

**Opportunities Exist to  
Improve the Administration  
of the Earned Income Tax Credit**

**June 2003**

**Reference Number: 2003-40-139**

**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.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

June 27, 2003

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Assistant Inspector General for Audit (Small Business and  
Corporate Programs)

SUBJECT: Final Audit Report - Opportunities Exist to Improve the  
Administration of the Earned Income Tax Credit  
(Audit # 200340035)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) progress in improving the administration of the Earned Income Tax Credit (EITC) Program since September 30, 2000. This review is a follow-up to the Treasury Inspector General for Tax Administration report issued in September 2000.<sup>1</sup>

The EITC is a major Federal effort to assist the working poor. The IRS has the responsibility for administering the EITC, which is a refundable credit available to taxpayers who file returns with certain earned income. The EITC was established to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment rather than welfare. Historically, the EITC Program has been vulnerable to high rates of noncompliance (overclaims).<sup>2</sup> Based on an IRS report of the estimated \$31.3 billion in EITC claims made by taxpayers for Tax Year 1999, an estimated \$8.5 to \$9.9 billion (27 to 32 percent) should not have been paid. The General Accounting Office has listed the IRS' administration of the EITC among the high-risk areas for the Federal Government.

IRS efforts to improve the administration of the EITC Program are ongoing. The IRS reports that it has denied approximately \$2.25 billion in erroneous claims since September 2000. It has implemented a number of initiatives targeting outreach,

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<sup>1</sup> *Management Advisory Report: Administration of the Earned Income Credit* (Reference Number 2000-40-160, dated September 2000).

<sup>2</sup> An EITC overclaim is the amount of the EITC claimed by taxpayers above the amount to which they are entitled.

education, and compliance efforts. The IRS also participated in a joint Treasury-IRS task force to study EITC overclaims. This resulted in the IRS initiating a significant change to the way it will address EITC noncompliance, for example by requiring EITC applicants who meet certain criteria to pre-certify and requiring new information on EITC returns.

The IRS recently reorganized the EITC Program Office to capitalize on the strategic planning and research resources in the Wage and Investment Division's Office of Strategy and Finance. It also created an Executive Advisory Council made up of IRS executives involved in the administration of the EITC Program to help provide better oversight and coordination of the Program. The Program Office has drafted new annual performance measures for the EITC Program for Fiscal Years (FY) 2003 and 2004.

However, the EITC Program Office will not be able to measure the success of its efforts because the IRS has been unable to provide meaningful outcome data necessary to establish long-term performance measures and goals. The IRS was appropriated \$437 million for the administration of the EITC Program from FYs 2001 through 2003. Without long-term performance measures and goals, the IRS cannot be assured that the activities where these funds were spent helped it achieve the Program's purpose. In addition, the administration of the EITC is fragmented and crosses different IRS functions and business units. We believe that competing goals and differing approaches created by the IRS' current structure may have been caused by inadequate direct executive oversight and accountability. The reorganized EITC Program Office and Executive Advisory Council may alleviate some of the differing approaches taken to administer the Program and help ensure coordination among the offices and functions involved.

We recommended that the Commissioner, Wage and Investment Division, establish long-term goals and measures for the EITC Program that reflect the Program's anticipated outcomes over time and a consistent method to measure progress toward these long-term goals. However, since the new EITC Program Office and Executive Advisory Council were just created this fiscal year, we are not recommending any changes to the EITC Program Office. As part of our ongoing audit coverage of the EITC, we will revisit our concern to determine if the recent changes to the Program provide accountability and recognition of its value and importance to both its internal and external stakeholders.

Management's Response: IRS management agreed with our recommendation to establish long-term goals for the administration of the EITC Program. The IRS also agreed with the need to establish a process to measure EITC participation. However, the IRS did not agree with the need to establish a method to measure EITC compliance, stating it already has an effective process to measure compliance. The IRS stated that it had conducted two EITC compliance studies, and a third study is in process.

The IRS also disagreed with our outcome measure of \$437 million from FYs 2001 through 2003. The IRS responded that while it has not quantified long-term EITC goals, it has always been committed to administering an EITC Program that ensures participation by only eligible taxpayers.

Office of Audit Comment: We agree that the IRS has conducted studies in the past to measure compliance with the EITC. However, we previously reported that those studies were not conducted using a consistent test methodology, and the test methodologies for both the Tax Years 1997 and 1999 studies were flawed.<sup>3</sup> The IRS is in the process of conducting a third study of EITC compliance. Again, the test methodology is inconsistent with prior studies. The IRS has taken steps to modify the test results from each study to make them comparable. However, to ensure consistent measurement over time, the tests should be conducted using the same or similar test methodologies. Only through consistent measurement will the IRS be able to demonstrate its progress over time and show how it has reduced erroneous payments or increased participation. While we continue to believe our recommendation is worthwhile, we do not intend to elevate this disagreement to the Department of the Treasury.

We also believe the \$437 million is a valid representation of the IRS' need to develop long-term goals and measures. We do not believe that the IRS has demonstrated the effectiveness of its measures. The *President's Management Agenda, Fiscal Year 2002*, places the burden of proof on the agency to demonstrate that the programs they advocate actually accomplish their goals and do so better than alternative ways of spending the same money. The IRS cannot determine if the EITC Program results are significant to its efforts to reduce EITC noncompliance and increase participation because it has not established a long-term goal against which to measure progress.

In FY 2002, the Office of Management and Budget (OMB) evaluated the EITC Program using the Program Assessment Rating Tool (PART) and found that the Program was ineffective because the IRS could not demonstrate that its efforts have had a significant impact on EITC compliance. Using the PART, the OMB is getting closer to using performance information to end or reform programs that either cannot demonstrate positive results or are clearly failing, and putting resources in programs that can prove they are successful. A copy of management's complete response to the draft report is included as Appendix IX.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-7085.

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<sup>3</sup> *There Are Significant Weaknesses in the Internal Revenue Service's Efforts to Measure Earned Income Credit Compliance* (Reference Number 2002-40-021, dated December 2001).

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of the Earned Income Tax Credit**

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## Opportunities Exist to Improve the Administration of the Earned Income Tax Credit

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### Background

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In 1975, the Congress amended the Internal Revenue Code to provide a credit to taxpayers with certain earned income.<sup>1</sup> The credit, known as the Earned Income Tax Credit (EITC), is a refundable credit established to offset the impact of Social Security taxes on low-income families and to encourage them to seek employment rather than welfare. The Internal Revenue Service (IRS) has the responsibility for administering the EITC.

Since 1975, additional legislation has been passed in an attempt to clarify the qualifications for the credit and make it easier for more people to claim it. This has made the administration of the credit more complex. The IRS has gone from the use of a single line on the tax return for the EITC to a 53-page publication and schedule in Tax Year (TY) 2002 devoted to EITC instructions and computations. See Appendix V for details on the EITC rules.

The EITC is America's largest antipoverty program. The Urban Institute<sup>2</sup> estimates that the revenue cost of the EITC was \$31 billion for Calendar Year (CY) 2000. By comparison, food stamps cost the Federal Government \$19 billion that same year. Temporary Assistance to Needy Families, the replacement for welfare, cost \$21 billion. The other big tax subsidy for children, the child credit, cost \$19 billion, but only \$4.2 billion of that amount went to families with incomes less than \$30,000.<sup>3</sup>

The EITC grew substantially from 1975 until 1995 and has remained steady since 1995. The number of taxpayers claiming the EITC increased from about 6.2 million in TY 1975 to 19.1 million in TY 2001. During the same period, the average credit increased from about \$202 to \$1,691. See Figures 1 and 2 for the total number of taxpayers claiming EITC and the total dollars claimed.

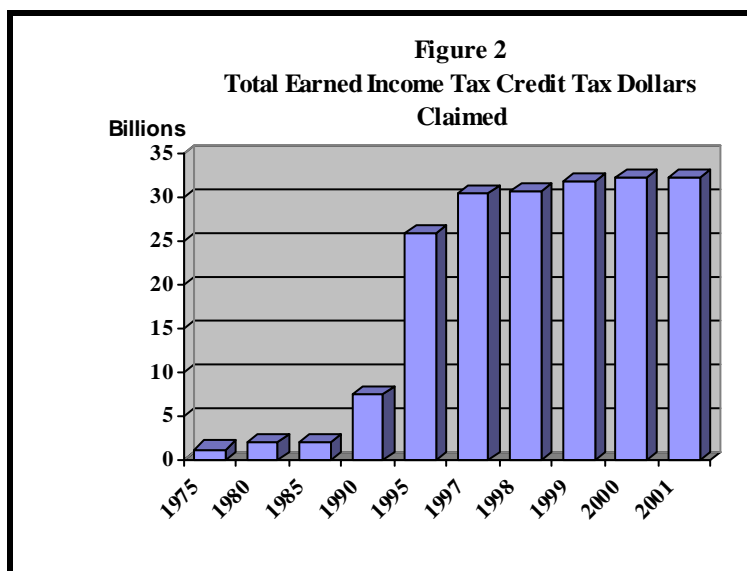
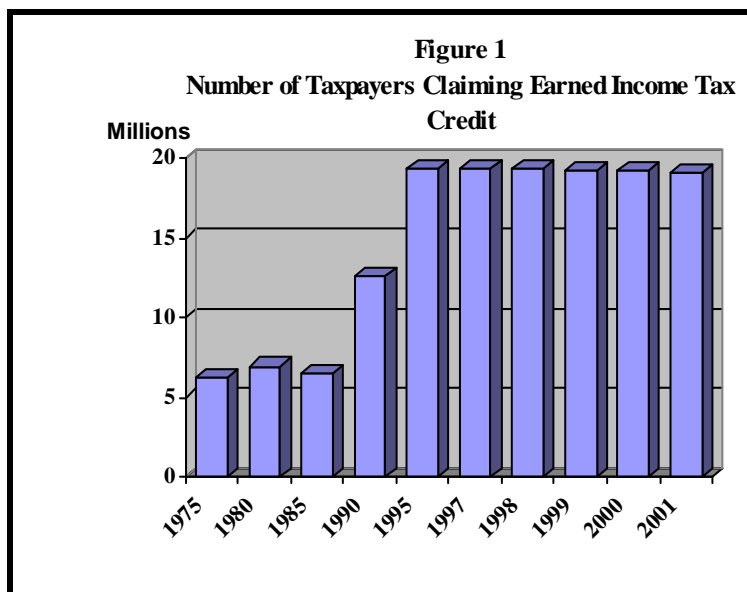
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<sup>1</sup> Tax Reduction Act of 1975, Pub. L. No. 94-12, § 204, 89 Stat. 26, 30-32.

