

Department of Health and Human Services

**OFFICE OF  
INSPECTOR GENERAL**

**UNPAID CHILD SUPPORT AND INCOME  
TAX DEDUCTIONS**



**JUNE GIBBS BROWN**  
Inspector General

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OIG-05-95-00070

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This report was prepared under the direction of W. Mark Krushat and Joseph Penkrot, Office of Evaluation and Inspections (OEI), Richard Mencl, Office of Audit Services (OAS) and Frank Burgess, Internal Revenue Service (IRS). Participating in this project were the following people:

#### OEI

Michelle Adams  
Raymond Balandron  
Natalie Coen  
William Moran  
Ann O'Connor

#### OAS

Marieann Ballerino  
Roy Carter  
Ray Cordahl  
John Drake  
Jay Gavens  
Clark Geiger

#### IRS

Joseph Green  
Paul Nay  
Anita Parker  
James Pervisky  
Leon Skros  
Gale Smith  
Joan Dean

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# EXECUTIVE SUMMARY

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## PURPOSE

This review examines a new method to identify noncustodial parents with delinquent child support obligations who incorrectly claim the Earned Income Tax Credit (EITC), the rates for head of household tax filing status, tax exemptions related to children no longer in their custody, or the child care credit.

## BACKGROUND

This review was a joint effort between the Office of Inspector General (OIG) and the Internal Revenue Service (IRS).

### *Tax Credits and Deductions Claimed by Noncustodial Parents*

The EITC is a refundable tax credit available to the working poor. The credit amount depends on earnings and the number of children, and rises with earnings until a maximum is reached. Historically, the EITC enjoyed wide bipartisan support in Congress as a means to assist the working poor and encourage employment in lieu of welfare programs.

A taxpayer qualifies as head of household and may use a lower tax rate and a higher standard deduction if they provide more than half the cost of keeping up the main home of a child claimed as a dependent. In addition to this dependency test, a noncustodial parent must pay more than the combined total of any Aid to Families With Dependent Children payments<sup>1</sup> and resources provided by the custodial parent in keeping up the home for the child.

Taxpayers are permitted to claim an exemption for their children if they provide half of their children's support. The custodial parent is generally assumed to provide the majority of a child's total support. However, a noncustodial parent providing support can sometimes claim a child as a dependent if the custodial parent or the court has awarded the exemption to the noncustodial parent.

Federal tax laws allow parents a tax credit for some of their child care expenses if the expenses are necessary in allowing them to work or seek employment. Divorced or separated parents cannot claim credit for child care unless the children are living with them.

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<sup>1</sup> Recent welfare reform legislation replaces the AFDC program with Temporary Assistance for Needy Families.

### *Child Support Collections*

Annually, State child support agencies forward a list of noncustodial parents who have not met their child support obligations to the Office of Child Support Enforcement (OCSE), the Federal agency responsible for administering the child support enforcement program. The OCSE reconciles any discrepancies, merges the States' files, and forwards the national file to IRS. The IRS withholds any tax refund due these individuals and forwards this money to the States to reduce or eliminate the child support arrears for these noncustodial parents. In 1994, OCSE sent 3.6 million cases to IRS.

We decided to test the feasibility of using OCSE data to identify the incorrect claiming of child custody and support on Federal tax returns. We drew a sample from the 1993 OCSE national file of delinquent noncustodial parents prepared for IRS. The OIG examined State child support enforcement files for 2,000 randomly selected noncustodial parents from this list, gathered information from State and local records, and sent a comprehensive database to IRS for their analysis.

### **FINDINGS**

**An administratively simple and coordinated approach between OCSE and IRS can help identify noncustodial parents misrepresenting their children's living arrangements on their tax returns.**

Children's Social Security Numbers and related data routinely collected by child support enforcement agencies, commonly called IV-D agencies, can be used effectively and efficiently by IRS. In many cases, IV-D agencies are aware of the living arrangements of children routinely claimed by noncustodial parents on their tax returns. While it would be prohibitively expensive for IRS itself to collect this data, IV-D agencies can supply this information simply and inexpensively.

States currently are making efforts to comply with Federal OCSE requirements to establish certified child support enforcement computer systems by the 1997 deadline. When certified, State IV-D agencies can systematically identify common data elements that disclose children's living arrangements and whether their parents are entitled to claim them for income tax purposes.

**In 32 percent of the cases reviewed, additional tax liabilities resulted from the EITC, tax rates for head of household filing status and/or exemptions that were claimed incorrectly. These cases result in projected additional tax liabilities of \$212 million for 1993.**

Based on child support data obtained by OIG and the detailed IRS review of the custodial and noncustodial parents' 1993 tax returns, we estimate there were over 640,000 cases where noncustodial parents did not meet their child support obligations.

Approximately 1 in 3 of these cases would have resulted in additional tax liabilities based on our review. Nationally, IRS and OIG estimate that \$212,118,000 in additional Federal income taxes would have been collected in 1993 had this category of taxpayers filed correctly.

