TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

The Earned Income Tax Credit Examination Compliance Strategy Can Be Improved

September 2, 2021

Report Number: 2021-30-051

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Final Audit Report issued on September 2, 2021

Report Number 2021-30-051

Why TIGTA Did This Audit

This audit was initiated to assess the current state of the IRS's Earned Income Tax Credit (EITC) examination strategy, including whether returns with the highest risks were being selected for examination, whether additional efficiencies could be identified in the audits that the IRS does conduct, and whether disproportionate audits were being conducted upon EITC claimants in certain States.

Impact on Taxpayers

The Payment Integrity Information Act of 2019 and subsequent legislation strengthened agency reporting requirements and redefined "significant improper payments" in Federal programs. The Office of Management and Budget has declared the EITC Program a high-risk program that is subject to reporting in the Department of the Treasury Agency Financial Report. The IRS estimated that 23.5 percent ($16 billion) of EITC payments were issued improperly in Fiscal Year 2020. Without proper controls, billions of taxpayer dollars are vulnerable to erroneous claims and fraudulent tax schemes.

What TIGTA Found

The EITC is an anti-poverty provision of the tax code that keeps millions of families out of poverty every year. The EITC, however, also accounts for an estimated $27 billion, or 11 percent, of the individual income underreporting Tax Gap and has accounted for almost 31 percent of all IRS audits in the last 10 years. The IRS's EITC examination strategy is not part of a larger IRS examination strategy that encompasses all examinations by which resources devoted to EITC examinations can be more easily assessed in the context of other challenges to taxpayer noncompliance. Also, due to IRS processing limitations, the IRS does not prioritize certain high-risk EITC claims for examination. Lastly, the IRS's examination rates for EITC claims appear disproportionate with respect to certain Southern States; however, the examinations are aligned with tax returns flagged by IRS compliance filters.

What TIGTA Recommended

TIGTA made four recommendations to the IRS to improve its detection and prevention of EITC claims with the highest tax compliance risks. These recommendations include 1) considering how refundable credits could fit into the IRS's traditional analysis of how taxpayers' noncompliance contributes to the Tax Gap, 2) evaluating the current programming for prerefund EITC selection to ensure that cases are prioritized, 3) evaluating and revising the scoring process to ensure that the highest risk cases are available for examination, and 4) tailoring EITC-related educational efforts for the States with disproportionate error rates.

The IRS agreed with three of the four recommendations. The IRS stated that significant investments in the IRS have been proposed to address the Tax Gap, *i.e.*, modernizing information technology, improving data analytic approaches, and hiring and training staff dedicated to complex enforcement activities. In addition, the IRS agreed to evaluate the current EITC programming and scoring process by submitting a Lean Business Case evaluation to determine if cases are being properly prioritized and the highest risk cases are available for examination.

The IRS disagreed with the recommendation to tailor its EITC educational efforts for the States with disproportionate error rates, stating it already has extensive outreach and education strategy in place. However, TIGTA believes that tailoring the IRS's EITC educational outreach, in conjunction with audit results or concentration of filter breaks, would be beneficial and reduce the disproportionate error rate in certain Southern States.

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 2, 2021

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The Earned Income Tax Credit Examination Compliance Strategy Can Be Improved (Audit # 201930012)

This report presents the results of our review to determine whether the Internal Revenue Service's procedures for selecting returns with Earned Income Tax Credit claims for audit are effective for determining the highest tax compliance risks. This review is part of our Fiscal Year 2021 Annual Audit Plan and addresses the major management and performance challenge of *Improving Tax Reporting and Payment Compliance*.

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

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).

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Background

The Earned Income Tax Credit (EITC) is a refundable credit created in 1975 that was designed to supplement the income of low- to moderate-income workers and families by providing a credit intended to help offset payroll taxes. According to the Internal Revenue Service (IRS), the EITC has become one of the Government's largest anti-poverty programs for working families. In 2017, it was estimated that the EITC helped 5.7 million people, including 3 million children, out of poverty.[1] The EITC encourages work, as earned income is a requirement to obtain the EITC, and generally the amount of the EITC increases with additional earned income up to a certain income threshold, creating a greater incentive to work.[2]

While the EITC makes important contributions to reducing poverty, the EITC program has also been identified by the Office of Management and Budget (OMB) as a high-risk and high-priority program due to the high improper payment rate, and as a result, the IRS is required on an annual basis to determine an improper payment rate based on statistical sampling.[3] The Payment Integrity Information Act of 2019[4] (which amended earlier improper payment–related legislation such as the Improper Payments Information Act of 2002,[5] as amended by the Improper Payments Elimination and Recovery Act of 2010,[6] and the Improper Payments Elimination and Recovery Improvement Act of 2012[7]) increased Federal agencies' requirements to report improper payments.

The IRS must develop and submit a corrective action plan to the OMB annually that includes improper payment root cause identification, reduction targets, and identification of accountable officials. The IRS estimated that 23.5 percent, or $16 billion, of EITC payments were improperly paid in Fiscal Year (FY) 2020.[8] The IRS has identified two root causes for improper payments of the EITC as:

1) The inability to authenticate eligibility – data needed does not exist. These errors include those that arise from the lack of data to verify qualifying child eligibility requirements and the accuracy of the income reported by the taxpayer when the income is not also reported by third parties, such as an employer.

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1 Center for Disease Control, www.cdc.gov/policy/hst/hi5/taxcredits.

2 IRS, Publication 596, *Earned Income Credit (EIC)*. Reference to the EITC Tables for Tax Year 2020 reflects that the credit increases as additional income is earned and then begins to decrease gradually (depending on the number of qualifying children) starting at earned income levels between $19,350 to $19,400 for taxpayers filing as single, head of household, or qualifying widow(er) and $25,200 to $25,250 for taxpayers filing as married filing jointly.

3 An improper payment is one that should not have been made, was made in an incorrect amount, or was made to an ineligible recipient.

4 Pub. L. No. 116-117, 134 Stat. 113.

5 Pub. L. No. 107-300, 116 Stat. 2350.

6 Pub. L. No. 111-204, 124 Stat. 2224.

7 Pub. L. No. 112-248, 126 Stat. 2390.

8 Department of the Treasury, *Department of the Treasury Agency Financial Report Fiscal Year 2020* p. 247-248.

2) Program design or structural issues.[9] These errors occur because the information needed to confirm accuracy of information reported on the tax return is not available when the tax return is processed.

The inability to authenticate eligibility was by far the biggest root cause, making up approximately 94 percent of total improper payments.[10] These root cause categories were identified based on the framework the OMB provided in its guidance for implementing improper payment reporting. However, in the past, the IRS and other stakeholders have identified other causes for improper payments; prime among them is the complexity of EITC law.[11]

Some members of Congress have expressed concerns that EITC return filers are disproportionally among the most audited individuals despite being responsible for a small percentage of the Tax Gap, while other members of Congress have expressed concerns about the high rate of improper payments (estimated at $16 billion in the *Department of the Treasury Agency Financial Report Fiscal Year 2020)*. As we subsequently describe in further detail, due to resource limitations, all IRS examinations have been significantly reduced in recent years, including EITC audits.

Taxpayer eligibility for the EITC

Pursuant to Internal Revenue Code (I.R.C.) § 32, 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. In order to receive the EITC, taxpayers must file a Form 1040, *U.S. Individual Income Tax Return*, or Form 1040-SR, *U.S. Tax Return for Seniors*, whether or not they are required by law and must meet the following requirements:

Eligibility Requirements[12]	
Income	Must have earned income from employment or self-employment. Cannot file Form 2555, *Foreign Earned Income*. Investment income for the year must be $3,650 or less for Tax Year 2020. For Tax Year 2020, the EITC phases out entirely for taxpayers with an adjusted gross income of: ➢ $15,820 with no Qualifying Children ($21,710 if married filing jointly). ➢ $41,756 with one Qualifying Child ($47,646 if married filing jointly). ➢ $47,440 with two Qualifying Children ($53,330 if married filing jointly). ➢ $50,954 with three or more Qualifying Children ($56,844 if married filing jointly).

