American Rescue Plan Act: Assessment of Processes to Identify and Address Improper Child and Dependent Care Credit Claims

March 14, 2022

Report Number: 2022-47-023
HIGHLIGHTS: American Rescue Plan Act: Assessment of Processes to Identify and Address Improper Child and Dependent Care Credit Claims

Final Audit Report issued on March 14 2022 Report Number 2022-47-023

Why TIGTA Did This Audit

The Child and Dependent Care Credit (CDCC) provides a tax credit for paid expenses for the care of a qualifying individual to enable the taxpayer, and their spouse if filing a joint return, to work or actively look for work. Provision 9631 of the American Rescue Plan Act temporarily expands the CDCC by making the credit fully refundable and increasing the amount of the credit for Tax Year 2021 for taxpayers who live in the United States for more than half of the year. To claim the CDCC, the taxpayer must file a Form 2441, Child and Dependent Care Expenses. Our objective was to assess the IRS’s implementation of the expanded CDCC eligibility requirements.

Impact on Tax Administration

Although refundable credits help low-income individuals reduce their tax burden and provide incentives for specific activities such as seeking or obtaining a job, unintended consequences are that they can result in the issuance of improper payments and can be the targets of unscrupulous individuals. As such, they pose a significant risk as an avenue for those seeking to defraud the Government.

What TIGTA Found

TIGTA’s review of nearly 6.3 million Tax Year 2019 tax returns that received the CDCC identified a number of weaknesses in the controls over the processing of CDCC claims. TIGTA issued 11 alerts to the IRS so it could address the processing deficiencies before taxpayers begin filing claims for the refundable CDCC during Processing Year 2022. IRS management agreed to take actions to address processing weaknesses associated with six of these alerts: 1) the care provider is a relative; 2) the care provider Taxpayer Identification Number is obviously invalid; 3) qualifying persons’ names and Taxpayer Identification Numbers are missing; 4) qualifying persons claimed are born after the tax year; 5) taxpayers circumvent limits for prior year expenses; and 6) both spouses on a joint tax return do not have earned income.

However, the IRS is not taking actions to address all processing deficiencies TIGTA alerted them to during this audit. This includes not taking the steps needed to ensure that requirements to claim the CDCC are met at the time tax returns are processed. In addition, the IRS is not taking actions to update its filing instructions and publications to provide additional guidance to taxpayers or revising programming and processes to identify potentially erroneous CDCC claims. As a result, the IRS may potentially allow improper payments associated with erroneous CDCC claims.

What TIGTA Recommended

TIGTA made nine recommendations to the Commissioner, Wage and Investment Division, that included developing post-refund compliance processes to identify tax returns with potentially erroneous CDCC claims. TIGTA also recommended that the IRS seek legislative authority to disallow the CDCC in certain cases.

The IRS agreed with seven of the nine recommendations. The IRS would not commit to developing some of the recommended processes such as post-refund compliance reviews for ineligible care providers.
March 14, 2022

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – American Rescue Plan Act: Assessment of Processes to Identify and Address Improper Child and Dependent Care Credit Claims (Audit # 202140728)

This report presents the results of our review to assess the Internal Revenue Service’s implementation of the expanded Child and Dependent Care Credit (CDCC) eligibility requirements. The American Rescue Plan Act\(^1\) temporarily expands the CDCC for taxpayers who work or are looking for work. The CDCC will be fully refundable for Tax Year 2021. The amount of the credit, rate used to determine the credit, and income phase-out limits increased significantly. In addition, the amount of employer-provided dependent care benefits has more than doubled. These changes make the CDCC one of the largest refundable credits. This review is part of our Fiscal Year 2022 Annual Audit Plan and addresses the major management and performance challenge of Reducing Fraudulent Claims and Improper Payments.

Management’s complete response to the draft report is included as Appendix III.

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).

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Background

The Child and Dependent Care Credit (CDCC) provides a tax credit for paid expenses for the care of a qualifying individual to enable the taxpayer, and their spouse if filing a joint return, to work or actively look for work. Provision 9631 of the American Rescue Plan Act\(^1\) temporarily makes the CDCC fully refundable\(^2\) for Tax Year 2021 for taxpayers whose main home is in the United States for more than half the tax year. The Act also increases the amount of the credit for Tax Year 2021. These changes will make the CDCC one of the largest refundable tax credits administered by the Internal Revenue Service (IRS). Figure 1 provides an overview of the changes to the CDCC for Tax Year 2021.

**Figure 1: Comparison of Changes to CDCC Requirements**

<table>
<thead>
<tr>
<th></th>
<th>Old Provision</th>
<th>American Rescue Plan Act Provision</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Maximum Qualifying Expenses</strong></td>
<td>$3,000 (one qualifying person); $6,000 (two or more)</td>
<td>$8,000 (one qualifying person); $16,000 (two or more)</td>
</tr>
<tr>
<td><strong>Maximum Credit</strong></td>
<td>35% of qualifying expenses (with phase-down to 20%)</td>
<td>50% of qualifying expenses (two-part phase-out)</td>
</tr>
<tr>
<td><strong>Limitation</strong></td>
<td>Limited to tax liability (nonrefundable)</td>
<td>Refundable</td>
</tr>
<tr>
<td><strong>Adjusted Gross Income Phase-Out</strong></td>
<td>Begins at $15,000</td>
<td>Begins at $125,000; ends at $438,000</td>
</tr>
<tr>
<td><strong>Employer-Provided Dependent Care Benefits Exclusion</strong></td>
<td>Limited to $5,000</td>
<td>Limited to $10,500</td>
</tr>
</tbody>
</table>


Figure 2 shows the number of tax returns and the amount of CDCC claimed for Tax Years 2017 through 2019.

**Figure 2: CDCC Claims for Tax Year 2017 Through Tax Year 2019**

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Taxpayers Filing a Tax Return With CDCC Claim</th>
<th>CDCC Claimed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>6,481,296</td>
<td>$3.7 Billion</td>
</tr>
<tr>
<td>2018</td>
<td>6,431,949</td>
<td>$3.7 Billion</td>
</tr>
<tr>
<td>2019</td>
<td>6,292,732</td>
<td>$3.7 Billion</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>19,205,977</strong></td>
<td><strong>$11.1 Billion</strong></td>
</tr>
</tbody>
</table>

Source: TIGTA analysis of Individual Return Transaction File.

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\(^2\) A refundable credit is not limited to the amount of an individual’s tax liability and can result in a Federal tax refund that is larger than the amount of Federal income tax withholding for that year. See Appendix IV for a glossary of terms.
Process for claiming the CDCC

A taxpayer must file Form 2441, *Child and Dependent Care Expenses*, and enter the name, address, Taxpayer Identification Number (TIN) of the provider, and amount paid to the person or organization who provided the care to claim the CDCC. The care provider cannot be the taxpayer’s spouse at any time during the year, a person whom the taxpayer (or taxpayer’s spouse) can claim as a dependent, the taxpayer’s child under age 19 even if not claimed as a dependent, or a parent of the qualifying person if the qualifying person is the taxpayer’s child and under age 13. The taxpayer is also required to enter the qualifying person’s name, TIN, and qualified expenses incurred and paid for the care of that qualifying person. A qualifying person is:

- A qualifying child under age 13 whom the taxpayer can claim as a dependent. If the child turned 13 during the year, the child is a qualifying person for the part of the year they were under age 13.
- The taxpayer’s disabled spouse who was not physically or mentally able to provide their own care.
- Any disabled person who was not physically or mentally able to provide their own care whom the taxpayer can claim as a dependent or could claim as a dependent except:
  - The disabled person had gross income of $4,200 or more in Tax Year 2019.
  - The disabled person filed a joint return.
  - The taxpayer (or their spouse if filing jointly) could be claimed as a dependent on another taxpayer’s return.

