

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation

September 23, 2021

Report Number: 2021-40-070

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

HIGHLIGHTS: Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation

Final Audit Report issued on September 23, 2021

Report Number 2021-40-070

Why TIGTA Did This Audit

During Calendar Year 2019, the IRS's Automated Questionable Credit, Automated Underreporter, and Examination programs adjusted more than \$1.9 billion in Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC) claims on 617,297 tax returns.

Our overall objective was to evaluate the reasons for disallowance of these credits and the assistance provided to taxpayers during the examination process. As part of our evaluation, TIGTA assessed the extent to which taxpayer confusion resulted in the disallowance of the credits.

Impact on Taxpayers

The IRS estimated that, in Fiscal Year 2020, \$16.0 billion in EITC and \$4.5 billion in ACTC payments were improper. Improper payments result in individuals receiving credits to which they are not entitled, and in cases for which the same qualifying child is claimed more than once, an improper payment to the wrong claimant can take away funds for those the credits were intended to benefit.

What TIGTA Found

Addressing complex and inconsistent eligibility rules could reduce unintentional errors and increase participation. Changes that could help include simplifying the qualifying child relationship rules, making Taxpayer Identification Number (TIN) requirements consistent, and making the definition of income consistent.

TIGTA's analysis of 698,495 tax returns claiming the EITC or ACTC with an Automated Questionable Credit, Automated Underreporter, or Examination program review closed during Calendar Year 2019 found that 475,862 (68 percent) of the tax returns were identified because of an income reporting discrepancy. The IRS adjusted the EITCs and the ACTCs (totaling more than \$1.1 billion) on 432,534 (91 percent) of the 475,862 returns.

The Protecting Americans From Tax Hikes Act of 2015 included provisions to assist the IRS in identifying income reporting errors during tax return processing. However, the Act did not provide the IRS with correctable error authority to address these claims. Without this flexibility, the IRS must audit each tax return to prevent or recover unsupported refundable tax credits. As such, the majority of identified claims with income reporting errors are not addressed.

In addition, multiple use of the same qualifying children continues to result in millions of dollars in improper refundable credit payments. Analysis of Tax Year 2018 tax returns identified 187,523 unique qualifying child TINs that were used multiple times to claim the EITC or the ACTC on 300,234 tax returns. TIGTA estimates that taxpayers received more than \$331.6 million in erroneous credits for children who are not the taxpayers' qualifying children.

Finally, some egregious multiple TIN uses are not being addressed. The IRS has not established processes to alert parents and legal guardians of the potential theft of their child's identity. It is crucial that the IRS notifies parents and legal guardians when it knows a child's TIN has been used multiple times on different tax returns so the parent or guardian can take the steps necessary to protect their child's identity.

What TIGTA Recommended

TIGTA recommended that the IRS improve the soft notices issued to taxpayers it identifies as claiming a qualifying child whose TIN has been used on more than one tax return and establish processes to notify individuals of the potential theft of their child's identity. TIGTA also recommended that the IRS establish processes to identify and address potential fraud schemes associated with the multiple use of a qualifying child's TIN on tax returns to claim a refundable tax credit.

IRS management agreed with all three recommendations. The IRS plans to modify the language in the soft notice to instruct taxpayers to file amended returns when appropriate and inform taxpayers of what they can do if they suspect their child's identity has been compromised. IRS management plans to explore an additional treatment to address the duplicate TIN issue.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 23, 2021

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

A handwritten signature in blue ink that reads "Michael E. McKenney".

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation (Audit # 202040004)

This report presents the results of our review to evaluate the reasons for disallowance of the Earned Income Tax Credit and the Additional Child Tax Credit and the assistance provided to taxpayers during the examination process. This review is part of our Fiscal Year 2021 Annual Audit Plan and addresses the major management and performance challenge of *Protecting Taxpayer Rights*.

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

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 Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services).

Table of Contents

| | |
|--|---------|
| Background | Page 1 |
| Results of Review | Page 5 |
| Addressing Complex and Inconsistent Eligibility Rules May Reduce Unintentional Errors and Increase Participation | Page 6 |
| The Majority of Refundable Credit Selections Involve Income Reporting Discrepancies | Page 7 |
| Multiple Refundable Credit Claims Using the Same Qualifying Child Result in Millions of Dollars in Improper Refundable Credit Payments | Page 10 |
| Recommendations 1 through 3: | Page 12 |
| Appendices | |
| Appendix I – Detailed Objective, Scope, and Methodology | Page 13 |
| Appendix II – Overview of the Automated Questionable Credit Program | Page 15 |
| Appendix III – Overview of the Automated Underreporter Program | Page 16 |
| Appendix IV – Overview of the Examination Program | Page 17 |
| Appendix V – Calendar Year 2019 Case Closure Information | Page 18 |
| Appendix VI – History of Changes to the Earned Income Tax Credit and the Child Tax Credit | Page 19 |
| Appendix VII – Comparison of Eligibility Requirements for the Tax Year 2018 Earned Income Tax Credit and Additional Child Tax Credit | Page 20 |
| Appendix VIII – Management’s Response to the Draft Report | Page 22 |
| Appendix IX – Glossary of Terms | Page 26 |
| Appendix X – Abbreviations | Page 28 |

Background

Refundable tax credits are designed to help low-income individuals reduce their tax burden and provide incentives for other activities. Unlike nonrefundable tax credits, which are limited to the amount of an individual's income tax liability, refundable credits may result in a refund even if there is no tax liability. As such, individuals can receive a refund to which they are not entitled by erroneously claiming a refundable tax credit. The two largest and most widely claimed refundable tax credits are the:

1. **Earned Income Tax Credit (EITC)** – The EITC is used to supplement the wages of low-income workers by offsetting the impact of Social Security taxes and encourages them to seek employment. Taxpayers must meet specific criteria to qualify for the EITC, which include having a valid Social Security Number (SSN).¹ Additional criteria apply for taxpayers who have qualifying children, which include certain age, relationship, residency tests, *etc.* The IRS developed Publication 596, *Earned Income Credit (EIC)*, for use by taxpayers to determine their eligibility. Taxpayers include Schedule EIC, *Earned Income Credit*, with their tax return to report information about their qualifying children. The resulting EITC amount a taxpayer can receive is based on the taxpayer's earned income and number of qualifying children. The maximum allowable EITC for Calendar Year 2020 was \$6,660.

2. **Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC)** – The CTC is used to adjust the individual income tax structure to reflect an individual's reduced ability to pay taxes as family size increases. To qualify for the CTC, a taxpayer must have a qualifying child. The ACTC is the refundable portion of the CTC and is provided to qualifying individuals even if no income tax is withheld or paid, *i.e.*, the credit can exceed the tax liability. The amount of the ACTC a taxpayer may receive is dependent on the total amount of the taxpayer's CTC and earned income. For Calendar Year 2020, the CTC can reduce an individual's taxes owed by as much as \$2,000 for each qualifying child, with up to \$1,400 of this amount being refundable. Taxpayers use Schedule 8812, *Additional Child Tax Credit*, to determine their eligibility and compute their allowable ACTC amount. Taxpayers are required to file Schedule 8812 with their tax return.

Figure 1 shows the EITCs and ACTCs claimed for Tax Years 2016 through 2018.

Figure 1: EITC and ACTC Claims for Tax Years 2016 Through 2018²

| Tax Year | EITC Returns | EITC Amount | ACTC Returns | ACTC Amount |
|----------|--------------|----------------|--------------|----------------|
| 2016 | 27.3 million | \$66.6 billion | 18.7 million | \$26.0 billion |
| 2017 | 26.2 million | \$64.5 billion | 17.7 million | \$25.1 billion |
| 2018 | 25.5 million | \$67.2 billion | 19.9 million | \$37.0 billion |

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of the Individual Return Transaction File as of April 23, 2020.

¹ See Appendix VIII for a glossary of terms.

² We did not include Tax Year 2019 due to the effect of the COVID-19 pandemic on taxpayers and the IRS during the 2020 Filing Season.

The American Rescue Plan Act of 2021³ expands refundable credit eligibility, increases amounts, and requires issuance of advance payments

The amounts associated with these credits continue to grow as legislative changes increase the number of individuals eligible for these credits and the amount individuals can claim. For example, the American Rescue Plan Act of 2021, enacted in March 2021, includes provisions temporarily expanding the EITC and the CTC for Tax Year 2021.