[9] Department of the Treasury, *Department of the Treasury Agency Financial Report Fiscal Year 2019* p. 205. Program design or structural errors occur due to information not available at the time the return is processed to confirm payment accuracy.

[10] Payment Accuracy, *Department of the Treasury, Earned Income Tax Credit, 2020 Q4*, https://www.paymentaccuracy.gov/payment-accuracy-high-priority-programs/ (last visited Feb. 8, 2021).

[11] John Koskinen, IRS Commissioner, *Improper Payments*, Committee on House Oversight and Government Reform Subcommittee on Government Operations (July 9, 2014). Commissioner Koskinen identified complexity of the law as the primary cause of EITC errors. He also cited cash payments and a lack of third-party data that would allow the IRS to authenticate payments as causes.

[12] Eligibility requirements described in this chart are those in effect for Tax Year 2020.

Filing Requirements	Filing Status cannot be married filing separately. Taxpayer, spouse (if married filing jointly), and any qualifying children claimed must each have a valid Social Security Number. Must be a U.S. citizen or resident alien for the whole year or a nonresident alien married to a U.S. citizen or resident alien and filing a joint return. Cannot be the qualifying child (for EITC purposes) of another person. If claiming a credit without a qualifying child, the taxpayers must: ➢ Be at least 25 but younger than 65 at the end of the tax year. ➢ Live in the United States for more than half the year. ➢ Not be the dependent of another person.

The American Rescue Plan Act of 2021 made a number of temporary and permanent amendments to expand the EITC so that more taxpayers could qualify for the credit.[13] Temporary changes for Tax Year 2021 only included expanding the EITC to make it available so more childless workers and couples qualify for the EITC, *e.g.*:

- Lowered the minimum age to claim the childless EITC from 25 to 19 (except for certain full-time students) and eliminated the upper age limit entirely.
- Raised the credit percentage from 7.65 percent to 15.30 percent and increased the income at which the maximum credit amount is reached to $9,820. As a result, the maximum credit increases for taxpayers with no dependents from $538 to $1,502.
- Raised the earned income range over which the credit is phased out from $5,280 to $11,610.
- Childless workers and families with dependents can choose to use their 2019 income to figure the EITC as long as it was higher than their 2021 income. In some instances, this option will give them a larger credit.

Permanent changes expanding the EITC for 2021 and future years include:

- Singles and couples who have Social Security Numbers can claim the credit even if their children do not have Social Security Numbers. In this instance, they would get the smaller credit available to childless workers. In the past, these filers did not qualify for the credit.
- More workers and working families who have investment income can get the credit. Starting in 2021, the limit on investment income is increased to $10,000. After 2021, the $10,000 limit is indexed for inflation. The current limit is $3,650.
- Married but separated spouses can choose to be treated as not married for EITC purposes. To qualify, the spouse claiming the credit cannot file jointly with the other spouse, cannot have the same principal residence as the other spouse for at least six months of the year, and must have a qualifying child living with them for more than half the year.

[13] Pub. L. No. 117-2.

If taxpayers are claiming a qualifying child for EITC purposes, they must attach a Schedule EIC, *Earned Income Credit*, to the Form 1040 listing the children. In addition, the qualifying children need to meet the following requirements:

Qualifying Children Requirements
Qualifying children for the EITC cannot be used by more than one person to claim the EITC and must pass all of the following tests: ➢ Relationship • Son, daughter, stepchild, foster child, or a descendant of any of them (for example, taxpayer's grandchild). • Brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them (for example, taxpayer's niece or nephew). • Adopted child. The term "adopted child" includes a child who was lawfully placed with the taxpayer for legal adoption. ➢ Joint Return The child cannot file a joint return for the tax year unless neither the child nor the child's spouse would have had a separate filing requirement and they filed the joint return only to claim a refund of withheld or estimated taxes. Age A qualifying child must be: • Under age 19 at the end of the tax year and younger than the taxpayer (or the taxpayer's spouse if filing jointly); • Under age 24 at the end of the tax year, a student, and younger than the taxpayer (or the taxpayer's spouse if filing jointly); or • Permanently and totally disabled at any time during the year, regardless of age. ➢ Residency The child generally must have the same main home as the taxpayer (or the taxpayer's spouse if filing a joint return) in the United States for more than half of the tax year.

IRS compliance activities for the EITC

In general, IRS examinations are an important part of the IRS's overall taxpayer compliance strategy, in part because examinations have been shown to have ripple effects across tax compliance.[14] The IRS believes that EITC audits and other refundable credit audits play an important role in deterring noncompliance with EITC provisions and in protecting revenue. Due to resource limitations, all IRS audits have been decreasing over recent years. In FY 2019, the IRS conducted 81,000 fewer EITC examinations than in FY 2018; however, all other IRS audits also decreased, leaving the percentage of EITC audits to overall audits approximately the same.

IRS education and outreach efforts for the EITC

The IRS has numerous educational and outreach efforts for taxpayers who might qualify for the EITC but do not claim the EITC and for those who claim the EITC but are not entitled. Each year, the IRS sponsors an EITC Awareness Day and has also held multiple stakeholder engagement summits to discuss outreach and communication strategies related to the EITC and refundable tax credits for the upcoming year. In the summer of 2016, the IRS organized a two-day Summit

[14] National Tax Association, 95th Annual Conference on Taxation, *The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results* (Nov. 14–16, 2002).

conference focused on the EITC. In *The Earned Income Tax Credit Summit*, the IRS indicated that it wanted input to help improve its administration of the EITC:

> *The objective of the Summit is to solicit suggestions for new strategic and tactical approaches that will improve EITC administration and increase participation by eligible taxpayers. The Service is reaching out to EITC stakeholders in all sectors—tax industry professionals, State and Federal agencies, consumer advocates, and non-government organizations—to discuss ways to reduce EITC errors, mitigate compliance risks, increase participation for eligible EITC populations, and ease taxpayer and government burden.*[15]

Additionally, after several newspaper articles appeared in tax-related publications asserting that certain Southern States with disproportionate minority and low-income taxpayers were being audited at greater rates, we were asked by a member of Congress to consider incorporating further research into the area in this report.[16] This audit was conducted to assess: 1) the current state of the IRS's EITC examination strategy, 2) whether additional efficiencies could be identified in EITC audits that the IRS does conduct, and 3) whether disproportionate audits are being conducted with respect to certain Southern States and, if so, why.

Results of Review

The IRS Has Proposed Removing Refundable Tax Credits From the Reporting Requirement for Improper Payments

The Treasury Inspector General for Tax Administration (TIGTA) has performed annual reviews (as required by law) in order to report on the IRS's efforts to protect revenue and improve EITC compliance with a goal to reduce improper payments below 10 percent. Because the OMB has identified the EITC as being at high risk for improper payments, the IRS is required to report annually on its efforts to reduce EITC improper payments. However, due to the complexities of the EITC program, the OMB advised the IRS that the IRS's reduction target may remain constant as long as the complexities are clearly explained.

Each year, TIGTA issues a report on the IRS's refundable credit improper payment rate, including not just the EITC but also the Additional Child Tax Credit and American Opportunity Tax Credit. Given the significant amount of EITC payments each year, as well as the relatively high EITC improper payment rate, and the legislative intent behind the EITC as an anti-poverty measure, this report focuses only on EITC-related issues. Over the last five years, TIGTA has made many recommendations to protect revenue and improve EITC compliance, and the IRS has worked cooperatively to do so, including recommendations, as follows:

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[15] Internal Revenue Service, *Earned Income Tax Credit Briefing* p. 3 (2016).

[16] Paul Kiel and Hannah Fresques, *Where in the U.S. Are You Most Likely to Be Audited by the IRS?*, April 1, 2019, https://projects.propublica.org/graphics/eitc-audit. Presenting estimates from Kim M. Bloomquist, *Regional Bias in IRS Audit Selection*, Tax Notes Today Federal, March 19, 2019.

