

Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns



This page intentionally left blank.

Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns

[Rosemary Marcuss](#)

Director, Research, Analysis & Statistics

[Alain Dubois](#)

Acting Deputy Director, Research, Analysis & Statistics

[Janice Hedemann](#)

Director, Office of Research

[Mary-Helen Risler](#)

Chief, Compliance Analysis & Modeling

[Kara Leibel](#)

Economist

Suggested Citation:

Internal Revenue Service

Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns

Research, Analysis & Statistics Report

Publication 5162

Washington, DC

August 2014

This page intentionally left blank.

Table of Contents

Executive Summary	iii
Introduction	1
IRS Enforcement and Activities	1
The Earned Income Tax Credit Since 1999	2
The Data	4
The nature of National Research Program EITC audits.....	5
Two alternative sets of estimates.....	6
Reliability of National Research Program EITC audit data	8
Sample weighting and related methodological considerations	8
Statistical precision of the estimates	8
Combining across years.....	9
Adjusting for inflation.....	9
Results	10
Overview of compliance	10
Sources of errors	15
Qualifying child errors	21
Tax return preparers	24
Conclusion	27
References.....	28
Appendix.....	29

Figures and Tables

Table 1. Summary of EITC Compliance Estimates	11
Table 2. EITC Compliance Estimates by Number of Qualifying Children Claimed.....	12
Table 2a. Dollar Amounts That Were Reported vs. Dollar Amounts That Should Have Been Reported.....	12
Table 2b. Dollar Overclaim Percentages and Distribution by Taxpayer Eligibility	13
Figure 1: Distribution of Overclaim Returns by Size of Overclaim	14
Figure 2: Distribution of EITC Claims by Size of Claim.....	15
Table 3. EITC Overclaims: Known and Unknown Errors.....	16
Table 4. Distribution of Overclaims With Known Error By Presence of Income Misreporting and Qualifying Child Errors	16
Table 5. Total Dollars of EITC Overclaims Attributable to Common Types of EITC-Related Errors	19
Table 6. Summary of Outcomes for Returns Claiming Qualifying Children	21
Table 7. Frequency of Specific Qualifying Child Errors	23
Table 8. Number of Returns By Preparer Type and EITC Claim Status.....	25
Table 9. Overclaims and Underclaims on EITC Returns by Preparer Type	26
Table A1. Frequency of errors in 1999 and 2006-2008	29
Table A2. Dollars of overclaims in 1999 and 2006-2008	30
Table A3. EITC-Related Errors as Percentage of Total Overclaim Dollars.....	30

This page intentionally left blank.

Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns

Executive Summary

This report presents information about the nature of errors taxpayers made when claiming the Earned Income Tax Credit (EITC) in Tax Years 2006 through 2008. This is the latest of several analyses of EITC compliance undertaken by the IRS over the years to help understand behavior and develop strategies for improving the administration of the credit. Prior to this report, the most recent analysis was conducted for Tax Year (TY) 1999 in a report commonly called the 1999 Compliance Study.

As with the earlier studies of compliance, the analysis in this report relies on audit data; in this case, the audits were conducted by IRS' National Research Program (NRP). NRP audits are like other IRS audits but provide the added benefit that they can be used for population estimates of taxpayer reporting compliance. One challenge with using audit data is that taxpayers do not always respond to or participate in the audit as required. In particular, 15 percent of EITC filers selected for an NRP audit of a TY 2006-2008 return did not participate in the audit, compared to 6 percent selected for an audit for a TY 1999 return. When this happens, the audit outcomes may not reflect their "true" eligibility for the credit.¹ To address this uncertainty, two sets of estimates are presented throughout this paper, reflecting different assumptions about the true compliance behavior of these taxpayers: the "higher" estimate assumes that audit non-participants are generally noncompliant and the "lower" estimate assumes that the true compliance of audit non-participants is the same as the compliance of otherwise similar audit participants.

We find no discernible change in the overall tendency for noncompliance between 1999 and 2006-2008. This is based on a comparison of "dollar overclaim percentages," defined as total dollars overclaimed as a percent of total dollars initially claimed for EITC (before considering IRS corrections or enforcement). In TY 2006-2008, the estimates of the overclaim percentage are 28.5 percent (lower estimate) and 39.1 percent (higher estimate). Comparable figures from the 1999 Compliance Study are 30.9 percent and 35.5 percent.

These figures and related figures in this report do not correspond directly to the EITC improper payment rate and are higher than EITC improper payment amounts. For Fiscal Years 2010

¹ When a taxpayer does not participate in an audit, the EITC is generally disallowed because eligibility for the credit has not been substantiated by the taxpayer as required. It is possible that audit non-participants do meet the eligibility requirements for the credit and would have otherwise been entitled to the credit but for their lack of compliance with audit procedures. "True" eligibility refers to whether or not these eligibility requirements are met, which may or may not be reflected by the audit outcome.

through 2013, the improper payment rate estimate averaged 24.2 percent annually.² Among other methodological differences, the improper payment estimates account for the effects of IRS actions to prevent or recover erroneous payments, whereas the estimates in this report do not. Because the improper payment rate accounts for the effects of enforcement, the improper payment rate is lower than the dollar overclaim percentages presented in this report. Hence, the estimates in this report do not reflect the cost of EITC errors to the Federal government.