Figure 3 illustrates the eligibility criteria for the CDCC.

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3 See Appendix II.
Figure 3: CDCC Eligibility

Processing Form 2441

The IRS processes tax returns, related documents, and payments at three Submission Processing sites in Kansas City, Missouri; Austin, Texas; and Ogden, Utah. The IRS has developed filters used to identify CDCC claim errors before paper and electronically filed (e-filed) tax returns are accepted for posting to the Master File. For example:

- **Modernized Electronic Filing Business Rules** – For Tax Year 2019, there were 21 active Modernized Electronic Filing business rules that systemically check information specific to Form 2441 CDCC claims. For example, these rules check to ensure that the:
  
  o Qualifying person’s TIN does not equal the Social Security Number (SSN) of another qualifying person, the provider, or the primary/secondary taxpayer on the same Form 2441.
  
  o Amount of the CDCC on Form 2441 is correctly carried forward to the front of the tax return.
  
  o Care Provider(s) Identifying Number field contains an Employer Identification Number (EIN) or SSN.
  
  o Qualifying expenses are greater than $0.
  
  o Dollar figure is entered in the field Amount paid to care provider(s).
  
  o Qualifying person’s name and SSN are entered on the form.
  
  o Care provider’s SSN is not the same as the primary or secondary SSN.
o Qualifying person’s SSN is a valid, issued number.

o Qualifying person’s SSN is not used on another Form 2441 for the same tax year.

o Prior Year Qualifying Expense is annotated on Form 2441 and the qualifying person’s name, SSN, provider information, and credit amount are provided.

• **Code and Edit Rules** – Both paper and e-filed tax returns are subject to review to ensure that the tax returns are perfected before entering the processing stream. For e-filed returns, this process occurs after the tax return is accepted. For paper tax returns claiming the CDCC, tax examiners in the Code and Edit function review and edit the accuracy of the information for the lines on Form 2441 listed below. To address errors, tax examiners may correspond (via letter) with the taxpayer to request additional information. Tax examiners review the tax returns with CDCCs for the following conditions:

  4 o Care Provider’s Name – Line 1(a): The first four letters of the corporation or surname is underlined.

  4 o Provider’s Identifying Number – Line 1(c): If the TIN is missing, qualifying expenses will be disallowed unless “Tax Exempt,” “Due Diligence,” or “LAFCP” is notated.

  4 o Qualifying Person’s Last Name – Line 2(a): If missing, the tax examiner attempts to identify the information using the dependent information on the front of the return, Schedule EIC, Earned Income Credit, any attachments, and primary taxpayer’s name.

  4 o Qualifying Person’s TIN – Line 2 (b): The tax examiner attempts to identify the TIN elsewhere on the tax return or attachments.

  4 o Qualifying Expenses – Line 3: If blank and unable to compute, correspond with the taxpayer using Letter 12-C, Individual Return Incomplete for Processing: Forms 1040 & 1040-SR.

  4 o Earned Income – Lines 4 and 5 (if Married Filing Jointly): The tax examiner attempts to identify the income using the tax return, schedules, and attachments.

• **Error Resolution System** – The IRS uses its Error Resolution function to identify and address tax return errors. The following are the error conditions identified and error codes set by IRS systems for e-filed and paper tax returns with a CDCC claim:

  4 o Error Code 278 generates when a CDCC is present and Adjusted Gross Income per the return is equal to one of the following amounts: $15,000, $17,000, $19,000, $21,000, $23,000, $25,000, $27,000, $29,000, $31,000, $33,000, $35,000, $37,000, $39,000, or $41,000.

  4 o Error Code 279 generates when both of the following exist: a) the taxpayer’s amount for the CDCC on Form 2441 and the computer’s amount differ and b) a math error is

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4 Internal guidelines instruct the tax examiner to correspond for any missing required provider information when corresponding for other missing return items.

5 LAFCP means Living Abroad Foreign Care Provider.


7 To determine the amount of the credit, the taxpayer multiplies their work-related expenses by a percentage that is dependent on the adjusted gross income shown on their tax return.
present. These errors are identified on paper and e-filed tax returns via computer programming.

- Error Code 579 generates when one of the following exists: the taxpayer reports all income but did not compute the tax or any of the allowable carryover statutory credits (e.g., Foreign Tax Credit, General Business Credit) differ from their respective computer-generated amounts.

## Results of Review

As we previously noted, the CDCC will be one of the largest fully refundable tax credits that can be claimed by individuals. Our prior and extensive reviews of the IRS’s administration of refundable credits has identified that, although refundable credits help low-income individuals reduce their tax burden and provide incentives for specific activities such as seeking or obtaining a job, unintended consequences are that they can result in the issuance of improper payments and can be the targets of unscrupulous individuals. As such, they pose a significant risk as an avenue for those seeking to defraud the Government. When the IRS makes payments to individuals and businesses, it must make every effort to confirm that the right recipient is receiving the right payment for the right reason at the right time. Not collecting or analyzing sufficient taxpayer information may lead to erroneous credits and improper payments.

Recognizing the significant risk of potentially improper/fraudulent CDCC claims, we analyzed the nearly 6.3 million Tax Year 2019 tax returns that received CDCCs to evaluate IRS processes to detect potentially fraudulent and erroneous claims. Our review identified a number of weaknesses in the controls over the processing of CDCC claims. We issued 11 alerts to the IRS so it could address the processing deficiencies before taxpayers begin filing claims for the refundable CDCC during Processing Year 2022. IRS management agreed to take actions to address processing weaknesses associated with six of these alerts, including the following:

- **The care provider listed on Form 2441 is not an eligible care provider (because they are a relative)** – Our analysis identified 5,669 tax returns with erroneous CDCC claims totaling more than $3.3 million whereby the taxpayer incorrectly claimed qualified care expenses paid to the primary taxpayer, secondary taxpayer, or a dependent on the tax return. IRS internal guidelines state that, if the care provider is the primary taxpayer, spouse, or a dependent of the taxpayer, the CDCC amount should be disallowed. However, management noted that these tax returns were not identified because the IRS’s internal guidelines did not include instructions to disallow the credit on paper returns. In addition, the e-file business rules only rejected tax returns when the care provider TIN matched the primary or secondary TIN on the tax return. The rules did not check whether the care provider TIN matched a dependent TIN.

**Management Action in Response to E-Mail Alert:** For paper tax returns, IRS management agreed to update internal guidelines to instruct tax examiners to disallow the expenses if the care provider TIN is the same as the primary taxpayer, spouse, or a dependent of the taxpayer. For e-filed tax returns, the IRS agreed to add a business rule that will reject an e-filed tax return when the care provider’s TIN matches the TIN of a dependent of the taxpayer.
• **The care provider TIN on Form 2441 is invalid** – Our analysis identified 5,448 tax returns with erroneous CDCC claims totaling over $3.3 million in the CDCC whereby the care provider’s TIN was obviously invalid (e.g., 123456789, 111111111, or 888888888). Unless an exception applies, taxpayers claiming the CDCC must identify all persons and organizations that provide care for their child or dependent by entering the care provider’s name, address, and TIN on Line 1 of Form 2441. If the care provider is an individual, the TIN is their SSN. If the care provider is an organization, then it is the EIN. According to IRS management, the invalid provider TINs were not identified because the provider TINs were not being verified during processing.