<sup>2</sup> The Urban Institute is a nonprofit nonpartisan policy research and educational organization established to examine the social, economic, and governance problems facing the nation.

<sup>3</sup> *Making EITC More European*, Tax Notes Today, dated November 13, 2002.

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Source for Figures 1 and 2: IRS Statistics of Income Bulletins and IRS Processing Reports.

Historically, the EITC Program has been vulnerable to high rates of noncompliance (overclaims).<sup>4</sup> The IRS reported that an estimated \$8.5 to \$9.9 billion (27 to 32 percent) of the estimated \$31.3 billion in EITC claims made by

<sup>4</sup> An EITC overclaim is the amount of the EITC claimed by taxpayers above the amount to which they are entitled.

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taxpayers for TY 1999 should not have been paid. The General Accounting Office (GAO) has listed the IRS' administration of the EITC among the high-risk areas for the Federal Government.

The IRS reports that it has denied approximately \$2.25 billion in erroneous claims since September 2000. However, the IRS has not been able to determine if it has been effective in reducing noncompliance and has not been able to determine how much of the noncompliance is due to the complex EITC provisions or to fraud.

*The President's Management Agenda, Fiscal Year 2002*,<sup>5</sup> includes five Government-wide initiatives, one of which is improved financial management. This initiative calls for the Administration to establish a baseline on the extent of erroneous payments. In addition, it discusses the reduction of improper payments as a key element under its initiative to improve financial performance within the Federal Government.

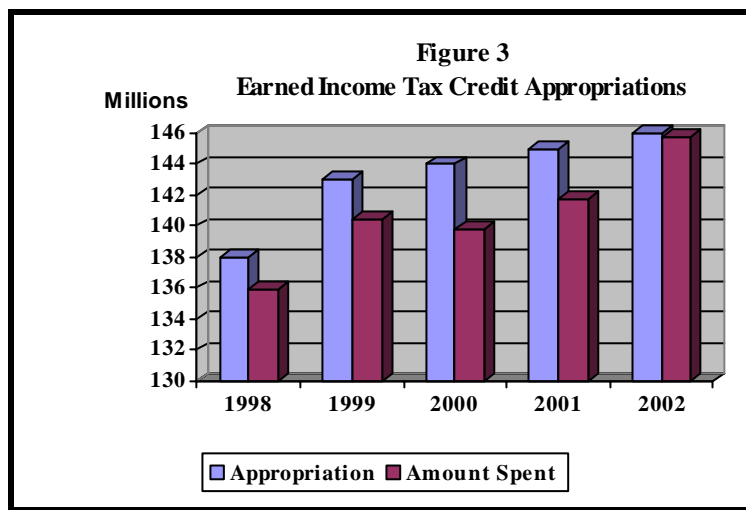
To help improve the administration of the EITC and reduce overclaims, in 1997, the Congress provided a \$716 million appropriation to the IRS over a 5-year period (Fiscal Years (FY) 1998 through 2002). For FY 2003, the Congress provided an additional \$146 million appropriation to the IRS for the administration of the EITC. The following figure shows the amount of the appropriation spent by the IRS by fiscal year.

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<sup>5</sup> Executive Office of the President, Office of Management and Budget, *The President's Management Agenda, Fiscal Year 2002* (Washington, D.C.: August 2001).



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Source: IRS Tracking – EITC Appropriation.

This audit is a follow-up to the Treasury Inspector General for Tax Administration (TIGTA) report issued in September 2000.<sup>6</sup> It was conducted in the EITC Program Office, Office of Strategy and Finance, in the IRS' Wage and Investment (W&I) Division in Atlanta, Georgia. This audit was conducted in accordance with *Government Auditing Standards* from November 2002 through March 2003. We evaluated the IRS' progress in administering the EITC Program between October 1, 2000, and October 31, 2002. Our testing was limited to reviewing TIGTA and IRS management reports issued in FYs 2001 and 2002 and discussing the EITC Program with appropriate IRS officials. We did not conduct testing to verify the accuracy of the reports, nor did we do any audit tests to validate the data reported by the IRS. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### Efforts to Improve the Administration of the Earned Income Tax Credit Are Ongoing

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The IRS initiated a number of activities during FYs 2001 and 2002 to improve participation and compliance in the EITC Program. In addition, the IRS completed actions to address TIGTA recommendations from prior reports aimed at improving the administration of the credit.

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<sup>6</sup> *Management Advisory Report: Administration of the Earned Income Credit* (Reference Number 2000-40-160, dated September 2000).

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### **Increased outreach and education activities**

The IRS has implemented actions designed to bring people who are eligible for the EITC but not claiming it into the EITC Program. During FYs 2001 and 2002, the IRS implemented outreach and education activities to help increase participation. For example:

- The EITC Advocacy Strategy provides proactive outreach campaigns for organizations that are advocates of EITC activities.
- The English as a Second Language Strategy campaigns for EITC awareness. It targets individuals for whom English is a second language regarding their EITC rights and responsibilities and the availability of assistance for return preparation.
- The EITC Public Awareness Strategy sponsors special EITC events and outreach sessions across the country in geographical areas where a high number of taxpayers eligible for the EITC reside.

### **Additional compliance initiatives**

In addition to its increased outreach and education activities, the IRS implemented initiatives to improve its compliance efforts. For example:

- The EITC Fraud Strategy focuses on identifying and screening specific types of cases determined to have a high level of potential fraud.
- The Return Preparer Strategy focuses on preparers who are paid by taxpayers to prepare their tax returns. The primary focus was on educating preparers on the qualifications to claim the EITC, the most common errors made when claiming the EITC, and the EITC due diligence rules.<sup>7</sup> Of taxpayers claiming the EITC, 62 percent go to a paid tax return preparer. Tax return preparers are responsible for 68 percent of the errors or overclaims on EITC returns.

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<sup>7</sup> Tax preparers must meet certain criteria when preparing an EITC return to show that they exercised due diligence in preparing the return.

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- The Risk-Based Examination Program focuses on developing an examination case selection process using a risk-based approach. Workload is selected based upon data analysis and evaluation of risk.

A comprehensive list of FYs 2001 and 2002 initiatives can be found in Appendix VI.

In its continuing efforts to increase participation and reduce noncompliance in the EITC Program, the IRS has focused more on educating tax return preparers to reduce errors and improve compliance. However, in FY 2003, the IRS is beginning to shift its focus more toward enforcement of the preparers' due diligence requirements.<sup>8</sup>

The IRS is also restructuring its Public Awareness Strategy. The IRS has begun looking at ways to refine its EITC messages to reflect public awareness of the EITC. The IRS advised us that current marketing studies show that when people are asked about the EITC, they know what the credit is 88 percent of the time.

In FY 2002, the Department of the Treasury formed a joint Treasury-IRS task force to study EITC overclaims. The task force used the TY 1999 compliance study as the basis for its recommendations. As a result of the task force, the IRS is making preparations to radically change the way it addresses EITC noncompliance. The IRS will require EITC applicants meeting certain criteria to pre-certify that the children claimed on their returns are really qualifying children for the EITC. Also, the IRS will delay refunds on returns deemed to be at high risk for filing status or income errors while agents take action to resolve cases. High-risk returns will be identified by researching taxpayer historical compliance and by requiring new information on EITC returns.

### **Completed actions on prior report recommendations**

During FYs 2001 and 2002, the TIGTA issued 9 audit reports recommending 29 improvements to the EITC

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<sup>8</sup> Requirements designed to show tax return preparers were attentive to the qualifications of the EITC and the accuracy of the information provided by the taxpayer when preparing EITC returns.

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Program. The IRS agreed with and took corrective action on 19 of the 29 recommendations. The IRS did not agree with 10 of the recommendations for various reasons.

Actions taken in response to TIGTA recommendations include:

- Redesigning the form used to request realignment of EITC funds and to request additional resources.
- Requesting, on a monthly basis, copies of the supporting documentation that functions gather to support their EITC workload results.
- Establishing a monthly computer extract of nonreversed refunds suspended during the EITC recertification process.<sup>9</sup> The listing is forwarded on a monthly basis to each Examination Branch for action and resolution.

Appendix VII provides a list of the TIGTA audit recommendations along with the IRS' corrective actions.

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### Long-Term Performance Goals and Measures Are Still Needed

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The mission of the EITC Program is to ensure that eligible taxpayers receive the EITC and unsubstantiated claims are eliminated. Although the IRS has taken a number of steps to improve its administration of the EITC, the EITC Program Office cannot determine if these or any future actions will allow the IRS to reach its ultimate goals of increasing participation and reducing overclaims. As discussed in prior TIGTA reports,<sup>10</sup> the IRS has been unable to provide the meaningful outcome data necessary to establish long-term performance goals and measures. However, Federal Government agencies are expected to identify high-quality outcome measures and accurately monitor performance of programs.

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<sup>9</sup> IRS process for recertifying eligibility for the EITC in the year following a disallowance of the credit.

<sup>10</sup> *The Internal Revenue Service Should Continue to Develop Its Measures Program to Ensure That Its GPRA [Government Performance and Results Act] Measures Cover All of the Major Components of Tax Administration* (Reference Number 2002-10-097, dated May 2002), and *Management Advisory Report: Administration of the Earned Income Credit* (Reference Number 2000-40-160, dated September 2000).