It is important to note that similar incorrect claims could also be made by a noncustodial parent not delinquent in child support payments. We limited our review to those in arrears because there is no readily available data source to examine the broader universe. Additionally, while outside the scope of this review, this incorrect Federal tax information is often used in preparing State tax returns, thereby depriving States of tax revenues due them.

## **RECOMMENDATION**

**The OCSE and the States should work with IRS to identify data available from State welfare agencies and child support record systems which would assist in the identification of inappropriate tax benefits claimed by noncustodial parents.**

The OCSE and the States should work with IRS to determine the additional data needed and available from State welfare agencies and child support records systems. As State data systems are certified by OCSE, the data exchange with IRS will become easier and should minimize the staff work involved for child support agencies. Once States have certified child support enforcement systems, national and uniform collection of this data can be easily coordinated between these agencies.

### ***Potential Savings***

It is difficult to make accurate projections because varying assumptions can be applied to the broader population. However, based on the size of this population, the data collected here, and other information independently developed by IRS, we believe there could be total annual tax losses of \$1.4 billion or more as a result of noncustodial parents inappropriately claiming custody of children on Federal income tax returns. By applying the revenue protection strategy used in this review to identify all noncustodial parents, not just the ones known to IV-D agencies, IRS can disallow incorrect exemptions and tax credits.

## **AGENCY COMMENTS AND OIG RESPONSE**

We received written comments from the Administration for Children and Families (ACF). The ACF favors delaying system changes pending a possible need for legislation to permit the data exchange we proposed. However, we feel strongly that States and OCSE should build the capacity for this exchange while they are developing new systems. We incorporated other technical changes they suggested into this final report, where appropriate. Appendix C contains the ACF response.

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# INTRODUCTION

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## PURPOSE

This review examines a new method to identify noncustodial parents with delinquent child support obligations who incorrectly claim the Earned Income Tax Credit (EITC), the rates for head of household tax filing status, tax exemptions related to children no longer in their custody, or the child care credit.

## BACKGROUND

### *Earned Income Tax Credit*

The EITC is a refundable tax credit available to the working poor even if the family has no tax liability. Until 1994, only working parents with custody could qualify for the EITC; now a small credit is available for those without dependent children. The credit amount depends on earnings and the number of children residing at home. The EITC rises with earnings until a maximum is reached and is phased out as income increases. After the earnings limit is exceeded, no EITC is payable. (In 1993, working parents of one child, with earnings under \$23,050 could qualify for the EITC.)

Historically, the EITC enjoyed wide bipartisan support in Congress as a means to assist the working poor and encourage employment in lieu of welfare programs. In 1993, 14.7 million people claimed \$15 billion from the EITC. In its current form, it is expected to credit more than \$30 billion annually to poor, working families by the turn of the century, more than the projected costs of the Food Stamp program, or Temporary Assistance for Needy Families, which replaces the Aid to Families With Dependent Children program (AFDC)<sup>2</sup>.

In October 1994, the General Accounting Office (GAO) issued a report summarizing problems with noncompliance with EITC requirements. The GAO reported an IRS statement that 92 percent of questionable electronically-filed returns were returns with EITC claims. As a result of these problems, IRS began more careful scrutiny of all tax returns claiming the EITC.

### *Tax Rates for Head of Household Filing Status*

A taxpayer who qualifies as head of household may use a tax rate that is lower than individuals filing as single or married with separate returns. In addition, heads of household receive a higher standard deduction. To use the head of household filing status, the taxpayer must be considered unmarried on the last day of the year and

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<sup>2</sup> Recent welfare reform legislation replaces the AFDC program with Temporary Assistance for Needy Families. Throughout this report, we refer to AFDC since that program was in place at the time of our study.



must have provided more than half the cost of keeping up the main home of a child who lived with the taxpayer for more than 6 months during the year. To achieve head of household status, a parent must pay more than the total of AFDC payments plus resources provided by the other parent in keeping up the home for the child. An unmarried child does not have to qualify as the taxpayer's dependent in order for the taxpayer to qualify for head of household filing status.

### ***Tax Exemptions for Children***

The Tax Code generally allows a parent to claim an exemption for a dependent child if the parent provides half of the child's total support. Generally, a noncustodial parent cannot claim children not living with them as dependents since the custodial parent is assumed to provide the majority of a child's total support.<sup>3</sup> However, under certain circumstances a noncustodial parent providing support can claim a child as a dependent.

Most commonly, the noncustodial parent claims the child as an exemption when:

- the custodial parent agrees, in writing, not to claim the child as a tax exemption<sup>4</sup>; or,
- a pre-1985 divorce decree specifies that the noncustodial parent can claim the exemption, and the noncustodial parent contributes at least \$600 towards the child's support that year.