- The IRS should use the erroneous refund penalty (I.R.C. § 6676) more effectively.[17] TIGTA previously reported that the IRS was not making use of the erroneous refund penalty, which is assessed (unless there was reasonable cause) based on "excessive" refund claims (pursuant to I.R.C. § 6676(b), excessive means the denied portion of the refund was excessive in relation to the refund to which the taxpayer was entitled).[18] The IRS reported in its FY 2020 *Progress Report on Efforts to Reduce Refundable Credit Errors* that it has ongoing compliance efforts to reduce improper payments by proposing return preparer penalties for failure to exercise due diligence. The IRS stated that, for the 2021 Filing Season, the Wage and Investment (W&I) Division implemented the I.R.C. § 6676 penalty, which is being applied to specific populations with repeat or potentially egregious filing behavior.
- The majority of taxpayers who are recertified are not verified by the IRS.[19] TIGTA previously reported that the IRS was not verifying the majority of EITC claims by taxpayers whose previous EITC was denied.[20] TIGTA recommended that the IRS ensure that a systemic process is implemented to set the recertification indicator on taxpayers' accounts when refundable credit claims are disallowed as part of the IRS's Automated Questionable Credit program, and the IRS agreed.
- Bans were not being used effectively to address refundable tax credit noncompliance and ensure efficient use of limited examination resources. TIGTA recommended that the IRS make more effective use of the two-year bans from claiming the EITC for those taxpayers who claimed and were denied the EITC (as well as the Additional Child Tax Credit or the American Opportunity Tax Credit) for reckless or intentional disregard.[21] The IRS reported in its FY 2020 *Progress Report on Efforts to Reduce Refundable Credit Errors* that it has ongoing compliance efforts to impose the bans in appropriate cases. The IRS stated that, in February 2021, the W&I Division Campus Exam function expanded

[17] The Small Business and Work Opportunity Tax Act of 2007 (Pub. L. No. 110-28, §§ 8201-8248) provides the IRS with the ability to assess the erroneous claim for refund or credit penalty (referred to as the erroneous refund penalty).

[18] TIGTA, Report No. 2020-40-025, *Improper Payment Reporting Has Improved; However, There Have Been No Significant Reductions to the Billions of Dollars of Improper Payments* p. 7 (Apr. 2020). TIGTA found that, for Tax Years 2015, 2016, and 2017, the IRS disallowed more than $1.7 billion in refundable tax credit claims but did not assess more than $341 million in erroneous refund penalties.

[19] I.R.C. § 32(k)(2) requires individuals whose EITC claim has been reduced or disallowed to recertify their eligibility before they can receive the credit again.

[20] TIGTA, Report No. 2020-40-008, *Authorities Provided in the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims* (Feb. 2020). TIGTA identified 289,059 (93 percent) returns for which the IRS did not verify the taxpayers' eligibility before recertifying them to receive a refundable tax credit. These taxpayers received more than $532 million in refundable tax credits. IRS management stated that, to determine whether a taxpayer is eligible to again claim a tax credit after it was disallowed on a prior tax return, an audit must be conducted. Moreover, the absence of an audit does not mean that the taxpayers were not entitled to claim the credit. TIGTA's review identified 311,883 tax returns for which the taxpayers' tax accounts had a recertification indicator that either were processed during Calendar Year 2018 (as of July 31, 2018) or had an examination that was closed during FY 2018.

[21] TIGTA, Report No. 2020-40-008, *Authorities Provided by the Internal Revenue Code Are Not Effectively Used to Address Erroneous Refundable Credit and Withholding Credit Claims* p. 15 (Feb. 2020). TIGTA identified 3,934 taxpayers who were allowed to claim more than $12.9 million in credits despite having the same credit disallowed in the two prior tax years (Tax Years 2015 and 2016).

assertion of the two-year ban by implementing systemic assertion of the ban for the Additional Child Tax Credit.

Other efforts have been made by the IRS to reduce improper payments. For example, the IRS implemented a Return Preparer Strategy conducted in coordination with the Small Business/ Self-Employed Division that conducts due diligence visits and issues compliance letters to tax return preparers with a history of unsupported EITC claims as well as other claims.

Notwithstanding the IRS's efforts to address EITC noncompliance, the rate of EITC improper payments has remained consistently high (although each year the IRS is able to protect significant amounts of revenue through its compliance efforts). Figure 1 shows the IRS's EITC improper payment rates and amounts for FYs 2018 through 2020.

Figure 1: EITC Improper Payments for FYs 2018 Through 2020

	FY 2018	FY 2019	FY 2020
Total Improper Payment Amount	$73.6 Billion	$68.7 Billion	$68.2 Billion
EITC Improper Payment Rate	25.1%	25.3%	23.5%
EITC Improper Payment Amount	$18.4 Billion	$17.4 Billion	$16.0 Billion

Source: Department of the Treasury Agency Financial Report for FYs 2018 through 2020.

The Department of the Treasury and the IRS believe refundable credits should not be treated as improper payments

In their *Business Case to Eliminate Redundant Reporting of Refundable Tax Credits*, dated October 30, 2020, the Department of the Treasury (hereafter referred to as Treasury Department) and the IRS informed the OMB that the tax system is primarily a collection system and not a payment program. The Treasury Department and the IRS contend that refundable tax credits do not meet the definition of payments in the traditional sense and, therefore, should be reported only under the Tax Gap framework that comprehensively assesses the tax collection system. On December 1, 2020, officials at the Treasury Department and the IRS met with OMB officials to further discuss the business case and request that erroneous claims for refundable tax credits no longer be reported under improper payment requirements. The Treasury Department and the IRS reported in the *Department of the Treasury Agency Financial Report Fiscal Year 2020* that the necessary compliance dollars to reach an improper payment rate goal of 10 percent is impractical and would deprive the IRS of resources necessary to pursue larger components of the Tax Gap.[22] The OMB has not decided whether to grant this request.

The EITC Examination Strategy Is Not Part of a Larger IRS Examination Strategy

To better understand the IRS's EITC examination strategy, we asked IRS officials whether the EITC and other refundable credit examination strategies are part of a larger IRS examination strategy or plan that assesses the entire tax noncompliance risk when selecting EITC claims for examination. We were told that there is no overarching IRS examination plan that includes the

[22] Department of the Treasury, *Department of the Treasury Agency Financial Report Fiscal Year 2020* p. 248.

EITC. The IRS does not have a larger examination plan at its Deputy Commissioner for Services and Enforcement level. Examination planning is performed in each of the divisions that conduct examinations (*i.e.*, Large Business and International Division, Small Business/Self-Employed Division, Tax Exempt and Government Entities Division, and W&I Division,). The EITC examination strategy is part of the W&I Division's Refundable Credits Strategy and is not part of a larger integrated IRS examination strategy or plan.

After learning that the EITC strategy is not part of a larger IRS examination plan at the IRS's Deputy Commissioner for Services and Enforcement level, we asked W&I Division officials for an explanation of their EITC examination strategy and whether there was a single document or series of documents that reflect what constitutes the W&I Division's EITC compliance strategy. We were provided a five-page, high-level PowerPoint document (attached as Appendix II) titled *Refundable Credits Strategy*. The document addresses six general strategic goals as well as four primary goals.[23] One of the primary goals is compliance, which includes a number of different programs, including audits of tax returns and amended returns that claim refundable credits.[24] Audits of EITC claims generally comprise 75 to 78 percent of all W&I Division audits. W&I Division officials explained that the size of EITC noncompliance and the need to reduce improper payments warrant this predominate percentage of their audit work devoted to EITC audits.

The majority of W&I Division's work is correspondence examinations related to EITC claims. The W&I Division meets throughout the year to discuss EITC strategies and develop plans to work examinations for the upcoming year. W&I Division leadership communicates those plans to the Deputy Commissioner for Services and Enforcement. In developing the EITC workplan, W&I Division officials determine a total closure target for W&I Division examinations based on the available resources of full-time equivalents. This target is divided between EITC and non-EITC work based on resources, work available, and coverage. This percentage is usually around 75 to 78 percent for the EITC and 22 to 25 percent for non-EITC.[25] The IRS has a number of compliance tools to utilize in its EITC workplan, such as: math error authority, recertification, two- and 10-year bans, Dependent Database (DDb) (pre and post-refund), pick-ups, Schedule C EITC, Questionable Refund Program (QRP), and Duplicate Taxpayer Identification Number (DUPTIN).[26]

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[23] The listed strategic goals are empower taxpayers, protect the tax system, collaborate with partners, cultivate our workforce, advance data and analytics, and drive efficient operations. The listed primary goals are education, outreach, compliance, and administration.

