.¹³ We believe modifying the tax return could increase overall participation and eliminate the need for reminder notices, saving the IRS nearly \$2 million annually.

¹² The average refund was \$1,798 for taxpayers with children and \$261 for childless taxpayers.

¹³ GAO/GGD-93-145, *Earned Income Tax Credit: Design and Administration Could Be Improved* p. 54 (Sept. 1993).



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Reminder notices increased EITC participation by less than one percentage point

IRS management was unaware of how little EITC notices increased participation rates. Using TY 2014 data, we calculated that the notices increased:

- Claiming participation—the percentage of eligible taxpayers that claimed EITC **including** taxpayers that did not file a tax return—from 78.0 percent to 78.7 percent (0.7 percentage points).¹⁴
- Dollar participation—the percentage of total eligible EITC dollars claimed by eligible taxpayers—from 84.5 percent to 84.7 percent (0.2 percentage points).
- Tax filer claiming participation—the percentage of eligible taxpayers that claimed EITC **excluding** taxpayers that did not file a tax return—from 90.7 percent to 91.6 percent (0.9 percentage points).

The increase is limited because only a small percentage of potentially eligible tax filers are issued a notice. In TY 2014, just 361,000 of the estimated 1.7 million potentially eligible filers (21 percent) were issued a notice. The gap is due to the difficulty in estimating eligibility. For example, the Census Bureau Current Population Survey Annual Social and Economic Supplement assumes all children lived with the taxpayer(s) for an entire year. Therefore, no children are disqualified in the survey for not meeting the “more than half of the year” residency test. Also, the IRS does not send notices to certain taxpayers identified as potentially eligible. For example, taxpayers with children between the ages of 19 and 23 are not sent a notice because the IRS cannot determine if the child is a full-time college student.

Refunding the EITC using reminder notices requires additional costs

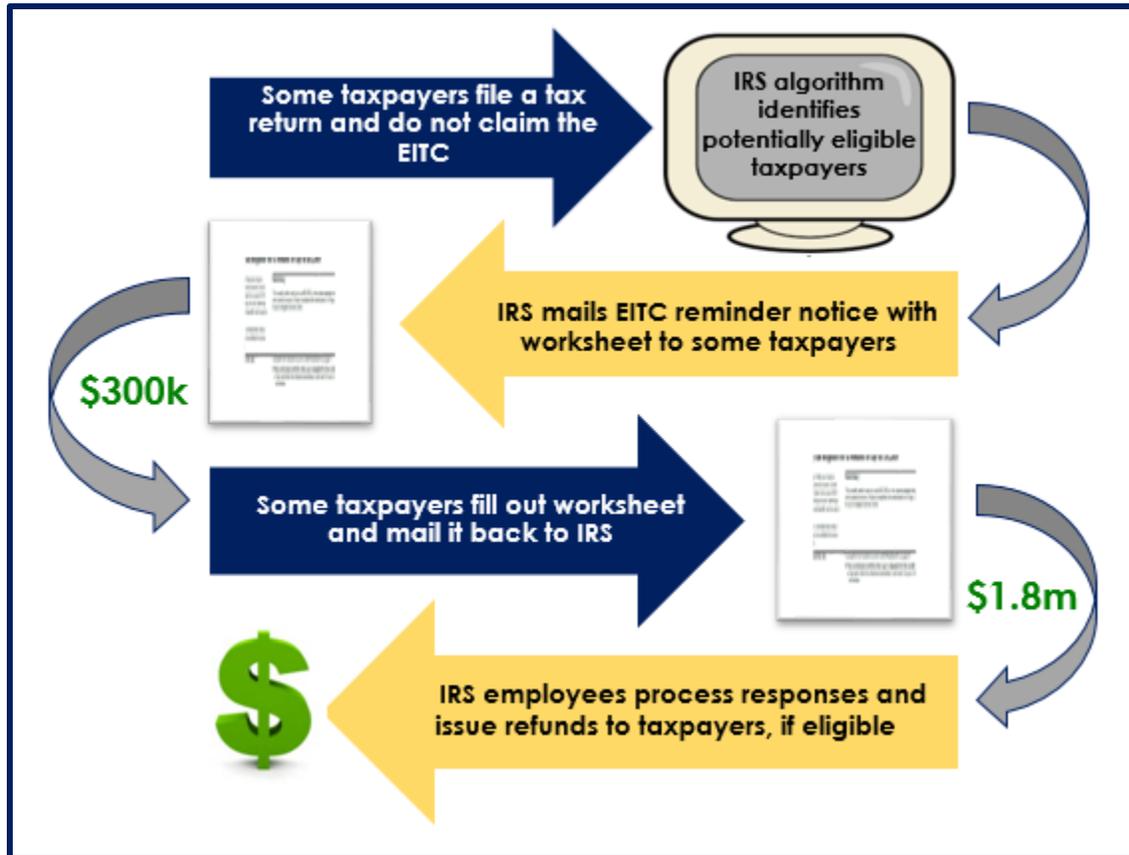
Most taxpayers claim the EITC directly on their Form 1040 tax return when they file. However, reminder notices require additional interactions between the taxpayer and the IRS to collect more eligibility information before issuing the refund. This back-and-forth process increases the costs to issue an EITC refund (see Figure 4 for a graphic of the process). The IRS estimates that this process costs over \$2 million annually. The IRS spends \$300,000 designing, printing, and mailing the notices. Employee labor for handling taxpayer responses, processing refunds, and answering phone calls accounts for the remaining \$1.8 million (86 percent) of the estimated annual total costs.

¹⁴ According to the IRS, some taxpayers who respond to the notice and receive the EITC are ineligible. Therefore, the increase is likely less than 0.7 percentage points.



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Figure 4: EITC Reminder Notices Require Additional Interactions and Costs to Refund the Credit



Source: TIGTA analysis of Internal Revenue Manual Section 3.11.6.9.11.4 (November 9, 2017) and program costs provided by the IRS Chief Financial Officer.

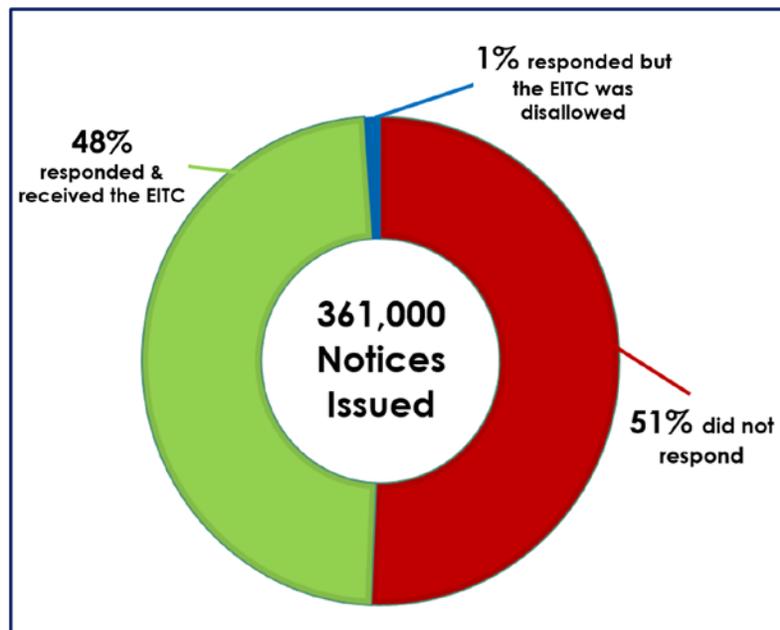
Reminder notices are also ineffective because many taxpayers do not respond. Our analysis showed that response rates to the TY 2014 notices for taxpayers with children and childless taxpayers were 28 percent and 57 percent, respectively.¹⁵ Figure 5 provides the combined results for both notice types in TY 2014, showing that over half of taxpayers did not respond to the TY 2014 reminder notices.