- For the EITC, the legislation temporarily modifies the definition of an eligible individual without qualifying children by decreasing the minimum age from 25 to 19, eliminating the maximum age limit of 64, and increasing the earned income and phase-out amounts. The legislation also permanently modified the EITC to allow taxpayers who have qualifying children who failed to meet the SSN requirement to file for self-only EITC and modifies the eligibility requirement to allow taxpayers who file as married filing separately to claim the EITC when certain conditions are met.
- For the CTC, the legislation temporarily modifies the amount of CTC per qualifying child from \$2,000 to \$3,000 (\$3,600 for children under age six), makes the entire amount of the CTC fully refundable, and allows for advance payments of a portion of the CTC starting in July 2021.

EITC and ACTC improper payments

The Office of Management and Budget has identified both the EITC and the ACTC as programs susceptible to significant improper payments.⁴ Improper payments result in individuals receiving credits to which they are not entitled. For Fiscal Year 2020, the IRS estimates that 24 percent, or \$16 billion, of the total EITC payments and 12 percent, or \$4.5 billion, of the total ACTC payments were improper. The Payment Integrity Information Act of 2019⁵ requires the IRS to determine EITC and ACTC improper payments and report annually on its efforts to prevent future improper payments.

In an effort to reduce improper payments associated with these credits, the IRS has implemented a number of programs. Some of these programs identify questionable claims before a refund is paid and prevent an improper payment (referred to as prerefund programs). Other programs recover erroneous tax credit payments after they have been made (referred to as post-refund programs). The following prerefund and post-refund programs identify and prevent EITC and ACTC improper payments.

- Automated Questionable Credit (AQC)⁶ – The AQC program is a prerefund process that reviews tax returns identified during processing with questionable EITC and ACTC claims. The questionable claims sent to the AQC program for review are identified by the IRS's Dependent Database and Return Review Program filters. For example, these filters identify refundable credit claims for which the income information reported by the

³ Pub. L. No. 117-2, enacted March 11, 2021.

⁴ The Office of Management and Budget defines significant improper payments as gross annual improper payments in a program exceeding both 1.5 percent of program outlays and \$10 million of all program or activity payments made during the fiscal year reported or \$100 million in payments regardless of the improper payment percentage of total program outlays.

⁵ Pub. L. No. 116-117, 134 Stat. 113 (2020).

⁶ See Appendix II for an overview of the AQC program from initial taxpayer contact to case closure.

taxpayer on their tax return does not match the income information reported to the IRS by employers, *i.e.*, income reported on Forms W-2, *Wage and Tax Statement*, or for which the return was filed by a prisoner who was incarcerated for the entire tax year. The AQC program will send the taxpayer a letter informing them of a proposed adjustment to their claim. The taxpayer is asked to respond back to the IRS with their agreement to the proposed adjustment or to provide documentation to substantiate their claim.

- Automated Underreporter (AUR)⁷ – The AUR program is a post-refund program that is designed to systemically identify individual income tax returns for which various income and deduction discrepancies exist. The AUR program does not consider whether a taxpayer claims the EITC or the ACTC when identifying returns for review. However, processes can result in adjustments to the EITC and the ACTC because the amount of both credits is dependent on the taxpayer's income.
- Examination⁸ – The IRS conducts both prerefund and post-refund examinations of tax returns with EITC and ACTC claims. Examinations are conducted via correspondence and in person. Correspondence examinations generally include issues that are limited to the refundable credits themselves, such as issues with qualifying children. In-person examinations generally include tax returns with other questionable tax issues, *i.e.*, the return is not identified because of the EITC or ACTC claim. However, correcting these other tax issues can also result in a related adjustment to the EITC and the ACTC. Of the 274,285 examination cases closed in Calendar Year 2019, 118,179 (43 percent) were prerefund examinations, with the remaining 156,106 (57 percent) being post-refund examinations.⁹

In addition to the previously mentioned programs, the IRS has developed processes and procedures to identify refundable credit fraud schemes and efforts to intentionally misstate eligibility for these credits. For Fiscal Year 2020, IRS management stated that it detected and stopped 591,839 fraudulent returns claiming the EITC and/or ACTC from being processed through their fraud detection filters, preventing over \$3 billion in total erroneous refunds which contained over \$1.1 billion in EITCs and ACTCs claimed. Additionally, IRS management stated that the IRS examined 148 returns through its EITC Fraud program, resulting in approximately \$809,000 assessed.

A prior TIGTA review found that the multiple use of qualifying children results in significant erroneous credit payments

Generally, a qualifying child's Taxpayer Identification Number (TIN) cannot be used to claim a credit on more than one tax return per tax year. When a qualifying child is used on more than one tax return, individuals may inappropriately receive tax benefits. The IRS has developed processes to identify the use of the same qualifying child on multiple tax returns. For electronically filed returns, the IRS will reject the return if the qualifying child's TIN has already been used on another return. If the taxpayer is claiming the child legitimately, the taxpayer will have to file their return with the IRS by paper.

⁷ See Appendix III for an overview of the AUR program from initial taxpayer contact to case closure.

⁸ See Appendix IV for an overview of the Examination program from initial taxpayer contact to case closure.

⁹ See Figure 3 for the primary reason all 274,285 examination cases were selected.

Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation

In September 2010, we reported that individuals inappropriately received an estimated \$380 million in personal tax exemptions and tax credits in Tax Year 2007 because of the multiple use of TINs.¹⁰ Our review of Tax Year 2007 tax returns identified more than 2.4 million unique TINs that were used on 3.2 million returns to claim a personal exemption or one or more of the tax credits TIGTA analyzed. The highest number of uses for one TIN was 1,801 times. We forecasted that erroneous exemptions and credits could exceed \$1.9 billion over five years. We made four recommendations to the IRS to reduce duplicate TIN use. Figure 2 lists our prior audit recommendations and the IRS’s response.

Figure 2: Prior Audit Recommendations and the IRS’s Agreement

| Recommendation | IRS Agreement | Corrective Action |
|---|---------------|--|
| Revise the criteria used to determine who will receive a notice to include additional individuals identified by the Duplicate TIN database whose TIN is used to claim the EITC and other tax credits. | Disagreed | Although the IRS disagreed with our recommendation, IRS management stated that they have since expanded the criteria for soft notices to include other multiple-use TINs and credits besides the EITC. |
| Identify alternative compliance processes that will include all individuals claiming the EITC with TINs that were used on other tax returns to claim the EITC. | Agreed | The IRS will continue to identify and test alternative compliance processes for individuals claiming the EITC with childrens’ TINs used on other EITC returns. |
| Implement a process to identify filers involved in the multiple use of Individual Taxpayer Identification Numbers who were not entitled to use them and prevent or recover erroneous claims. | Disagreed | N/A ¹¹ |
| Establish processes to prevent or recover tax benefits erroneously provided to taxpayers when a TIN is used more than a certain number of times in a single tax year. | Agreed | Although the IRS agreed to develop referral processes to Criminal Investigation for the most egregious instances, this has not taken place. |

Source: TIGTA, Report No. 2010-40-117, Multiple Use of Taxpayer Identification Numbers Continues to Result in Significant Erroneous Exemptions and Credits (Sept. 2010).

The IRS also has the following post-refund processes to address multiple uses of a qualifying child’s TIN:

- Issuance of soft notices – The IRS uses soft notices to address qualifying child TINs that are used on two or three different tax returns to claim the EITC, the ACTC, education credits, Child and Dependent Care Credit, *etc.* The notice asks the taxpayer to verify that their use of the TIN was correct before filing next year’s tax return and states that an amended return may need to be filed if the child’s TIN was used in error. The IRS issued 351,398 soft notices for Tax Year 2018 returns. The IRS reported that, because of these

¹⁰ TIGTA, Report No. 2010-40-117, *Multiple Use of Taxpayer Identification Numbers Continues to Result in Significant Erroneous Exemptions and Credits* (Sept. 2010).

¹¹ Filers’ qualifying children are now required to have a valid SSN for the CTC or the ACTC.

soft notices, 187,778 (53 percent) taxpayers changed their behavior and did not claim at least one or more of the same dependents on their Tax Year 2019 return.

- **Examinations** – The IRS identifies taxpayers for examination who previously received a soft notice yet continue to claim the TIN. It also identifies when a child’s TIN claimed on the taxpayer’s return was used on three¹² or more returns. The IRS issued 8,911 notices to inform taxpayers that their Tax Year 2018 return was under audit because of a multiple TIN use. The IRS reported that 5,164 (58 percent) taxpayers changed their behavior and did not claim at least one or more of the same dependents on their Tax Year 2019 return.