[24] The other compliance programs include math error notices, document matching, Return Preparer Strategy, due diligence visits to tax preparers, and an audit improvement team.

[25] EITC examinations may also include review of the Child Tax Credit.

[26] Recertification inventory consists of taxpayers claiming the EITC after being disallowed under examination in a prior year. The IRS is authorized pursuant to I.R.C. § 32(k)(1)(B)(i)–(ii) to ban taxpayers from claiming the EITC for 10 years if it determines during an audit that they claimed the credit improperly due to fraud or ban taxpayers from claiming the EITC for two years if it is determined that the claim was due to reckless or intentional disregard of the rules. The DDb is a rules-based selection application designed to identify potentially ineligible tax returns claiming the EITC and other refundable credits. The DDb filters tax returns and applies a set of business rules to identify and select the most productive returns for examination. The Pick-Up Program consists of returns selected for audit when the prior year audit is still open at the time a subsequent return is filed while meeting specific IRS filtering criteria. The QRP consists of individuals filing false returns claiming questionable income or withholding (false or inflated). Cases with the EITC in addition to the false/inflated income or withholding will be referred to Examination. The DUPTIN program consists of claims in which the same qualifying child has been used to claim the EITC on multiple returns.

W&I Division Examination uses the Exam Planning Scenario Tool to develop the workplan. The Exam Planning Scenario Tool uses historical data, which include no-change, agreement, default, and response rates, to help determine the volumes to be worked in each category based on the available inventory.

Figure 2 shows that the EITC remains an overall productive audit issue for the IRS.

Figure 2: EITC Examination Results in the W&I Division

	FY 2017	FY 2018	FY 2019
Returns Examined	326,197	329,937	256,513
Total Dollars Assessed[27]	$1,544,386,447	$1,503,968,805	$1,105,729,992
Average Hours per Return	1.3	1.3	1.6
Average Dollars per Hour	$3,696	$3,577	$2,774
Average Dollars Assessed per Return	$4,735	$4,558	$4,311
No-Change Rate	9.7%	10.4%	13.3%

Source: IRS W&I Division statistics of EITC closures for FYs 2017 through 2019.

Due to resource restraints, EITC examinations continued to decline in FY 2020; only 157,490 EITC audits were conducted. As Figure 2 shows, EITC examinations are productive in that relatively little time is spent on the exams with significant adjustments identified within that time frame. These examinations are generally correspondence examinations conducted by tax examiners and are considered to be relatively low complexity. Most of these examinations are conducted on a prerefund basis, *i.e.*, before the credits are paid out to the taxpayers.

As such, the resources dedicated to EITC audits are not currently considered as part of a larger integrated framework together with the other compliance risks that make up the Tax Gap. As the IRS reported in the *Department of the Treasury Agency Financial Report Fiscal Year 2020*, the most recent annual gross Tax Gap estimate is $441 billion ($381 billion, after enforcement efforts and other late payments, is referred to as the net Tax Gap). The largest portion of the net Tax Gap is due to underreporting by individual taxpayers and is estimated to be $245 billion. The EITC makes up about $27 billion,[28] or about 11 percent, of the individual taxpayers' share of the underreporting component of the Tax Gap, and according to IRS Statistics of Income data, on average over the past 10 years, EITC examinations accounted for almost 31 percent of all IRS audits.[29] However, during our review, we found that the IRS is not always selecting the most productive cases for examination.

[27] This represents total dollars assessed during the examination, which may include other non-EITC adjustments.

[28] Department of the Treasury, *Department of the Treasury Agency Financial Report* p. 193 (2020). This amount reflects the IRS's estimate for the portion of the Individual Income Tax Underreporting Tax Gap for Tax Years 2011 through 2013 attributed to the EITC. TIGTA has previously reported the IRS's estimate of improper payment amount for the EITC to be $16 billion for FY 2020 in TIGTA Report No. 2021-40-036, *Improper Payment Rates for Refundable Tax Credits Remain High* p. 3 (May 2021). This reflects EITC payments that should not have been made, were made in an incorrect amount, or were made to an ineligible recipient.

[29] Tax Gap estimates are cited from IRS Publication 1415, *Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011–2013* (Rev. 9-2019).

The IRS's current programming does not prioritize certain high-risk EITC claims

The IRS selects approximately 85 percent of all EITC examinations from tax returns identified through DDb or QRP compliance filters. The majority of EITC examinations are completed before the refund is issued, *i.e.*, prerefund examinations. The IRS also audits a limited number of tax returns claiming the EITC after the refund is already paid (post-refund examinations), *i.e.*, client preparer and DUPTINs claiming the EITC.

When a return claiming the EITC is filed, the tax return is screened with both QRP and DDb compliance filters at the same time. DDb and QRP filters are designed to identify different types of risks on a tax return.

[redacted]

Depending on the filtering rules that a tax return breaks, the return can end up in either the QRP or DDb prerefund selection pool. If the tax return is identified by both QRP and DDb filters, the DDb scoring is not considered for prerefund examination, and the tax return will remain in the QRP population of potential cases for selection. Figure 3 shows that tax returns are evaluated independently for prerefund examination. If a tax return is not selected for a prerefund examination through its respective system, the tax return is processed and could be selected for a post-refund examination.

Figure 3: EITC Return Processing and Correction for the DDb and the QRP

[redacted]

Source: TIGTA's analysis of IRS procedures and processing for DDb and QRP correction streams.

IRS management noted that cases flagged by both QRP and DDb compliance filters are generally expected to be more productive, *i.e.,* cases result in higher assessments when compared to cases flagged by QRP filters alone. However, the IRS stated that the verification of the income process in the QRP selection pool may take several months, making it difficult to merge these two processes. Although refunds for these returns are frozen and prevented from issuance when flagged, [redacted] The IRS states that all returns in the QRP pool meeting selection criteria may be referred to Examination based on the order in which returns are filed. [redacted] Therefore, the current process is not designed to allow the IRS to weigh the risk of returns identified in both the QRP and DDb workstreams to prioritize the most productive QRP cases for examination.

Our review of cases flagged by both the QRP and the DDb in FY 2019 identified 21,589 tax returns that were identified by both systems but not ultimately selected for prerefund examination because they were not selected for examination through the QRP system. Therefore, these 21,589 tax returns were identified as problematic by two separate systems of compliance filters but were not selected for examination before the refund was issued. Figure 4 shows that we analyzed the population of QRP audits closed during FYs 2017 through 2019 and determined that cases which broke both QRP and DDb filtering criteria were more productive than QRP returns that did not break any DDb filtering rules.

Figure 4: Analysis of QRP Examination Results

Examination by FY	QRP Audits With No DDb Filter Breaks		QRP Audits With DDb Filter Breaks	
	QRP Audits Closed	Average Audit Assessment	QRP Audits Closed	Average Audit Assessment
2017	3,592	$2,993	2,233	$3,733
2018	18,084	$4,697	16,078	$5,329
2019	29,373	$3,768	35,239	$4,872

Source: TIGTA's analysis of the Audit Information Management System and the DDb for QRP examinations.

As mentioned previously, the IRS's goal is to select the most productive and highest risk EITC returns for examination. All returns screened for QRP and DDb examination consideration that break a DDb filter rule will receive a DDb risk score. IRS management agreed that prioritizing cases with both QRP and DDb filter rule breaks would be more productive; [redacted] Additional programming would be needed to allow [redacted] that could be used during the selection process.

Recently, the IRS has taken steps to address part of this issue by creating a test process for cases that were identified in both workstreams, the QRP and the DDb, to be matched for examination consideration. The IRS made programming additions to track the cycle of returns breaking QRP and DDb filtering rules for further analysis. Depending on the results of that analysis, the IRS intends to incorporate programming changes, starting in FY 2022, [redacted] Additionally, starting in February 2019, the IRS implemented and tested programming to address certain totally fraudulent income or withholding cases through the Automated Questionable Credit program, reducing the burden on Examination.[30] Although the IRS has taken steps to address part of this problem, additional programming and prioritization of the cases with both QRP and DDb issues is essential to ensure that the IRS is working the most productive cases.