¹⁵ Appendix V provides additional results by notice type for Tax Years 2013-2015.



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Figure 5: Over Half of Taxpayers Did Not Respond to the TY 2014 Reminder Notice



Source: TIGTA analysis of IRS Individual Master File.¹⁶

Taxpayers must return the enclosed worksheet to receive the credit. The IRS did not receive responses to about 183,000 notices. The IRS estimates that 20 percent of notices are returned as undelivered. This could be explained by recent Census Bureau data which shows that low-income taxpayers are twice as likely to move annually than the rest of the population.¹⁷ In addition, some taxpayers who receive the notice may be ineligible. Taxpayers are instructed to not return the EITC worksheet if they are ineligible.

Modifying the Form 1040 series could improve EITC administration

Instead of spending over \$2 million annually to obtain additional EITC eligibility information using notices, the IRS could modify the tax return to include the necessary information. This one-time cost could improve eligibility determinations and increase participation.

The IRS must use notices because it does not capture enough information on the original tax return to accurately determine eligibility on behalf of the taxpayer as the return is processed. As far back as September 1993, the GAO recommended eliminating Schedule EIC and modifying the Form 1040 series to include all the required EITC eligibility information. The Form 1040

¹⁶ The Individual Master File is the IRS database that maintains transactions or records of individual tax accounts.

¹⁷ U.S. Census Bureau, Current Population Survey, 2016 Annual Social and Economic Supplement.



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series does not collect data that answer the residency test (for both taxpayers and children) or the age test (for children). This information is important to collect because errors made claiming a qualifying child are one of the primary causes of EITC improper payments. When completed, Schedule EIC captures age and residency for taxpayers claiming qualifying children. Childless taxpayers do not need to submit a separate schedule to claim the credit.

IRS management remains concerned that there is not enough space on the tax return to collect more EITC information. However, there are options to capture some information. For example, the IRS could replace a box that reminds taxpayers to verify the accuracy of their Social Security Number(s) and use it to collect information on whether or not a taxpayer lived in the United States for more than half the year. IRS analysts stated that this reminder box is important, but they have not conducted any studies justifying its need to be on the tax return over other information. Figure 6 shows that, with additional minor modifications to the exemption section, the tax return could include most of the information currently requested on the reminder notices. In Figure 6, we provide a comparison of the current and suggested modified Form 1040.



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Figure 6: Minor Modifications to the Form 1040 Could Collect More EITC Eligibility Information

Current Form 1040

Form 1040 Department of the Treasury—Internal Revenue Service (99) 2016 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2016, or other tax year beginning ., 2016, ending ., 20 See separate instructions.

Your first name and initial Last name Your social security number

If a joint return, spouse's first name and initial Last name Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. Apt. no. Make sure the SSN(s) above and on line 6c are correct.

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. You Spouse

Foreign country name Foreign province/state/county Foreign postal code

Filing Status 1 Single 4 Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
 2 Married filing jointly (even if only one had income)
 3 Married filing separately. Enter spouse's SSN above and full name here. ▶ 5 Qualifying widow(er) with dependent child

Check only one box.

Exemptions 6a Yourself. If someone can claim you as a dependent, do not check box 6a } Boxes checked on 6a and 6b
 b Spouse } No. of children on 6c who:
 c Dependents: } • lived with you
 (1) First name Last name (2) Dependent's social security number (3) Dependent's relationship to you (4) if child under age 17 qualifying for child tax credit (see instructions) } • did not live with you due to divorce or separation (see instructions)
 If more than four dependents, see instructions and check here ▶ Dependents on 6c not entered above
 d Total number of exemptions claimed Add numbers on lines above ▶

Modified Form 1040

Form 1040 Department of the Treasury—Internal Revenue Service (99) 2016 OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2016, or other tax year beginning ., 2016, ending ., 20 See separate instructions.

Your first name and initial Last name Your social security number

If a joint return, spouse's first name and initial Last name Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions. Apt. no. Check here if you lived in the U.S. for more than half the year

City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions). Presidential Election Campaign Check here if you, or your spouse if filing jointly, want \$3 to go to this fund. Checking a box below will not change your tax or refund. You Spouse

Foreign country name Foreign province/state/county Foreign postal code

Filing Status 1 Single 4 Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
 2 Married filing jointly (even if only one had income)
 3 Married filing separately. Enter spouse's SSN above and full name here. ▶ 5 Qualifying widow(er) with dependent child

Check only one box.

Exemptions 6a Yourself. If someone can claim you as a dependent, do not check box 6a } Boxes checked on 6a and 6b
 b Spouse } No. of children on 6c who:
 c Dependents: } • lived with you for more than half the year
 (1) First name Last name (2) social security number (3) relationship to you (4) age at the end of 2016 (5) if dependent qualifies for:
 child tax credit earned income tax credit (see instructions) } • did not live with you due to divorce or separation (see instructions)
 If more than four dependents, see instructions and check here ▶ Dependents on 6c not entered above
 d Total number of exemptions claimed Add numbers on lines above ▶

Source: TIGTA markup of Form 1040 showing suggested modifications.



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

The IRS could automatically refund the EITC to some eligible taxpayers who did not claim the credit instead of sending notices

Appropriate modifications to the tax return could enable the IRS to resume the practice of issuing EITC refunds without further interaction with eligible taxpayers who did not claim it on their return. For example, adding residency test information to the tax return may enable the IRS to refund the EITC to childless taxpayers. In fact, the IRS Office of Research, Applied Analytics, and Statistics recently considered studying eliminating the reminder notice for childless taxpayers and sending a refund instead. This proposal, although never implemented, did not include modifications to the tax return. We provide a discussion of this option in Appendix VI.

The IRS has not fundamentally changed its post-filing EITC outreach approach for nearly 25 years. Until TY 1993, the IRS automatically calculated and refunded the EITC for taxpayers who did not claim the credit but appeared eligible based on their tax return. This practice only applied to taxpayers with children because there was no childless EITC at the time. Automatic refunds were discontinued after an IRS survey found that 45 percent of taxpayers were ineligible, mostly because of claiming children that were over the age limit. Subsequently, the IRS began issuing reminder notices.