**Management Action in Response to E-Mail Alert:** IRS management agreed to develop programming so that e-filed tax returns for Processing Year 2022 will be rejected when an obviously invalid care provider TIN (e.g., 123456789, 111111111, or 888888888) is present on Form 2441. For Forms 2441 with an invalid care provider TIN submitted with a paper tax return, internal guidance will be updated to disallow the credit when an invalid care provider TIN is present on Form 2441.

• **The required qualifying person’s name and TIN on Form 2441 are missing** – Our analysis identified 741 tax returns with erroneous CDCC claims totaling $464,400 whereby the qualifying person’s name or TIN was not entered on Form 2441. Taxpayers claiming the CDCC must enter the qualifying person(s) name and TIN on Line 2 of Form 2441. The credit may be reduced or disallowed if the correct information is not provided by the taxpayer. IRS management noted that these erroneous credits were allowed as a result of employee error. Specifically, the tax examiners did not follow internal guidelines to disallow the credit when the qualifying person’s name and TIN was not provided.

**Management Action in Response to E-Mail Alert:** IRS management agreed to review and revise its internal guidance to provide additional clarification as needed to ensure that Error Resolution function examiners understand the requirements. For e-filed tax returns, the IRS agreed to update programming that will reject the tax return when the qualifying person’s name and TIN is not provided on Form 2441.

• **Excess qualifying expenses are allowed when a qualifying person listed on Form 2441 is not alive** – Our analysis identified eight tax returns with erroneous CDCC claims totaling $7,150 whereby the taxpayers included qualifying persons on Form 2441 who were not yet alive during the respective tax year of the CDCC. Specifically, the qualifying persons we identified were born after December 31, 2019.

**Management Action in Response to E-Mail Alert:** For Processing Year 2022, IRS management agreed to develop a compliance filter to identify for further review any tax returns claiming a CDCC for a child who was born after the tax year for which the claim was made. IRS management plans to request IRS Counsel guidance to reject a submission if the date of birth is after the tax period of the return.

• **Programming limitations allow taxpayers to circumvent limits for prior year expenses** – Our analysis identified 1,183 Tax Year 2019 tax returns with erroneous CDCC claims totaling over $1.5 million for prior year expenses when the taxpayer claimed the maximum amount of qualified expenses for the tax year on a Tax Year 2018 Form 2441. Taxpayers with qualifying expenses for Tax Year 2018 that were not paid until Calendar Year 2019 may increase the amount of the allowable CDCC in Tax Year 2019. However, the total
amount of CDCC attributable to expenses incurred in Calendar Year 2018 and paid in Calendar Year 2019 cannot exceed $1,050 for one qualifying person ($2,100 for two or more). This amount is added to the taxpayer’s Tax Year 2019 credit. Current processes do not review the prior year tax return to ensure that the maximum credit has not already been claimed. According to IRS management, the excess expenses were allowed because IRS systems do not have sufficient information from the tax return to verify the accuracy of the prior year expenses claimed on Form 2441 because prior year expenses information is not transcribed from the tax return. As such, the IRS programmed its system to allow a maximum of $2,100 for all prior year CDCC claims on Tax Year 2021 tax returns.

Management Action in Response to E-Mail Alert: For Processing Year 2022, IRS management agreed to develop a compliance filter to identify tax returns claiming questionable prior year expenses and the refundable CDCC for further review.

- The primary and secondary taxpayer do not both have earned income listed on Form 2441 – Our review identified 329 tax returns with erroneous CDCC claims totaling $309,045 whereby earned income was not reported on Form 2441 as required. Specifically, we found that earned income was not always reported for both the primary and secondary taxpayer on a jointly filed tax return and for the primary taxpayer for all other filing statuses when a CDCC was claimed on the tax return. Taxpayers may be able to claim the CDCC if they paid qualifying expenses to care for their child or other qualifying person so they (and their spouse if filing jointly) could work or look for work. Generally, both the taxpayer and spouse must have earned income (including wages, salaries, tips, other taxable employee compensation, or net earnings from self-employment) during the year.\(^8\) Current processes require the tax examiners to review the tax return and attachments to identify income (such as from Forms W-2, Wage or Tax Statement; Schedule C, Profit or Loss from Business; or Schedule SE, Self-Employment Tax) when the taxpayer does not identify earned income on Form 2441. According to IRS management, the erroneous CDCC credits were due to tax examiner error when earned income was not reported.

Management Action to E-Mail Alert: IRS management agreed to reinforce internal guidance to tax examiners to ensure that examiners understand they should use income from Form 1040 in the validation of the credit claimed on Form 2441.

We commend management for taking the actions detailed previously to address the processing deficiencies we identified. However, we remain concerned that the IRS is not taking actions to address the additional processing deficiencies we alerted it to during this audit. This includes not taking the steps needed to capture key information from paper tax returns that can be used to ensure that requirements to claim the CDCC are met at the time tax returns are processed. In addition, the IRS is not taking actions to update its filing instructions and publications to provide additional guidance to taxpayers, revising programming and processes to identify potentially erroneous CDCC claims, or taking actions to prevent married taxpayers from filing separately to

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\(^8\) Section 21(d) creates a special rule for taxpayers that are disabled or are full-time students (or who have spouses who are disabled or full-time students) which treats these individuals as having received a certain amount of earned income for purposes of the CDCC. While the imputed income is not reported on the tax return, it is taken into account when determining the amount of the CDCC.
circumvent the CDCC limits. As a result, the IRS may potentially allow improper payments associated with erroneous CDCC claims.

**2** **Needed to Identify and Address Improper Child and Dependent Care Credit Claims During Tax Return Processing**

Our review identified ****************************** will allow the IRS to better identify erroneous CDCC claims at the time tax returns are processed or to aid in the post-processing analysis of tax returns. For each of the fields detailed below, **************************** for use in verifying that CDCC claims meet requirements:

- **The care provider's** (including annotations of) – Our analysis of the nearly 6.3 million Tax Year 2019 tax returns that received CDCCs identified 43,818 paper tax returns with potentially erroneous CDCC claims totaling nearly $26.5 million whereby the taxpayer claimed qualified care expenses but did not provide the Internal Revenue Code § 21(e)(9) requires taxpayers to identify all persons or organizations that provide care for a qualified child or dependent by giving the provider’s name, address, and TIN to receive the CDCC. A provider TIN must be present for a taxpayer to qualify for the CDCC unless the provider is tax-exempt and not required to obtain an SSN or EIN, the taxpayer was unable to obtain the SSN or EIN after reasonable efforts, or the taxpayer is living abroad and the care provider may not have (and may not be required to get) an SSN or EIN. In these situations, the taxpayer notes “Tax Exempt,” “Due Diligence,” or “LAFCP” on the form. According to the IRS’s processes, if the required provider information is missing, the tax examiner must correspond with the taxpayer if other items are missing on the tax return.

We alerted the IRS on July 15, 2021, that it is allowing erroneous CDCCs when the taxpayer does not listed on Form 2441. IRS management disagreed with our preliminary audit results, stating that current procedures do not require. The physical tax returns are, and the data captured in the IRS’s database from the. Therefore, IRS management stated that they could not determine if these credits were allowed in error. IRS management’s position is that the allowed credit is correct because they

- **The amount paid to the care provider** – As we discussed previously, we identified 1,183 tax returns totaling over $1.5 million in erroneous CDCCs for prior year expenses when the taxpayer claimed the maximum amount of qualified expenses for the tax year on the Tax Year 2018 Form 2441. These taxpayers received CDCCs for which they were not entitled.