Results of Review

The *Department of the Treasury Agency Financial Report Fiscal Year 2020* notes that eligibility rules for refundable credits are complex and lead to high improper payment rates. The report states that rules differ by credit and are complex because they must address complicated family relationships and residency arrangements to determine eligibility. The lack of third-party data to verify eligibility requirements for these refundable credits also complicates the IRS’s ability to administer these credits. Such data may not exist, may be unreliable or inaccurate, or may be reported to the IRS too late to be useful during tax return processing. The IRS also has limited authority to correct mismatches at filing and must use audits to correct errors, which increases taxpayer burden.

However, our analysis of 698,495 tax returns claiming the EITC or the ACTC that had an AQC, AUR, or Examination program review closed during Calendar Year 2019¹³ found that the majority of erroneous EITC and ACTC claims were selected because of an income reporting discrepancy rather than because of potential noncompliance with an eligibility rule. The IRS closed:

- 432,534¹⁴ (62 percent) tax returns with EITC or ACTC adjustments totaling more than \$1.1 billion with an income reporting discrepancy. Income reporting discrepancies occur when the income or withholding reported by the taxpayer on the tax return did not match amounts reported by the employer on third-party income documents sent to the IRS. The amount of EITC and ACTC a taxpayer receives is linked directly to the taxpayer’s income. As such, there could be a motivation for a filer to falsely increase or decrease their income to maximize their credit.
- 184,763 (26 percent) tax returns with EITC or ACTC adjustments totaling more than \$846.1 million that were selected for a reason other than an income discrepancy. These include selections for eligibility requirements such as relationship, residency, or citizenship issues.
- 81,198 (12 percent) tax returns with no change being made to the EITC or the ACTC, meaning the taxpayer substantiated their eligibility to receive the credit(s) claimed. We

¹² Returns with three uses are excluded from potential selection when Federal Case Registry data show the claimant has custody of the child.

¹³ These include Tax Years 2016 through 2018 tax returns. Appendix V provides additional information about these 698,495 returns, such as credit(s) claimed, method of preparation, *etc.*

¹⁴ There were 475,862 returns closed with an income reporting discrepancy. The remaining 43,328 with an income reporting discrepancy were no change cases and are included in the 81,198 returns.

Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation

found that 24,713 (30 percent) of these returns were reviewed before the taxpayer's refund was paid. These taxpayers' refunds were held for an average of 288 calendar days (more than 9 months), and the IRS paid interest of more than \$4.5 million. This reflects the time it took taxpayers to provide the documentation necessary to support their claim and for the IRS to review the documentation.

Finally, a significant number of erroneous EITC and ACTC claims involving multiple uses of the same qualifying child TIN on more than one tax return continue to go unaddressed. For example, our analysis of Tax Year 2018 returns claiming the EITC or the ACTC identified 300,234 returns for which at least one qualifying child's TIN was used on more than one tax return. We estimate that 155,074 of the 300,234 returns erroneously received more than \$331.6 million in credits for a qualifying child's TIN that was used on another return.¹⁵ Of greater concern is that IRS data files show no relationship between the qualifying child and the filer for 95,875 (32 percent) of the 300,234 returns we identified. This may be an indication of child identity theft, yet the IRS has not developed processes and procedures to address these claims as potential identity theft.

Addressing Complex and Inconsistent Eligibility Rules May Reduce Unintentional Errors and Increase Participation

The requirements to claim the EITC and the ACTC have continued to increase in complexity over time. For example, when the EITC was created in 1975, the amount an individual was entitled to receive was based solely on the individual's earnings. Today, the EITC has four earnings limitations dependent on the taxpayer's filing status and the number of qualifying children. Since the credit's enactment, it has been modified to increase amounts and to differentiate between family size and structure. Appendix VI shows the history of the EITC and the ACTC since enactment.

Although the rules for claiming these refundable credits are similar, they are not the same. The complexity of the rules causes taxpayers to erroneously claim the credits. Much of the complexity that leads to errors stems from claims involving qualifying children. This is because of the intricacy of the rules regarding who can claim a child in instances of divorce, separation, and three-generation families. The complexity of these rules increases compliance burden for taxpayers and administrative costs for the IRS. Simplifying these rules could reduce taxpayer burden, reduce unintentional errors, improve the IRS's ability to identify questionable claims more accurately, and potentially increase participation by eligible individuals who do not claim these credits because they are unsure whether they qualify.

Our analysis of EITC and ACTC eligibility rules found that the qualifying child relationship rules are difficult to understand. In addition, the definition of key eligibility requirements is different between the two credits. This can cause confusion for taxpayers when trying to determine which credit(s) they are eligible to claim. Simplifying credit requirements to make it easier for taxpayers to determine whether they are eligible could benefit both taxpayers and the IRS in administering these programs. The following are three opportunities to simplify the requirements:

¹⁵ Internal Revenue Code § 152(c)(4)(B) allows for a qualifying child to be used on only one tax return.

- Simplify the Qualifying Child Relationship Rules – The IRS’s compliance studies show that 20 percent of the children claimed in error for the EITC and 15 percent claimed in error for the ACTC failed the relationship test. Many of these errors may be the result of confusion about who is eligible to claim the child when more than one taxpayer has a qualifying relationship. To be a qualifying child, a child must satisfy an allowable relationship to the taxpayer.¹⁶ There are tiebreaker rules to help taxpayers determine who can claim the child in these instances. However, these rules require the affected taxpayers to compare their income to make that determination, which is often not realistic.
- Make TIN Requirements Consistent – Both the EITC and the ACTC require taxpayers to have a valid TIN. However, the definition of a valid TIN differs for each credit. EITC rules require the taxpayer and the taxpayer’s spouse to have an SSN. However, the taxpayer, their spouse, or both can have an SSN or Individual Taxpayer Identification Number to claim the ACTC. Making TIN requirements consistent for the EITC and the ACTC could make it easier for taxpayers to determine whether they are eligible to claim both credits.
- Make the Definition of Income Consistent – The EITC, the CTC, and the ACTC require taxpayers to meet income requirements to claim the credits. However, the definition of income is not the same for the credits. For example, taxpayers’ Adjusted Gross Income (AGI) must be below certain dollar thresholds to qualify for the EITC, but taxpayers are required to use “modified” AGI for the CTC and the ACTC. Most taxpayers do not understand what modified AGI is as this is not a line item on their tax return. Further, earned income is not a requirement for the CTC, but it is for the EITC and the ACTC. Simplifying the income requirements and making the definition of income consistent for the EITC and the ACTC could reduce confusion among taxpayers who are unsure if they are eligible to claim these credits.

The Majority of Refundable Credit Selections Involve Income Reporting Discrepancies

The IRS closed reviews of 475,862 tax returns with an EITC or ACTC claim during Calendar Year 2019 that were selected because of an income reporting discrepancy. The IRS adjusted erroneous EITC and ACTC claims totaling more than \$1.1 billion on 432,534 (91 percent) of the 475,862 returns it closed. The majority of the 475,862 returns the IRS identified with an income reporting discrepancy were identified by the AUR program. The AUR program matches income reported on the tax return to third-party income documents to identify income and deduction discrepancies. The AUR program does not consider whether a taxpayer claims the EITC or the ACTC when identifying returns for review. However, once returns are selected and worked by the AUR program, changes to income reported on the return can then result in adjustments to the EITC or ACTC that is claimed. This is because the amount of these credits is dependent on the taxpayer’s income. Figure 3 shows EITC and ACTC claims the IRS closed during Calendar Year 2019, the primary reasons for selection, and the programs used to review the return.

¹⁶ Son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, half-brother, half-sister, or a descendant of any of them, *e.g.*, grandchild, niece, or nephew.

Figure 3: Calendar Year 2019 Case Closures by Primary Selection Reason

| Primary Selection Reason | AQC Program | AUR Program | Examination Program | Total | Percentage |
|----------------------------|---------------|----------------|---------------------|----------------|---------------|
| Income/Withholding | 26,053 | 389,923 | 59,886 | 475,862 | 68% |
| Relationship/Residency | 340 | 0 | 157,116 | 157,456 | 23% |
| Other ¹⁷ | 17 | 0 | 30,053 | 30,070 | 4% |
| Other Income ¹⁸ | 0 | 0 | 24,173 | █ | 3% |
| Prisoner | 6,865 | 0 | █ | █ | 1% |
| Citizenship | 1,012 | 0 | 3,055 | 4,067 | 1% |
| Total | 34,287 | 389,923 | 274,285 | 698,495 | 100.0% |

Source: TIGTA's analysis of AQC program work-type data and Examination project code data for Calendar Year 2019.