According to the Office of Management and Budget, agencies should evaluate alternative means of achieving program objectives.¹⁸ However, the IRS continues to rely on reminder notices year after year to increase EITC participation. In March 2011, some members of Congress requested that the IRS reinstate automatic calculations to increase EITC distributions.¹⁹ Instead, the only recent changes made by the IRS were to the notice's content and design.

Recommendation

Recommendation 1: The Commissioner, Wage and Investment Division, should evaluate alternative approaches to post-filing outreach that reduce costs and increase the number of eligible taxpayers who receive the EITC. For example, the IRS should consider eliminating Schedule EIC and modifying Form 1040 to collect necessary eligibility information (such as ages of children and duration of residency) instead of sending reminder notices.

Management's Response: The IRS agreed with our recommendation and plans to study the costs and benefits of modifying the Form 1040 and consider whether suggested changes can provide sufficient information to eliminate the need to send the CP 27

¹⁸ Office of Management and Budget Circular A-94, *Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs* (Oct. 1992).

¹⁹ Rhode Island Congressional Delegation letter to Commissioner Douglas Shulman (Mar. 3, 2011).



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notice. The IRS will also conduct additional analysis on the effectiveness of the recommended changes and other potential changes to Form 1040.

Recent Versions of the Notice Sent to Taxpayers With Children Contained Erroneous Eligibility Instructions

The notice issued to taxpayers with children in TYs 2014 and 2015 contained erroneous eligibility instructions. The instructions confused both taxpayers attempting to determine their eligibility and tax examiners processing the responses. This confusion caused some tax examiners to mistakenly deny the credit and likely caused some eligible taxpayers to disqualify themselves. Although the IRS became aware of the error in July 2015, internal processes delayed revising the notice until February 2017. For nearly two years, the IRS did not take any actions to notify taxpayers or employees of the issue. We issued a memorandum to IRS executives in December 2016 describing the issue after we observed errors. Shortly afterwards, the IRS updated instructions used by tax examiners to process taxpayer responses.

The notice had three questions to determine if a taxpayer's child met the age test by being either:

- Under the age of 19; or
- A student under the age of 24; or
- Permanently disabled (in which case there is no age requirement).

However, Figure 7 shows that the notice instructions incorrectly imply that a “yes” answer was required for all three questions for a child to qualify for EITC.

Figure 7: Erroneous Instructions in the CP 09 Notice (TYs 2014 and 2015)

Step 2 — continued

Dependent #1 Name	Social Security number or Taxpayer ID number
Did the dependent live with you in the U.S. for more than 6 months in 2015? <input type="checkbox"/> Yes <input type="checkbox"/> No	
Was the dependent any of the following:	
• Born after January 1, 1997, or <input type="checkbox"/> Yes <input type="checkbox"/> No	
• Born after January 1, 1992 and a student, or <input type="checkbox"/> Yes <input type="checkbox"/> No	
• Permanently disabled during 2015? <input type="checkbox"/> Yes <input type="checkbox"/> No	
Is the dependent younger than you? <input type="checkbox"/> Yes <input type="checkbox"/> No	

Step 3

Refer to your answers from Step 2 to determine if your dependents meet the requirements.

- If you answered **no** to **any** questions for a dependent, he or she **doesn't meet** the requirements.
- If you answered **yes** to **all** questions for a dependent, he or she **meets** the requirements.

How many dependents meet the requirements? _____

Source: TIGTA analysis of TYs 2014 and 2015 CP 09 notice.



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For example, a hypothetical taxpayer with a 14-year-old child that is not permanently disabled would check the first box in Step 2 with a “yes,” then answer the remaining bullets “no.” But according to Step 3, the taxpayer would be ineligible. Our review of some responses showed that taxpayers realized they had disqualified themselves by truthfully answering all of the boxes and attempted to self-correct the issue. Figure 8 provides a hypothetical example of taxpayer confusion.

Figure 8: Example of Taxpayer Confusion Responding to the CP 09 Notice

Step 2 — continued

Dependent #1 Name Jane Doe Social Security number or Taxpayer ID number 123-45-6789

Did the dependent live with you in the U.S. for more than 6 months in 2015? Yes No

Was the dependent any of the following:

- Born after January 1, 1997, or No
- Born after January 1, 1992 and a student, or Yes No
- Permanently disabled during 2015? Yes No

Is the dependent younger than you? Yes No

Step 3

Refer to your answers from Step 2 to determine if your dependents meet the requirements.

- If you answered **no** to **any** questions for a dependent, he or she **doesn't meet** the requirements.
- If you answered **yes** to **all** questions for a dependent, he or she **meets** the requirements.

How many dependents meet the requirements? ~~0~~ 1

Callout boxes:

- Red box: Taxpayer eventually realized in Step 3 that answering “no” to these questions made them ineligible and crossed out answers.
- Red box: Taxpayer realized “no” answers in Step 2 made them ineligible and crossed out answer.

Source: Example generated based on TIGTA observation of taxpayer responses to CP 09 notices.

The notice also may have caused some eligible taxpayers to believe they were ineligible and, therefore, to not respond. Our analysis showed that over 145,000 taxpayers did not return the TY 2014 or 2015 notice worksheet to the IRS.²⁰

According to the IRS Taxpayer Bill of Rights, taxpayers have the right to be informed. They are entitled to clear explanations of the laws in all instructions and notices. The erroneous instructions in the reminder notice infringed upon this right. Compounding the problem, the IRS did not take any actions to alert taxpayers of the error.

Some eligible taxpayers who responded to the erroneous CP 09 notice were denied the EITC

We also observed that tax examiners were confused about how to process taxpayer responses. As a result, some eligible taxpayers were denied the credit. In some cases, taxpayers could have been eligible to receive as much as \$6,000 in EITC. To determine eligibility, some tax examiners followed the erroneous instructions in the notice even though they contradicted EITC

²⁰ Some of these taxpayers may have not received the notice, while some others may have been truly ineligible.



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

eligibility rules. In some instances, tax examiners mistakenly issued the taxpayer a letter denying the credit if they checked any of the “no” boxes for the age test. In other instances, tax examiners mistakenly considered a “no” answer as a taxpayer’s confirmation of ineligibility and destroyed the response per employee instructions.²¹

Our analysis showed that 5,200 taxpayers who responded to the TY 2014 and 2015 notice were denied the credit by tax examiners. The actual number of disallowed claims is likely higher because some ineligible responses may have been destroyed by IRS employees and not counted. As a result, we did not review the population of denied responses to determine how many taxpayers were mistakenly denied the credit. The IRS may have also caused a long-term unintended consequence by mistakenly denying the credit because some taxpayers may then incorrectly believe they are ineligible to claim the credit in future tax years.

Taxpayers also have the right to pay no more than the correct amount of tax. Incorrect EITC eligibility determinations caused by the erroneous notice instructions infringed upon this right. Wage and Investment Division management did not take any actions to address the issue once it was identified. Management did not review the population of denied claims to ensure that employees made the correct determination. Further, the instructions used by employees to process taxpayer responses were not updated until January 2017, and only in response to a memorandum we issued to IRS executives describing the error.