It should be noted that subsequent to 1985, no minimum dollar amount is required. Hence, the noncustodial parent could receive the benefit of a tax exemption even if no support is provided.

### ***Child Care Credit***

Federal tax law allows parents to deduct some of their child care expenses if the expenses are necessary in allowing them to work or seek employment. Parents can claim this credit for children under age 13. Divorced or separated parents cannot claim credit for child care for children not living with them.

### ***Child Support Collections***

Title IV-D of the Social Security Act requires noncustodial parents to support their children by paying periodic child support determined by a court order. Many

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<sup>3</sup> *Payments made to the mother on behalf of the child under the Aid to Families With Dependent Children (AFDC) are not considered support provided by the custodial parent.*

<sup>4</sup> *Typically, the custodial parent completes Form 8332 for IRS. The Form 8332 does not have to be renewed, but a copy must be submitted with the tax return.*

noncustodial parents have their child support automatically withheld from their wages by their employer. Automatic wage withholding of child support payments began in 1985 on cases in arrears. Since 1989, on all new and modified child support court orders, employers must withhold child support due from wages of noncustodial parents. Noncustodial parents who do not have this automatic wage withholding must make periodic payments to the child support agency themselves.

Despite these requirements, child support enforcement agencies report that \$6.1 billion of the \$13 billion owed for child support went uncollected in 1993. According to U.S. Census Bureau data, only 4.5 million of the 6.1 million noncustodial parents required to pay child support are handled by child support enforcement agencies.

Child support enforcement agencies, commonly called IV-D agencies, forward the collected child support to the custodial parent. In the case of families receiving AFDC, the first \$50 of collected child support is forwarded to the custodial parent<sup>5</sup>, with the balance used to partially offset AFDC benefits paid to that family.

Annually, the State IV-D agencies forward lists of noncustodial parents in arrears to the Office of Child Support Enforcement (OCSE), the Federal agency responsible for administering the child support enforcement program.<sup>6</sup> This list includes arrears carried over from previous years. The OCSE reconciles any discrepancies, merges the States' files, and forwards the national file to the Internal Revenue Service (IRS). In 1994, OCSE sent 3.6 million cases to IRS. The IRS withholds any tax refund due these individuals, deducts costs of collections, and forwards this money to the States to reduce or eliminate the child support arrears for these noncustodial parents. In 1994, this joint IRS-OCSE project intercepted over one million tax refunds and recovered \$720 million in overdue child support payments.

## **METHODOLOGY**

This review was a joint effort between the Office of Inspector General (OIG) and IRS. Both agencies agreed that the major issues to be resolved by this effort would be limited to:

- how many delinquent noncustodial parents incorrectly claim the EITC, child care credit, head of household filing status, and exemptions for children;
- what is the extent of loss to the Federal Government as a result of these incorrect claims; and,

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<sup>5</sup> *Beginning in October 1997, States no longer are required to "pass through" the first \$50 collected.*

<sup>6</sup> *For AFDC cases, the amount in arrears must be over \$150, for non AFDC cases, the amount must exceed \$500.*

- whether it is practical to use OCSE data on delinquent noncustodial parents to identify and prevent tax losses that would result from inappropriate claiming of child custody and support.

It is important to note that similar incorrect claims could also be made by a noncustodial parent not delinquent in child support payments. We limited our review to those in arrears because there is no readily available data source to examine the broader universe. Additionally, while outside the scope of this review, this incorrect Federal tax information is often used in preparing State tax returns, thereby depriving States of tax revenues due them.

The OIG also enlisted OCSE support in gaining State cooperation. The OCSE provided the tax refund intercept tape. Also, the OCSE sent a letter to the sample-selected States explaining the joint OIG-IRS efforts and requesting their help. All of these States cooperated in the project.

### *Sampling Procedures*

We initially selected 2,000 child support obligors from lists submitted by the States to IRS for income tax refund offset, using a two stage random sample. The 1993 tax refund offset lists were used since they were the most recent lists available at the time of this review. We first selected eight States (New York, Pennsylvania, Florida, Georgia, North Carolina, Michigan, Iowa and Texas) with probability proportional to the number of obligors per State. By accessing the Social Security earnings records for 1993, we eliminated those obligors with less than \$3,000 in earned income. From among the remaining individuals, we selected 250 per State using simple random sampling.

We collected detailed case information in the eight States about each obligor selected (described in the next section.) The IRS was able to identify 1,390 noncustodial parents for whom 1993 tax returns were filed. This is in keeping with IRS experience which has found that first, up to 30 percent of taxpayers subjected to offsets fail to file subsequent returns, second, this is a low income population that may not need to file, and finally, it is a population that has already demonstrated noncompliance with Federal rules. Of these noncustodial parents, the IRS reviewed 698 returns where the noncustodial parent was delinquent for child support in 1993. An additional 344 returns for custodial parents associated with noncustodial cases were identified and reviewed to determine whether duplicate exemptions were claimed. Of the remaining 692 noncustodial parents, 129 returns were not available and 563 had arrearages from previous years. See Appendix A for a detailed description of the sampling methodology.