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### **Consistent, timely data have not been available to establish a baseline and annual goals**

The IRS has attempted to measure its progress toward meeting the Program's mission of reducing overclaims and ensuring all taxpayers who are eligible claim the EITC. However, collecting information to compute an EITC compliance rate under the IRS' current processes has been time-consuming and resource-intensive.

In CYs 2000 and 2002, the IRS conducted studies to estimate the compliance rates using TYs 1997 and 1999 EITC tax returns, respectively. In CY 2002, it conducted another study to estimate participation rates using TY 1996 tax returns.

However, the methods used to conduct the compliance studies differed and provided inconsistent results. In December 2001, the TIGTA reported that the IRS had made some improvements in its methodology to measure EITC compliance from TYs 1997 to 1999,<sup>11</sup> but the IRS used unsupported data and dissimilar methodologies. Though the IRS did not agree with our assessment, the IRS adjusted the results of the CYs 2000 and 2002 compliance studies to compensate for the differences in the methodologies. The adjustments allowed the IRS to compare the results of the two studies.

The IRS has used the results of its compliance studies to guide its EITC efforts. However, the information gained from the studies is not current. The study of TY 1997 tax returns was started in CY 1998 and was not completed until CY 2000. The most recent compliance study using TY 1999 data was started in CY 2000 and was not completed until CY 2002. The IRS is using this dated information to make Program decisions regarding its current compliance efforts. In addition, the IRS' study of the EITC participation rate, completed in CY 2002, estimated participation in the EITC Program on TY 1996 returns. While the scope of the study appears to encompass most

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<sup>11</sup> *There Are Significant Weaknesses in the Internal Revenue Service's Efforts to Measure Earned Income Credit Compliance* (Reference Number 2002-40-021, dated December 2001).

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potentially eligible taxpayers, the data are not current enough to reflect the changing population.

### **Long-term performance goals and measures have not been established**

While the IRS has created short-term performance measures, it has not established long-term performance goals and measures to gauge its efforts to increase participation and reduce noncompliance in the EITC Program. In FY 1997, the IRS established a goal to improve compliance with the EITC by \$5 billion over 10 years. However, this goal does not appear in its FYs 2001 or 2002 strategic planning or budget documents. The goal also does not appear in evaluations of the performance of the Program. The IRS also has not established a long-term goal for improving participation in the Program.

The IRS has established short-term performance measures that measure the Program's activities and productivity. For example, to measure compliance, the IRS counts how many tax returns claiming the EITC are examined and how many examinations are closed, grades the quality of examination cases, and quantifies the average length of time an examiner takes to examine an EITC tax return. To measure education and outreach efforts to reduce errors on EITC returns prepared by paid preparers, the IRS counts the number of tax preparer contacts. The IRS uses these results to set short-term goals for the Program.

These are valid indicators or measures to gauge the activity or productivity (i.e., output) of the Program and are appropriate measures to assess short-term goals for the Program. However, these goals do not measure the outcome of the Program, i.e., the results of the IRS' efforts to reduce noncompliance and increase participation in the EITC Program.

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The Government Performance and Results Act of 1993<sup>12</sup> and related Office of Management and Budget (OMB) circulars require Federal agencies, as part of the strategic planning process, to develop general goals and objectives, including outcome-related goals and objectives, for the major functions and operations of the agency. The agencies must develop goals and objectives that define the level of performance to be achieved by a program activity. Those goals should be quantifiable and measurable unless authorized to be in an alternative form.

Both the GAO<sup>13</sup> and the TIGTA<sup>14</sup> have reported the need for the IRS to develop long-term Program goals and measures. In addition, as part of the FY 2004 budget process, the OMB recently assessed the EITC Program, giving it an ineffective rating mainly because of the significant amount of EITC overclaims.<sup>15</sup> The OMB reported that its assessment indicates the EITC compliance initiative failed to reduce EITC erroneous payments to acceptable levels. While the IRS has a strong planning process closely linked to its budget process, it has not yet set performance targets that allow it to demonstrate results or developed long-term performance goals for the EITC Program.

Without long-term goals and measures, the IRS cannot be assured the EITC Program is meeting its purpose of alleviating the impact of Social Security credits on low-income wage earners and encouraging them to seek employment rather than welfare. Not having long-term goals and measures impairs management's and the Congress' ability to make informed decisions related to the EITC. In addition, the IRS will not be able to meet the

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<sup>12</sup> Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

<sup>13</sup> *Internal Revenue Service: Serious Weaknesses Impact Ability to Report on and Manage Operations* (GAO/AIMD-99-196, dated August 1999).

<sup>14</sup> *The Internal Revenue Service Should Continue to Develop Its Measures Program to Ensure That Its GPRA Measures Cover All of the Major Components of Tax Administration* (Reference Number 2002-10-097, dated May 2002).

<sup>15</sup> OMB Program Assessment Rating Tool (PART).

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*President's Management Agenda, Fiscal Year 2002*, goal for improving financial performance and reducing erroneous payments.

The IRS is also not assured that it is effectively spending the roughly \$143 million budgeted annually for the EITC. The amount budgeted for the EITC in FYs 2001, 2002, and 2003 totaled \$437 million. In addition, the President's FY 2004 budget proposal contains an additional \$100 million for the IRS to expand its efforts to combat EITC overclaims. Yet the IRS has neither established goals or measures nor set a baseline with which to determine the success of the new Program.

The IRS has recognized the need to develop better performance measures for the EITC Program. It has drafted new annual performance measures for FYs 2003 and 2004 and is developing ways to collect the data necessary to quantify those measures. The IRS also advised us that it is taking steps to gather more current information on EITC compliance and participation. Specifically the IRS:

- Obtained a copy of current Census Bureau information for use in an updated analysis of participation in the EITC Program.
- Included EITC compliance in its FY 2003 National Research Project (NRP). The NRP is similar to prior IRS studies to measure the level of voluntary compliance with the Internal Revenue Code.
- Developed a method to be able to compare the results of the NRP to the TYs 1997 and 1999 EITC compliance studies.

### **Recommendations**

The Commissioner, W&I Division, should:

1. Establish long-term goals and related measures for the EITC Program that reflect the Program's anticipated outcomes over time.



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Management's Response: The IRS agreed with the need to establish long-term goals and measures for the EITC Program.

2. Establish a consistent method to measure progress toward its long-term goals. The method should include an assessment of the frequency with which the measures are computed.

Management's Response: The IRS agreed with the need to establish a consistent method to measure EITC participation. However, it disagreed that a consistent method was needed to measure EITC compliance since an effective process already exists.

Office of Audit Comment: The IRS measured EITC compliance using TYs 1997 and 1999 tax returns. However, we previously reported that the methodology used to conduct these studies was inconsistent and flawed.<sup>16</sup> The IRS is in the process of conducting a third study of EITC compliance, but the methodology being used is not consistent with the prior two studies. The IRS has modified the results of its TYs 1997 and 1999 studies to make them comparable and plans to do the same with the current compliance study. Only through consistent measurement will the IRS be able to demonstrate its progress over time and show how it has reduced erroneous payments or increased participation.

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### **Fragmented Management Reduces the Effectiveness of Efforts to Improve Administration of the Credit**

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The administration of the EITC crosses different IRS functions and business units. The EITC Program Office conducts the EITC strategic planning and oversees outreach and education efforts. Two different business units process and examine the tax returns claiming the EITC. Two additional functions provide taxpayers with avenues to appeal and resolve any EITC processing or examination problems.

This fragmented administration, in effect, diffuses the accountability for the Program results. In addition, although

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<sup>16</sup> *There Are Significant Weaknesses in the Internal Revenue Service's Efforts to Measure Earned Income Credit Compliance* (Reference Number 2002-40-021, dated December 2001).

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the Program has had an average annual appropriation of \$143 million, there is no executive level to head EITC efforts to provide accountability and recognition to the value and importance of the Program to both its internal and external stakeholders. The significance of the EITC Program within the IRS shows no signs of diminishing as long as noncompliance is high. In the President's FY 2004 budget proposal, an additional \$100 million is being requested for new EITC compliance initiatives.

In FY 2001, the IRS realigned its programs into four major business units, each focusing on providing service to specific types of taxpayers. The IRS moved the EITC Program Office under the W&I Division, which is responsible for serving those taxpayers who mainly file tax returns to report either earned income reported by third parties or investment income, and who have no international activity. The EITC Program Office Manager reported directly to the Commissioner, W&I Division.

In July 2002, the IRS reorganized the EITC Program Office and moved it under the Director, Strategy and Finance, within the W&I Division. The Program Manager now reports to the Director, Strategy and Finance, rather than to the Commissioner, W&I Division. The IRS moved the EITC Program Office into the Office of Strategy and Finance to capitalize on the strategic planning and research resources within the W&I Division.

Although the IRS has restructured the EITC Program Office, administration of the credit is still shared throughout the IRS. This process crosses many functional lines and includes conflicting goals and differing approaches for achieving full participation and reducing overclaims. For example, one function's goal is to process paper tax returns and issue refunds within 45 days. Another function's goal is to identify fraudulent returns during processing of the return and stop payment of refunds. See Appendix VIII for a detailed description of the roles and responsibilities of the IRS offices and functions participating in the EITC Program.

In August 2002, the IRS created the EITC Executive Advisory Council to help coordinate the EITC Program.

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The Council's charter states that it serves as the policy-setting body responsible for providing strategy, budget, and operational recommendations to the Commissioner, W&I Division. The Director, Strategy and Finance, W&I Division, chairs the Council, with membership drawn from executives from the Small Business/Self-Employed Division, National Taxpayer Advocate,<sup>17</sup> Criminal Investigation function, and Appeals. The Council also includes representatives from the offices of the Chief Counsel, Chief Financial Officer, National Headquarters Research and Analysis, Communications and Liaison, and the National Treasury Employees Union. The Council provides oversight of and end-to-end accountability for the Program through its membership. According to the Advisory Council Charter, the EITC Program Office will provide ongoing Program management of the Council.