Legislation was enacted to assist the IRS in identifying the misreporting of income associated with refundable credit claims

Congress recognized the risk of taxpayers misreporting their income to inflate refundable credit claims. To address this risk, Congress included provisions in the Protecting Americans From Tax Hikes Act of 2015¹⁹ to assist the IRS in identifying these types of errors during tax return processing. The Act changed the date for third parties to file their Form W-2 with the Social Security Administration to January 31.²⁰ Previously, third-party income and withholding information was not due to the IRS until well after the tax return filing season began.

The Act also prohibits the IRS from issuing tax refunds that include the EITC or the ACTC prior to February 15. This delay was to allow the IRS time to match the income reported by the taxpayer in support of a refundable credit claim to the Forms W-2 the IRS receives from their employer before the refund is paid. Figure 4 provides an overview of the IRS's income matching process.

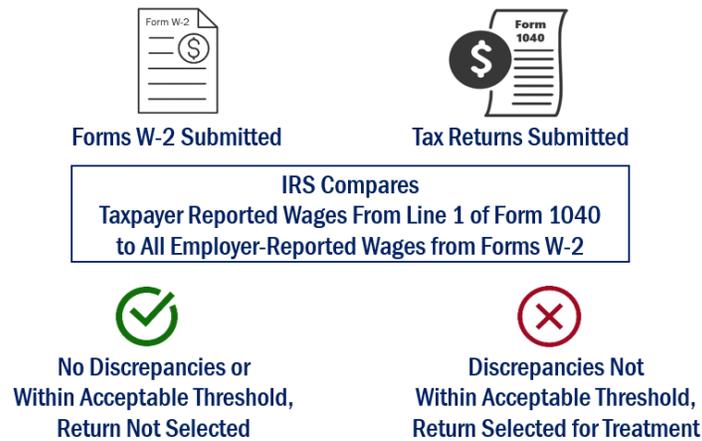
¹⁷ These returns include a variety of questionable selection reasons, such as amended returns, questionable mortgage interest, and disaster claims.

¹⁸ These returns include Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, loss or income, questionable Premium Tax Credits, non-EITC math errors, etc.

¹⁹ Pub. L. No. 114-113, 129 Stat. 2242.

²⁰ The Social Security Administration provides Form W-2 data to the IRS per a data sharing agreement. The Act also requires employers to report nonemployee compensation paid to individuals by January 31.

Figure 4: Overview of the IRS's Income Document Matching Process



Source: TIGTA's summary of Internal Revenue Manual 4.19.3.

The majority of identified refundable credit claims with income reporting errors are not addressed

The Protecting Americans From Tax Hikes Act provides the IRS with third-party income data to match against returns with EITC and ACTC claims. However, as we continue to report, the Act did not provide the IRS with correctable error authority to address refundable credit claims with identified income reporting discrepancies. Since Fiscal Year 2013, the IRS has included a legislative proposal in its annual budget requesting greater flexibility to address third-party income reporting discrepancies.²¹ However, it has yet to be provided with this authority.

Without this flexibility, the IRS must audit each tax return to prevent or recover unsupported refundable tax credits. The IRS reports that it costs \$1.99 to address a return using its error authority compared to as much as \$564 to address a return in its Examination program. As such, the majority of refundable tax credit claims with income reporting discrepancies are not being addressed. For example, in May 2021,²² we reported that our analysis of Tax Year 2019 tax returns processed as of July 30, 2020, identified more than 1.9 million tax returns with an income discrepancy of \$1,000 or more between what was reported by taxpayers on their tax return to what was reported on Forms W-2. These 1.9 million tax returns had refunds that included nearly \$4.9 billion in EITCs and more than \$2.3 billion in ACTCs. The IRS took no actions to address these erroneous claims despite the fact that its income matching processes are highly accurate in identifying questionable credit claims.

The IRS has processes and procedures that enable a taxpayer to disagree with a proposed adjustment. For example, a taxpayer may respond to the proposed adjustment notice from the IRS with an explanation as to why they disagree with the proposed adjustment.²³ This was the case with 43,328 (9 percent) of the 475,862 tax returns the IRS identified and reviewed with an income reporting discrepancy. Appendices II through IV provide an overview, by program, of the processes taxpayers take when they disagree with an IRS proposed adjustment.

²¹ The IRS's Fiscal Year 2018 legislative proposal requests did not include correctable error authority.

²² TIGTA, Report No. 2021-40-036, *Improper Payment Rates for Refundable Tax Credits Remain High* (May 2021).

²³ This example is for the AUR program, which represents the majority of income reporting discrepancy cases.

Multiple Refundable Credit Claims Using the Same Qualifying Child Result in Millions of Dollars in Improper Refundable Credit Payments

Our analysis of Tax Year 2018 returns identified 187,523 unique qualifying child TINs that were used as a qualifying child multiple times to claim the EITC or the ACTC on 300,234 tax returns. One TIN was claimed as a qualifying child on 41 tax returns. We estimate taxpayers received more than \$331.6 million in erroneous credits associated with the misuse of qualifying child TINs. Additional review of the 187,523 TINs found that they were used 284,316 times to claim the EITC and 278,297 times to claim the ACTC. Figure 5 provides a breakdown by the number of uses of the same qualifying child to claim refundable credits for Tax Year 2018.

Figure 5: Number of Times Qualifying Child TINs Used by Credit for Tax Year 2018

| Uses | EITC | ACTC |
|--------------|----------------|----------------|
| 2 | 283,102 | 276,284 |
| 3 | 984 | 1,637 |
| 4 to 9 | 134 | 247 |
| 10 or More | 96 | 129 |
| Total | 284,316 | 278,297 |

Source: TIGTA's analysis of the Individual Return Transaction File for Processing Year 2019.

A number of multiple TIN uses involve taxpayers with no relationship to the child claimed, which IRS audit results show as an indicator of an erroneous claim

As Figure 5 shows, a majority of the multiple qualifying child TIN uses frequently involve claims on two returns. As we reported in Fiscal Year 2010, the majority of these types of uses generally involve [REDACTED] who claim the same child or children. For example, IRS data showed that the taxpayer has a relationship, [REDACTED], to the qualifying child for 204,359 (68 percent) of the 300,234 returns we identified. However, IRS data show no relationship between the filer and the questionable qualifying child claimed on the remaining 95,875 (32 percent) returns. A total of 88,253 unique qualifying child TINs were used on these 95,875 returns, with refundable credits claimed on these returns totaling more than \$577 million.

The IRS uses data received from the Social Security Administration and the Department of Health and Human Services to determine whether a taxpayer has a relationship with the qualifying child or children claimed on their tax return. Specifically:

- Social Security Administration data generally contain relationship data of parents for children born after 1998. The data are compiled from a child's SSN application, which includes the parent's information.
- Department of Health and Human Services data generally contain relationships for children if individuals owe or are owed child support or if child support is sought to be established. The IRS began receiving the data in Calendar Year 1999. However, the data will not identify [REDACTED], all of which could legitimately claim the child for the EITC or the ACTC.

IRS audit results show that a significant percentage of claims with no relationship between the qualifying child and the taxpayer are adjusted when reviewed. For example, during Calendar Year 2019, the IRS closed a review of 3,228 of the 95,875 returns we identified and adjusted the refundable credit(s) claimed on 3,009 (93 percent) of these returns. However, due to limited IRS examination resources, the majority of EITC and ACTC claims for which IRS data show no relationship between the taxpayer and a qualifying child TIN that is used multiple times go unaddressed.

As mentioned previously, the IRS has developed a soft notice process to notify individuals when a qualifying child claimed on their return has been used by someone else. Modifying the language in the soft notice could result in the recovery of additional erroneous EITC and ACTC claims. The soft notice tells taxpayers that they “may need” to correct their tax return if the use of the child’s TIN was in error. We believe more taxpayers may voluntarily return erroneous EITC or ACTC credits if the notice tells taxpayers that they “should correct” their tax return if the child does not meet the requirements to be claimed as their qualifying child.

Some egregious uses of the same qualifying child TIN are not being addressed

In September 2010, we reported that our analysis of Tax Year 2007 tax returns involving erroneous exemptions and credits resulting from a multiple TIN use identified 1,437 TINs that were used on five or more tax returns. We identified two TINs with more than 1,000 attempted uses each in Tax Years 2005 through 2007.²⁴ We recommended that the IRS establish processes to prevent or recover tax benefits erroneously provided to taxpayers when a TIN is used more than a certain number of times in a single tax year. IRS management agreed with our recommendation and stated that they would implement procedures to refer the most egregious instances of multiple TIN uses to Criminal Investigation for consideration.