### ***Gathering Data***

The OIG reviewed child support records at State IV-D offices during April and May 1995. Specifically, we collected information about every noncustodial parent, custodial parent and child involved with the case. We determined the amount of child support owed and collected from the noncustodial parent for each child in 1993. We examined whether the child lived with the noncustodial parent at any time during 1993 and if any events took place that year that would affect child support obligations, like the child marrying or reaching the age of majority. We traced the custodial parent's AFDC status during 1993 as well.

We sent a database with this comprehensive child support information to IRS for their analysis. The IRS reviewed the tax returns for both custodial and noncustodial parents and calculated the tax liability based on our four criteria. The results were used for research purposes only, not for enforcement.

### ***Projections***

To account for the sampling plan and provide results that accurately reflect the distribution of cases in the population studied, all percentages in the report reflect the proper weighting of the data. This will also be true of the totals presented. When sample based results are presented, we will identify them.

Our review was conducted in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

## FINDINGS

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**An administratively simple and coordinated approach between OCSE and IRS can help identify noncustodial parents misrepresenting their children's living arrangements on their tax returns.**

Children's Social Security Numbers and related data routinely collected by IV-D agencies can be used effectively and efficiently by IRS. In many cases, IV-D agencies are aware of the living arrangements of children routinely claimed by noncustodial parents on their tax returns. While it would be prohibitively expensive for IRS itself to collect this data, IV-D agencies can supply this information simply and inexpensively.

States currently are making efforts to comply with Federal OCSE requirements to establish certified child support enforcement computer systems by the 1997 deadline. When certified, State IV-D agencies can systematically identify many of the data elements needed to disclose children's living arrangements and whether their parents are entitled to claim them for income tax purposes.

**In 32 percent of the cases reviewed, additional tax liabilities resulted from the EITC, tax rates for head of household filing status and/or exemptions that were claimed incorrectly. These cases result in projected additional tax liabilities of \$212 million for 1993.**

Based on child support data obtained by OIG and the detailed IRS review of the custodial and noncustodial parents' 1993 tax returns, we estimate there were over 640,000 cases where noncustodial parents did not meet their child support obligations. Approximately 1 in 3 of these cases would have resulted in additional tax liabilities based on our review.

Nationally, IRS and OIG estimate that \$212,118,000 in additional Federal income taxes would have been collected in 1993 had this category of taxpayers filed correctly. The appendices following the body of this report provide details regarding the projections. The breakout for the adjustment projections is depicted in Table A on the following page.

The scope of this review was limited to Federal tax loss projections. However, States also use Federal tax data to calculate State tax liability. Accordingly, these States may be losing substantial State tax revenues as well.

## *IRS Proposed Adjustments*

In accomplishing this review, IRS intensively reviewed 698 tax returns (and 344 returns of related custodial parents) of the 1,390 cases. When possible IRS made side by side analyses of noncustodial and custodial parents' returns. The IRS found that 475 cases appeared to have correctly handled the issues related to the children. The IRS projected tax adjustments for the 223 remaining returns, 32 percent of the sample reviewed. The returns with erroneous handling of the child-related issues showed a total of \$233,075 in tax adjustments, equating to an average adjustment of \$1,045.

It was apparent from the review that the erroneous dependency exemptions, which serve as the basis for each of the adjustments described below, were almost entirely claimed as "Children at Home." This claim avoids the extra documentation required if the dependents are claimed "Children Away from Home". In fact, 88 percent of the cases resulting in tax adjustments claimed the dependents lived at home in error. This figure was 98 percent for those claiming the EITC in error, 85 percent for those cases on AFDC, 95 percent for those with no valid documentation, 96 percent for those claiming head of household status in error, and 100 percent for those claiming child care credits in error. It is apparent that the self-reporting compliance features on the IRS tax forms are not being consistently followed by taxpayers in this population of child support delinquents.

**Table A**

	Number Cases <sup>+</sup>	Projected Population <sup>+</sup>	Projected Revenues	Percent of Total
<b>Total</b>	<b>223</b>	<b>202,703</b>	<b>\$212,118,892</b>	
<b>Noncustodial Returns</b>				
Disallow EITC claim.	119	104,362	\$100,371,530	47 %
Disallow exemptions due to AFDC payments for child.	96	85,387	\$42,949,588	20 %
Disallow exemption due to lack of documentation.	80	75,044	\$35,138,845	16 %
Disallow head of household status.	78	72,546	\$20,777,243	10 %
Disallow child care credit.	7	5,170*	\$2,605,109*	1 %
<b>Custodial Returns</b>				
Disallow exemption due to AFDC payments for child.	29	24,884	\$9,688,103	5 %
Deny custodial exemption, noncustodial parent exemption allowed.	2	1,675*	\$588,466*	<1 %

\* The 95 percent confidence interval includes the value 0.