[30] The Automated Questionable Credit program is for certain types of workstreams that do not meet the traditional examination workload. Letters are issued to taxpayers proposing tax assessments. If taxpayers do not respond, the IRS will make an immediate adjustment reflecting the claim disallowance/assessment.

Multiple taxpayers are using the same dependent Taxpayer Identification Numbers (TIN) to claim the EITC, and some have been doing so for numerous years without correction

Our review of EITC claims filed during Processing Years (PY) 2017 through 2019 identified 616,444 individuals who received nearly $2 billion in potentially erroneous EITCs by using a dependent TIN used by other taxpayers for the same purpose. These taxpayers' returns were not corrected or selected for examination by the IRS. Figure 5 shows the number of EITC claims made during PYs 2017 through 2019 using a DUPTIN that were allowed.

Figure 5: PYs 2017 Through 2019 DUPTINs Identified and Not Corrected or Examined

PY	Number of EITC Claims Using a DUPTIN	Total Amount of the EITC Claimed
2017	196,726	$634,895,369
2018	218,588	$706,829,890
2019	201,130	$657,584,413
Total	616,444	$1,999,309,672

Source: TIGTA's analysis of the Individual Return Transaction File, Individual Master File, and Audit Information Management System databases.

The IRS has implemented processes to identify and prevent revenue loss and to change taxpayer behavior resulting from multiple uses of dependent TINs. This process starts with the IRS's maintenance of the DUPTIN database, where information on duplicate uses of a dependent's TIN are stored for review.[31] Using information from the DUPTIN database, the IRS has developed correction streams to address these instances, which include:

- Issuance of soft notices.[32]
- Prerefund DDb DUPTIN filtering for potential DDb examination.
- Annual post-refund DUPTIN review for potential examination.

Figure 6 shows the number of DUPTINs identified in the different correction streams for PYs 2017 through 2019.

[31] The DUPTIN database contains information on duplicate uses of an individual's TIN. It includes a record of how each Social Security Number was used on a Form 1040 return.

[32] A soft notice is sent for information purposes only to inform the taxpayer they may have claimed one of several tax benefits in error.

Figure 6: PYs 2017 Through 2019 DUPTINs Identified in the Different Correction Streams

PY	Number of DDb Filter Breaks Identified With a DUPTIN	Number of Soft Notices Issued for a DUPTIN	Number of Prerefund DUPTIN Audits	Number of Post-Refund DUPTIN Audits
2017	330,494	135,792	4,821	13,941
2018	311,850	128,887	2,708	0
2019	335,058	121,989	1,377	8,050

Source: IRS DUPTIN statistics for PYs 2017 through 2019.

However, the IRS's DUPTIN correction streams do not prevent taxpayers from engaging in the same behavior in subsequent years. While the IRS DUPTIN correction streams intend to discourage taxpayers from claiming erroneous EITCs using a DUPTIN, our analysis determined that current IRS controls in place may not be preventing some taxpayers from continuing these erroneous claims. Of the 616,444 unique taxpayers identified for PYs 2017 through 2019 whose claim using DUPTINs was not corrected or selected for examination, 75,645 (12 percent) taxpayers continued to use a DUPTIN for multiple years to claim the EITC without correction.

- 62,355 taxpayers claimed a DUPTIN for at least two consecutive years.
- 13,290 taxpayers claimed a DUPTIN for at least three consecutive years.

The IRS tracks DUPTIN repeaters for two years; however, there is no additional weight for examination selection placed on repeaters. We believe DUPTINs filed in multiple years pose a high risk, and the IRS should prioritize these cases in the selection process by weighting repeater DUPTIN returns higher to increase the chance of selection.

Recommendation 1: The Deputy Commissioner for Services and Enforcement and related examination planning and research staff should consider how refundable credits, including the EITC, would be examined to a different extent if the claims are considered for compliance purposes closer to the proportion that they contribute to the Tax Gap.

Management's Response: The IRS agreed with this recommendation. IRS management stated that examinations are a critical piece of their compliance efforts to help ensure fairness in the tax system. Significant investments in the IRS have been proposed to address the Tax Gap. This includes a sustained, multiyear commitment that provides certain funding to make investments in modernizing information technology, improving data analytic approaches, and hiring and training staff dedicated to complex enforcement activities, like large corporations; large, multitiered partnerships; and high-wealth/high-income individuals. The IRS stated that it is developing plans to hire and train employees in these complex enforcement activities as well as increasing audit coverage in these areas. At the same time, the IRS stated that its plan will also include increasing the coverage achieved in recent years across all areas of noncompliance and income distribution among the filing population. However, the IRS stated that the funding appropriations for FY 2022 and beyond are unknown, as are the resources that will be available to address all aspects of the Tax Gap.

The Commissioner, W&I Division, should:

Recommendation 2: Evaluate the current programming for the prerefund selection process to ensure that cases identified by both QRP and DDb selection pools are prioritized for DDb prerefund selection.

Management's Response: The IRS agreed with this recommendation. IRS management stated that they would review the potential programming needed to identify QRP referrals with DDb rule breaks and submit a request for a Lean Business Case evaluation, as appropriate.[33] However, the IRS stated that all programming updates are subject to limited resources, budgetary constraints, and competing priorities.

Recommendation 3: Evaluate and revise the scoring process to ensure that the cases with the highest risk are scored as such. This process should include adding weight to cases with higher QRP and DDb scores and DUPTIN repeaters.

Management's Response: The IRS agreed with this recommendation. IRS management stated they would review the requirements to determine if any additional changes could be made to the audit populations. DUPTIN returns are primarily worked as post-refund audits, not prerefund audits, and some of the duplicates may be taxpayers who are entitled to the refundable credit. In addition, the IRS stated that QRP returns cannot be scored for audit selections. [redacted] IRS management stated that they will review the potential programming needed to identify QRP referrals with DDb rule breaks and submit a request for a Lean Business Case evaluation for applicable programming updates. However, the IRS stated that all programming updates are subject to limited resources, budgetary constraints, and competing priorities.

[33] A Lean Business Case is used in the prioritization of digital capable services. When changes are desired for a system, a Lean Business Case evaluation is completed to prioritize the requested changes and allocate the resources needed for implementation of approved changes.

Examination Rates Among the States Are Aligned With Tax Returns Flagged by Compliance Filters

We were asked by U.S. Representative Charlie Crist to assess whether there is a disproportionate number of IRS audits in certain Southern States with a disproportionate percentage of EITC audits. Similar concerns about this issue have been expressed in the past.[34] On April 10, 2019, during a hearing before the Committee on Finance, members of Congress expressed concern that certain Southern States were being disproportionately audited.[35]

Our analysis of the IRS's examinations of EITC claims shows that its audit selection process appears disproportionate with respect to certain Southern States. However, the IRS's audit selection process focuses on areas where there appear to be the most errors based on the IRS's compliance filters, and there are more indications of noncompliance in these States. In PY 2019, the IRS received 25,972,193 claims for the EITC in the 50 U.S. States.[36] The percentage of claims examined from each State ranged from 2.5 percent to 0.31 percent.[37] Our review of the number of examinations completed in each State found that some States had a higher percentage of tax returns with EITC selected for examination. For example, Figure 7 identifies the 10 States that had the highest percentage of EITC claims examined compared to the respective percentage of claims in those States. Figure 7 shows that the top States with the highest percentage of EITC claims examined did not always rank as the States with the highest percentage of overall claims filed.

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[34] For example, in 1998, Congressman Bob Etheridge of North Carolina made the following statement, following the issuance of a GAO report:

> *The GAO reports that 47 percent of the random tax audits during the past 3 years were in 11 Southern states that represent only 29 percent of the population. More than 85 percent of those audits had incomes of less than $25,000, many of whom depend upon the Earned Income Tax Credit for our working poor. Why should an individual be three times more likely to be audited in North Carolina than in the State of Massachusetts? North Carolinians are honest people. Why should they be subjected to this kind of treatment? As a former small businessman and a Southern taxpayer, I am outraged at this report and call for immediate action to reform the IRS*. 144 Cong. Rec. H761-03, Proceedings and Debates of the 105th Congress, Second Session, *Reform the IRS*, March 4, 1998.