Despite knowing that the notice contained errors, the IRS issued it to over 100,000 taxpayers

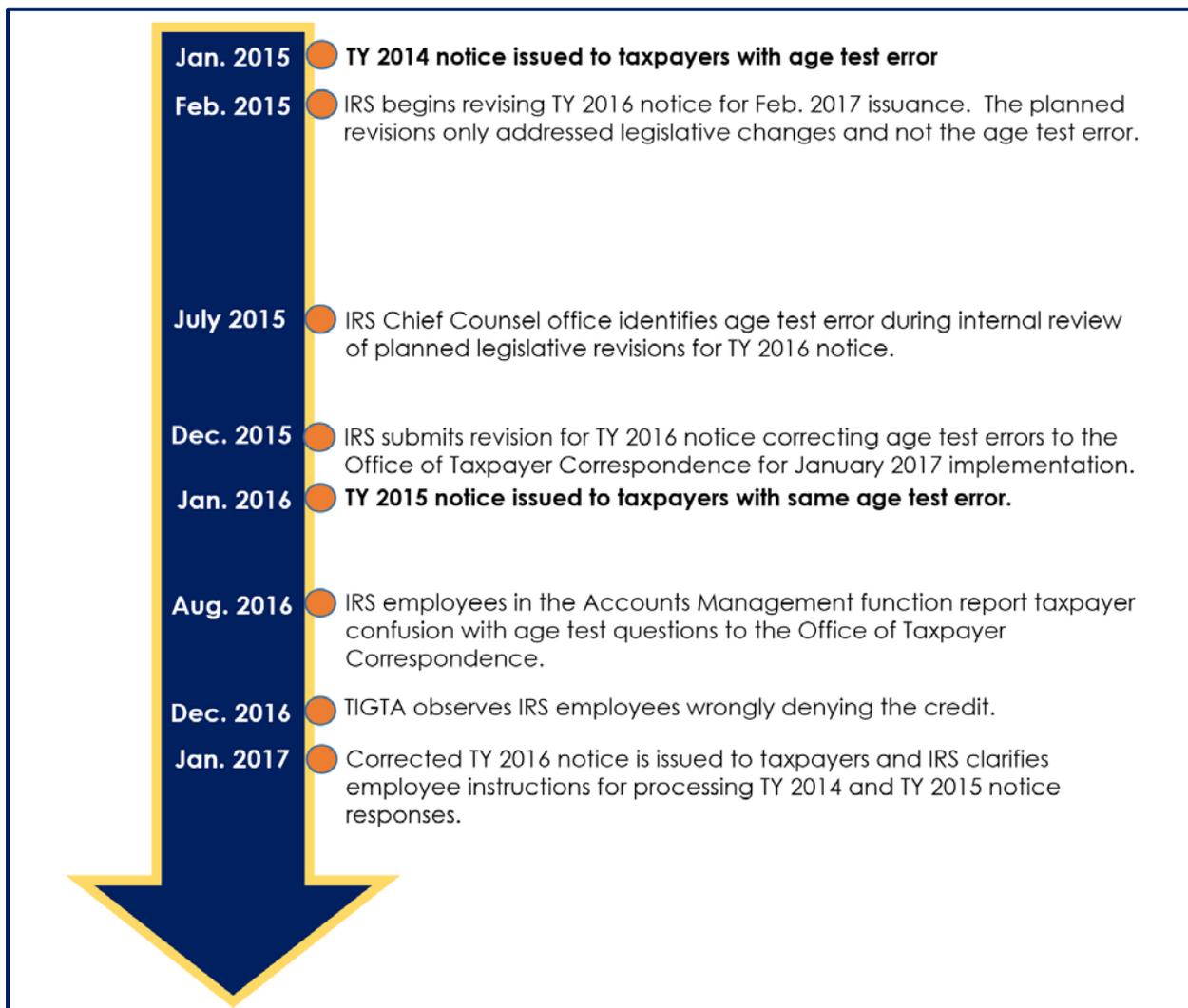
The IRS does not have a “fast track” process to timely resolve an error with the content or design of a notice, so they continued to issue it. As a result, it took two years to revise the notice. Wage and Investment Division management became aware of the error during an internal review in July 2015. The IRS Chief Counsel’s office suggested revisions to the age test questions, stating that “without the change, no one will be eligible for EITC.” Despite the concerns raised by the Chief Counsel office, the notice was issued to taxpayers with erroneous eligibility questions. A revised notice was issued in February 2017 (see Figure 9).

²¹ Internal Revenue Manual Section 3.11.6.2.1 (November 9, 2017).



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Figure 9: The IRS Took Two Years to Revise the Error on the Reminder Notice Sent to Taxpayers with Children



Source: TIGTA analysis of IRS notice revision requests and internal email correspondence.

Management stated that the two-year time frame is consistent with the time frame for developing notices in general. According to the IRS, the lengthy process is caused by limited resources and multiple levels of review by affected functions. In theory, the extended time frame and review process should increase the likelihood that an error is identified. However, when an error makes it through the multilevel review process, there are no fast-track options to correct it.

Consequently, the notice was sent to 103,000 taxpayers in Calendar Year 2016 even though the IRS was aware that it contained errors.



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

Despite the error and lack of direction, IRS employees gave 24,000 taxpayers who responded to the TY 2015 reminder notice \$45.6 million in EITC refunds. However, these taxpayers may have experienced some additional burden claiming the credit.

Recommendation

Recommendation 2: The Commissioner, Wage and Investment Division, should establish procedures to timely notify taxpayers who have received reminder notices with an error.

Management's Response: The IRS agreed with our recommendation and will ensure close coordination among affected business functions when notice errors occur.

Improvements to Performance Measures Are Needed to Adequately Assess Reminder Notice Effectiveness

Although the objective of the reminder notices is to increase EITC participation, the IRS has not specified a participation rate target. While the IRS tracks some data on the notices, enhanced performance measures would allow the IRS to better assess the effectiveness of the notices at increasing participation.

The IRS has not developed a specific objective for EITC reminder notices

Useful program objectives can be developed using the “SMART” convention.



The objective of the reminder notices is to increase participation, specifically among taxpayers who filed a tax return without claiming the credit but who appear eligible. According to the IRS, participation means both claiming participation and dollar participation (*i.e.*, the percentage of total eligible dollars claimed). However, IRS has not established a specific or time-bound objective. An example of a “SMART” objective for the reminder notices could be to “increase tax filer claiming participation to X percent within X numbers of years.” Establishing a specific target for an increase in participation over a specified period of time would allow IRS to better assess whether its efforts are having a positive result on claiming participation.