+ Due to the possibility of multiple adjustments per case, the sum of the individual values do not add to the total.

### ***EITC Adjustments***

We found that 37 percent of the noncustodial parents whose 1993 tax returns were reviewed claimed the EITC. However, over 44 percent of those cases who claimed the EITC, had an error in the amount of the EITC claimed.<sup>7</sup> We projected the EITC adjustments to exceed \$100 million based on the number and magnitude of the errors IRS identified. The EITC errors represent the most significant dollar adjustments noted in this review. We estimated that the total EITC claimed by this population exceeded \$270 million; thus, at least 37 percent of the total EITC claimed by this population was in error. The remainder of the EITC which was allowed in this review was based on children other than those owed the delinquent child support; therefore, additional EITC errors could exist in the cases.

### ***Adjustments for Parent Exemptions for Children***

Overall, 58 percent of the noncustodial parents (An estimated 375,494 cases) claimed children for tax exemptions. In 48 percent of these cases, the claim was not allowable because either the child was supported by AFDC, the child did not live with the noncustodial parent, or there was no valid evidence allowing the noncustodial parent to claim the exemption, such as an IRS Form 8332. We also estimate that in over 24,000 cases, custodial parents claimed children for tax exemptions that were unallowable due to AFDC support.

### ***Adjustments for Head of Household filing status***

We estimate that in about one-third (over 209,000) of the cases with arrearages in 1993, the noncustodial parents filed using the tax rates associated with head of household status. In over 34 percent of those cases, noncustodial parents claimed head of household status erroneously because the children did not live in their household for more than 6 months. We did not challenge the claim of head of household status if other children (for example, by a subsequent marriage) were shown on the return; therefore, overall compliance on this issue can not be determined.

### ***Adjustments for Child Care Credits***

Although we looked for noncustodial parents claiming the child care credit incorrectly, we found very few instances where this took place. Errors associated with claiming the child care credit for the sampled noncustodial children only constitute an estimated one percent of the total error amount.

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<sup>7</sup> In their 1994 report, *"Earned Income Credit -- Data on Noncompliance and Illegal Alien Recipients*, the General Accounting Office estimated that 29 percent of all EITC claims were in error. (GAO/IGD-95-27)

***Child Support Profile of Noncustodial Parents in the Sample***

The 1,390 noncustodial parents in our sample paid 66 percent of the \$3,388,356 in child support they owed for their 2,420 children in 1993. On average, they have child support orders covering 1.47 children, 44 percent of whom receive AFDC payments. These noncustodial parents averaged \$922 in payments of the \$1,400 in child support they owed per child in 1993. Roughly, they paid just \$77 of the \$117 in child support they owed each month.

Table B provides the distribution of the cases reviewed, by the reported Adjusted Gross Income. The figures are projected to the studied population. The data shows that the majority of the adjustments are in the income category of \$5,000 to \$14,999 per year.

**Table B**

Adjusted Gross Income Category	Projected Total Number	Projected Total AGI	Tax Adjustments		
			Projected Number	Projected Amount	Percent of AGI
Total	640,162	\$11,206,393,398	202,704	\$212,118,892	1.9%
\$1 - \$4,999	36,204	\$146,600,226	5,885	\$2,562,670	1.7%
\$5,000 - \$14,999	285,957	\$2,819,643,842	91,103	\$117,022,636	4.2%
\$15,000 - \$24,999	198,877	\$3,892,242,070	65,494	\$61,962,027	1.6%
\$25,000 - \$34,999	69,386	\$2,052,079,020	23,452	\$16,913,046	0.8%
\$35,000+	49,738	\$2,295,828,240	16,770	\$13,658,513	0.6%



## RECOMMENDATION

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Over the years, IRS offset of income tax refunds recovered millions in unpaid child support, benefitting children, custodial parents, State IV-D agencies and the Federal Government. The IRS/OCSE/State partnership should be reviewed to determine the feasibility of expanding the exchange of information so that noncustodial parents not meeting their child support obligations cannot benefit from their delinquency when they file their income tax returns.

Besides IRS collections increasing as a result of fewer incorrect claims for the EITC, head of household, exemptions, and child care, we believe child support enforcement may be enhanced as a result. Some noncustodial parents may be deterred from falling behind in child support payments if they realize that IRS scrutiny of their tax returns will increase.

At present, taxpayers in this population of child support delinquents do not consistently provide the accurate, self-reporting compliance data required on the IRS tax forms. This speaks for the need of an IRS return processing mechanism to protect government revenue. In the absence of timely and effective data sharing, these parents may continue to claim they are providing support for their children (44 percent of whom receive welfare), or otherwise claim certain tax advantages that IRS cannot easily verify or disprove.