[35] *The 2019 Tax Filing Season and the 21st-Century IRS, Hearing before the Committee on Finance United States Senate, 116 Cong.* (Apr. 10, 2019) (Statement of Hon. Michael F Bennet).

[36] See Appendix III for the ranking and total number of EITC claims listed for the 50 U.S. States.

[37] See Appendix IV for the ranking and total EITC examinations compared to EITC claims for the 50 U.S. States.

Figure 7: Analysis of EITC Claims and Examinations

Ranking of EITC Examinations Compared to Claims	State	Number of EITC Claims	Number of EITC Examinations	Percentage of EITC Claims Examined	Ranking of Overall EITC Claims Filed
1	MS	363,784	9,081	2.50%	24
2	LA	499,644	11,236	2.25%	16
3	AL	479,490	10,201	2.13%	18
4	GA	1,065,401	17,401	1.63%	5
5	TN	615,528	8,788	1.43%	11
6	SC	475,935	5,540	1.16%	19
7	NC	909,445	10,449	1.15%	7
8	TX	2,655,273	27,859	1.05%	2
9	AR	287,705	2,998	1.04%	29
10	NV	260,139	2,698	1.04%	31

Source: TIGTA's analysis of PY 2019 claims and FY 2019 examinations using the Individual Return Transaction File, Individual Master File, and Audit Information Management System databases.

However, the percentage of examinations in each State corresponded with the number of tax returns flagged by the IRS's filters in each State. Figure 8 shows that the top States with the highest percentage of examinations also ranked at or near the top of all States in percentage of filter rule breaks.[38]

Figure 8: Analysis of EITC Examinations and DDb Filter Breaks

Ranking of EITC Examinations Compared to Claims	State	Number of EITC Examinations	Percentage of EITC Claims Examined	Number of EITC DDb Filter Breaks	Percentage of EITC Claims With DDb Filter Breaks	Ranking of DDb Filter Breaks
1	MS	9,081	2.50%	14,094	3.87%	1
2	LA	11,236	2.25%	18,281	3.66%	2
3	AL	10,201	2.13%	14,235	2.97%	3
4	GA	17,401	1.63%	28,799	2.70%	4
5	TN	8,788	1.43%	14,387	2.34%	7
6	SC	5,540	1.16%	11,835	2.49%	5
7	NC	10,449	1.15%	20,584	2.26%	8
8	TX	27,859	1.05%	55,133	2.08%	10
9	AR	2,998	1.04%	6,993	2.43%	6
10	NV	2,698	1.04%	5,223	2.01%	13

Source: TIGTA's analysis of FY 2019 examinations using the Individual Return Transaction File, Individual Master File, and Audit Information Management System databases along with IRS-provided counts of DDb filter breaks.

The IRS conducts correspondence audits nationwide at different IRS campuses. A taxpayer's geographic location is not a factor in selecting an EITC return for audit. As previously noted, the EITC examination inventory is primarily selected systemically using risk-based scoring criteria

[38] See Appendix V for the ranking and total number of DDb EITC filter breaks listed for the 50 U.S. States.

from the DDb and the QRP. Tax returns with potentially erroneous EITC claims are flagged and placed in the IRS's inventory.

According to IRS management, the examination selection criteria are not based on geographic location. However, EITC claims from some States break exam filtering rules and meet exam selection criteria at a greater rate. Additionally, the IRS does not use examination results or concentration of these filtering rule breaks in its strategies for targeting EITC educational and outreach efforts. Although the IRS has completed limited research to review variances in geographic locations, IRS management noted that they could complete a more in-depth review to better understand why some States have a larger number of tax returns with EITC claims flagged for review. This type of analysis could provide additional insight to identify the reasons for these variances and develop strategies to mitigate noncompliance.

It is clear, however, that the IRS's audit selection methodology results in more EITC audits in certain Southern States, whose populations may be disproportionately low-income and minority. Additionally, enhancing EITC educational campaigns may be warranted in areas that tend to be audited more often due to apparent noncompliance.

Recommendation 4: The Commissioner, W&I Division, should tailor EITC-related educational efforts for the States with disproportionate error rates.

> **Management's Response:** The IRS disagreed with this recommendation. IRS management stated that they already have an extensive outreach and education strategy in place tailored to reach EITC taxpayers in all communities, including those who may be potentially eligible but do not currently claim the credit. IRS management stated that they would continue to include all communities in their outreach areas.
>
> > **Office of Audit Comment:** Although the IRS states that all communities are included in their outreach areas, the disproportionately higher error rate in certain Southern States indicates that the current outreach is not working in these States. Without targeted outreach, based on examination results or concentration of filter rule breaks, disproportionate error rates will continue in these areas.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the IRS's procedures for selecting returns with EITC claims for audit are effective for determining the highest tax compliance risks. To accomplish our objective, we:

- Determined how Examination resources were allocated, how compliance risks were assessed, and whether there was an overall IRS Examination plan that encompasses all of the examinations conducted by the IRS.
- Determined the applicable policies, procedures, and controls that are in place for selection and examination of EITC claims.
- Analyzed the IRS's approach to the selection of EITC claims for examination and determined whether areas of highest risk of noncompliance were being identified, including identifying geographical areas of audit disparity.
- Determined if the IRS was effectively identifying erroneously claimed credits and the actions the IRS had taken to correct them.
- Evaluated data and determined whether additional filters were needed to prevent potentially erroneous EITC claims from going undetected. We analyzed the applicable criteria and evaluated whether the filters in place were adequately designed to identify taxpayers who did not meet such criteria.

Performance of This Review

This review was performed with information obtained from the W&I Division Headquarters in Atlanta, Georgia; the Small Business/Self-Employed Division Headquarters in Lanham, Maryland; and the Large Business and International Division Headquarters in Washington, D.C., during the period August 2019 through May 2021. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Matthew Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations); Linna Hung, Director; Glen Rhoades, Director; Tim Greiner, Acting Director; Michele Jahn, Audit Manager; Antony Shang, Lead Auditor; and Kim McMenamin, Senior Auditor.

Validity and Reliability of Data From Computer-Based Systems

We reviewed and analyzed computerized information obtained from IRS systems to include the Individual Return Transaction File, Individual Master File, DDb, and Audit Information Management System. We evaluated the data by 1) performing electronic testing of required data elements, 2) reviewing existing information about the data and the system that produced them, and 3) interviewing agency officials knowledgeable about the data. We determined that the data were sufficiently reliable for purposes of this report.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: IRS policies, procedures, and practices to identify, select, and process EITC claims for audit. We evaluated these controls by reviewing and analyzing relevant data, interviewing IRS management, and performing analysis on IRS individual taxpayer data related to the preparation of these credits.

Appendix II

Wage and Investment Division Refundable Credits Program Management's Refundable Credits Strategy

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Appendix III

Ranking of EITC Claims in the 50 U.S. States[1]

Ranking of Total EITC Claims	State	Number of EITC Claims	Percentage of Overall Claims Filed
1	CA	2,916,473	11.20%
2	TX	2,655,273	10.20%
3	FL	2,169,204	8.33%
4	NY	1,661,611	6.38%
5	GA	1,065,401	4.09%
6	IL	942,309	3.62%
7	NC	909,445	3.49%
8	PA	905,130	3.48%
9	OH	900,845	3.46%
10	MI	761,357	2.92%
11	TN	615,528	2.36%
12	NJ	597,523	2.29%
13	VA	594,391	2.28%
14	AZ	571,640	2.20%
15	IN	517,586	1.99%
16	LA	499,644	1.92%
17	MO	486,454	1.87%
18	AL	479,490	1.84%
19	SC	475,935	1.83%
20	WA	413,619	1.59%
21	MD	404,593	1.55%
22	MA	391,580	1.50%
23	KY	385,335	1.48%
24	MS	363,784	1.40%
25	WI	357,538	1.37%
26	CO	341,855	1.31%
27	OK	328,735	1.26%
28	MN	323,118	1.24%
29	AR	287,705	1.10%
30	OR	263,345	1.01%
31	NV	260,139	1.00%
32	CT	220,856	0.85%
33	NM	203,454	0.78%
34	KS	199,780	0.77%
35	IA	198,104	0.76%
36	UT	184,259	0.71%
37	WV	142,928	0.55%
38	NE	128,704	0.49%
39	ID	127,091	0.49%
40	HI	96,913	0.37%
41	ME	96,509	0.37%
42	RI	81,231	0.31%
43	MT	75,885	0.29%
44	DE	73,238	0.28%
45	NH	71,782	0.28%
46	SD	59,638	0.23%
47	AK	45,886	0.18%
48	ND	42,716	0.16%
49	VT	41,543	0.16%
50	WY	35,091	0.13%
Total 50 States		25,972,193	99.75%

Source: TIGTA's analysis of PY 2019 claims using the Individual Return Transaction File, Individual Master File, and Audit Information Management System databases.