Federal Government management control standards require that agencies ensure appropriate authority, responsibility, and accountability are defined and delegated to accomplish the mission of the organization.<sup>18</sup> The standards also require that an appropriate organizational structure be established to effectively carry out program responsibilities.

We believe that the reorganization of the EITC Program Office and this Council will alleviate some of the differing approaches toward administering the Program and help ensure coordination among the offices and functions involved. Nevertheless, we believe that competing goals and differing approaches created by the IRS' current structure may have been caused by not having direct executive oversight and accountability. However, since the new EITC Program Office and Executive Advisory Council were just created this fiscal year, we are not recommending any changes to the EITC Program Office. As part of our ongoing audit coverage of the EITC, we will determine if these recent changes provide accountability to and

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<sup>17</sup> The National Taxpayer Advocate is not a voting member to maintain the Taxpayer Advocate Service's independence from the IRS.

<sup>18</sup> OMB Circular A-123, as revised June 21, 1995.

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recognition of the value and importance of the Program to both its internal and external stakeholders.

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### Appendix I

#### Detailed Objective, Scope, and Methodology

The objective of this review was to assess the Internal Revenue Service's (IRS) progress in improving the administration of the Earned Income Tax Credit (EITC) Program since Fiscal Year (FY) 2000. To accomplish this objective, we completed the following tests:

- I. Determined the organizational structure, status, goals, and strategies for the EITC Program at the end of FY 2000 (i.e., September 30, 2000). This information served as our benchmark for measuring progress in FYs 2001 and 2002. We reviewed a Treasury Inspector General for Tax Administration (TIGTA) report issued September 2000<sup>1</sup> and the IRS' 2000 business plans and reports to determine the status of the Program at the end of FY 2000.
- II. Determined the changes and progress the IRS has made since September 30, 2000, in the administration of the EITC Program to ensure that everyone who qualified for the credit was aware of their eligibility for it and to help reduce and prevent taxpayers who were not entitled to the EITC from receiving it.
  - A. Identified the projects/programs/initiatives the IRS implemented during FYs 2001 and 2002 in an effort to increase the number of eligible taxpayers who claim the EITC (EITC participation rate) by researching the IRS' FYs 2001 and 2002 strategic plans, identifying new legislative changes, and meeting with appropriate IRS officials in the EITC Program Office.
  - B. Identified TIGTA and General Accounting Office concerns with the IRS' ability or efforts to improve participation in the EITC Program and reduce and prevent EITC overclaims and determined which corrective actions the IRS indicated would be completed prior to the end of FY 2002.
  - C. Evaluated the IRS' activities during FYs 2001 and 2002 to determine its progress in increasing participation in the EITC Program and reducing EITC overclaims by comparing FYs 2001 and 2002 performance results to the results as of the end of FY 2000. We also researched the Internet to compare the EITC to other common assistance programs such as Food Stamps, Temporary Assistance to Needy Families, Assisted Housing, etc.

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<sup>1</sup> *Management Advisory Report: Administration of the Earned Income Credit* (Reference Number 2000-40-160, dated September 2000).

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- D. Identified what the IRS did to prepare for or address changes in the economy or taxpayer base that could affect EITC participation by reviewing the various IRS studies. We also reviewed the IRS' FY 2003 strategic plan for the Wage and Investment Division, the Small Business/Self-Employed Division, and the EITC Program Office to identify planned projects, programs, or initiatives and determined if those planned projects, programs, or initiatives reflected the trends identified.
- III. Identified strengths and weaknesses in the IRS' organizational structure with regards to EITC participation and overclaims and evaluated the IRS' ability to significantly improve the administration of the EITC Program.

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**Appendix II**

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**Appendix III**

**Report Distribution List**

Commissioner N:C

Deputy Commissioner for Services and Enforcement N:DC

Commissioner, Small Business/Self-Employed Division S

Deputy Commissioner, Wage and Investment Division W

Director, Strategy and Finance W:S

Earned Income Tax Credit Program Manager W:EITC

Chief Counsel CC

National Taxpayer Advocate TA

Director, Legislative Affairs CL:LA

Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O

Office of Management Controls N:CFO:AR:M

Audit Liaisons:

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### Appendix IV

#### Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. This benefit will be incorporated into our Semiannual Report to the Congress.

##### Type and Value of Outcome Measure:

- Reliability of Information – Actual; \$437 million for Fiscal Years (FY) 2001 through 2003 (see page 7).

##### Methodology Used to Measure the Reported Benefit:

This outcome is the actual amount appropriated to the Internal Revenue Service (IRS) for the administration of the Earned Income Tax Credit (EITC). The IRS was appropriated \$437 million in FYs 2001 through 2003 (\$145 million in FY 2001, \$146 million in FY 2002, and \$146 million in FY 2003) to administer the EITC Program. However, the IRS cannot determine how effective its efforts to administer the EITC Program have been because it has not established long-term goals and measures that reflect the outcome of the EITC Program.

Reliability of Information is defined as ensuring the accuracy, validity, relevance, and integrity of data, including the sources of data and the applications and processing thereof, used by the organization to plan, monitor, and report on its financial and operational activities. Without long-term goals and measures, management information is insufficient to make judgments on the planning, monitoring, and reporting of the EITC Program.

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### Appendix V

#### Earned Income Tax Credit Rules

Below is a general description of the qualifications taxpayers must meet to be eligible for the Earned Income Tax Credit (EITC). A detailed description of these rules can be found in Internal Revenue Service publication *Earned Income Credit* (EIC) (Publication 596).

**Everyone must meet all of the following rules:**

- You must have a valid Social Security Number.
- Your filing status cannot be “Married filing separately.”
- You must be a United States citizen or resident alien all year.
- You cannot file Foreign Earned Income (Form 2555) or Foreign Earned Income Exclusion (Form 2555-EZ).
- Your investment income must be \$2,550 or less.
- You must have earned income.

**Rules to meet if you have a qualifying child (must meet all):**

- Your child must meet the relationship, age, and residency tests.
- Your qualifying child cannot be used by more than one person to claim the EITC.
- You cannot be a qualifying child of another person.

**Rules if you do not have a qualifying child (must meet all):**

- You must be at least age 25 but under age 65.
- You cannot be the dependent of another person.
- You cannot be a qualifying child of another person.
- You must have lived in the United States more than half of the year.

**Figuring and claiming the EIC (must meet both rules):**

- Your adjusted gross income must be less than:
  - \$33,178 (\$34,178 for married filing jointly) if you have more than 1 qualifying child.
  - \$29,201 (\$30,201 for married filing jointly) if you have 1 qualifying child.
  - \$11,060 (\$12,060 for married filing jointly) if you do not have a qualifying child.
- Your earned income must be less than:
  - \$33,178 (\$34,178 for married filing jointly) if you have more than 1 qualifying child.
  - \$29,201 (\$30,201 for married filing jointly) if you have 1 qualifying child.
  - \$11,060 (\$12,060 for married filing jointly) if you do not have a qualifying child.

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**Appendix VI**

**Earned Income Tax Credit  
Fiscal Years 2001 and 2002 Initiatives**

**Fiscal Year 2001 Initiatives**

Summary of Results:

- Resources: 2,404 Full Time Equivalents (FTE)<sup>1</sup> (108 percent of 2,236 planned FTEs).
- Funds spent for Earned Income Tax Credit (EITC) activities: \$143 million (99 percent of the \$145 million budgeted).
- Revenue Protected: \$1.2 billion EITC revenue realized through the fourth quarter of Fiscal Year (FY) 2001.

<b>Initiative</b>	<b>Description of Initiative</b>
<b>Communication</b>	<ul style="list-style-type: none"> <li>• Developed communication strategies to implement a national EITC campaign to support territories' local marketing and promotional efforts.</li> <li>• Provided support for conventions and conferences focusing on low-income wage earners and on family issues to market and promote the EITC to external stakeholders.</li> <li>• Targeted efforts to tax professionals to ensure they knew about new tax law changes and due diligence guidelines through mail-outs, Internet bulletins, and publications such as the FY 2001 EITC Tax Professional Kit.</li> <li>• Continued to (1) inform and educate taxpayers and tax professionals of new and existing laws governing the EITC, (2) encourage EITC taxpayers to seek assistance from responsible preparers, and (3) publicize the penalties incurred when abusing or fraudulently claiming the credit.</li> </ul>

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<sup>1</sup> An FTE is a measure of labor hours. One FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.

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<b>Initiative</b>	<b>Description of Initiative</b>
<b>Education and Assistance</b>	<ul style="list-style-type: none"> <li>• Expanded the Internal Revenue Service’s (IRS) Volunteer and Education Programs to target prevention efforts and to decrease incorrect claims through community education and outreach activities.</li> <li>• Assisted taxpayers in determining if they were eligible for the EITC by providing quality customer service with EITC toll-free assistance.</li> <li>• Continued to review EITC tax forms, instructions, and publications to help taxpayers file correct EITC claims.</li> <li>• Proceeded with the EITC Preparer Outreach Program for high volume preparers of EITC returns. The EITC Preparer Outreach Program is an integrated compliance strategy designed to build a partnership with the preparer community and influence preparer and taxpayer compliance with EITC tax laws.</li> </ul>
<b>Prevention and Identification</b>	<p>Continued to identify and stop inappropriate EITC claims before issuing refunds by:</p> <ul style="list-style-type: none"> <li>• Using the expanded math error authority<sup>2</sup> to stop more than 371,000 potentially incorrect EITC claims this fiscal year.</li> <li>• Sending pre-filing season letters to taxpayers who erroneously claimed a dependent who was also claimed by another taxpayer or provided information on their Tax Year (TY) 1999 returns that indicated their qualifying child exceeded the age limit.</li> <li>• Sending notices and stopping refunds to taxpayers with identifiable EITC errors on their returns.</li> <li>• Using the IRS’ Criminal Investigation function’s Questionable Refund Detection Teams<sup>3</sup> to identify questionable EITC claims, EITC-based refund schemes, and questionable EITC preparers.</li> </ul>

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<sup>2</sup> To combat filing fraud, the Congress passed the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, to help the IRS deal with questionable credits and deductions more effectively by using math error procedures. As a result, the IRS can disallow questionable credits during the processing of returns.