### **THE OCSE AND THE STATES SHOULD WORK WITH IRS TO IDENTIFY DATA AVAILABLE FROM STATE WELFARE AGENCIES AND CHILD SUPPORT RECORD SYSTEMS WHICH WOULD ASSIST IN THE IDENTIFICATION OF INAPPROPRIATE TAX BENEFITS CLAIMED BY NONCUSTODIAL PARENTS.**

The identification of additional data that would be useful to the IRS would improve the collection of delinquent child support. However, for this proposed exchange to be effective, it must be fair and work to the mutual benefit of both the Department of Treasury and the Department of Health and Human Services (DHHS). For example, once the data elements have been identified and the appropriate system approved and in place, OCSE could provide the data for IRS enforcement purposes without charge. The IRS, in turn, could provide tax refund offset services using OCSE data without charge. In this fashion, both Departments could economically meet their fiscal collection obligations.

Some examples of data that IRS will need to identify incorrect returns include the custodial parent's Social Security Number (SSN), the child's SSN, welfare status and amounts, and the child support owed and paid by a noncustodial parent in a calendar year. This data already is available routinely now to the State IV-D agencies, and will be an integral part of the OCSE-designated certified data systems scheduled to be fully operational by October 1, 1997.

As State data systems are certified by OCSE, the data exchange with IRS will become easier and should minimize the staff work involved for child support agencies. Once States have certified child support enforcement systems, national and uniform collection of this data can be easily coordinated between the two Departments. The OCSE will generate data to assist the IRS in identifying tax filers claiming dubious exemptions or head of household status.

### *Potential Savings*

We estimate a potential 1 year savings of just more than \$212 million based on our results. According to data provided by the Bureau of the Census, there were approximately 6.1 million noncustodial parents with court orders for child support in 1991. Based upon this, the data collected here and other information independently developed by IRS, we believe there could be total annual tax losses of \$1.4 billion or more as a result of noncustodial parents inappropriately claiming custody of children on Federal income tax returns.

Whether this amount, or any fraction of this money, can be collected will depend on many factors. For instance, since most of the cases involve low income tax payers, it may not be effective to conduct audits and attempt to collect taxes due. The most cost efficient revenue protection strategy would be to intercept a tax refund, if one exists. We recognize that our projection may overestimate the actual amounts that are available to be collected using this method.

However, the amounts we project may also represent a lower limit. For one thing, we only reviewed a population of noncustodial cases that have, or had, arrears at one time, and were above the IRS intercept dollar thresholds. The larger population of noncustodial parents may also include inappropriate claims like we found. For example, a non custodial parent not delinquent in paying child support could falsely claim the child as a dependent. This could happen if the child is not residing in the taxpayer's home. Furthermore, we did not verify the validity of other children in the household. In addition, IRS only reviewed tax returns for cases with arrears for 1993. About half the cases in the sample did not have arrears for that specific year and may represent additional errors should they be reviewed. Also, the knowledge that tax returns claiming the EITC are subject to this level of review may provide a sentinel effect for this population. Although no funds may be collected in the first year of such scrutiny, subsequent filings may be more accurate and we thus avoid future losses.

With the recent passage of the Personal Responsibility and Work Opportunity Reconciliation Act (Act), Congress established a Federal Case Registry of Child Support Orders (Section 311 of the Act). This registry will include a minimum set of data as prescribed by regulations established by the Secretary of DHHS. With the proper data elements outlined here, and by applying the revenue protection strategy used in this review to identify all noncustodial parents, not just the ones known to IV-D agencies, IRS could use this data to disallow incorrect exemptions and tax credits. In doing so, we believe that additional annual tax loses can be prevented. (It

should be noted that any pending legislation would need to be reviewed to insure that it presents no legal impediments to IRS access to the data for this purpose.)

In any event, this review demonstrates the feasibility of an administrative approach to increase tax compliance without the need for extensive and expensive IRS auditing. Besides potentially saving substantial funds for the U.S. Treasury, we believe we have found an economical incentive to increase child support payments and enhance responsible behavior by noncustodial parents.

### *Agency Response*

In their response to our draft report, staff from the Administration for Children and Families (ACF) provided a number of technical corrections and other suggestions. Where appropriate, we incorporated these changes into this final report.

The ACF referred us to recommendations in a 1996 Office of Management and Budget's Benefit Systems Review Team report. These recommendations suggest that any system changes calling for matches, such as proposed here, be delayed until after implementation of the expanded Federal Parent Locator System.

We defer to IRS as to whether legislative action may be necessary to allow the IRS to obtain custodial data in a revenue protection program. However, we believe that action to pursue such legislation and to make any necessary adaptations to the Federal Parent Locator system or any other data system should take place as soon as possible. Once States and OCSE implement new data collection systems, it may be a very difficult, costly, and lengthy process to change the components of those systems. A better approach is to incorporate identified needs at the design stage and save future costs as well as the inevitable inertia that accompanies ad hoc system changes.