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

Enhanced performance measures could better allow the IRS to assess the effectiveness of reminder notices

Although the IRS collects some data on the notices, enhanced performance measures could better allow the IRS to assess the effect that reminder notices have on increasing EITC participation. The IRS uses the following performance measures to evaluate the effectiveness of the EITC eligibility reminder notices:

- Total number of notices issued.
- Total number of responses that resulted in EITC refunds.
- Percentage of responses that resulted in EITC refunds.
- Total dollar amount of the EITC refunded.

Performance measures should provide management with meaningful information. The “total number of responses that resulted in EITC refunds” and the “total dollar amount of the EITC refunded” are meaningful because they tell the IRS something about how EITC participation has increased as a result of sending reminder notices.

On the other hand, the “total number of notices issued” is an output measure that only tells the IRS how many notices it sent in any given year. However, measures should indicate a preferred direction within a time period. The IRS has not stated whether issuing more or fewer notices indicates success. In addition, the “percentage of responses that result in EITC refunds” does not measure the effect notices have on increasing EITC participation. The rate of notice responses resulting in refunds will always be high. First, because the notice tells the taxpayer not to respond if they are ineligible, the IRS only receives responses from eligible taxpayers (or taxpayers who mistakenly believe they are eligible). Secondly, because employees are instructed to destroy ineligible responses.

We also identified some data that are not measured that could give meaningful insights. For example, our analysis showed that about half of taxpayers do not respond to the notices. However, the IRS does not track these data. Tracking response rates might have allowed the IRS to identify issues regarding notice quality, such as the one we observed, and then take appropriate corrective actions, such as revising the content and design to improve clarity.

Recommendation

Recommendation 3: The Commissioner, Wage and Investment Division, should establish a specific objective for increasing EITC participation rates for eligible taxpayers. Following this, relevant performance measures should then be designed to determine whether the established objectives have been achieved.

Management’s Response: The IRS agreed with our recommendation and will consider whether a meaningful and objective performance goal for increasing EITC participation is possible.



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

Appendix I

Objective, Scope, and Methodology

The overall objective of our review was to evaluate whether EITC post-filing outreach activities (CP 09 and 27 eligibility reminder notices) are effective channels to reach eligible taxpayers and increase EITC participation rates. To accomplish this objective, TIGTA:

- Reviewed prior TIGTA, IRS, GAO, and academic research on EITC participation, administration, and outreach.
- Interviewed key stakeholders in the academic and tax administration community.
- Interviewed IRS management about the goals, objectives, and performance measures for the EITC reminder notice activity.
- Obtained and reviewed the costs associated with administering the activity.
- Reviewed the methodology used to identify notice recipients.
- Reviewed the content and design of the notices.
- Researched IRS procedures used to process taxpayer responses to the notices.
- Observed IRS employees processing taxpayer responses to the notices.
- Analyzed program results for TYs 2013 through 2015.
- Performed a recidivism analysis to determine the subsequent-year effects of the notices.
- Performed a sensitivity analysis to predict the outcomes of automatically refunding EITC to childless taxpayers.

This review was performed at the IRS National Headquarters Office of Research, Analysis, and Statistics in Washington, D.C., at the IRS National Headquarters Media and Publications office in Washington, D.C., and at the IRS Submission Processing Campus in Kansas City, Missouri, during the period of October 2016 through June 2017. We conducted this inspection/evaluation in accordance with the Council of the Inspectors General for Integrity and Efficiency Quality Standards for Inspection and Evaluation. Major contributors to this report were Phil Shropshire (Director), Heather Hill (Supervisory Evaluator), Matt Schimmel (Lead Evaluator), and Jackie Nguyen (Senior Evaluator).



*The Internal Revenue Service Should Consider Modifying the Form
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Eligible Tax Filers*

Appendix II

Report Distribution List

Deputy Commissioner for Operations Support
Deputy Commissioner for Services and Enforcement
Director, Customer Assistance, Relationships, and Education
Director, Media and Publications
Director, Tax Forms and Publications
Director, Return Integrity and Compliance Services
Office of Legislative Affairs
Director, Office of the Chief Risk Officer
Director, Office of Research, Applied Analytics, and Statistics
Director, Office of Audit Coordination
Deputy Inspector General for Audit



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Appendix III

EITC Eligibility Rules

Taxpayers claiming the EITC must meet specific criteria to qualify for the credit. Additional criteria apply for those taxpayers who have qualifying children. Figure 1 lists the basic EITC eligibility requirements. Figure 2 shows the additional eligibility tests of age, relationship, residency, and joint return requirements that must be met by taxpayers claiming the EITC with a qualifying child. The maximum EITC available for Tax Year 2016 ranges from \$506 for taxpayers with no qualifying children to \$6,269 with three or more qualifying children.

Figure 1: Basic EITC Eligibility Rules for TY2016

First, you must meet all the rules in these columns.		Second, you must meet all the rules in one of these columns, whichever applies.		Third, you must meet the rule in this column.
Chapter 1 Rules for Everyone		Chapter 2 Rules If You Have a Qualifying Child	Chapter 3 Rules If You Do Not Have a Qualifying Child	Chapter 4 Figuring and Claiming the EITC
<p>1. Your adjusted gross income must be less than:</p> <ul style="list-style-type: none"> • \$47,955 (\$53,505 for married filing jointly) if you have three or more qualifying children, • \$44,648 (\$50,198 for married filing jointly) if you have two qualifying children, • \$39,296 (\$44,846 for married filing jointly) if you have one qualifying child, or • \$14,880 (\$20,430 for married filing jointly) if you do not have a qualifying child. 	<p>2. You must have a valid Social Security Number by the due date of your 2016 tax return (including extensions).</p> <p>3. Your filing status cannot be married filing separately.</p> <p>4. You must be a U.S. citizen or resident alien all year.</p> <p>5. You cannot file Form 2555 or Form 2555-EZ (relating to foreign earned income).</p> <p>6. Your investment income must be \$3,400 or less.</p> <p>7. You must have earned income.</p>	<p>8. Your child must meet the relationship, age, residency, and joint return tests.</p> <p>9. Your qualifying child cannot be used by more than one person to claim the EITC.</p> <p>10. You cannot be a qualifying child of another person.</p>	<p>11. You must be at least age 25 but under age 65.</p> <p>12. You cannot be the dependent of another person.</p> <p>13. You cannot be a qualifying child of another person.</p> <p>14. You must have lived in the United States more than half of the year.</p>	<p>15. Your earned income must be less than:</p> <ul style="list-style-type: none"> • \$47,955 (\$53,505 for married filing jointly) if you have three or more qualifying children, • \$44,648 (\$50,198 for married filing jointly) if you have two qualifying children, • \$39,296 (\$44,846 for married filing jointly) if you have one qualifying child, or • \$14,880 (\$20,430 for married filing jointly) if you do not have a qualifying child.

Source: IRS Publication 596, *Earned Income Credit (EIC)*, for use in preparing 2016 Tax Returns.