<sup>3</sup> A Questionable Refund Detection Team identifies fraudulent returns, stops payment of fraudulent refunds, and refers identified fraudulent refund schemes to the Criminal Investigation function.

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Initiative	Description of Initiative
	<ul style="list-style-type: none"> <li>• Evaluating compliance research work related to EITC claimant characteristics and patterns of noncompliance to determine the IRS' overall efforts to improve education and outreach products, enhance abuse detection capabilities, and improve enforcement efforts.</li> <li>• Including the Social Security Numbers (SSN) of parents linked with their newborn children<sup>4</sup> and child support orders<sup>5</sup> in the IRS' Dependent Database programming<sup>6</sup> to identify potential inappropriate claims of dependents and qualifying children for tax benefits.</li> </ul>
<b>Research</b>	<ul style="list-style-type: none"> <li>• Worked with the Department of HHS and the Social Security Administration to use their data in a systematic approach to better distinguish between compliant and noncompliant taxpayers.</li> <li>• Conducted new studies to evaluate the IRS' Preparer Outreach Program. The IRS used the results of these and other studies to determine the most appropriate way to allocate future resources.</li> <li>• Assembled data for the TY 1999 EITC Compliance Study to analyze the overall compliance level among EITC recipients.</li> </ul>
<b>Customer Service</b>	<ul style="list-style-type: none"> <li>• Offered assistance to EITC-eligible taxpayers on Saturdays during the filing season<sup>7</sup> in addition to offering assistance during regular hours at the IRS' Taxpayer Assistance Centers.</li> <li>• Provided toll-free telephone assistance to callers 7 days a week, 24 hours a day.</li> <li>• Provided volunteer return preparation services in the local community to help taxpayers file EITC returns.</li> <li>• Completed outreach education visits to over 2,000 tax preparers who prepared EITC tax returns.</li> </ul>

<sup>4</sup> This information is obtained from the Social Security Administration.

<sup>5</sup> The IRS obtains information on child support orders from the Department of Health and Human Services (HHS).

<sup>6</sup> The IRS' Dependent Database is an examination selection process based on the characteristics of typically noncompliant EITC taxpayers.

<sup>7</sup> The period from January through mid-April when most individual income tax returns are filed.

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**Fiscal Year 2002 Initiatives**

Summary of Results:

- Resources: 2,498 FTEs (102 percent of 2,439 planned FTEs).
- Funds spent on EITC activities: \$145.8 million (99.9 percent of the \$146 million budgeted).
- Revenue Protected: \$1.08 billion EITC revenue realized through the fourth quarter of FY 2002.

<b>Initiative</b>	<b>Description of Initiative</b>
<b>Communication</b>	<ul style="list-style-type: none"> <li>• Continued to inform and educate taxpayers and tax professionals about new and existing laws governing the EITC through an extensive marketing and taxpayer information campaign. The EITC message was outreach and compliance.</li> <li>• Made presentations to local organizations and businesses throughout the country and staffed informational booths at conventions and conferences focusing on low-income wage earners to promote the EITC.</li> <li>• Continued to target outreach activities to tax preparers to ensure awareness of tax law changes and due diligence requirements.</li> </ul>
<b>Education and Assistance</b>	<ul style="list-style-type: none"> <li>• Focused IRS Volunteer and Education Programs on the prevention of erroneous claims and outreach to EITC-eligible nonclaimants.</li> <li>• Conducted a proactive campaign in each geographical territory, partnering with organizations that were advocates of EITC-eligible/low-income taxpayers, such as tax professionals and small business owners, to emphasize the EITC requirements.</li> <li>• Initiated an education and outreach strategy for military members on the 2002 EITC tax law changes. The IRS estimated that an additional 400,000 military personnel would be eligible for the EITC as a result of the new tax law changes.</li> </ul>

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Initiative	Description of Initiative
	<ul style="list-style-type: none"> <li>• Continued to establish additional volunteer sites to assist EITC-eligible taxpayers with return preparation assistance and electronic filing.</li> <li>• Conducted special EITC events in geographical areas where a high number of EITC-eligible taxpayers reside.</li> <li>• Continued to help walk-in taxpayers and toll-free callers in determining their EITC eligibility.</li> </ul>
<b>2002 EITC Return Preparer Strategy<sup>8</sup></b>	<ul style="list-style-type: none"> <li>• Selected paid preparers completing more than 75 EITC returns in 2001 and separated them into 2 groups: a test group and a control group. The goal was to determine if training paid preparers reduced the number of errors made on EITC returns. The IRS contacted only the test group.</li> <li>• Planned to measure the effect of the 2002 EITC Return Preparer Strategy by comparing the number of errors for TYs 2000 and 2001 in the primary categories on tax returns prepared in the test group to tax returns prepared by the control group.</li> </ul>
<b>Wage and Investment Division's Stakeholder Partnerships, Education, and Communication (SPEC) Methodology</b>	<ul style="list-style-type: none"> <li>• Established partnerships with large employers and support organizations to provide education and assistance about the EITC to low-income families.</li> <li>• Sent an information package to 508 paid preparers identified through the 2002 EITC Return Preparer Strategy who had made significant errors on tax returns that did not have a Profit or Loss from Business (Sole Proprietorship) (Schedule C) attached in 2001. The package contained: (1) an explanation on why the letter was being sent to the preparer and some key information that would help them avoid common errors, (2) a 2001 tax kit, and (3) a schedule of 13 free educational seminar locations and dates.</li> </ul>
<b>Small Business/ Self-Employed Division's Taxpayer</b>	<ul style="list-style-type: none"> <li>• Visited 585 (84 percent) of the 697 paid preparers identified in the EITC Return Preparer Strategy as having made errors on tax returns with a Schedule C in 2001. During the visits, the</li> </ul>

<sup>8</sup> The EITC Return Preparer Strategy is a national initiative to help paid preparers avoid making errors on EITC returns. The IRS used this initiative primarily to build partnerships with the preparer community and influence compliance with the EITC tax laws.

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Initiative	Description of Initiative
<b>Education and Communication (TEC) Methodology</b>	TEC trained the paid preparers on the 2002 EITC requirements with an emphasis on due diligence requirements.
<b>Prevention and Identification</b>	<ul style="list-style-type: none"> <li>• Continued identifying and stopping inappropriate EITC claims before the refund was issued.</li> <li>• Implemented legislative authority to use math error procedures to identify inappropriate EITC claims.</li> <li>• Used electronic filing software to validate return data, such as SSNs, and prevent erroneous claims from entering the processing system.</li> <li>• Expanded EITC examination efforts using the Dependent Database to address potential EITC fraud in the IRS campuses and territories.</li> <li>• Continued to receive child support orders from the Department of HHS for use in the Dependent Database programming to identify potential inappropriate claims of dependent and qualifying children.</li> <li>• Scanned 1.6 million potentially fraudulent EITC returns and prevented the issuance of related false refunds.</li> <li>• Operated a Fraud Detection Center at each of the IRS campuses.</li> <li>• Identified EITC-related tax refund scams and abusive return preparers through its Questionable Refund Program and Return Preparer Program.</li> <li>• Developed a Concept of Operations addressing the recommendations made by the joint Treasury-IRS task force<sup>9</sup> on EITC compliance and their implementation.</li> <li>• Participated in the Government-wide Chief Financial Officers/Offices of Inspector General Erroneous and Improper Payments Work Group, which identified lessons learned and best practices to enhance the administration of the EITC Program.</li> </ul>

<sup>9</sup> The IRS and the Department of the Treasury established a task force to thoroughly examine the complexity of the EITC law and compliance issues identified in the TY 1999 EITC Compliance Study.



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Initiative	Description of Initiative
<b>Research</b>	<ul style="list-style-type: none"> <li>• Completed three EITC research studies. The studies:               <ul style="list-style-type: none"> <li>➤ Analyzed TY 1999 EITC filers who did not repeat as EITC filers in TY 2000 and the underlying reasons.</li> <li>➤ Evaluated the fluctuation in EITC recipients from TYs 2000 to 2001, the associated fluctuation in Adjusted Gross Income (AGI) for repeat EITC recipients, the number of subsequent year nonrecipients who were not eligible because of AGI, and the number of subsequent year nonfilers.</li> <li>➤ Compared staffing and support costs for Math Error Notice Code processing and EITC Compliance Examination to the amounts of EITC revenue ultimately protected by these initiatives.</li> </ul> </li> <li>• Initiated two EITC research studies. The studies will:               <ul style="list-style-type: none"> <li>➤ Develop an EITC Analytical Bridge to provide a “comparability factor” that accounts for the difference between the National Research Program<sup>10</sup> and EITC Compliance Study approaches.</li> <li>➤ Determine the effectiveness of the child support order data received from the Department of HHS in identifying EITC noncompliance as measured by the proportion of EITC returns where the EITC was disallowed and the estimated EITC dollars protected.</li> </ul> </li> </ul>
<b>Program Oversight</b>	<ul style="list-style-type: none"> <li>• Realigned the EITC Program Office under the Wage and Investment (W&amp;I) Division’s Office of Strategy and Finance.</li> <li>• Established an EITC Executive Advisory Council in August 2002 to serve as the policy-setting body responsible for providing strategy, budget, and operational recommendations to the Commissioner, W&amp;I Division.</li> </ul>

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<sup>10</sup> The National Research Program is the IRS’ most recent study to calculate the tax compliance rate. The study includes a computation of the compliance rate for the EITC.