However, we found that, although the IRS agreed with our prior recommendation, no referral processes were developed. As such, qualifying child TINs continue to be abused. For example, our analysis of Tax Year 2018 returns claiming the EITC or ACTC found a qualifying child TIN was used 10 or more times on 80 unique returns to claim the EITC and 100 unique returns to claim the ACTC. As we detailed previously, one TIN was claimed as a qualifying child on 41 different tax returns. None of these returns were referred to Criminal Investigation for review.

However, IRS management noted that the IRS examined 35 of the 80 returns claiming the EITC and 44 of the 100 returns claiming the ACTC. As we reported previously, we believe that the potential for fraud rises when the multiple use of a TIN increases to more than two uses because the uses are less likely to result from a misunderstanding or a child custody dispute. The IRS is making an effort to address some of these egregious claims via an audit, but these types of claims may be coordinated fraud and warrant Criminal Investigation.

Finally, in response to our prior report, IRS management also noted that they would pursue identifying and testing alternative compliance processes for individuals claiming TINs used on other returns. According to IRS management, the IRS has since expanded the soft notice program to address gaps in the soft notice population and improved the selection of returns for examination by including additional credits in its Duplicate TIN database.

²⁴ Our prior audit did not limit its analysis to only dependent TINs.

Processes have not been established to identify and alert parents and legal guardians to the potential theft of their child's identity

The IRS is in a unique position to identify potential child identity theft and provide individuals with the information they need to minimize the impact on their children, including when a child's TIN is used multiple times to claim the EITC or the ACTC. As mentioned previously, the IRS has developed a soft notice process to notify individuals when a qualifying child's TIN claimed on their return has been used by someone else.

However, the soft notice does not contain language similar to what the IRS provides to other taxpayers who it believes were potential victims of identity theft. Specifically, the soft notice does not provide steps taxpayers can take to protect the child's personal information. The probability of a parent or legal guardian discovering that their child's identity has been stolen is low. Further, the potential impact on the child's future is profound as it could damage or destroy a child's ability to obtain approval for student loans, obtain a job, or secure a place to live. It is crucial that the IRS notify parents and legal guardians when it knows a child's TIN has been used on multiple tax returns so they can take proactive steps similar to those the IRS suggests when an adult's identity is being used fraudulently.

The Commissioner, Wage and Investment Division, should:

Recommendation 1: Modify the language in soft notices sent to individuals who claim a multiple-use child's TIN to instruct individuals to amend their return if they determine the child's TIN was used in error.

Management's Response: The IRS agreed with this recommendation and plans to modify the language in the soft notice to instruct taxpayers to file amended returns when appropriate.

Recommendation 2: Establish processes to notify individuals who claim a multiple-use child's TIN to the potential theft of their child's identity and provide actions they can take to report the theft and protect their child's identity from future misuse.

Management's Response: The IRS agreed with this recommendation and plans to inform taxpayers of what they can do if they suspect their child's identity has been compromised.

Recommendation 3: Establish processes to identify potential fraud schemes associated with the multiple use of a qualifying child's TIN on tax returns to claim a refundable tax credit, and address the individual(s) or entities who are promoting this fraud.

Management's Response: The IRS agreed with this recommendation but already has current procedures in place for fraud referrals. However, IRS management plans to explore an additional treatment to address the duplicate TIN issue, which may include tax return preparers who file a significant volume of tax returns with duplicated dependents.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to evaluate the reasons for disallowance of the EITC and the ACTC and the assistance provided to taxpayers during the examination process. To accomplish our objective, we:

- Evaluated individual income tax returns with the EITC and the ACTC disallowed by the AQC, AUR, and Examination programs during Calendar Year 2019 and determined the reasons for selection.
- Analyzed individual income tax returns that were reviewed by the AQC, AUR, and Examination programs and closed during Calendar Year 2019 and identified trends among the returns when originally submitted to the IRS.
- Analyzed individual income tax returns for which the refunds were held until reviewed and closed as no change during Calendar Year 2019 and determined the average number of days the refunds were delayed.
- Reviewed IRS studies and other bodies of work that reported on complexities of the refundable credits.
- Evaluated the IRS's identification of multiple uses of qualifying child TINs and its ability to prevent individuals from inappropriately receiving refundable credits.

Performance of This Review

This review was performed with information obtained from Wage and Investment Division's Return Integrity and Compliance Services function in Atlanta, Georgia, during the period January 2020 through June 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 Russell P. Martin, Assistant Inspector General for Audit (Returns Processing and Account Services); Deann L. Baiza, Director; Jeffrey D. Cullum, Audit Manager; Kimberly Ann M. Holloway, Lead Auditor; and Laura P. Haws, Information Technology Specialist, Applied Research and Technology.

Validity and Reliability of Data From Computer-Based Systems

During this review, we obtained extracts from the Individual Master File for Tax Years 2016, 2017, and 2018, and the Individual Return Transaction File for Tax Year 2018. In addition, we obtained the following data from the IRS: Kidlink File for Calendar Years 1983 through 2019 and the Federal Case Registry File. Before relying on the data, we ensured that each file contained the specific data elements we requested. In addition, we selected judgmental samples of each extract and verified that the data in the extracts were the same as the data captured in the

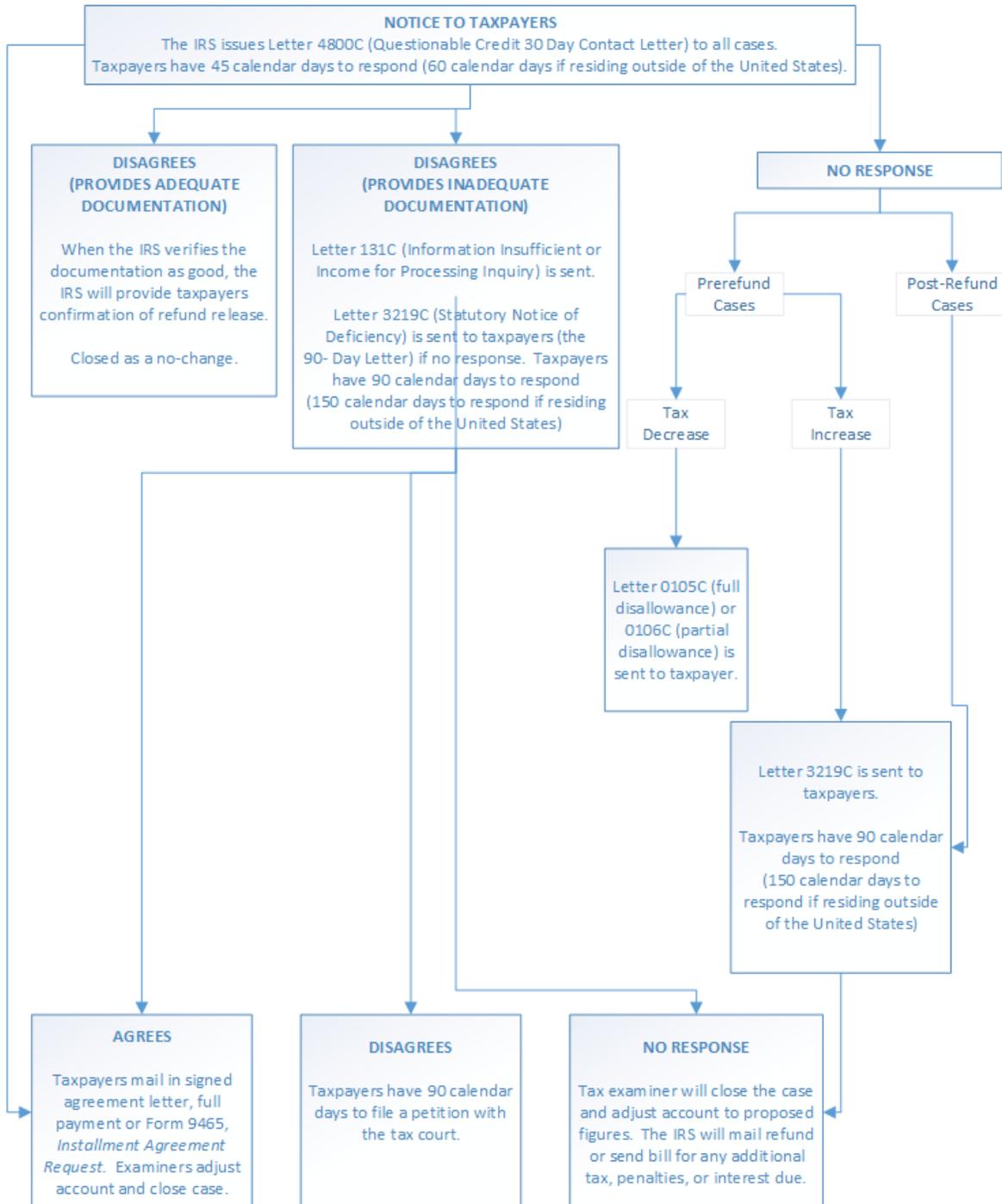
Integrated Data Retrieval System, when applicable. We also performed analysis to ensure the validity and reasonableness of our data, such as ranges of dollar values and obvious invalid values. Based on the results of our tests, we believe that the data used in our review were reliable.