IRS systems provide a graphic interface that shows all data on a Form 2441 when the form is submitted with an e-filed tax return. Data from a paper tax return that
the clerks in the Data Transcription function IRS systems. To review data on a paper tax return that IRS management must. Figure 4 shows an excerpt of Form 2441 and the fields that are transcribed (denoted with a “T”).

**Figure 4: Fields Transcribed From Form 2441**

Management stated that no new programming changes can be made for Tax Year 2021; however, they plan to evaluate the need for related to the care provider’s name and TIN if the refundable CDCC is extended beyond Tax Year 2021. Without sufficient information about the care provider and the amount paid for care, erroneous credits may be allowed.

**The Commissioner, Wage and Investment Division, should:**

**Recommendation 1:** Update processes to from Form 2441 the care provider’s and the amount paid to the care provider.

**Management’s Response:** The IRS partially agreed with this recommendation. At the time of this response, legislation has not been enacted to extend the refundable credit status of the CDCC or to retain the amount of credit allowable for Tax Year 2021. However, IRS management plans to monitor pending legislation and, if the CDCC is subsequently extended as a refundable credit for Tax Year 2022 or later, they will evaluate their processes and request the requisite programming and procedural changes to address this issue.

**Recommendation 2:** Update paper verification processes to generate errors in the Error Resolution System when the or amounts paid to the care provider are missing.
Management’s Response: The IRS partially agreed with this recommendation. At the time of this response, legislation has not been enacted to extend the refundable credit status of the CDCC or to retain the amount of credit allowable for Tax Year 2021. However, IRS management plans to monitor pending legislation and, if the CDCC is subsequently extended as a refundable credit for Tax Year 2022 or later, they will evaluate their processes and request the requisite programming and procedural changes to address this issue.

Processes Are Needed to Identify and Address Erroneous Claims When the Qualifying Person Is the Primary or Secondary Taxpayer

Our review of the nearly 6.3 million Tax Year 2019 tax returns that received CDCCs identified 3,322 tax returns with erroneous CDCC claims totaling more than $2.0 million whereby the taxpayer claimed qualified care expenses for an individual who is the primary or secondary taxpayer on the tax return. For Tax Year 2019, Internal Revenue Code § 21(a)(1) allows taxpayers to claim payments for child and dependent care for:

- A qualifying child who is a dependent and under age 13 when the care was provided or, if the child turned 13 during the year, the child is a qualifying person for the part of the year they were under age 13.
- A spouse who was not physically or mentally able to provide their own care and lived with the taxpayer for more than half the year.
- A person who was not physically or mentally able to provide their own care, lived with the taxpayer for more than half the year, and was either the taxpayer’s dependent or would have been the taxpayer’s dependent except that their gross income exceeded $4,200, they filed a joint return, or the taxpayer could be claimed as a dependent on someone else’s Tax Year 2019 tax return.

We alerted the IRS on July 7, 2021, that the IRS may be allowing CDCCs when a qualifying person listed on Form 2441 is not an eligible qualifying person. IRS management disagreed with our concerns, noting that taxpayers are allowed to claim care expenses for a spouse who is physically or mentally incapable of caring for themselves. Special rules also apply for determining the amount of earned income a disabled spouse or a full-time student spouse is treated as having for purposes of the CDCC calculation. To address the IRS’s concern cited as the basis for its disagreement, we reviewed a judgmental sample of 14 tax returns we identified.

We used the available information from the tax returns and supporting schedules and attachments to determine that the adult qualifying person on Form 2441 was either working, evidenced by Forms W-2 attached to the tax return, or the tax return was notated that the qualifying person was unemployed. Without additional information from the taxpayer, the IRS cannot determine...

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A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.
The Commissioner, Wage and Investment Division, should:

**Recommendation 3:** Revise Form 2441 to include checkboxes to note whether dependent care expenses are for a spouse or dependent who is physically or mentally incapable of caring for themselves or if special deemed earned income rules apply.

**Management’s Response:** The IRS agreed with this recommendation and plans to revise Form 2441 for Tax Year 2022 by adding a checkbox to indicate whether a taxpayer or their spouse was a student or disabled during the tax year and they intend to enter deemed income on Form 2441. There will also be a line that directs the reader to the instructions for Form 2441, where more information about who qualifies as a student or disabled is provided. Management also plans to add a new question to Form 2441 to identify disabled individuals since anyone over the age of 12 listed on line 2 must be disabled. For Tax Year 2021, the IRS revised the instructions for Form 2441 by adding a caution paragraph that states “Don’t list a person on line 2 unless they qualify as an eligible person under Qualifying Person(s), earlier.” This paragraph was added to address the issue of potentially ineligible individuals being listed as qualifying individuals.

**Recommendation 4:** Develop a process to identify tax returns with adult Individual Taxpayer Identification Numbers. These tax returns should be considered for selection for post-refund compliance reviews.

**Management’s Response:** The IRS agreed with this recommendation and has developed a compliance filter for Processing Year 2022 to identify tax returns claiming the CDCC for an adult who may not be disabled for possible post-refund treatment. Returns will be evaluated to determine potential noncompliance. IRS management also plans to assess this population once adequate data are available from Tax Year 2021 returns to determine the scope of potential noncompliance that meets their selection tolerance.

**Individual Taxpayer Identification Numbers Are Accepted for Child and Dependent Care Credit Claims**

Our analysis of nearly 6.3 million Tax Year 2019 tax returns that received CDCCs identified 49,859 tax returns whereby Individual Taxpayer Identification Number (ITIN) was used to identify the primary or secondary taxpayer or dependent(s). We also identified ITINs used to identify care providers as well as ITINs that were used on multiple tax returns. As a result, the IRS allowed more than $30 million in erroneous CDCCs.

Publication 503, *Child and Dependent Care Expenses*, explains that taxpayers may be able to claim the CDCC if they paid qualifying expenses to care for their child or other qualifying person so they (and their spouse if filing jointly) could work or look for work in Tax Year 2019. To be able to claim the CDCC, taxpayers must identify the name and TIN of qualifying persons as well as the name, address, and TIN of the care provider on Form 2441 unless an exception applies. While ITINs are acceptable to identify persons on a tax return who do not have an SSN, expired ITINs must be renewed before they are used on a tax return.
We alerted the IRS on July 16, 2021, that it is allowing the CDCC when a taxpayer uses an **ITIN on Form 2441. IRS management partially agreed with our findings. IRS management stated that ** and that ** used to identify the primary or secondary taxpayer. The IRS agreed to modify the programming for Processing Year 2022 to generate errors in the Error Resolution System when the ITIN of one of the first two dependents on a tax return has **. Error Resolution function tax examiners will disallow the credit for the dependent with the ** ITIN. However, IRS management’s proposed action will only address 536 of the 46,554 ** ITINs we identified.

We question management’s disagreement to address claims whereby the primary or secondary taxpayer has an ** ITIN as the IRS has a process that does exactly this for other types of credit claims. Specifically, Congress enacted the *Protecting Americans From Tax Hikes Act* on December 18, 2015, which included refundable credit program integrity provisions specifically intended to reduce fraudulent and improper Earned Income Tax Credit, Child Tax Credit, Advance Child Tax Credit, and American Opportunity Tax Credit payments. In response, the IRS has developed processes to systemically identify both e-filed and paper tax returns that contain ** ITIN. Once identified, these tax returns are forwarded to the IRS Error Resolution function for additional review. Once received, IRS Error Resolution function employees confirm the status of the ITIN using the National Account Profile. Tax returns with ** are adjusted to disallow tax credits associated with the **. The IRS acknowledged that, while the *Protecting Americans From Tax Hikes Act* included more stringent TIN requirements for certain refundable credits, it did not **. Thus, the IRS cannot apply ** to the CDCC. Finally, the IRS has not sought the legal authority to disallow the CDCC when a taxpayer uses an ** ITIN for the primary or secondary taxpayer or the care provider.