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**Appendix VII**

**Treasury Inspector General for Tax Administration Recommendations  
Related to the Earned Income Tax Credit**

During Fiscal Years 2001 and 2002, the Treasury Inspector General for Tax Administration (TIGTA) issued nine audit reports<sup>1</sup> that addressed the Internal Revenue Service's (IRS) administration and processing of the Earned Income Tax Credit (EITC). Of the 29 audit recommendations made, 5 suggested improvements to the IRS' internal processes or the information used to manage its various EITC programs. The table below provides details of the remaining 24 audit recommendations and the actions taken by the IRS. These recommendations focus mainly on compliance with EITC laws, protection of taxpayers' rights, and reporting the results of the EITC Program. Copies of these reports can be obtained at [www.treas.gov/tigta](http://www.treas.gov/tigta).

Reference Number	Title	Recommendation and Corrective Actions	Status
2001-40-030	Improvements Are Needed in the Earned Income Credit Recertification Program	<p><b>Recommendation:</b> The IRS should ensure that the recertification indicators on taxpayers' accounts are accurate. Accordingly, it should remove indicators from taxpayers' accounts if they have proven EITC eligibility.</p> <p><b>Corrective Action:</b> On January 1, 2000, the IRS formalized EITC recertification procedures by including them in the Internal Revenue Manual (IRM), which is available to all EITC examiners.</p>	Closed <sup>2</sup> January 2001
		<p><b>Recommendation:</b> The IRS should clarify the March 2000 procedures to specifically instruct employees as to what information and actions are needed to prove taxpayers are qualified to receive the income-only EITC. These procedures should also be clarified to ensure that taxpayers are not considered recertified when they file Information to Claim Earned Income Credit After Disallowance (Form 8862) but do not claim or receive an EITC.</p> <p><b>Corrective Action:</b> The IRS revised the March 2000 procedures and included them in the December 2000 IRM to specifically instruct employees as to what information and actions are needed to prove taxpayers are qualified to receive</p>	Closed January 2001

<sup>1</sup> Reports include the 8 audit reports included in the table contained in this Appendix and *Letter Report: Allegation of Taxpayer Abuse Involving the Earned Income and Child/Dependent Care Tax Credit* (Reference Number 2001-40-035, dated December 2000).

<sup>2</sup> Status for all reports listed is based on information in the Department of the Treasury's Joint Audit Management Enterprise System (JAMES). We did not verify the status of the recommendations reported in the JAMES.

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Reference Number	Title	Recommendation and Corrective Actions	Status
		the income-only EITC. The IRS also revised EITC Credit Denied (Letter 3094) in October 2000 to explain to taxpayers how to claim the income-only EITC.	
		<p><b>Recommendation:</b> The IRS should identify and resolve recertification accounts with incorrectly suspended refunds.</p> <p><b>Corrective Action:</b> The IRS requested a one-time extract to identify recertification accounts with suspended refunds and issued an electronic alert to Examination function personnel with instructions for working these cases. Additionally, a Request for Information Services has been approved and tested for a monthly extract beginning January 1, 2001, of nonreversed refunds. This listing will be forwarded on a monthly basis to each Examination Branch for action and resolution.</p>	Closed March 2001
		<p><b>Recommendation:</b> The IRS should establish minimum standards for auditors for determining the extent of source documents required to allow the child-related EITC and children claimed as exemptions.</p> <p><b>Corrective Action:</b> The IRS revised the IRM to include guidelines for EITC examiners, and examiners must know the tax law that relates to the various programs. Training packages for the applicable tax law allowing deductions and credits are also available to the EITC examiners. Remote Examination conducts performance reviews of the centers to ensure the IRM and tax laws are followed. The IRS conducted and videotaped a national train-the-trainer class that was provided to all centers to ensure consistency in training. Examiners have access to <i>Your Federal Income Tax for Individuals</i> (Publication 17), <i>Earned Income Credit</i> (Publication 596), and IRS Tax Code and Regulations through the IRS' electronic resource system. Examiners must review all documentation, consider the facts and circumstances on each case, and use sound judgment to make the proper determination.</p>	Closed January 2001
		<p><b>Recommendation:</b> The IRS should revise letters sent to taxpayers in the Recertification Program to ensure letter accuracy and to better explain the Program and should revise computer programming to ensure only appropriate letters are generated.</p> <p><b>Corrective Action:</b> On September 21, 2000, the IRS revised Letter 3094 to inform taxpayers that additional documentation may be required to substantiate their claims for the EITC when they file Form 8862 following disallowance. In addition, the IRS designed a letter, CP 75A, specifically for</p>	Closed January 2001

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Reference Number	Title	Recommendation and Corrective Actions	Status
		the Recertification Program, which tells the taxpayer his or her refund will be delayed. The IRS has implemented a program change to suppress the CP 75A when the taxpayer has a balance due on the original filing.	
		<p><b>Recommendation:</b> The IRS should notify potentially qualified taxpayers subject to recertification that they might be entitled to the income-only EITC. Any corrective action should take into consideration the rules for taxpayers previously denied the EITC due to reckless or intentional disregard for the law or fraud.</p> <p><b>Corrective Action:</b> The IRS has revised Letter 3094 to tell taxpayers they may qualify for the income-only EITC even though the child-related EITC was denied.</p>	Closed January 2001
		<p><b>Recommendation:</b> To increase revenue protection, the IRS should consider changing the Recertification Program regarding when taxpayers are recertified. If this recommendation is adopted, the IRS should make a business decision as to what actions are necessary for taxpayers to receive the income-only EITC after the child-related EITC has been denied. Any changes should take into consideration the rules for taxpayers previously denied the EITC due to reckless or intentional disregard for the law or fraud.</p> <p><b>Corrective Action:</b> To provide the necessary legal guidance and satisfy the requirements of the corrective action, the Office of Chief Counsel issued amendments to the Federal regulations related to the EITC Recertification Program (26 CFR<sup>3</sup> Parts 31 and 602).</p>	Closed July 2001
2001-40-064	Improvements Are Needed to Assess the Use and Impact of the Earned Income Credit Appropriation	<p><b>Recommendation:</b> The Wage and Investment (W&amp;I) Division should establish a process to ensure the workload results information reported in the IRS Tracking Earned Income Tax Credit Appropriation report to the Congress is complete, accurate, and reliable.</p> <p><b>Corrective Action:</b> On a monthly basis, the EITC Program Office will request from all appropriate functions copies of the supporting documentation the functions have gathered to support their EITC workload results. EITC Program Office staff will review this documentation to ensure the results reported by the functions are accurate.</p>	Closed June 2001

<sup>3</sup> Code of Federal Regulations.

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		<p><b>Recommendation:</b> The W&amp;I Division should effectively measure the impact of the EITC initiatives on improving EITC compliance.</p>	Rejected
2001-40-102	The Implementation of a New Audit Selection Program for Earned Income Credit Filers Could Result in Significant Taxpayer Burden	<p><b>Recommendation:</b> The Commissioner, W&amp;I Division, should ensure that Department of Health and Human Services (HHS) data are included as selection criteria in its original audit selection program to identify taxpayers for EITC audits. The use of these data should be monitored and results tracked to identify needed adjustments to the specific methodology of its use.</p> <p><b>Corrective Action:</b> The Director, W&amp;I Division, Examination Strategy and Selection, will include the Electronic Fraud Detection System scoring model in the Dependent Database (DDb) for Tax Year 2001 processing to provide more efficient workload delivery. Management will monitor DDb selection results during Processing Year (PY) 2002. Research will perform a complete analysis of DDb selects at the end of the PY 2002 audit process.</p>	Closed December 2001
		<p><b>Recommendation:</b> The Commissioner, W&amp;I Division, should continue to coordinate with the Department of HHS to obtain information from states that do not currently provide data. Furthermore, the Commissioner should also coordinate with the Department of HHS to ensure a clear understanding of the development and updating processes for the data and to ensure that the data provided are as accurate as possible and that the IRS is aware of the characteristics and issues that affect its accuracy.</p> <p><b>Corrective Action:</b> The Commissioner, W&amp;I Division, continues to work with the Department of HHS, Office of Child Support Enforcement, on the status of state reporting and definition and updating of data elements.</p>	Closed August 2001
2001-40-185	Substantial Earned Income Credit Is Paid to Non-Entitled Individuals Who Use Not Valid for Work Social Security Numbers	<p><b>Recommendation:</b> Develop a process to identify and prevent EITC payments to those individuals who file tax returns with nonwork Social Security Numbers (SSN) issued to claim Federal benefits. This process must include a manner in which the IRS can distinguish those nonwork SSNs issued to obtain Federal benefits from those issued for other purposes.</p> <p><b>Corrective Action:</b> The IRS and officials from the Department of the Treasury and Social Security Administration (SSA) continue to hold discussions to determine the best way to identify taxpayers with nonwork SSNs who are not eligible for the EITC.</p>	Closed June 2002