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: the processes to identify, select, and address questionable EITC and ACTC returns as well as the processes the IRS uses to identify and address multiple uses of the same qualifying child's TIN on different tax returns. We evaluated these controls by meeting with IRS management and reviewing the Internal Revenue Manual or other supporting documentation.

Overview of the Automated Questionable Credit Program

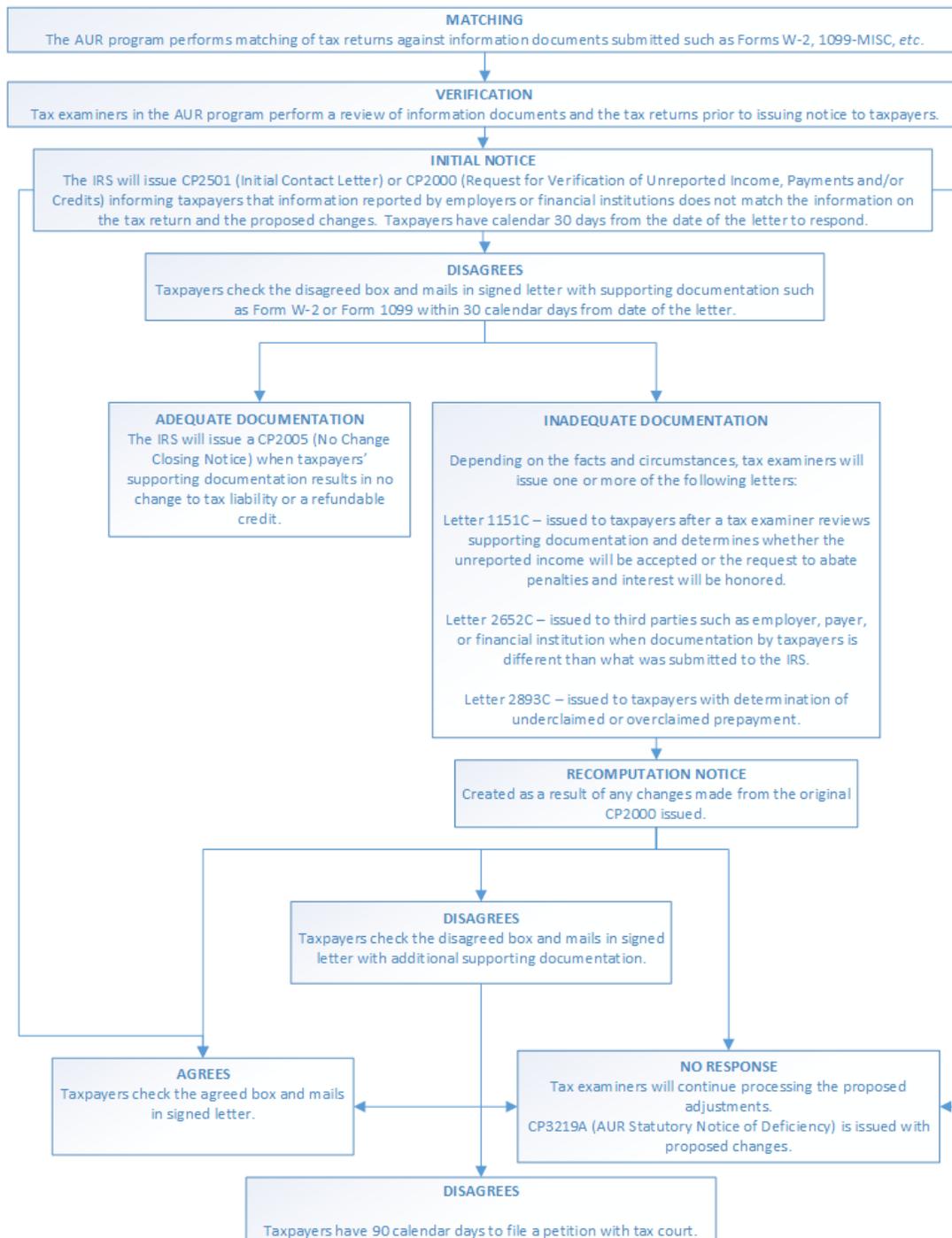
The following figure is an overview of the AQC program from initial contact with the taxpayer to case closure.



Source: TIGTA's review and summary of Internal Revenue Manual 25.25.7.

Overview of the Automated Underreporter Program

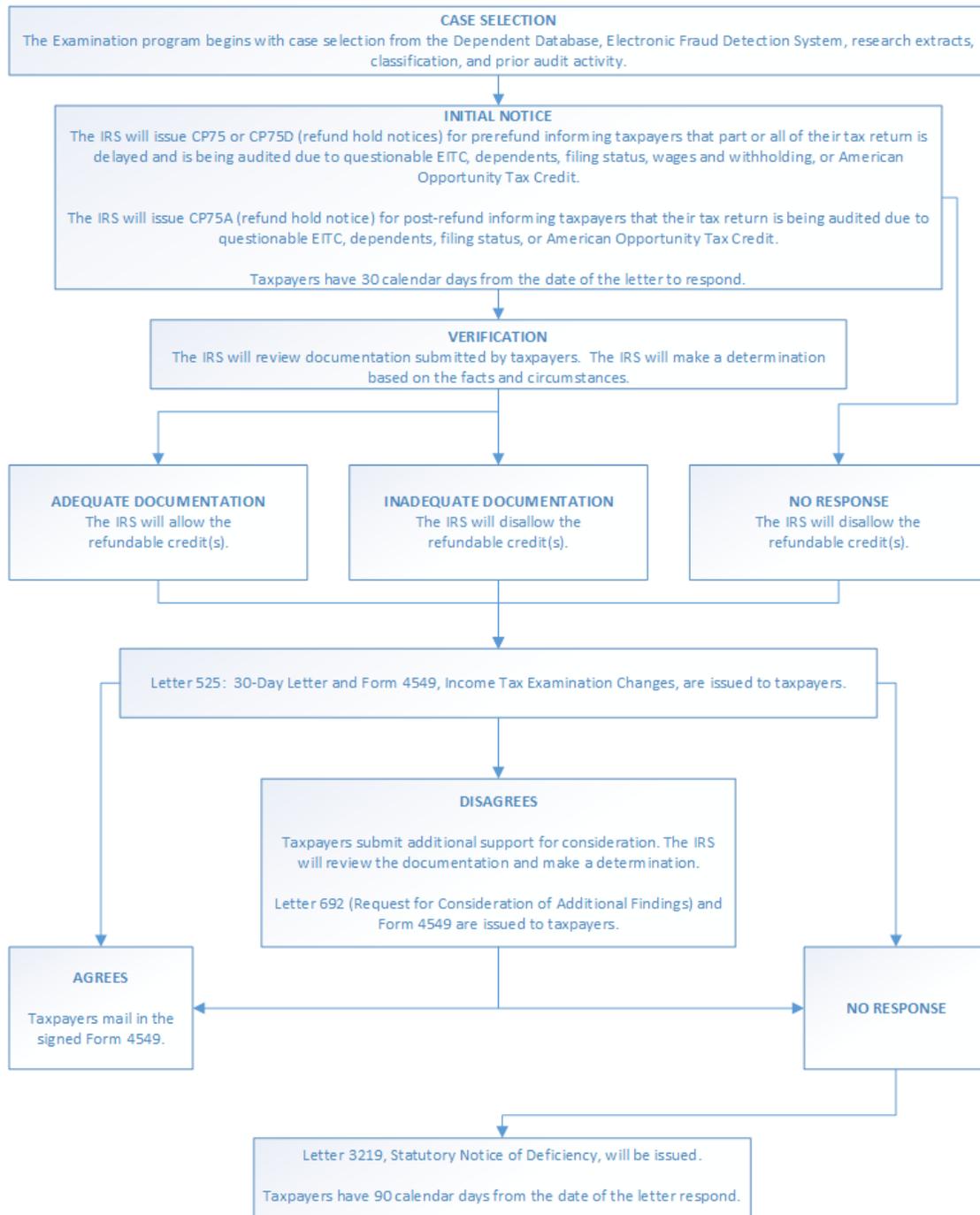
The following figure is an overview of the AUR program from initial contact with the taxpayer to case closure.