The Commissioner, Wage and Investment Division, should:

**Recommendation 5:** Work with the Department of the Treasury, Office of Tax Policy, to obtain the legal authority to disallow the CDCC when the primary or secondary taxpayer is identified by an ** ITIN on Form 2441.

**Management’s Response:** The IRS agreed with this recommendation and plans to elevate this issue to the Office of Tax Policy for consideration as a legislative request. However, IRS management stated the legal authority to deny the CDCC to individuals filing with ** ITINs must ultimately be provided by Congress.

**Recommendation 6:** Develop a process to identify tax returns with ** ITINs used to identify the care provider. These tax returns should be considered for selection for post-refund compliance reviews.

**Management’s Response:** The IRS disagreed with this recommendation. IRS management stated that they do not have the legal authority to disallow the CDCC when a taxpayer uses an ** ITIN for the care provider.

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Office of Audit Comment: We agree that the IRS currently does not have the legal authority to disallow the CDCC with [redacted] ITIN at the time tax returns are processed. To address the current lack of legal authority, our recommendation focuses on developing procedures to identify these claims to then address them via post-refund treatment.

Vague Guidance in Form 2441 Instructions and Publication 503 May Cause Taxpayers to Incorrectly Claim Child and Dependent Care Credits

Our review of nearly 6.3 million Tax Year 2019 tax returns that received CDCCs identified 9,936 tax returns that received more than $5.7 million in potentially erroneous CDCCs that claimed qualified expenses listing expenses for a care provider [redacted]. For example, these tax returns claimed qualifying expenses for [redacted]; however, the IRS does not [redacted]. As such, taxpayers may be per Form 2441 instructions, and the IRS [redacted].

Form 2441 instructions state that a taxpayer can include the cost of care provided outside the home for a qualifying person who regularly spends at least eight hours a day in the home. The instructions note that taxpayers can include the cost of a day camp, even if it specializes in a particular activity such as computers or soccer. Expenses for sending a qualifying person to an overnight camp, summer school, or tutoring program should not be included.

We alerted the IRS on July 30, 2021, that the instructions for Form 2441 and Publication 503 are vague in some areas and could cause taxpayers to incorrectly claim CDCCs. For example, Form 2441 instructions do not provide clear guidance on qualifying expenses from a qualifying care provider. IRS management disagreed with our concerns, stating that Form 2441 instructions and Publication 503 already state that the care of a qualifying person “doesn’t include the cost of food, lodging, education, clothing, or entertainment.” Further, they noted that day camp is considered qualifying care, and Form 2441 instructions and Publication 503 state that, “You can include the cost of a day camp, even if it specializes in a particular activity, such as computers or soccer.”

However, it is not clear from the care provider titles used by the taxpayers that the swim or karate lessons were part of a day camp scenario. From researching websites for the care providers listed, it did not appear that the care providers offered day camps but only specific lessons. IRS management should clarify Form 2441 instructions and Publication 503, using examples, so that taxpayers may better understand the distinction between a day camp that focuses on karate, for example, versus taking a qualifying person to hourly karate lessons a number of days per week.

The Commissioner, Wage and Investment Division, should:

Recommendation 7: Revise Form 2441 instructions and Publication 503, using examples, so taxpayers may better understand the requirements for qualifying care and expenses.
Management’s Response: The IRS agreed with this recommendation and has added two examples on page 8 of Publication 503, under “Camp,” to help clarify that expenses incurred for summer camp qualify for the credit, but expenses incurred for summer tutoring do not qualify. The examples are based on examples in Treasury Regulation § 1.21-1(d)(12).

Recommendation 8: Develop a process to identify tax returns with care provider expenses that should be selected for post-refund compliance reviews. The IRS disagreed with this recommendation. IRS management believes the determination as to whether the expenses qualify for the dependent care depends on the Treasury Regulation rules and the specific facts and circumstances of each situation.

Office of Audit Comment: We agree that the determination as to whether expenses qualify depends on the specific facts and circumstances of each situation. As such, our recommendation focuses on developing procedures to identify tax returns claiming CDCC with questionable qualifying expenses (e.g., tuition for home schooling) to allow the IRS the opportunity to review these in a post-refund environment. This would allow the IRS to evaluate the facts and circumstances on a case-by-case basis.

Married Taxpayers File Separately to Claim Child and Dependent Care Credits

Our review of nearly 6.3 million Tax Year 2019 tax returns that received CDCCs identified 580 married couples claiming $643,239 in potentially erroneous CDCCs when the taxpayers filed using a Married Filing Separately status but both the spouse and the other spouse were allowed the CDCC. Taxpayers may be able to claim the CDCC when they paid qualifying expenses to care for their child or other qualifying person so they could work or look for work. Internal Revenue Code § 21(e)(2) requires married couples to file a joint return to receive the CDCC unless the taxpayer is legally separated or living apart from their spouse during the last six months of the year.

The IRS currently does not have the ability to identify potentially erroneous CDCCs when the taxpayers filed using a Married Filing Separately status but both were allowed the CDCC. We identified 174 couples who filed using the Married Filing Separately status for Tax Year 2019. These couples were allowed $269,188 in CDCCs.

We alerted the IRS on September 1, 2021, that it does not have the ability to identify potentially erroneous CDCCs when the taxpayers filed using a Married Filing Separately status but both were allowed the CDCC. The IRS agreed with our findings. IRS management noted in its response to our e-mail alert that this situation will be addressed in future years. The IRS agreed with this recommendation and added two examples on page 8 of Publication 503, under “Camp,” to help clarify that expenses incurred for summer camp qualify for the credit, but expenses incurred for summer tutoring do not qualify. The examples are based on examples in Treasury Regulation § 1.21-1(d)(12).
We agree that these tax returns would require a **********. However, systemically identifying these tax returns would assist the IRS to flag the returns that meet this criteria for further review. As such, our recommendation is designed to help the IRS identify which tax returns would need to be reviewed either at the time of processing or in a post-refund environment. On December 6, 2021, the IRS informed us that Processing Year 2022 tax returns which claim the CDCC for a child who has been claimed as a dependent by ********** are considered for further review under the Wage and Investment Division duplicate TIN process already in place.

**Recommendation 9:** The Commissioner, Wage and Investment Division, should coordinate with the Small Business/Self-Employed Division to develop a compliance plan for post-refund treatment of cases involving **********.

**Management’s Response:** The IRS agreed with this recommendation. For Processing Year 2022, returns that claim the CDCC for a ********** are considered for further review under the Wage and Investment Division duplicate TIN process already in place. However, IRS management plans to assess this population once adequate data are available from Tax Year 2021 returns to determine the scope of potential noncompliance that meets our selection tolerance.
Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this audit was to assess the IRS’s implementation of the expanded CDCC eligibility requirements. To accomplish our objective, we:

- Analyzed the nearly 6.3 million Tax Year 2019 tax returns processed during Processing Year 2020 that received the CDCC to evaluate existing IRS processes to detect potentially fraudulent and erroneous claims.
  - Reviewed a judgmental1 sample of 14 of 3,322 Tax Year 2019 tax returns whereby the taxpayer claimed qualified care expenses for an individual who is the primary or secondary taxpayer on the tax return. We selected five tax returns with the largest CDCC dollar amounts and the 10 tax returns that were assigned Error Codes 279 or 579. One of the tax returns was in both of these populations.
- Determined if the IRS’s established business rules were appropriately rejecting incorrect/incomplete Forms 2441.
- Determined if the Code and Edit function appropriately identified incorrect/incomplete paper Forms 2441 and prevented incorrect claims from processing.
- Determined if the Error Resolution function correctly identified incorrect/incomplete Forms 2441 and disallowed the CDCC claimed on tax returns with Form 2441 errors.