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Figure 2: Additional EITC Eligibility Rules for Qualifying Children

Eligibility Test	Qualifying Child Criteria
Relationship	<p>Must meet one of the following relationship tests:</p> <ul style="list-style-type: none"> • Son, daughter, stepchild, foster child, or a descendant of any of them (for example, your grandchild), • Brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them (for example, your niece or nephew), or • Adopted child.
Age	<p>Must meet one of the following age tests:</p> <ul style="list-style-type: none"> • Under age 19 at the end of Tax Year 2016 and younger than you or your spouse (if filing jointly), • Under age 24 at the end of Tax Year 2016, a student, and younger than you or your spouse (if filing jointly), or • Permanently and totally disabled at any time during Tax Year 2016, regardless of age.
Residency	<p>The child must have lived with you in the United States for more than half of Tax Year 2016.</p>
Joint Return	<p>The child cannot file a joint return for the year. <i>Exception:</i> An exception to the joint return test applies if your child and his or her spouse file a joint return only to claim a refund of income tax withheld or estimated tax paid.</p>

Source: IRS Publication 596, Earned Income Credit (EIC), for use in preparing Tax Year 2016 returns.



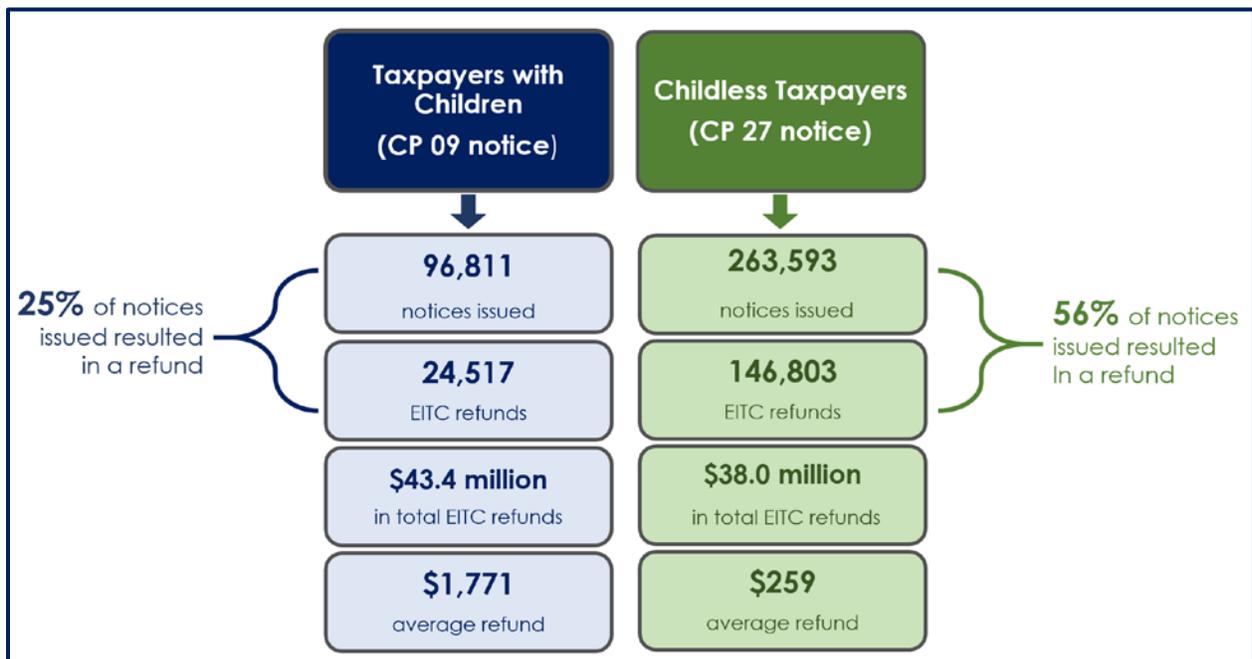
The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

Appendix IV

EITC Reminder Notice Results

As shown in Figure 1, for TYs 2013 through 2015, the IRS issued an average of 360,400 reminder notices to taxpayers potentially eligible for the EITC. On average, approximately 171,320 taxpayers (48 percent) responded to the notices and received \$81.4 million in EITC. Taxpayers with qualifying children are eligible to receive a larger credit. The average refund amount was \$1,771 for taxpayers with children (CP 09 respondents) and \$259 for taxpayers without children (CP 27 respondents).

Figure 1: EITC Reminder Notice Results, TYs 2013 Through 2015



Source: TIGTA analysis of IRS Individual Master File data (through December 2016).



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

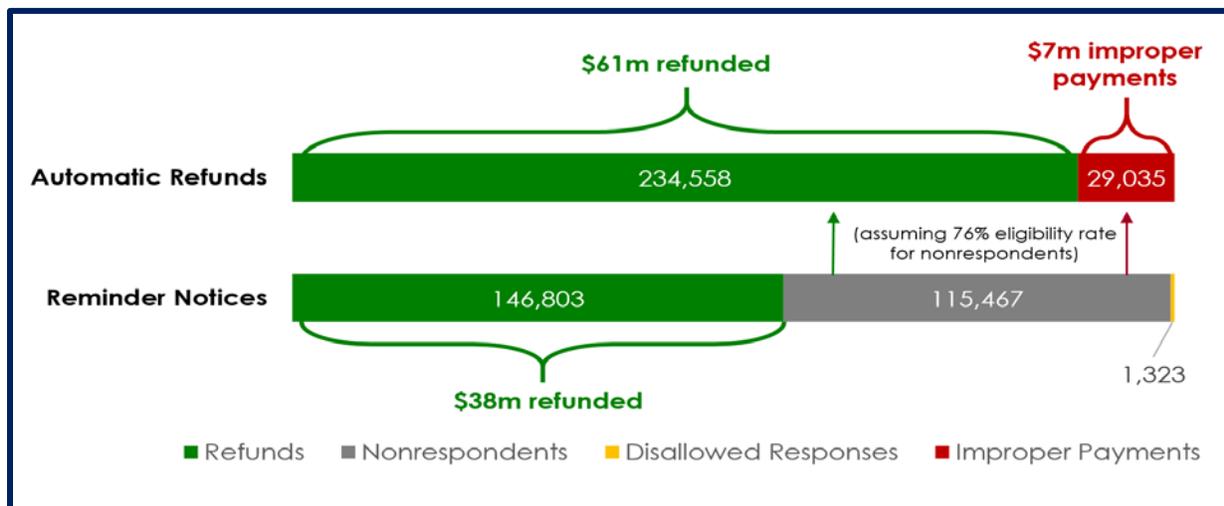
Appendix V

Automatic EITC Refunds to Childless Taxpayers

Instead of spending money annually mailing notices to childless taxpayers, the IRS could refund the EITC automatically. This would potentially increase the number of taxpayers who receive the EITC because taxpayers who do not respond to the notice (and therefore, do not get the credit) would now receive it automatically. However, some nonrespondents may be ineligible.¹

As shown in Figure 1, for TYs 2013 through 2015, the IRS issued an average of 263,600 notices to childless taxpayers that generated 146,800 responses, refunding \$37.9 million. However, the IRS does not know how many nonrespondents are eligible. To calculate the potential outcome of automatic refunds, we assumed 76 percent of the 115,500 nonrespondents were eligible for an average refund of \$259.² We estimate that this would result in 88,000 additional childless EITC refunds totaling almost \$23 million, with a risk of \$7 million in improper payments.