[1] The other 0.25 percent of the EITC claims are from State codes that are something other than the 50 U.S. States, such as the District of Columbia (D.C.) and the Armed Forces (AP and AE).

Appendix IV

Analysis of EITC Claims and Examinations for the 50 U.S. States

Ranking of EITC Examinations Compared to Claims	State	Number of EITC Claims	Number of EITC Examinations	Percentage of EITC Claims Examined
1	MS	363,784	9,081	2.50%
2	LA	499,644	11,236	2.25%
3	AL	479,490	10,201	2.13%
4	GA	1,065,401	17,401	1.63%
5	TN	615,528	8,788	1.43%
6	SC	475,935	5,540	1.16%
7	NC	909,445	10,449	1.15%
8	TX	2,655,273	27,859	1.05%
9	AR	287,705	2,998	1.04%
10	NV	260,139	2,698	1.04%
11	IL	942,309	9,722	1.03%
12	FL	2,169,204	21,941	1.01%
13	MI	761,357	7,603	1.00%
14	DE	73,238	708	0.97%
15	MD	404,593	3,509	0.87%
16	AZ	571,640	4,832	0.85%
17	OH	900,845	7,606	0.84%
18	NJ	597,523	4,879	0.82%
19	OK	328,735	2,592	0.79%
20	CT	220,856	1,699	0.77%
21	KY	385,335	2,921	0.76%
22	VA	594,391	4,437	0.75%
23	NY	1,661,611	12,342	0.74%
24	IN	517,586	3,782	0.73%
25	MO	486,454	3,550	0.73%
26	CA	2,916,473	21,264	0.73%
27	RI	81,231	587	0.72%
28	PA	905,130	6,257	0.69%
29	NM	203,454	1,358	0.67%
30	WI	357,538	2,198	0.61%
31	WV	142,928	845	0.59%
32	KS	199,780	1,120	0.56%
33	MA	391,580	2,150	0.55%
34	WA	413,619	2,264	0.55%
35	HI	96,913	523	0.54%
36	SD	59,638	315	0.53%
37	ND	42,716	218	0.51%
38	CO	341,855	1,677	0.49%
39	NE	128,704	623	0.48%
40	OR	263,345	1,210	0.46%
41	UT	184,259	846	0.46%
42	MT	75,885	347	0.46%
43	MN	323,118	1,439	0.45%
44	IA	198,104	872	0.44%
45	AK	45,886	199	0.43%
46	WY	35,091	144	0.41%
47	ID	127,091	480	0.38%
48	NH	71,782	262	0.36%
49	ME	96,509	313	0.32%
50	VT	41,543	129	0.31%
Total 50 States		25,972,193	246,014	

Source: TIGTA's analysis of PY 2019 claims and FY 2019 examinations using the Individual Return Transaction File, Individual Master File, and Audit Information Management System databases.

Appendix V

Analysis of EITC DDb Filter Breaks for the 50 U.S. States

Ranking of Percentage of DDb Filter Breaks	State	Number of EITC DDb Filter Breaks	Number of EITC Claims	Percentage of EITC Claims With DDb Filter Breaks
1	MS	14,094	363,784	3.87%
2	LA	18,281	499,644	3.66%
3	AL	14,235	479,490	2.97%
4	GA	28,799	1,065,401	2.70%
5	SC	11,835	475,935	2.49%
6	AR	6,993	287,705	2.43%
7	TN	14,387	615,528	2.34%
8	NC	20,584	909,445	2.26%
9	DE	1,600	73,238	2.18%
10	TX	55,133	2,655,273	2.08%
11	MD	8,298	404,593	2.05%
12	AZ	11,555	571,640	2.02%
13	NV	5,223	260,139	2.01%
14	OH	18,073	900,845	2.01%
15	IL	18,078	942,309	1.92%
16	FL	41,498	2,169,204	1.91%
17	NM	3,813	203,454	1.87%
18	KY	7,182	385,335	1.86%
19	PA	16,851	905,130	1.86%
20	OK	6,067	328,735	1.85%
21	MI	13,542	761,357	1.78%
22	MO	8,171	486,454	1.68%
23	IN	8,645	517,586	1.67%
24	VA	9,909	594,391	1.67%
25	SD	990	59,638	1.66%
26	NY	27,393	1,661,611	1.65%
27	WV	2,278	142,928	1.59%
28	NJ	9,515	597,523	1.59%
29	CT	3,459	220,856	1.57%
30	RI	1,269	81,231	1.56%
31	CA	43,380	2,916,473	1.49%
32	HI	1,421	96,913	1.47%
33	ND	593	42,716	1.39%
34	AK	604	45,886	1.32%
35	KS	2,595	199,780	1.30%
36	WA	5,175	413,619	1.25%
37	MA	4,875	391,580	1.24%
38	WI	4,324	357,538	1.21%
39	NE	1,546	128,704	1.20%
40	MT	844	75,885	1.11%
41	CO	3,683	341,855	1.08%
42	MN	3,450	323,118	1.07%
43	IA	2,075	198,104	1.05%
44	OR	2,751	263,345	1.04%
45	UT	1,882	184,259	1.02%
46	WY	325	35,091	0.93%
47	NH	619	71,782	0.86%
48	ME	822	96,509	0.85%
49	ID	1,081	127,091	0.85%
50	VT	267	41,543	0.64%
Total 50 States		490,062	25,972,193	

Source: TIGTA's analysis PY 2019 claims using the Individual Return Transaction File and Individual Master File databases along with IRS-provided counts of DDb filter breaks.

Appendix VI

Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

COMMISSIONER
WAGE AND INVESTMENT DIVISION

August 17, 2021

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Kenneth C. Corbin Digitally signed by Kenneth C. Corbin Date: 2021.08.17 13:24:02 -04'00'
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – The Earned Income Tax Credit Examination Compliance Strategy Can Be Improved (Audit # 201930012)

Thank you for the opportunity to review and provide comments on the subject draft report. We appreciate you calling attention to the important role that Earned Income Tax Credit (EITC) examinations play in the IRS's overall taxpayer compliance strategy. We also appreciate your acknowledgement of the extensive outreach and education efforts we undertake to increase participation in EITC and to reduce errors made in claiming it. Additionally, we appreciate the comments of the Treasury Inspector General for Tax Administration (TIGTA) that the IRS has been responsive to many recommendations made over the past five years to protect revenue and improve EITC compliance. We have expanded the implementation of the Erroneous Claim for Refund or Credit penalty[1] to reduce improper claims for the EITC.

Procedures have been created for recertification of other refundable credits such as the American Opportunity Tax Credit (AOTC), the Child Tax Credit (CTC), and the Additional Child Tax Credit (ACTC). Recertification indicators are set on taxpayer accounts when the credit(s) have been denied or reduced as the result of an examination, or audit, of the taxpayers' returns. Affected individuals are required to attach Form 8862, *Information to Claim Credits After Disallowance*, and recertify eligibility when they file their next tax return claiming the same type of credit. We have established procedures to systemically assert two-year bans on the CTC and ACTC claims during an audit when it is determined that the taxpayer has recklessly disregarded the rules and regulations when claiming the credit(s).