Performance of This Review

This review was performed with information obtained from the IRS Wage and Investment Division’s Customer Account Services and Return Integrity and Compliance Services in Atlanta, Georgia, and the Submission Processing branch in Austin, Texas, during the period March through November 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 Martin, Assistant Inspector General for Audit (Returns Processing and Account Services); Linna Hung, Director; Paula Johnson, Audit Manager; Edgar Moon, Lead Auditor; Audrey Graper, Auditor; and Julia Woods, Information Technology Specialist (Data Analytics).

Validity and Reliability of Data From Computer-Based Systems

During this review, we obtained extracts from the IRS’s Individual Master File and Individual Return Transaction File databases for Processing Years 2018, 2019, and 2020 that were available on TIGTA’s Data Center Warehouse. We obtained extracts of Tax Year 2019 Form 2441 information from the Individual Return Transaction File database that was available on TIGTA’s

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1 A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.
Data Center Warehouse. Before relying on the data, we ensured that each file contained the specific data elements we requested. In addition, we selected random samples of either the extract or the results throughout the analysis and verified that the data in the extracts were the same as the data captured in the IRS’s Integrated Data Retrieval System and Employee User Portal. We also performed analysis to ensure the validity and reasonableness of our data, such as ranges of dollar values and tax periods. Based on the results of our testing, we believe that the data used in our review were sufficiently reliable for the 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: processes for the IRS’s implementation of the expanded CDCC eligibility requirements. We tested these controls by reviewing and analyzing relevant documents, data, and calculations related to the issuance of the CDCC.
### Form 2441, Child and Dependent Care Expenses

**Part I**  
Persons or Organizations Who Provided the Care — You must complete this part.

If you have more than two care providers, see the instructions.

<table>
<thead>
<tr>
<th>(a) Care provider’s name</th>
<th>(b) Address (number, street, apt. no., city, state, and ZIP code)</th>
<th>(c) Identifying number (SSN or EIN)</th>
<th>(d) Amount paid (see instructions)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Did you receive dependent care benefits?  
- No  
- Yes

Complete only Part II below.

**Caution:** If the care was provided in your home, you may owe employment taxes. For details, see the instructions for Schedule 2 (Form 1040 or 1040-SR, line 7a; or Form 1040-NR, line 58a).

### Part II  
Credit for Child and Dependent Care Expenses

2 Information about your qualifying person(s). If you have more than two qualifying persons, see the instructions.

<table>
<thead>
<tr>
<th>(a) Qualifying person’s name</th>
<th>(b) Qualifying person’s social security number</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3 Add the amounts in column (c) of line 2. Don’t enter more than $3,000 for one qualifying person or $6,000 for two or more persons. If you completed Part III, enter the amount from line 31.

4 Enter your earned income. See instructions.

5 If married filing jointly, enter your spouse’s earned income (if you or your spouse was a student or was disabled, see the instructions); all others, enter the amount from line 4.

6 Enter the smallest of line 3, 4, or 5.

7 Enter the amount from Form 1040 or 1040-SR, line 8b; or Form 1040-NR, line 35.

8 Enter on line 8 the decimal amount shown below that applies to the amount on line 7.

<table>
<thead>
<tr>
<th>If line 7 is:</th>
<th>But not over</th>
<th>Decimal amount is</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20–15,000</td>
<td>.35</td>
<td>$29,000–31,000</td>
</tr>
<tr>
<td>15,000–17,000</td>
<td>.34</td>
<td>31,000–33,000</td>
</tr>
<tr>
<td>17,000–19,000</td>
<td>.33</td>
<td>33,000–35,000</td>
</tr>
<tr>
<td>19,000–21,000</td>
<td>.32</td>
<td>35,000–37,000</td>
</tr>
<tr>
<td>21,000–23,000</td>
<td>.31</td>
<td>37,000–39,000</td>
</tr>
<tr>
<td>23,000–25,000</td>
<td>.30</td>
<td>39,000–41,000</td>
</tr>
<tr>
<td>25,000–27,000</td>
<td>.29</td>
<td>41,000–43,000</td>
</tr>
<tr>
<td>27,000–29,000</td>
<td>.28</td>
<td>43,000–No limit</td>
</tr>
</tbody>
</table>

9 Multiply line 6 by the decimal amount on line 8. If you paid 2018 expenses in 2019, see the instructions.

10 Tax liability limit. Enter the amount from the Credit Limit Worksheet in the instructions.

11 Credit for child and dependent care expenses. Enter the smaller of line 9 or line 10 here and on Schedule 3 (Form 1040 or 1040-SR, line 2; or Form 1040-NR, line 47).

For Paperwork Reduction Act Notice, see your tax return instructions.
### Form 441 (2019) Dependent Care Benefits

#### Part III

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>Enter the total amount of dependent care benefits you received in 2019. Amounts you received as an employee should be shown in box 10 of your Form(s) W-2. Don’t include amounts reported as wages in box 1 of Form(s) W-2. If you were self-employed or a partner, include amounts you received under a dependent care assistance program from your sole proprietorship or partnership.</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Enter the amount, if any, you carried over from 2018 and used in 2019 during the grace period. See instructions.</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Enter the amount, if any, you forfeited or carried forward to 2020. See instructions.</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Combine lines 12 through 14. See instructions.</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Enter the total amount of qualified expenses incurred in 2019 for the care of the qualifying person(s).</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Enter the smaller of line 15 or 16.</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>Enter your earned income. See instructions.</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Enter the amount shown below that applies to you.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• If married filing jointly, enter your spouse’s earned income (if you or your spouse was a student or was disabled, see the instructions for line 5).</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• If married filing separately, see instructions.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• All others, enter the amount from line 18.</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Enter the smallest of line 17, 18, or 19.</td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>Enter $5,000 ($2,500 if married filing separately and you were required to enter your spouse’s earned income on line 19).</td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>Is any amount on line 12 from your sole proprietorship or partnership?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>□ No. Enter -0-.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>□ Yes. Enter the amount here.</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>Subtract line 22 from line 15.</td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>Deductible benefits. Enter the smallest of line 20, 21, or 22. Also, include this amount on the appropriate line(s) of your return. See instructions.</td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>Excluded benefits. If you checked “No” on line 22, enter the smaller of line 20 or 21. Otherwise, subtract line 24 from the smaller of line 20 or line 21. If zero or less, enter -0-.</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>Taxable benefits. Subtract line 25 from line 23. If zero or less, enter -0-. Also, include this amount on Form 1040 or 1040-SR, line 1; or Form 1040-NR, line 8. On the dotted line next to Form 1040 or 1040-SR, line 1; or Form 1040-NR, line 8, enter “DCB”.</td>
<td></td>
</tr>
</tbody>
</table>

To claim the child and dependent care credit, complete lines 27 through 31 below.