A key element in the design of all the underlying data systems is the inclusion of the SSN of each child for whom child support payments have been ordered. It is crucial that this data element be included to perform the matches that will be needed--not only to prevent inappropriate income tax deductions which we have described in this report, but for other potential matches that might be designed in the future to help in the child support collection process. This step alone would go a long way to insuring the feasibility of efficacious data matches in the future, but if not tended to now, could forestall important matches for many years to come.

We have identified a substantial loss to the U.S. Treasury as a result of this lack of custodial data for IRS. The sooner we can halt these losses, the sooner we can boost the integrity of the EITC program. Finally, by halting these inappropriate deductions and credits, non custodial parents will be encouraged to fulfill their child support obligations.

# APPENDIX A

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## SAMPLING METHODOLOGY AND ESTIMATION PROCEDURES

To identify noncustodial parents, in arrears for their child support payments, we obtained the 1993 Office of Child Support Enforcement (OCSE)/Internal Revenue Service (IRS) Tax Offset file. This file is generated by the OCSE from data provided by the States. This file provides IRS with the means to identify individuals who are delinquent in child support. The IRS intercepts any Federal income tax refunds to offset arrearages in child support payments. The cases are identified by their Social Security Numbers and were verified as present on the IRS Master File.

There were 3,282,960 cases listed on the Tax Offset file. However, since a noncustodial parent may be identified as delinquent in more than one State or multiple times within a State, we created an unduplicated count by consolidating occurrences of the same SSN within the database. This left us with 2,762,398 unduplicated Social Security Numbers. Based on the unduplicated counts in each State, we then drew a sample of eight States with probability proportional to size using the Rao-Hartley-Cochran method (RAO).<sup>8</sup> These eight States produced a list of 937,534 unduplicated SSNs. We then submitted this list of SSNs to the Social Security Administration to determine the earned income associated with each of these SSNs for 1993. All individuals with less than \$3,000 in earned income were eliminated as these individuals were considered unlikely to file a tax return. The results of this procedure are presented in the following table.

**Table 1**

State	Total Number of Cases on Offset File	Percent of Total	Number with Earned Income of \$3,000+ (Source: SSA)	Proportion with \$3,000+ Earned Income
Texas	132,901	4.81%	92,715	69.76%
Iowa	43,970	1.59%	34,703	78.92%
Georgia	74,323	2.69%	51,713	69.58%
Pennsylvania	134,776	4.88%	87,970	65.27%
Florida	126,742	4.59%	85,912	67.78%
Michigan	204,076	7.39%	145,594	71.34%
North Carolina	62,950	2.28%	57,440	91.25%
New York	157,796	5.71%	79,070	50.11%
Total	937,534	33.94%	635,117	67.74%
Population Total	2,762,398		1,871,200	

Overall, roughly two-thirds of the unduplicated cases were found to have a reported earned income of over \$3,000. For purposes of our projections, we are accounting for

<sup>8</sup> Cochran, W.G. (1977). *Sampling Techniques*. John Wiley and Sons, New York, third edition, p.266

approximately 1,871,200 noncustodial parents appearing on the refund offset file produced by OCSE.

At the second stage of sampling, we drew a simple random sample of 250 Social Security Numbers from each of the eight selected States. Each of these represents a case for our purposes. For each of the individuals associated with each number, we went to the appropriate State or local Child Support Enforcement Office and obtained, among other data, the name and Social Security Number of all custodial parents and children associated with each noncustodial parent and information on the arrears related to 1993. Therefore, each case selected for this review will have one noncustodial parent, one or more custodial parents and one or more children included in the case file. All results, including any estimated potential losses, are calculated on a case basis. The results of this second stage sampling are presented in Table 2.

**Table 2**

State	SSNs Sampled	Returns Found	Returns Reviewed
Texas	250	179	140
Iowa	250	172	67
Georgia	250	178	84
Pennsylvania	250	184	72
Florida	250	166	72
Michigan	250	171	77
North Carolina	250	164	113
New York	250	176	73
Total	2,000	1,390	698

The data gathered from the case files was automated and given to the National Office for Research and Analysis, Office of Tax Compliance, IRS. The IRS reviewers located 1,390 of the 2,000 returns called for. They reviewed the 1993 tax returns for each noncustodial parent and all corresponding custodial parents where the parent had child support arrears related to 1993. A total of 698 cases out of the 1,390 met this criteria. For the 698 cases where tax returns were reviewed for the noncustodial parent, an additional 344 tax returns for the custodial parent were identified, found and reviewed.

Projections were made appropriate to the sampling methodology using the Two-stage RHC subroutine from the RAT-STATS Statistical Software.<sup>9</sup>

<sup>9</sup> Department of Health and Human Services, Office of Inspector General, Office of Audit Services, RAT-STATS Statistical Software.