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		<p><b>Recommendation:</b> Coordinate with the SSA to ensure that all available information is obtained to identify all nonwork SSNs issued.</p>	Rejected
		<p><b>Recommendation:</b> Ensure EITC eligibility information available or mailed to individuals is accurate as to whether the individuals are entitled to claim the EITC.</p> <p><b>Corrective Action:</b> The IRS stated that it would revise notices issued to taxpayers who may be eligible for the EITC (CP-09 and CP-27) to clarify the language regarding nonwork SSNs and EITC eligibility.</p>	Closed February 2002
2001-40-192	The Internal Revenue Service Successfully Processed Individual Tax Returns During the 2001 Filing Season	<p><b>Recommendation:</b> The Director, Customer Account Services, W&amp;I Division, should work with other appropriate officials to ensure that detailed comprehensive plans are developed when implementing significant tax law changes and initiatives. These plans should include a process to ensure that action items are completed prior to the beginning of the filing season.</p> <p><b>Corrective Action:</b> The data the TIGTA based the recommendation on came from the implementation of laws passed before 2000. Since then, the IRS has revised its methods of implementing tax law changes. We believe these changes result in the successful processing of returns affected by significant tax law changes and related initiatives. In fact, we believe our methods improve on the recommendations.</p>	Closed November 2001
2002-40-004	Earned Income Credit Was Paid to Taxpayers Who Did Not Provide Required Documentation During Audits	<p><b>Recommendation:</b> Develop expectations that case reviews are completed and establish a process to ensure reviews are done timely.</p> <p><b>Corrective Action:</b> The Director, Examination Strategy and Selection Unit, will issue guidance on managerial case reviews. The IRS will verify adherence to this guidance through periodic reviews of employee personnel files during site operational reviews.</p>	Closed July 2002
2002-40-020	Better Controls Are Needed to Ensure Appropriated Funds Are Used to Improve the Application of the Earned Income Credit	<p><b>Recommendation:</b> The Commissioner, W&amp;I Division, should establish procedures to ensure that funds appropriated by the Congress for the improved application of the EITC are used for that purpose. These procedures should include providing guidance to the appropriate functions on when to use the EITC-related funds for expenditures, maintaining reliable data, and conducting periodic reviews of the expenditures to ensure they are being used for EITC-related items.</p> <p><b>Corrective Action:</b> The EITC Program Office redesigned the form used to request the realignment of EITC funds and to request additional resources. The EITC Program Office now requires additional coordination approvals before authorizing the expenditures of EITC funds. The revised form and</p>	Closed December 2001

**Opportunities Exist to Improve the Administration  
of the Earned Income Tax Credit**

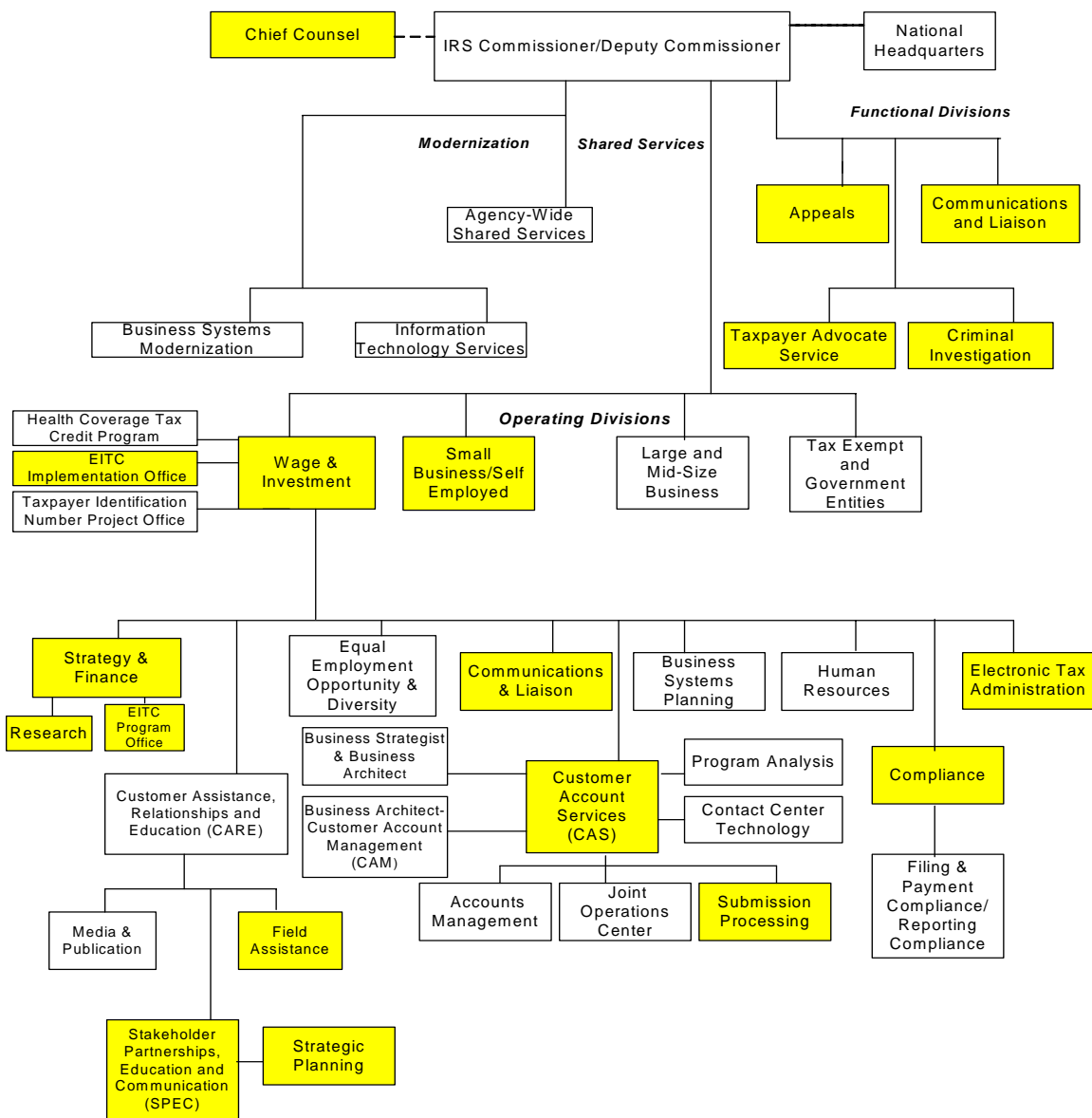
		procedures have been placed on the Chief Financial Officer web site in the Fiscal Year 2002 Financial Operating Guidelines and discussed with the functional EITC coordinators via conference call.	
2002-40-021	There Are Significant Weaknesses in the Internal Revenue Service's Efforts to Measure Earned Income Credit Compliance	<b>Recommendation:</b> The EITC Program Office should coordinate with the appropriate IRS Examination function to ensure the quality review process occurs immediately after the examinations are completed.	Rejected
		<b>Recommendation:</b> The EITC Program Office should coordinate with the appropriate IRS Examination function to ensure that IRS auditors are effectively trained on EITC issues and reminded of the importance of the studies.	Rejected
		<b>Recommendation:</b> The EITC Program Office should coordinate with the appropriate IRS Examination function to ensure that the examination results from the EITC compliance studies are accurately credited or charged to taxpayer accounts.	Rejected
		<b>Recommendation:</b> The EITC Program Office should coordinate with the appropriate IRS Examination function to develop an acceptable methodology concerning where and how audits are to be conducted on all future EITC compliance studies. Regardless of the preferred method, the IRS needs to ensure that taxpayers selected for these studies are treated fairly and consistently.	Rejected
		<b>Recommendation:</b> The EITC Program Office should coordinate with the IRS Research function to develop a standardized sampling methodology that will measure EITC compliance rates at the lowest cost with the least amount of burden to the taxpayers. The EITC Program Office should approve any deviation from this sampling plan.	Rejected
		<b>Recommendation:</b> The EITC Program Office should coordinate with the IRS Research function and the appropriate Examination function to capture and maintain detailed costing figures to monitor each study's return on investment.	Rejected
		<b>Recommendation:</b> The EITC Program Office should ensure that the scope of tasks needed to complete an entire study is taken into account when determining when subsequent studies should be completed.	Rejected

## Opportunities Exist to Improve the Administration of the Earned Income Tax Credit

### Organization Chart and Earned Income Tax Credit Roles and Responsibilities

The shaded functions in the organization chart below are responsible for various aspects of the Earned Income Tax Credit (EITC) Program.

#### Organization Chart





## Opportunities Exist to Improve the Administration of the Earned Income Tax Credit

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### EITC Roles and Responsibilities<sup>1</sup>

Managing the EITC is a complex operation that crosses over many functional boundaries within the Internal Revenue Service (IRS). To improve management over this process, the IRS established partners comprised of representatives from various IRS offices and functions. The following is a detailed description of those partners, including their roles and responsibilities.

#### **Function: Appeals**

The Office of Appeals reviews any taxpayer's dispute, including EITC Examination and Collection actions taken by the IRS. If a taxpayer cannot resolve the dispute over an EITC issue with the IRS, Appeals provides an independent, impartial review of the case after the examination action is proposed. It is the last opportunity for the IRS and the taxpayer to come to an agreement before the case may enter the tax court system.

Appeals' role is to ensure a resolution that is fair and impartial for both the Federal Government and the taxpayer. Appeals' goal is to resolve EITC controversies without litigation, in a way that enhances voluntary compliance regarding the rules of eligibility for the EITC and enhances public confidence in the IRS.

#### **Function: Office of Chief Counsel**

The National Headquarters components of the Office of Chief Counsel engage in the following EITC-related activities:

- Analyze proposed legislation dealing with the EITC.
- Draft regulations, such as the due diligence regulations and the recertification regulations.
- Draft other formal guidance, such as revenue rulings (although no EITC revenue rulings have been issued for many years).
- Issue written determinations, such as private letter rulings, technical advice memoranda, and all forms of Chief Counsel advice.
- Review for technical accuracy: *Earned Income Credit* (Publication 596); Information to Claim Earned Income Credit After Disallowance (Schedule EIC, Form 8862); Paid Preparer's Earned Income Credit Checklist (Form 8867); Earned Income Credit Advance Payment Certificate (Form W-5) and related instructions; and the United States Individual Income Tax Return (Form 1040) instructions relating to the EITC.
- Review EITC documents prepared by other functions for distribution to the public.
- Review briefs prepared by field Counsel offices in EITC tax court cases.

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<sup>1</sup> This information was obtained from the IRS' EITC Program Office Intranet site.

## **Opportunities Exist to Improve the Administration of the Earned Income Tax Credit**

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- Work with the Department of Justice on EITC cases before courts other than the tax court.
- Assist the EITC Program Office as requested.