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>27</td>
<td>Enter $3,000 ($6,000 if two or more qualifying persons)</td>
</tr>
<tr>
<td>28</td>
<td>Add lines 24 and 25.</td>
</tr>
<tr>
<td>29</td>
<td>Subtract line 28 from line 27. If zero or less, stop. You can’t take the credit. Exception. If you paid 2018 expenses in 2019, see the instructions for line 9.</td>
</tr>
<tr>
<td>30</td>
<td>Complete line 2 on the front of this form. Don’t include in column (c) any benefits shown on line 28 above. Then, add the amounts in column (c) and enter the total here.</td>
</tr>
<tr>
<td>31</td>
<td>Enter the smaller of line 29 or 30. Also, enter this amount on line 3 on the front of this form and complete lines 4 through 11.</td>
</tr>
</tbody>
</table>
February 14, 2022

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – American Rescue Plan Act: Assessment of Processes to Identify and Address Improper Child and Dependent Care Credit Claims.
(Audit #202140728)

Thank you for the opportunity to review and provide comments on the subject draft report. Provision 9631 of the American Rescue Plan Act (ARPA) temporarily expands the Child and Dependent Care Credit (CDCC) by making the credit fully refundable for taxpayers who live in the United States for more than half of the year. In addition, Provision 9631 temporarily increases the amount of the credit for tax year 2021.

The Treasury Inspector General for Tax Administration (TIGTA) reviewed nearly 6.3 million tax year 2019 returns that received the CDCC to evaluate the IRS’s processes to detect potentially fraudulent and erroneous CDCC claims. We are pleased that TIGTA’s review shows that 98 percent of the tax year 2019 CDCC claims were correctly processed.

The table below overwhelmingly shows the overall percentage of potentially erroneous claims to be extremely small when compared to the correct claims identified by TIGTA during the audit.

<table>
<thead>
<tr>
<th>TIGTA Identified Weakness</th>
<th>Volume of Potentially Erroneous Claims</th>
<th>Percent of Correct Claims</th>
</tr>
</thead>
<tbody>
<tr>
<td>Care provider listed on Form 2441, Child and Dependent Care Expenses, is not an eligible care provider</td>
<td>5,669 returns</td>
<td>&gt;99.9%</td>
</tr>
<tr>
<td>Care provider taxpayer identification number (TIN) is invalid</td>
<td>5,448 returns</td>
<td>&gt;99.9%</td>
</tr>
<tr>
<td>Required qualifying person’s name and TIN on Form 2441 is missing</td>
<td>741 returns</td>
<td>&gt;99.9%</td>
</tr>
</tbody>
</table>
Due to the closure of several Federal Records Centers (FRCs), Submission Processing was unable to retrieve the 2019 paper tax returns identified by TIGTA where the provider tax identification number (TIN) was missing. IRS management disagreed on 43,818 paper tax returns because Submission Processing could not conclusively categorize them as processing errors without viewing actual paper returns, and TIGTA confirmed that they had not reviewed the actual paper returns. After working with Counsel on math error authority for tax returns with Individual Taxpayer Identification Numbers (ITIN), Submission Processing has updated its programming to stop the CDCC claimed for dependents with an ITIN. Counsel confirmed that Submission Processing does not have.

As recognized, the IRS was responsive to many alerts to address processing deficiencies before taxpayers begin filing claims for the refundable CDCC during Processing Year 2022. The changes to the CDCC will make it one of the largest refundable credits. As a result, we developed new processing procedures for the expanded CDCC eligibility requirements and developed compliance filters to ensure taxpayers who are eligible receive the CDCC.

We also updated the 2021 Instructions for Form 2441, Child and Dependent Care Expenses, and Publication 503, Child and Dependent Care Expenses. The updated instructions and publication are currently available for tax year 2021. We started the process to update Form 2441, Dependent Care Expenses, and pending comment and

<table>
<thead>
<tr>
<th>Reason</th>
<th>Number of Returns</th>
<th>Accuracy Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess qualifying expenses allowed when a qualifying person was not yet born</td>
<td>8 returns</td>
<td>&gt;99.9%</td>
</tr>
<tr>
<td>Programming limitations allow taxpayers to circumvent limits for prior year expenses</td>
<td>1,183 returns</td>
<td>&gt;99.9%</td>
</tr>
<tr>
<td>Primary and secondary taxpayer do not both have earned income listed on Form 2441</td>
<td>329 returns</td>
<td>&gt;99.9%</td>
</tr>
<tr>
<td>Care providers on Form 2441</td>
<td>43,818 returns</td>
<td>&gt;99.3%</td>
</tr>
<tr>
<td>CDCC expenses allowed for the primary or secondary taxpayer</td>
<td>3,322 returns</td>
<td>&gt;99.9%</td>
</tr>
<tr>
<td>An Individual Taxpayer Identification Number (ITIN) was used to identify the primary, secondary or dependent(s)</td>
<td>49,859 returns</td>
<td>&gt;99.2%</td>
</tr>
<tr>
<td>Qualifying expenses allowed for a care provider whose main purpose did not appear to be for a qualifying person's well-being and protection</td>
<td>9,936 returns</td>
<td>&gt;99.8%</td>
</tr>
<tr>
<td>Taxpayers filed Married Filing Separately</td>
<td>580 returns</td>
<td>&gt;99.9%</td>
</tr>
<tr>
<td>Total</td>
<td>120,893 returns</td>
<td>&gt;98.0%</td>
</tr>
</tbody>
</table>
any potential legislative changes, the form will be updated for tax year 2022 and scheduled for release in December 2022.

We also developed several new pre- and post-refund compliance filters for audit consideration to identify taxpayers who may not be eligible for the CDCC. These taxpayers will be required to provide additional verification starting in Processing Year 2022.

Currently, the expanded CDCC is only for tax year 2021. The IRS understands that if the expanded credit is extended, additional processing procedures and compliance filters may be required.

Our responses to your specific recommendations are enclosed. If you have any questions, please contact me, or a member of your staff may contact Mike Beebe, Director, Return Integrity and Compliance Services, at 470-639-3250.

Attachment
Recommendations

The Commissioner, Wage and Investment (W&I) Division, should:

**RECOMMENDATION 1**

Update processes to remove from Form 2441 the care provider’s and the amount paid to the care provider.

**CORRECTIVE ACTION**

At the time of this response, legislation has not been enacted to extend the refundable credit status of the Child and Dependent Care Credit (CDCC), or to retain the amount of credit allowable for tax year 2021. We will monitor pending legislation and, if the CDCC is subsequently extended as a refundable credit for tax years 2022 or later, we will evaluate our processes and request the requisite programming and procedural changes to address this issue.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A

**CORRECTIVE ACTION MONITORING PLAN**

N/A

**RECOMMENDATION 2**

Update paper verification processes to generate errors in the Error Resolution System when the or amounts paid to the care provider are missing.

**CORRECTIVE ACTION**

At the time of this response, legislation has not been enacted to extend the refundable credit status of the Child and Dependent Care Credit (CDCC), or to retain the amount of credit allowable for tax year 2021. We will monitor pending legislation and, if the CDCC is subsequently extended as a refundable credit for tax years 2022 or later, we will evaluate our processes and request the requisite programming and procedural changes to address this issue.

**IMPLEMENTATION DATE**

N/A

**RESPONSIBLE OFFICIAL**

N/A
CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 3
Revise Form 2441 to include checkboxes to note whether dependent care expenses are for a spouse or dependent who is physically or mentally incapable of caring for themselves or if special deemed earned income rules apply.