Figure 1: Potential Outcome of Automatic Childless EITC Refunds



Source: TIGTA analysis of the IRS Individual Master File, TYs 2013 through 2015 (through December 2016).

¹ The IRS cannot distinguish between eligible taxpayers who did not respond to the notice and those who did not respond because they were ineligible.

² We used the most recent EITC improper payment rate (24 percent) as the eligibility rate for nonrespondents. However, if the IRS filters used to identify the notice population accurately predict eligibility, then automatic refunds would have less risk. On the other hand, if ineligible taxpayers are correctly following the instructions not to respond, then automatic refunds would have more risk. We used the average refund amount for taxpayers who responded to the notice in TYs 2013 through 2015 to determine the potential additional amount of EITC refunds.



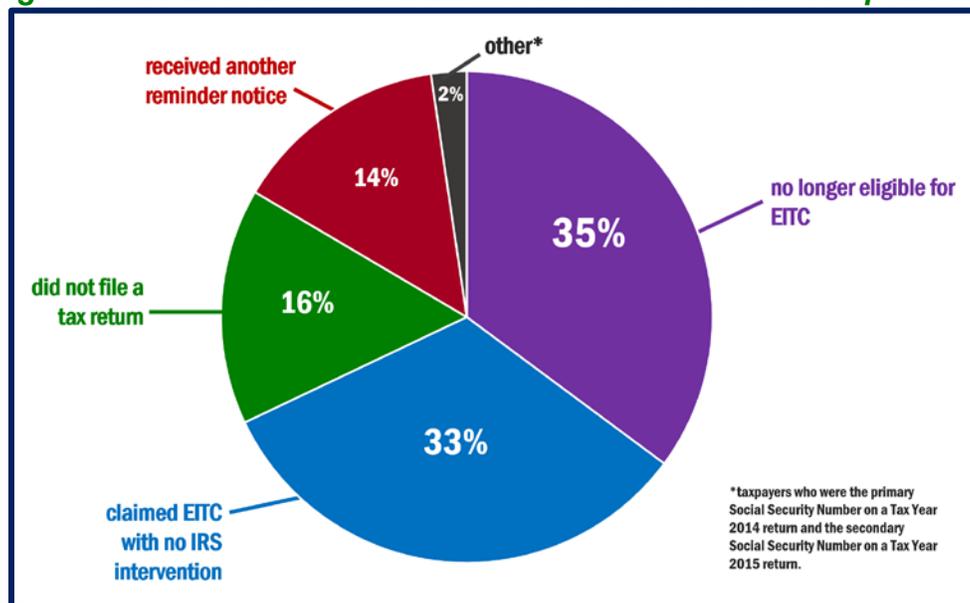
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Appendix VI

Subsequent Behavioral Effects of EITC Reminder Notices

In TY 2014, 174,563 taxpayers responded to the reminder notice and received an EITC refund. We reviewed TY 2015 data for this population to determine if the notices had any behavioral effects in the subsequent tax year. As shown in Figure 1, 35 percent of the population were ineligible for the EITC a year later.¹ This is consistent with the overall turnover rate in the EITC population, estimated to be around 30 percent. Positively, our analysis shows that the notices may increase awareness of the credit. For example, 33 percent of taxpayers who responded to the notice claimed the EITC in the following year. Our results also show that the notices may create a small unintended learning effect. For example, 14 percent of taxpayers who responded to the notice and were refunded the EITC received another reminder notice in the following year. It is possible some taxpayers think they are only eligible if the IRS sends them a notice.

Figure 1: TY 2015 Behavioral Effects for TY 2014 Notice Respondents



Source: TIGTA analysis of IRS Information Returns Transaction File.²

¹ We considered taxpayers who did not claim EITC on their tax return and were not issued a notice to be ineligible.

² The Information Returns Transaction File contains data transcribed from initial input of the original individual tax returns during return processing.



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Appendix VII

Potentially Eligible Tax Filers Who Did Not Claim EITC in Tax Year 2014 (by State)

The Census Bureau estimates that, in TY 2014, over 1.7 million taxpayers were potentially eligible for the EITC, filed a tax return, but did not claim the credit. Figure 1 shows this population by State. States are shown from highest to lowest nonclaimants numbers.³

Figure 1: Population of Potentially Eligible Taxpayers Who Filed a Tax Return but Did Not Claim the EITC in TY 2014

State	Potentially EITC-Eligible Tax Filers	Tax Filer Participation Rate	Taxpayers Who Were Potentially Eligible for the EITC, Filed a Tax Return, but Did Not Claim the EITC in TY 2014	
			Lower Estimate	Upper Estimate
California	2,550,425	86.4%	334,106	359,610
Texas	2,021,421	90.6%	179,906	200,121
Florida	1,467,534	93.2%	92,455	107,130
New York	1,187,113	92.4%	83,098	97,343
Illinois	784,730	89.4%	76,119	90,244
North Carolina	698,618	92.4%	48,205	57,985
New Jersey	463,170	89.2%	44,927	55,117
Georgia	755,601	93.3%	44,580	56,670
Pennsylvania	694,099	93.1%	43,728	52,057
Ohio	754,304	93.9%	41,487	50,538
Michigan	631,925	93.7%	36,020	43,603
Washington	361,838	89.5%	33,289	42,697
Virginia	466,955	92.0%	33,154	41,559
Tennessee	489,024	92.7%	32,765	39,122
Arizona	435,908	91.6%	32,693	40,539
Indiana	443,349	91.9%	31,034	40,788
Oregon	240,038	87.0%	29,525	35,286
Colorado	280,310	89.2%	26,349	34,198
Wisconsin	326,373	91.3%	25,457	31,332

³ The point estimates for all 50 States and the District of Columbia total to approximately 1.7 million taxpayers.



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

State	Potentially EITC-Eligible Tax Filers	Tax Filer Participation Rate	Taxpayers Who Were Potentially Eligible for the EITC, Filed a Tax Return, but Did Not Claim the EITC in TY 2014	
			Lower Estimate	Upper Estimate
Maryland	297,545	90.3%	25,291	32,432
Minnesota	274,972	90.0%	23,648	31,347
Massachusetts	304,030	91.5%	22,498	29,187
Missouri	375,055	93.8%	19,503	27,004
Utah	163,027	86.4%	18,748	25,595
South Carolina	338,713	93.5%	18,629	25,403
Oklahoma	246,091	91.8%	17,472	22,886
Nevada	192,436	89.8%	16,357	22,900
Alabama	342,566	94.5%	15,758	21,924
Kentucky	288,203	93.6%	15,563	21,327
Louisiana	333,112	94.5%	15,323	21,319
Connecticut	180,419	90.1%	14,614	21,109
Kansas	167,458	90.5%	13,229	18,588
Arkansas	223,188	93.1%	12,945	17,855
Iowa	162,860	92.8%	11,726	13,680
New Mexico	172,275	91.9%	10,681	17,400
Nebraska	109,435	91.0%	9,849	11,819
Mississippi	257,478	96.2%	9,784	11,844

Source: TIGTA analysis of Census Bureau IRS/American Community Survey Match, TY 2014.