Our refundable credit compliance strategy is twofold – to reduce errors and to ensure the credit is provided to eligible taxpayers. More than 70 percent of our EITC examinations are selected prior to refunds being issued. Returns are selected for review by the Dependent Database (DDb), which evaluates and prioritizes those claims considered to be at high risk of error. The audit selection methodology for EITC examinations does not include geographic factors. Enhanced filters are used to

[1] Internal Revenue Code § 6676.

evaluate information presented on the tax return when selecting those most likely to contain erroneous claims for the EITC and needing additional review. This means that fewer taxpayers entitled to receive the EITC, are burdened with an examination and delay in receiving their refunds. Any above-or below-average concentrations of selections in certain states is the sole result of those returns having attributes indicating a high risk for error. All returns are evaluated equally by the filters and business rules, and selections are made without influence or intervention by IRS personnel.

The TIGTA acknowledged that all EITC tax returns that break a DDb filter will receive a score and be available for examination selection. Cases selected for treatment by the Questionable Refund Program (QRP) cannot be prioritized due to programming restrictions; however, returns selected for this treatment stream contain indications of egregious behavior such as claiming false and questionable wages and withholdings. The program results for the inventory selected by DDb and QRP are similar.

The Duplicate Taxpayer Identification Number (DUPTIN) program population includes all returns where more than one taxpayer uses the same Taxpayer Identification Number (TIN) as a dependent or for purposes of claiming refundable tax credits or other tax benefits. The filers of these returns include both individuals entitled to claim the dependent, as well as those who are not entitled. The current treatment streams for DUPTIN resulted in 88 percent of taxpayers changing their behavior from calendar years 2017 through 2019. For the 12 percent who did not change their behavior, a portion of those taxpayers may be entitled to claim the dependents and applicable credits.

Each year, the Refundable Credits Program Management and the Communication and Liaison organizations partner to distribute EITC and other refundable credits information by carefully weaving it into traditional and social media communications as well as tax publications, forms, marketing materials and other products directed toward taxpayers and tax professionals. The objectives of our outreach and education strategies are to:

- Deliver clear and focused messaging to all qualifying taxpayers and paid tax return preparers.
- Provide consistent messaging to our internal and external partners, to help them reach eligible taxpayers and paid tax return preparers across all communities.
- Direct IRS employees and partners to resources and tools that can be used to help taxpayers determine their eligibility and to promote refundable credits.
- Reinforce due diligence requirements for paid tax return preparers.

As referenced in the report, the IRS sponsors an annual EITC Awareness Day, which is an annual event focusing on the underserved population and is designed to promote increased participation, decreased erroneous payments, and improved accuracy of filed returns. This initiative includes community organizations, elected officials, state and local governments, schools, employers, and other interested parties. The EITC Awareness Day uses intensive traditional and social media coverage to reach the broadest possible range of eligible taxpayers, including underserved populations and newly eligible workers. Our social media coverage includes digital platforms used to expand outreach messaging via Twitter, Facebook, Instagram, LinkedIn, and YouTube, reaching millions annually.

Since more than one-half of EITC claims are filed by paid preparers, the IRS has an extensive paid preparer strategy. The strategic initiatives focus on improving preparer compliance with due diligence requirements. The education and outreach for paid preparers includes due diligence presentations at the Nationwide Tax Forums, the Latino Tax Professionals Conference, the Software Developers Conference, and annual conventions of major tax preparation companies.

Additionally, the IRS provides the following online sites and tools geared to educate taxpayers and tax return preparers.

- **IRS.gov:** A website that contains tax topics, including information on refundable credits and qualification criteria, statistics, filing instructions, and taxpayer guidance.
- **EITC Central:** A microsite on IRS.gov, EITC Central is used by taxpayers, volunteers, and tax preparers to assist in preparing accurate claims of refundable credits. The EITC Central has the latest information on refundable credits -- fact sheets, statistics, marketing tools, continuing education and other training resources, social media tools, ready-made flyers and posters, communication products, and templates. It includes the Partner's Outreach Toolkit, Marketing Express, Information for the Press and the Tax Preparer's Toolkit.
- **EITC Assistant:** An online tool that helps taxpayers determine whether they qualify for the EITC and estimates the potential refund amount.

The IRS strives to reduce the number of estimated improper payments of refundable credits paid each year, balance service and compliance initiatives, and meet the needs of a wide-ranging taxpayer population, doing so within the constraints of fiscal limitations. We believe our compliance strategy is effective, however, we continually seek ways to improve the process, reduce burden to the government and taxpayers, and protect taxpayer rights.

Our responses to your specific recommendations are attached. 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

Attachment

Recommendation

RECOMMENDATION 1
The Deputy Commissioner for Services and Enforcement and related examination planning and research staff should consider how refundable credits, including the EITC, would be examined to a different extent if the claims are considered for compliance purposes closer to the proportion that they contribute to the Tax Gap.

CORRECTIVE ACTION
Examinations are a critical piece of our compliance efforts and help ensure fairness in the tax system. The challenge with auditing fewer lower-income taxpayers claiming EITC is that around 50 percent of the returns claiming EITC have overclaimed the credit. Significant investments in the IRS have been proposed to address the tax gap. This includes a sustained, multi-year commitment that provides certain funding to make investments in modernizing information technology, improving data analytic approaches and hiring and training staff dedicated to complex enforcement activities, like large corporations, large, multi-tiered partnerships and high wealth/high income individuals. We are developing plans to hire and train employees in these complex enforcement activities, as well as increasing audit coverage in these areas. At the same time, our plan will also include increasing the coverage achieved in recent years across all areas of noncompliance and income distribution among the filing population. At this time, the funding appropriations for fiscal years 2022 and beyond are unknown, as are the resources that will be available to address all aspects of the tax gap.

IMPLEMENTATION DATE
NA

RESPONSIBLE OFFICIAL
NA

CORRECTIVE ACTION MONITORING PLAN
NA

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 2
Evaluate the current programming for the pre-refund selection process to ensure that cases identified by both QRP and DDB selection pools are prioritized for DDB pre-refund selection.

CORRECTIVE ACTION
We will review the potential programming needed to identify the QRP referrals with DDb rule breaks and submit a request for a Lean Business Case (LBC) evaluation, as appropriate. However, all programming updates are subject to limited resources, budgetary constraints, and competing priorities.

IMPLEMENTATION DATE
August 15, 2022

RESPONSIBLE OFFICIAL
Director, Refundable Credits 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 3
Evaluate and revise the scoring process to ensure that the cases with the highest risk are scored as such. This process should include adding weight to cases with higher QRP and DDB scores and DUPTIN repeaters.

CORRECTIVE ACTION
We will review the requirements to determine if any additional changes can be made to this audit population. However, many of the duplicates may be the taxpayer(s) who are entitled to claim the dependent(s) for the refundable credit(s). The DUPTIN returns are primarily worked as post refund audits, not pre-refund audits.

[redacted] We will review the potential programming needed to identify the QRP referrals with DDb rule breaks and submit a request for an LBC evaluation to for applicable programming updates. However, all programming updates are subject to limited resources, budgetary constraints, and competing priorities.

IMPLEMENTATION DATE:
March 15, 2023

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RESPONSIBLE OFFICIAL
Director, Refundable Credits 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

RECOMMENDATION 4
The Commissioner, Wage and Investment Division, should tailor EITC-related educational efforts for the States with disproportionate error rates.

CORRECTIVE ACTION
The IRS already has an extensive outreach and education strategy in place, tailored to reach EITC taxpayers in all communities, including those who may be potentially eligible but do not currently claim the credit. We will continue to include all communities in our outreach areas.

IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Refundable Credits 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.

Appendix VII

Abbreviations

DDb	Dependent Database
DUPTIN	Duplicate Taxpayer Identification Number
EITC	Earned Income Tax Credit
FY	Fiscal Year
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
OMB	Office of Management and Budget
PY	Processing Year
QRP	Questionable Refund Program
TIGTA	Treasury Inspector General for Tax Administration
TIN	Taxpayer Identification Number
W&I	Wage and Investment

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Treasury Inspector General for Tax Administration

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Information you provide is confidential, and you may remain anonymous.