Source: TIGTA's review and summary of Internal Revenue Manual 4.19.3 and other relevant sections.

Overview of the Examination Program

The following figure is an overview of the campus examination program from initial contact with the taxpayer to case closure.



Source: TIGTA's review and summary of Internal Revenue Manual 4.19.14.

Appendix V

Calendar Year 2019 Case Closure Information

The following table provides additional information Calendar Year 2019 closures, such as the credits claimed, filing method, method of preparation, filing status, and type of income.

| | Change Response | Change No Response | No Change | Total | Percentage |
|---|-----------------|--------------------|---------------|----------------|----------------------------|
| Credit(s) Claimed | | | | | |
| ACTC Only | 10,678 | 21,133 | 8,874 | 40,685 | 5.82% |
| EITC Only | 46,745 | 125,665 | 21,419 | 193,829 | 27.75% |
| ACTC and EITC | 100,556 | 312,520 | 50,905 | 463,981 | 66.43% |
| Total Credit | 157,979 | 459,318 | 81,198 | 698,495 | 100.00% |
| Filing Method | | | | | |
| Paper Filed | 9,007 | 21,275 | 4,944 | 35,226 | 5.04% |
| Electronically Filed | 148,972 | 438,043 | 76,254 | 663,269 | 94.96% |
| Total Filing Method | 157,979 | 459,318 | 81,198 | 698,495 | 100.00% |
| Method of Preparation | | | | | |
| Paid Preparer | 74,666 | 213,041 | 50,553 | 338,260 | 48.43% |
| Self-Prepared | 81,464 | 242,981 | 29,432 | 353,877 | 50.66% |
| Volunteer Income Tax Assistance Prepared | 1,849 | 3,296 | 1,213 | 6,358 | 0.91% |
| Total Prepared | 157,979 | 459,318 | 81,198 | 698,495 | 100.00% |
| Filing Status | | | | | |
| Single | 25,947 | 88,980 | 14,945 | 129,872 | 18.59% |
| Married Filing Jointly (MFJ) | 51,314 | 91,036 | 25,621 | 167,971 | 24.05% |
| Married Filing Separately (MFS) | 248 | 569 | 236 | 1,053 | 0.15% |
| Head of Household | 80,245 | 278,312 | 40,282 | 398,839 | 57.10% |
| Widower With Dependent Children | 208 | 376 | 100 | 684 | 0.10% |
| MFS (Spouse Has No Filing Requirement) | 17 | 45 | 14 | 76 | 0.01% |
| Total Filing Status | 157,979 | 459,318 | 81,198 | 698,495 | 100.00% |
| Type of Income | | | | | |
| Wages Only (No Schedule C or F*) | 110,941 | 334,240 | 52,438 | 497,619 | 71.24% |
| With Schedule C but No Schedule F | 46,286 | 124,067 | 28,160 | 198,513 | 28.42% |
| With Schedule F but No Schedule C | 448 | 672 | 362 | 1,482 | 0.21% |
| Both Schedule C and F, Schedule C Is Larger | 224 | 268 | 148 | 640 | 0.09% |
| Both Schedule C and F, Schedule F Is Larger | 80 | 71 | 90 | 241 | 0.03% |
| Total Type of Income | 157,979 | 459,318 | 81,198 | 698,495 | 100.00%¹ |

Source: TIGTA's analysis of Individual Return Transaction File data. * = Schedule F, Profit or Loss From Farming.

¹ The percentages due not total 100% due to rounding.

Appendix VI

History of Changes to the Earned Income Tax Credit and the Child Tax Credit

The following figures provide a history of the changes to the EITC from 1975 to 2009 and the CTC from 1997 to 2017.

| | P.L. 94-12 1975 | P.L. 95-600 1978 | P.L. 98-369 1984 | P.L. 99-514 1986 | P.L. 101-508 1990 | P.L. 103-66 1993 | P.L. 107-16 2001 | P.L. 111-5 2009 |
|---|--------------------|---------------------|---------------------|---------------------|--------------------------------------|---|---------------------|---------------------------------|
| Maximum statutory credit for eligible taxpayers including variation based on the number of qualifying children ^a | \$400 | \$500 | \$550 | \$800 | one, \$1,057 two or more, \$1,114 | none, \$323 one, \$2,152 two or more, \$3,556 | same | 0-2, same 3 or more, \$4,001 |
| Credit Formula Based on: | | | | | | | | |
| Earnings | X | X | X | X | X | X | X | X |
| Number of Children (i.e., credit based in part on family size) | | | | | X | X | X | X |
| Marital Status | | | | | | | X | X |
| Credit Available to Childless Workers | | | | | | X | X | X |
| Credit Adjusted Annually for Inflation | | | | X | X | X | X | X |

Source: Congressional Research Service: The Earned Income Tax Credit: A Brief Legislative History (March 20, 2018).

| Parameter | 1997 | 1999 | 2001 | 2003 | 2004 | 2008 | 2009 | 2010 | 2013 | 2015 | 2017 |
|---------------------------------|---|--------------|--|----------------------|----------------------|---------------------|-------------------|-------------------|----------------------------------|-------------------|---|
| | P.L. 105-34 | P.L. 106-170 | P.L. 107-16 (EGTRRA) | P.L. 108-27 (JGTRRA) | P.L. 108-311 (WFTRA) | P.L. 110-343 (EESA) | P.L. 111-5 (ARRA) | P.L. 111-312 | P.L. 112-240 (ATRA) | P.L. 114-113 | P.L. 115-97 |
| Maximum Credit per Child | \$400 (1998) \$500 (after) | * | \$600 (2001-04) \$700 (2005-08) \$800 (2009) \$1,000 (2010) | \$1,000 (2003-04) | \$1,000 (2005-10) | * | * | \$1,000 (2011-12) | \$1,000 (permanent) | * | \$2,000 |
| Inflation adj. | NO | * | * | * | * | * | * | * | * | * | NO |
| Refundable ^a | NO | * | YES (2001-2010) | * | * | * | * | YES (2011-2012) | YES (permanent) | * | * |
| Max Refundable Credit per Child | na | na | same as max credit per child | * | * | * | * | * | * | * | \$1,400 ^e (2018-2025) |
| Refundability Threshold | na | * | \$10,000 (2001-10) | * | * | \$8,500 (2008) | \$3,000 (2009-10) | \$3,000 (2011-12) | \$3,000 (2013-2017) \$10,000 | \$3,000 permanent | \$2,500 (2018-2025) |
| Inflation Adj. | na | * | YES (2002-10) | * | * | NO | NO (2009-2010) | NO (2011-12) | NO (2013-2017) YES thereafter | NO | NO |
| Refundability Rate | na | * | 10% (2001-04) 15% (2005-10) | * | 15% (2004-2010) | * | * | 15% (2011-12) | 15% (permanent) | * | * |
| Phaseout Threshold ^b | \$55,000 MFS \$75,000 HOH \$110,000 MFJ | * | * | * | * | * | * | * | * | * | \$200,000 MFS \$200,000 HOH \$400,000 MFJ |

Source: Congressional Research Service: The Child Tax Credit: Legislative History (March 1, 2018).

Appendix VII

Comparison of Eligibility Requirements for the Tax Year 2018 Earned Income Tax Credit and Additional Child Tax Credit

| Eligibility Rule | EITC | ACTC |
|--------------------------------------|--|---|
| AGI | AGI must be less than: <ol style="list-style-type: none"> \$15,270 (\$20,950 for MFJ) with no qualifying child. \$40,320 (\$46,010 for MFJ) with one qualifying child. \$45,802 (\$51,492 for MFJ) with two qualifying children. \$49,194 (\$54,884 for MFJ) with three or more qualifying children. | The credit phases out when modified AGI is greater than: <ol style="list-style-type: none"> \$400,000 for MFJ. \$200,000 for all other filing statuses. |
| Earned Income | To qualify for the EITC, you must work and earn income. | Earned income must be greater than \$2,500. |
| Foreign Earned Income | Cannot claim foreign earned income exclusion. | Excluded foreign earned income is added to AGI. |
| Investment Income | Investment income must be \$3,500 or less. | Not applicable. |
| Residency Status | Primary or secondary taxpayer must be a U.S. citizen or resident alien all year (exceptions apply). | Child must be a U.S. citizen, U.S. national, or U.S. resident alien. |
| Qualifying Child – Relationship Test | Son, daughter, stepchild, foster child, brother, sister, half-brother, half-sister, stepbrother, stepsister, or a descendant of any of them (for example, grandchild, niece, or nephew). | Same. |
| Qualifying Child – Age Test | Under age 19 at the end of the tax year and younger than you (or your spouse, if filing jointly); Under age 24 at the end of the tax year, a student, and younger than you (or your spouse, if filing jointly); or Permanently and totally disabled at any time during the tax year, regardless of age. | Under age 17 at the end of the tax year. |
| Qualifying Child – Residency Test | The child must have lived with the claimant in the United States for more than half of the tax year (exceptions apply). | The child must have lived with the claimant for more than half of the tax year (exceptions apply). |
| Qualifying Child – Joint Return Test | The child does not file a joint return for the year (or files jointly only to claim a refund of taxes withheld or estimated tax payments). | Same. |

Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation

| Eligibility Rule | EITC | ACTC |
|---------------------------------|--|---|
| Qualifying Child – Support Test | Not applicable. | The child must not provide over half of their support for the tax year. |
| Qualifying Child – Use Test | <p>Cannot be used on another tax return to claim the EITC.</p> <p>Special tiebreaker rules apply if a child is the qualifying child of more than one taxpayer.</p> | <p>Cannot be used as a dependent on another tax return.</p> <p>Special tiebreaker rules apply if a child is the qualifying child of more than one taxpayer.</p> |
| Self-Only EITC | <p>To qualify for self-only EITC, the following rules must be met first: AGI, SSN, Filing Status, Residency Status, Foreign Earned Income, Investment Income, and Earned Income.</p> <p>In addition, the taxpayer must:</p> <ol style="list-style-type: none"> 1. Be at least 25 years old but less than 65 years old. 2. Not be a dependent on another taxpayer’s return. 3. Not be a qualifying child of another taxpayer. 4. Have lived in the United States for more than half of the tax year (exceptions apply). | Not applicable. Must have a qualifying child in order to receive credit. |

Source: TIGTA’s review of IRS Publication 972, Child Tax Credit and Credit for Other Dependents, and IRS Publication 596.

Appendix VIII

Management's Response to the Draft Report

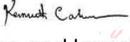


COMMISSIONER
WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

August 27, 2021

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

Digitally signed by
Kenneth C. Corbin
Date: 2021.08.27
12:24:02 -04'00'

SUBJECT: Draft Audit Report – Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation (Audit # 202040004)

Thank you for the opportunity to review and provide comments on the subject draft report. We appreciate the recognition of our accomplishments in developing processes and procedures to identify refundable credit fraud schemes and taxpayers who intentionally misstate eligibility for these credits. We also appreciate the recognition of the impact correctable error authority would have in improving our ability to address refundable credit claims with identified income reporting discrepancies. Having Congress pass legislation to grant us such authority would significantly increase the number of erroneous claims that could be addressed and resolved, and would reduce demand on limited examination resources that could be redirected to address more complex issues.

To address the issue of multiple usage of dependent Taxpayer Identification Numbers (TINs) by more than one person in the same tax year, we identify these occurrences through our Duplicate TIN Online (DUPTIN) program. While most instances of duplicate TIN usage involve two tax returns, such as separated parents or other familial care arrangements, the program also permits us to identify more egregious examples and take action to address them. Through progressive treatment processes, ranging from soft notices to examinations of the returns, the program has shown positive results over time. In 2007, the duplicate TIN condition was present on approximately 3.2 million returns. By 2018, that number had decreased by 73 percent to 850,000 returns. To further reduce this number, we are exploring additional treatment options to further reduce the duplicate usage of dependent TINs.

We use the soft notice process to notify taxpayers when they have included a dependent TIN on their tax return that was also used on another return for the same year. The purpose of the soft notice is to encourage individuals to voluntarily change their behavior if they are not the party entitled to claim the dependent. When duplicate use persists, the only way to correct it is through deficiency procedures. This not only

Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation

2

consumes limited examination resources but also weighs more heavily on those resources as multiple returns must be examined to determine which one is entitled to claim the dependent and which aren't. Consequently, alternative treatments are always being explored and considered.

Our responses to your specific recommendations are enclosed. 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

Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation

Attachment

Recommendations

The Commissioner, Wage and Investment Division, should:

RECOMMENDATION 1

Modify the language in soft notices sent to individuals who claim a multiple use child's TIN to instruct individuals to amend their return if they determine the child's TIN was used in error.

CORRECTIVE ACTION

We will modify the language in the soft notice for consistency to instruct taxpayers to file amended returns when appropriate.

IMPLEMENTATION DATE

December 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 2

Establish processes to notify individuals who claim a multiple use child's TIN to the potential theft of their child's identity and provide actions they can take to report the theft and protect their child's identity from future misuse.

CORRECTIVE ACTION

We will take actions to inform the taxpayers of what they can do if they suspect their child's identity has been compromised.

IMPLEMENTATION DATE

December 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

Establish processes to identify potential fraud schemes associated with the multiple use of a qualifying child's TIN on [REDACTED] tax returns to claim a refundable tax credit, and address the individual(s) or entities who are promoting this fraud.

CORRECTIVE ACTION

The IRS has current procedures for fraud referrals. However, we will explore an additional treatment to address the duplicate Taxpayer Identification Number issue, which may include tax return preparers who file a significant volume of tax returns with duplicated dependents.

IMPLEMENTATION DATE

February 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.

Appendix IX

Glossary of Terms

| Term | Definition |
|---|---|
| Correctable Error Authority | This authority allows the IRS to deny questionable or unsubstantiated claims for certain refundable credits arising out of mathematical or clerical errors. This is accomplished by sending notice to taxpayers explaining the changes. Taxpayers then have 60 days, after the notice is sent, to request an abatement of the tax if they disagree with the correction. Failure to do so results in an assessment that cannot be challenged in Tax Court. |
| Dependent Database | A risk-based audit selection tool used to identify tax returns for audit. This tool includes information databases with birth certificate information and court documents used to establish a relationship and residency between a taxpayer and the qualifying children claimed on a tax return. |
| Duplicate TIN Database | Provides information on duplicate uses of an individual's TIN. It maintains a record of how each TIN was used on a tax return, <i>e.g.</i> , primary, secondary, dependent. |
| Federal Case Registry | A database maintained by the Department of Health and Human Services that contains information about children if a divorce decree was issued or if the child is on public assistance. |
| Filing Season | The period from January 1 through mid-April when most individual income tax returns are filed. |
| Fiscal Year | 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. |
| Individual Master File | The IRS database that maintains transactions or records of individual tax accounts. |
| Individual Return Transaction File | A database maintained by the IRS that contains information on the individual tax returns it receives. |
| Individual Taxpayer Identification Number | A nine-digit number assigned by the IRS to taxpayers who are required to have a TIN for Federal tax purposes but are not eligible to obtain an SSN. |
| Integrated Data Retrieval System | IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer's account records. |
| Kidlink File | A database maintained by the Social Security Administration that contains information about children and their birth parents. |
| Processing Year | The calendar year in which the tax return or document is processed by the IRS. |
| Qualifying Child | A qualifying child enables a taxpayer to claim tax benefits such as refundable credits. In general, to be a qualifying child, the person must meet the relationship, age, residency, and joint return tests. |

Addressing Complex and Inconsistent Earned Income Tax Credit and Additional Child Tax Credit Rules May Reduce Unintentional Errors and Increase Participation

| Term | Definition |
|---------------------------------|---|
| Return Review Program | Uses predictive analytics, models, filters, clustering, a scoring system, business rules, selection groups, and prisoner identification data to identify potentially fraudulent tax returns, including identity theft. |
| Social Security Number | A nine-digit number issued to an individual by the Social Security Administration. The IRS uses this number to process tax documents and returns. |
| Soft Notice | A letter used by the IRS to notify individuals of potential discrepancies in an effort to increase self-correction and voluntary compliance. |
| Tax Year | A 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. |
| Taxpayer Identification Number | A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, it can be an Employer Identification Number, an SSN, or an Individual Taxpayer Identification Number. |
| Volunteer Income Tax Assistance | The IRS offers free assistance with tax return preparation, to those who qualify, through this program using specially trained volunteers. |

Abbreviations

| | |
|-------|---|
| ACTC | Additional Child Tax Credit |
| AGI | Adjusted Gross Income |
| AQC | Automated Questionable Credit |
| AUR | Automated Underreporter |
| CTC | Child Tax Credit |
| EITC | Earned Income Tax Credit |
| IRS | Internal Revenue Service |
| MFJ | Married Filing Jointly |
| SSN | Social Security Number |
| TIGTA | Treasury Inspector General for Tax Administration |
| TIN | Taxpayer Identification Number |



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

(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.