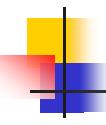# Dependent Database And Earned Income Tax Credit

Applicability For Development Of Risk-Based Examination Strategies

by Wendy Handin and Scott Mendelson

IRS Wage and Investment Division

Background

- ## 1997 EITC compliance study
  - Indicates high rate of non-compliance
  - Unintentional and intentional
- ## Kohl amend to Taxpayer Relief Act of 1997
  - Authorizes IRS to access federal case registry (FCR) of child support orders
- ## High noncompliance with EITC in TY 1999
  - $8.5 to $9.9 billion (27% to 31.7%) should not have been paid

Dependent Database (DDb)

- Identifies potentially non-compliant returns during processing
  - Return data and external data match
  - Scoring system applies points to returns based on programming of algorithms
- EITC workload selection tool

DDb Uses Data From:

- INTERNAL DATA SOURCES

- EXTERNAL DATA SOURCES
    - Department of Health and Human Services
        - Child Support Orders and Custodial Status from Federal Case Registry (FCR)
    - Social Security Administration
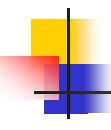   SSNs of parents linked with newborn children

EITC/DDb Research Projects

- EITC DDb Audit Study – Tax Year (TY) 1999

- Measuring EITC DDb Implementation – TY 2000

- Measuring Effectiveness of EITC DDb – TY 2001

- FCR Evaluation Study – TY 2001

- EITC Claims Project – Processing Year 2002

Risk-Based Exam Approach

- Uses level-of-risk of non-compliance defined by relevant characteristics
- Applies differentiated treatments
  - Notification letter (soft notice)
  - Audit
  - Math error
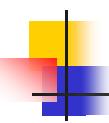- Contingent on specific level-of-risk

Benefits of Risk-Based Approach

- More efficient resource allocation

- Improved application of treatments

- Improved time sequencing

- Reduces burden on compliant taxpayers

Applicability of DDb

- Largest amounts of EITC over claims are due to taxpayers claiming children who are not their qualifying children

  - Residency issue

- DDb is best data source

- 2004 math error authority

Next Steps

- Develop more effective rules and scoring systems
- Build better models to predict EITC non-compliance
- Differentiate returns based on risk
- Apply treatment alternatives combined with appropriate time sequencing

Goals

- Combine DDb with a risk-based model

- Enhance and extend DDb scope

- Develop effective treatment criteria

- Reduce burden

- Protect revenue