The following States had fewer than 10,000 potentially eligible nonclaimants that filed a tax return:

- Alaska
- Delaware
- District of Columbia
- Hawaii
- Idaho
- Maine
- Montana
- New Hampshire
- North Dakota
- Rhode Island
- South Dakota
- Vermont
- West Virginia
- Wyoming



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Appendix VIII

Management's Response to the Draft Report


COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

FEB 28 2018

MEMORANDUM FOR GREGORY D. KUTZ
ACTING DEPUTY INSPECTOR GENERAL FOR
INSPECTIONS AND EVALUATIONS

FROM: Kenneth C. Corbin 
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers (IE-16-006)

Thank you for the opportunity to review and comment on the subject draft report. The Earned Income Tax Credit (EITC) is a tax credit for people who work and earn low to modest incomes. Those who qualify and claim the credit could pay less federal tax, pay no tax, or even get a tax refund. For the 2017 tax year, 27 million people received about \$65 billion in EITC.¹ The average amount received was more than \$2,400. We appreciate the recognition of our outreach efforts, which include the EITC Awareness Day, all-year outreach, and online tools, to address the eligible populations not claiming the credit.

Our annual EITC communications plan sets the framework for our efforts. The notices, highlighted in this report, are just one piece of our multi-faceted and strategic outreach efforts to reach eligible non-claimants. Although the notices sent to potentially eligible filers who do not claim the credit are not required by law, we believe they support our goal to increase participation for eligible individuals. Our other goal, equally important, is to avoid improper payments of the EITC to ineligible individuals.

As noted in the report, we send notices to only a portion of the filing population not claiming the credit. This is the population most likely to be eligible, and presents the least risk of improper payments being made. Generally, the notice process is not the end of our efforts with this population. The IRS has partnerships with several states and municipalities having their own EITC that also send notices to their taxpayers, significantly increasing the overall federal response rates for their populations.

¹ Source: EITC Calendar Year Report, June 2017. Historically, half-year data represents over 95 percent of EITC returns processed.



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

2

The IRS has sent these notices for over 25 years. During that time, we have reviewed and analyzed the practice. We surveyed recipients, studied and changed our filters, researched the benefits of sending a second notice, and revised the notices based on research studies. We continue to analyze the results of the notices annually, including volumes of notices sent, response rates, and EITC allowed. We note that the volume of notices sent each year has decreased significantly as electronic filing has increased. Most notices are now sent to individuals who do not use software that helps prevent eligible taxpayers from overlooking the credit. We agree that we should again reconsider the costs and benefits of sending notices and other possible alternatives for the population of filers.

The broader picture of EITC participation involves the other eligible individuals who do not claim the credit. The IRS's Office of Research, Applied Analytics and Statistics performed an analysis of the underserved EITC population who do not claim the credit, and has conducted studies to address specific segments of this population. The EITC Communication Plan develops outreach based on those research results and research results published by the U.S. Census Bureau. Going forward, we will continue our efforts to make outreach to eligible individuals a priority.

Attached are our comments and responses to your recommendations. If you have any questions, please contact me, or a member of your staff may contact Michael Beebe, Director, Return Integrity and Compliance Services, Wage and Investment Division, at (470) 639-3250.

Attachment



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

Attachment

Recommendations

Recommendation 1:

The Commissioner, Wage and Investment Division, should evaluate alternative approaches to post-filing outreach that reduce costs and increase the number of eligible taxpayers who receive the EITC. For example, the IRS should consider eliminating Schedule EIC and modifying Form 1040 to collect necessary eligibility information (such as ages of children and duration of residency) instead of sending reminder notices.

CORRECTIVE ACTION

We agree to evaluate alternative approaches to post-filing outreach. We have conducted research as part of our Earned Income Tax Credit (EITC) underserved strategy to address segments of non-claimants and potential actions that can be taken, and we continue to perform this research. The EITC Underserved Outreach Study has focused primarily on developing soft-touch messaging to encourage nonfilers who appear to be EITC eligible.

We will study the cost and benefits of modifying Form 1040, *U.S. Individual Income Tax Return*. We will consider whether suggested changes may provide enough information for single filers to eliminate the need for Computer Paragraph Notice 27, *EIC Potential for T/P Without Qualifying Children*. However, because the suggested revision does not capture key EITC requirements for claiming a child, the IRS will conduct additional analysis on the effectiveness, efficiency, and burden on taxpayers of the recommended changes and other potential changes to Form 1040.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Refundable Credits Policy and Program Management, Return Integrity and Compliance Services, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 2

The Commissioner, Wage and Investment Division, should establish procedures to timely notify taxpayers who have received reminder notices with an error.



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

2

CORRECTIVE ACTION

When errors are discovered, we will ensure close coordination, clear communication of procedures, and follow-up with functions who have a role in the notice process. We will update the Internal Revenue Manual to document the process for coordination, risk-based evaluation, and decisions made.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Customer Assistance, Relationships and Education, Wage and Investment Division

CORRECTIVE ACTION MONITORING PLAN

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

RECOMMENDATION 3

The Commissioner, Wage and Investment Division, should establish a specific objective for increasing EITC participation rates for eligible taxpayers. Following this, relevant performance measures should then be designed to determine whether the established objectives have been achieved.

CORRECTIVE ACTION

We agree to consider whether an objective performance goal for increasing participation is possible. As noted in the report, the IRS has always had the goal of increasing EITC participation of eligible taxpayers. We closely monitor the participation rate which increased and remained in the range of 78 to 80 percent since tax year 2007; however, there are many factors outside the control of the IRS that affect the participation rate. These factors include the complexity of the tax law and the frequency with which it changes, as well as the significant annual turnover within the participating population. The population of EITC eligible taxpayers is not static. As taxpayers become ineligible for the program, new individuals gain eligibility. Further, there is a relationship between participation and the improper payment rate. All these factors will be considered when deciding whether a meaningful participation increase goal is possible.

IMPLEMENTATION DATE

October 15, 2018

RESPONSIBLE OFFICIAL

Director, Refundable Credits Policy and Program Management, Return Integrity and Compliance Services, Wage and Investment Division



The Internal Revenue Service Should Consider Modifying the Form 1040 to Increase Earned Income Tax Credit Participation by Eligible Tax Filers

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CORRECTIVE ACTION MONITORING PLAN

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



To report fraud, waste, or abuse, call our toll-free hotline at:

1-800-366-4484

By Web:

www.treasury.gov/tigta/

Or Write:

Treasury Inspector General for Tax Administration
P.O. Box 589
Ben Franklin Station
Washington, D.C. 20044-0589

Information you provide is confidential and you may remain anonymous.