# APPENDIX B

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## VARIANCE AND ESTIMATED CONFIDENCE INTERVALS

**Appendix B**

**Variances and Estimated Confidence Intervals**

For each of the estimated totals presented in Table A in the report, we provide the standard errors and the 95 percent confidence intervals. We also provide an estimate of the precision of these totals. The precision is defined as the semi-width of the confidence interval as a percent of the estimate.

Class of Error	Estimate	Standard Error	95 % Confidence Interval		Precision
			Lower Limit	Upper Limit	
<b>NonCustodial Parents Returns:</b>					
Disallow EITC claims.	\$100,371,530	27,246,178	\$46,970,111	\$153,772,948	53.2%
Disallow exemptions due to AFDC payments.	\$42,949,588	6,289,626	\$30,621,921	\$55,277,255	28.7%
Disallow exemption due to lack of documentation.	\$35,138,845	9,284,912	\$16,940,417	\$53,337,273	51.8%
Disallow head of household status.	\$20,777,243	4,460,100	\$12,035,625	\$29,518,861	42.1%
Disallow child care credit.	\$2,605,109	1,632,034	(\$593,678)	\$5,803,896	122.8%
<b>Custodial Parents Returns:</b>					
Disallow exemption due to AFDC payments.	\$9,688,103	3,148,093	\$3,517,841	\$15,858,365	63.7%
Disallow custodial exemption, noncustodial exemption allowed.	\$558,466	489,614	(\$401,177)	\$1,518,109	171.8%



# APPENDIX C

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## AGENCY COMMENTS




DEPARTMENT OF HEALTH & HUMAN SERVICES

ADMINISTRATION FOR CHILDREN AND FAMILIES  
Office of the Assistant Secretary, Suite 600  
370 L'Enfant Promenade, S.W.  
Washington, D.C. 20447

September 24, 1996

TO: June Gibbs Brown  
Inspector General

FROM: Mary Jo Bane  
Assistant Secretary   
for Children and Families

SUBJECT: OIG Draft Report "Unpaid Child Support and Income Tax  
Deductions," (OIG-05-95-00070)

Thank you for the opportunity to respond to your draft report of findings concerning unpaid Child Support and Income Tax Deductions. If you have questions, please contact David Ross of my staff at (202) 401-9370.

General Comments:

This draft report presents findings that cross-matching data sources to identify federal tax-filing errors among noncustodial parents in child support cases can yield savings to the federal treasury.

We would defer to the Department of the Treasury, and especially the Office of the Assistant Secretary for Tax Policy, in estimating the impact of the proposed course of action on the federal treasury.

From a timing standpoint, we would also note, as referenced below, the views of the Benefit Systems Review Team convened by the Office of Management and Budget.

Technical Comments:

Page iii says the annual IRS offset file may have to be expanded to accommodate IRS needs. We recommend the report delete specific reference to the IRS tax offset file and not specify the means by which IRS obtain these data. Further research is needed on the restrictions on use of data in State and Federal Case Registries, and in Federal New Hire provisions of statute, before these data sources should be promoted.

Page iii also says that legislation now pending in Congress includes establishing a national registry of child support court orders. When the final report is updated to reflect passage of the Personal Responsibility and Work Opportunity Reconciliation

Page 2 - June Gibbs Brown

Act (PRWORA), we ask that you note that data of use to IRS reside in the State Child Support Case Registries -- which includes non-IV-D cases -- not necessarily the Federal Case Registry.

Section 316 (f) of PRWORA gives the Secretary of the Treasury access to information in the National Directory of New Hires for the purposes of administering section 32 of the Internal Revenue Code of 1986 (the advance payment of the earned income tax credit under section 3507 of such Code, and verifying a claim with respect to employment in a tax return).

The Office of Management and Budget issued a report by the Benefit Systems Review Team (BSRT), Improving the Coordination of Government Information Resources, (June 1996). In Chapter 4: Data Resources--The Tools to Fight Fraud and Reduce Error, the BSRT noted that the National Directory of New Hires and the companion Federal Case Registry, are powerful tools to ensure payment accuracy and maintain overall program integrity in Federally-sponsored income maintenance, annuity, disability benefit, and student loan programs. The BSRT recommended that the FPLS consider permitting Federally-sponsored income support programs with the opportunity to verify their benefit payments and debt collection efforts with data contained in Expanded FPLS. The report noted that the recommendation should be considered for legislative action after the initial Directory has been implemented and should be given careful congressional deliberation, similar to the review given by Congress to proposed modifications to access to IRS databases.

Page 2 says income withholding by employers began in 1989. In 1985, states were required to withhold earnings for arrearages equal to one month's worth of support, or less, and in IV-D cases, they were to do so without returning to court to file a withholding order. In 1989, in all new and modified IV-D orders, withholding was required whether there was an arrearage or not. Exceptions were permissible where the parties agreed otherwise or a court found good cause to waive the withholding requirement.