CORRECTIVE ACTION
For tax year 2021, the IRS revised the Instructions for Form 2441, Child and Dependent Care Expenses, by adding a caution paragraph for Line 2 that states “Don’t list a person on line 2 unless they qualify as an eligible person under Qualifying Person(s), earlier.” This paragraph was added to address the issue of potentially ineligible individuals being listed as qualifying individuals.

For tax year 2022, we will revise Form 2441 by adding a checkbox to Part I, line C. The line C checkbox will be used to indicate whether a taxpayer or their spouse was a student or disabled during the tax year and they intend to enter deemed income on Form 2441. The line also directs the reader to “If You or Your Spouse Was a Student or Disabled” in the Instructions for Form 2441, where more information about who qualifies as a student or disabled is provided. We will also add a new question to Form 2441, Part II, line 2, column (c), to identify disabled individuals, since anyone over the age of 12 listed on line 2 must be disabled.

IMPLEMENTATION DATE
February 15, 2023

RESPONSIBLE OFFICIAL
Director, Refundable Credit 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 4
Develop a process to identify tax returns with adult [REDACTED]. These tax returns should be considered for selection for post-refund compliance reviews.

CORRECTIVE ACTION (1 of 2)
For Processing Year 2022, W&I developed a compliance filter to identify tax returns claiming CDCC for an adult who may not be disabled for possible post-refund treatment. Returns will be evaluated to determine potential non-compliance.
IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Refundable Credit 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.

CORRECTIVE ACTION (2 of 2)
We agree to assess this population once adequate data is available from tax year 2021 returns to determine the scope of potential noncompliance that meets our selection tolerance.

IMPLEMENTATION DATE
March 15, 2023

RESPONSIBLE OFFICIAL
Director, Examination Case Selection, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 5
Work with the Department of the Treasury, Office of Tax Policy, to obtain the legal authority to disallow the CDCC when the primary or secondary taxpayer is identified by an ****2**** ITIN on Form 2441.

CORRECTIVE ACTION
We will elevate this issue to the Office of Tax Policy for consideration as a legislative request; however, the legal authority to deny the Child and Dependent Care Credit to individuals filing with ****2**** Individual Taxpayer Identification Numbers, must ultimately be provided by Congress.

IMPLEMENTATION DATE
June 15, 2023

RESPONSIBLE OFFICIAL
Director, Submission Processing, Wage and Investment Division
CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.

RECOMMENDATION 6
Develop a process to identify tax returns with ITINs used to identify the care provider. These tax returns should be considered for selection for post-refund compliance reviews.

CORRECTIVE ACTION
The IRS does not have legal authority to disallow the CDCC when a taxpayer uses an ITIN for the care provider.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

RECOMMENDATION 7
Revise Form 2441 instructions and Publication 503, using examples, so taxpayers may better understand the requirements for qualifying care and expenses.

CORRECTIVE ACTION
The IRS added two examples on page 8 of Publication 503, Child and Dependent Care Expenses, under “Camp”, to help clarify that expenses incurred for summer camp qualify for the credit, but expenses incurred for summer tutoring do not qualify. The examples are based on Examples 4 and 5 in Treasury Regulation § 1.21-1(d)(12).

IMPLEMENTATION DATE
February 15, 2022

RESPONSIBLE OFFICIAL
Director, Refundable Credit 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 8
Develop a process to identify tax returns with **********2************************************************. These tax returns should be selected for post-refund compliance reviews.

CORRECTIVE ACTION
The determination as to whether the expenses qualify for the dependent care depends on the Treasury Regulation rules and the specific facts and circumstances of each situation.

IMPLEMENTATION DATE
N/A

RESPONSIBLE OFFICIAL
N/A

CORRECTIVE ACTION MONITORING PLAN
N/A

Recommendation

RECOMMENDATION 9
The Commissioner, Wage and Investment Division, should coordinate with the Small Business/Self-Employed Division to develop a compliance plan for post-refund treatment of cases involving *******************************2************************************************.*************2*******************.

CORRECTIVE ACTION (1 of 2)
For Processing Year 2022, returns which claim the CDCC for a child who has been ******************2*************** are considered for further review under the W&I duplicate TIN process already in place.

IMPLEMENTATION DATE
Implemented

RESPONSIBLE OFFICIAL
Director, Refundable Credit Program Management, Return Integrity and Compliance Services, Wage and Investment Division
CORRECTIVE ACTION (2 of 2)
We agree to assess this population once adequate data is available from tax year 2021 returns to determine the scope of potential noncompliance that meets our selection tolerance.

IMPLEMENTATION DATE
March 15, 2023

RESPONSIBLE OFFICIAL
Director, Examination Case Selection, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN
We will monitor this corrective action as part of our internal management control system.
## Glossary of Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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</thead>
<tbody>
<tr>
<td>Data Center Warehouse</td>
<td>A TIGTA repository of IRS data.</td>
</tr>
<tr>
<td>Employee User Portal</td>
<td>The internal IRS portal that allows employees to access IRS data and systems (such as tax administration processing systems and financial information systems) in a secure, authenticated session.</td>
</tr>
<tr>
<td>Employer Identification Number</td>
<td>A unique, nine-digit number used to identify a taxpayer’s business account.</td>
</tr>
<tr>
<td>Error Resolution System</td>
<td>A system for the examination and correction of returns rejected because of taxpayer and processing errors.</td>
</tr>
<tr>
<td>Individual Return Transaction File</td>
<td>A database maintained by the IRS that contains information on the individual tax returns it receives.</td>
</tr>
<tr>
<td>Individual Tax Identification Number</td>
<td>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.</td>
</tr>
<tr>
<td>Integrated Data Retrieval System</td>
<td>IRS computer system capable of retrieving or updating stored information. It works in conjunction with a taxpayer’s account records.</td>
</tr>
<tr>
<td>Master File</td>
<td>The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.</td>
</tr>
<tr>
<td>Modernized Electronic Filing</td>
<td>A web-based platform for filing approximately 330 tax forms with the IRS. It serves to streamline filing processes and reduce the costs associated with a paper-based process.</td>
</tr>
<tr>
<td>National Account Profile</td>
<td>IRS database that is a compilation of selected entity data from various IRS Master Files that also includes data from the Social Security Administration.</td>
</tr>
<tr>
<td>Perfecting</td>
<td>Making returns acceptable for data entry through the editing process.</td>
</tr>
<tr>
<td>Processing Year</td>
<td>The calendar year in which the tax return or document is processed by the IRS.</td>
</tr>
<tr>
<td>Tax Year</td>
<td>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.</td>
</tr>
<tr>
<td>Taxpayer Identification Number</td>
<td>A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is either an EIN, an SSN, or an ITIN.</td>
</tr>
<tr>
<td>Transcription</td>
<td>The process of transferring information from documents to a computer-readable form.</td>
</tr>
</tbody>
</table>
## Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CDCC</td>
<td>Child and Dependent Care Credit</td>
</tr>
<tr>
<td>E-File(d)</td>
<td>Electronically File(d)</td>
</tr>
<tr>
<td>EIN</td>
<td>Employer Identification Number</td>
</tr>
<tr>
<td>IRS</td>
<td>Internal Revenue Service</td>
</tr>
<tr>
<td>ITIN</td>
<td>Individual Taxpayer Identification Number</td>
</tr>
<tr>
<td>SSN</td>
<td>Social Security Number</td>
</tr>
<tr>
<td>TIGTA</td>
<td>Treasury Inspector General for Tax Administration</td>
</tr>
<tr>
<td>TIN</td>
<td>Taxpayer Identification Number</td>
</tr>
</tbody>
</table>
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.