The field office components of the Office of Chief Counsel handle all EITC tax court matters.

### **Function: Research, Analysis, and Statistics of Income – Office of Revenue Analysis**

Along with the funding the IRS received to address the EITC, the IRS is “required” (by Committee language, not statutorily) to submit a quarterly report to the Congress on the way the funds have been spent and the results generated by EITC Program efforts. The EITC Program Office is responsible for preparing the quarterly report. The Office of Revenue Analysis provides financial data to the EITC Program Office for the quarterly reports. The report summarizes the major initiatives the IRS has undertaken as part of the EITC appropriation; the resources dedicated to and spent on each initiative; and the results, in terms of cases closed, enforcement revenue collected or protected, and compliance improvement generated.

### **Function: Chief, Criminal Investigation – Office of Refund Crimes**

Each IRS processing center has a Fraud Detection Center, which uses an automated fraud detection system to detect EITC-based criminal refund fraud schemes and questionable EITC preparer cases. Individual EITC returns that contain false documents or questionable issues are referred to Correspondence Examination for civil action.

### **Function: Small Business/Self-Employed (SB/SE) Division – Compliance Reporting**

The Headquarters of the SB/SE Division’s Compliance function is involved in two major EITC programs: the EITC Compliance Study and the EITC Return Preparer Outreach Strategy. Both of these programs are joint efforts with the Office of Research. The Headquarters of the SB/SE Division’s Compliance function develops instructions, procedures, and training for field personnel conducting these programs and monitors progress for quality and timeliness.

In the field, revenue agents and tax auditors in area offices conduct examinations of EITC returns and monitor compliance by return preparers with EITC laws and regulations. Increased emphasis on return preparer education and outreach, coupled with increased penalty applications (especially EITC due diligence penalties), will increase overall compliance with EITC requirements.

### **Function: National Taxpayer Advocate**

Generally, the Taxpayer Advocate intervenes in taxpayers’ cases, including EITC cases, when the IRS’ normal processes and systems for resolution fail. The Taxpayer Advocate also coordinates with the Citizen Advocacy Panels (CAPs); some CAPs have EITC subcommittees.

## **Opportunities Exist to Improve the Administration of the Earned Income Tax Credit**

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### **Function: Chief Communications and Liaison – Communications Division/Marketing and Taxpayer Information Branch**

The Communications Division is the IRS' focal point for planning, coordinating, and creating IRS communications activities and products. The Marketing and Taxpayer Information Branch is responsible for providing communications advice to the EITC Program Office. The Branch also produces both print and electronic products on the EITC and the Advance EITC.

### **Function: Chief, Communications and Liaison – National Public Liaison (NPL)**

The NPL Office maintains ongoing liaison relationships with national practitioner organizations, payroll and business trade associations, IRS advisory committees, other Federal Government agencies, and organizations with an interest in tax administration. This office communicates important EITC corporate messages, identifies partnering opportunities, and provides a forum for the introduction and discussion of new ideas. The NPL programs also serve as “one-stop” communication vehicles to transmit EITC information between external stakeholders and IRS functions. The NPL often identifies emerging EITC problems and operational issues and coordinates with IRS program owners to share information and resolve the problems.

### **Function: Wage and Investment Division**

Strategy and Finance/Research – The Research function conducts compliance research to provide a greater understanding of the EITC population, including the identification and prioritization of noncompliance key indicators or sets of indicators. The Research function develops and tests alternative treatments to address noncompliance. It supports operational programs, as needed, to successfully implement educational, assistance, and enforcement programs. It measures the results of the individual operational programs and changes in the overclaim rate.

Customer Account Services (CAS) – Each IRS campus has an Adjustments Section that works math error responses from taxpayers, either by written correspondence or by calls received on the toll-free telephone number. Math Error notices are issued for errors identified during tax return processing. CAS analysts are responsible for providing workplan projections, writing/updating instructions for processing math error responses, and monitoring resource use and workload volume.

The IRS offers 24 hours a day, 7 days a week toll-free coverage for the tax law during the filing season and math error notice toll-free calls year round. It also offers 16 hours a day, 6 days a week service for informant calls year round and tax law calls during the nonfiling season. Calls are distributed based on historical weekly demand patterns and are routed to assistors. There are 27 call sites throughout the country and Puerto Rico. Calls for all lines can be routed to any location based on the demand/need.

## **Opportunities Exist to Improve the Administration of the Earned Income Tax Credit**

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Submission Processing is responsible for identifying certain errors during tax return processing.<sup>2</sup> Math error notices are then sent to the taxpayers.

CAS analysts are responsible for developing workplans/schedules, allocating resources, monitoring workload volume and resource use, and providing instructions and guidelines in the Internal Revenue Manual.

Compliance Remote Examination – Each IRS campus has a Remote Examination Section that conducts correspondence examinations related to claims for the EITC that appear to be invalid. Each year, numerous projects are established to cover categories with an excessive EITC overclaim rate. These projects vary from year to year depending on where the major abuse occurs. The majority of EITC revenue protected by the IRS is due to the efforts of Remote Examination.

Remote Examination analysts work closely with the staffs of the Office of Refund Crimes in Criminal Investigation and Research to identify types of invalid EITC claims. In addition, analysts also develop workplans/schedules, write/update program instructions, allocate resources, and monitor resource use and workload volumes.

Stakeholder Partnership, Education and Communication (SPEC)/Products and Partnerships Development/Volunteer and Community Partners – Since the inception of the IRS' EITC Initiative, taxpayer education has played a vital role in seeking to curb erroneous EITC claims through extensive community education and outreach activities. Each territory office has a person responsible for EITC outreach. All around the country, each office conducts local campaigns to help individuals for whom English is a second language, low-income taxpayers, and organizations/advocacy groups of EITC-eligible taxpayers. Additional volunteer sites are being established throughout communities to assist EITC-eligible taxpayers with return preparation.

SPEC analysts develop workplans/schedules, allocate resources, and monitor resource use and workload volumes.

Field Assistance – Each territory has many Taxpayer Assistance Centers (TAC). The centers provide taxpayers the following types of EITC assistance: preparation of tax returns claiming the EITC, resolution of issues related to EITC Math Error notices, assistance to taxpayers with the EITC recertification process, and answers to EITC tax law questions. TAC staffs also conduct EITC awareness campaigns. These campaigns are designed to help low-income families and individuals most likely to be eligible for EITC, educating them on eligibility requirements and the availability of the Advance EITC.

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<sup>2</sup> To combat filing fraud, the Congress passed the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, to help the IRS deal with questionable credits and deductions more effectively by using math error procedures. As a result, the IRS can disallow questionable credits during the processing of returns.

## **Opportunities Exist to Improve the Administration of the Earned Income Tax Credit**

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Field Assistance analysts develop workplans/schedules, allocate resources, and monitor resource use and workload volumes.

Electronic Tax Administration (ETA)/Channel Management and Marketing – The ETA Office of Channel Management and Marketing prepares messages each year for placement on the IRS' web site, Digital Daily, and on the electronic filing (*e-file*) bulletin board. These messages inform *e-file* participants (return preparers) about the EITC, due diligence requirements, and other Revenue Protection information.

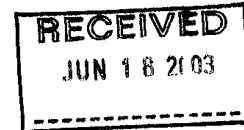
Opportunities Exist to Improve the Administration  
of the Earned Income Tax Credit

Appendix IX

Management's Response to the Draft Report




DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308



JUN 18 2003

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX  
ADMINISTRATION

FROM: John C. Duder   
Acting Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Opportunities Exist to Improve the  
Administration of the Earned Income Tax Credit (Audit No.  
200340035)

I was pleased that your audit determined that we have improved the administration of the Earned Income Tax Credit (EITC). As your report noted, we have recently implemented a number of initiatives to reduce erroneous EITC payments while ensuring participation by eligible taxpayers. Since September 2000, we denied over \$2 billion in erroneous claims. Also, during FY 2002 we advised approximately 958,000 taxpayers that, based on information included on their tax return, they appeared to qualify for the EITC. Although these are significant accomplishments, I agree with your recommendation that we establish long-term goals for the administration of the EITC.

I disagree with your actual outcome of \$437 million (the amount of the EITC appropriation from FY 2001 through 2003). You based this outcome on your conclusion that we cannot determine the effectiveness of our efforts to administer the EITC. While we haven't quantified long-term EITC goals, we have always been committed to administering an EITC Program that ensures participation by only eligible taxpayers. In addition, we have established a process for measuring EITC compliance that is accurate and relevant. For example, we conducted two prior studies of EITC compliance and have a third in process. We reported the results of our studies to stakeholders and used them to plan and monitor EITC program administration activities.

If you have any questions, please contact me or Mary E. Davis, Director, Strategy and Finance, at (404) 338-8800.

Attachment

## Opportunities Exist to Improve the Administration of the Earned Income Tax Credit

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### Attachment

#### **Recommendation 1**

Establish long-term goals and related measures for the EITC Program that reflects the Program's anticipated outcomes over time.

#### **Corrective Action**

We agree with this recommendation. Although we have always been committed to administering an EITC Program that ensures participation by only eligible taxpayers, we agree that we should better quantify these goals.

#### **Implementation Date**

September 30, 2003

#### **Responsible Officials**

Director, Strategy and Finance

#### **Recommendation 2**

Establish a consistent method to measure progress toward its long-term goals. The method should include an assessment of the frequency with which the measures are computed.

#### **Corrective Action**

We agree that we need to establish a process to measure EITC participation. However, we disagree that we need to establish a process to measure EITC compliance, since an effective one already exists. Specifically, we conducted two EITC compliance studies and a third study is in process. We cannot conduct more frequent studies due to the significant cost in terms of IRS resources and taxpayer burden that accompany these studies.

#### **Implementation Date**

September 30, 2003

#### **Responsible Official**

Director, Strategy and Finance