Furthermore, these estimates do not reflect the fact that some eligible taxpayers may not have claimed the credit to which they were entitled, for instance by failing to file or to claim the credit. In addition, they do not account for offsetting errors such as may occur if one parent erroneously claimed an EITC qualifying child that should have instead been claimed by the other parent. Thus, the estimates in this report principally reflect overclaims, not net EITC errors.

While the overall tendency for noncompliance is little changed, the growth in the EITC program has led to an increase in total dollars of claims and overclaims since 1999. Averaging over returns filed for TY 2006-2008, an estimated 23.7 million taxpayers claimed an annual total of \$49.3 billion in EITC, compared with 18.8 million taxpayers claiming a total of \$31.3 billion in EITC in TY 1999. Total overclaims for TY 2006-2008 are estimated to be \$14.0 billion (lower estimate) or \$19.3 billion (higher estimate). Similar figures from the 1999 Compliance Study are \$12.3 and \$14.0 billion, after adjusting for inflation (\$9.7 and \$11.1 billion in current dollars).

The majority of taxpayers who overclaim the EITC turn out to be ineligible for the credit rather than eligible for a smaller credit amount. About 79 percent (lower) and 85 percent (higher) of amounts erroneously claimed are attributed to taxpayers who were not allowed any EITC. Still, a large fraction of the taxpayers that overclaim the EITC do so by less than \$500 (44 percent according to the lower estimates and 38 percent according to the higher estimates).

The most common error made is income misreporting, occurring on two-thirds of returns with known errors; on half of returns with known errors, income misreporting is the *only* error.³ Qualifying child errors are the second most frequent type of error, appearing on 30 percent of overclaim returns where the errors are known. Despite occurring only half as often, qualifying child errors account for by far the most dollars of overclaims. Although one cannot precisely attribute overclaim dollars to separate error types due to the occurrence of multiple errors on the same return, if qualifying child errors are considered in isolation from other errors, they account for \$7.2 billion of overclaims (lower estimate) or \$10.4 billion of overclaims (higher estimate). These estimates are 52 percent and 54 percent of the two respective estimates of total overclaims. If qualifying child errors are considered in conjunction with other types of errors, they may account for as little as 42 percent (lower) or 44 percent (higher) of total overclaims (Leibel, 2014).

² For more information about EITC improper payments, please see the Department of the Treasury Agency Financial Reports at <http://www.treasury.gov/about/budget-performance/annual-performance-plan/Pages/default.aspx>.

³ When a taxpayer fails to participate in the audit, the credit is generally denied but the source of the error is not known.

Income misreporting – and in particular self-employment income misreporting – accounts for the second highest amount of overclaim dollars, with filing status errors being the third largest contributor to overclaims. Due to provisions of the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA) that relaxed the “tiebreaker” rules, tiebreaker errors did not contribute substantially to total overclaims in 2006-2008 as they had in the last compliance study in 1999.

Although qualifying child errors are responsible for the largest dollar amount of overclaims, between 73 and 87 percent of children claimed for the EITC were correctly claimed. Of the children claimed in error, the largest known error is failure to meet the residency test; roughly 75 percent of qualifying children known to have been claimed in error, or 10 percent of all children initially claimed for EITC, do not meet this requirement. The relationship test is the next most common qualifying child error: of those children known to be claimed in error, at least 20 percent fail to meet the relationship test; this is roughly 3 percent of all children claimed.

Twenty-nine percent of EITC claimants self-prepare their returns, compared with 43 percent of other taxpayers. Roughly 68 percent of EITC claimants have their returns prepared by a *paid* third party, with another 3 percent relying on free tax return preparation services offered by the IRS or IRS-sponsored programs.⁴ Unenrolled return preparers are the most common type of preparer chosen by EITC claimants; 26 percent of all EITC returns, and 43 percent of paid preparer returns are prepared by an unenrolled return preparer. These are also among the most prone to error: the dollar overclaim percentage for returns prepared by unenrolled return preparers is estimated to be 33 percent (lower) or 40 percent (higher).

Although comprising only 3 percent of all returns with EITC, returns prepared by volunteers in the IRS-sponsored VITA and TCE programs have the lowest error rates. Among these returns, the dollar overclaim percentage is estimated to be 11 percent (lower estimate) or 13 percent (higher estimate).

One cannot conclude without further research whether the lower errors on volunteer-prepared returns or the higher errors on returns prepared by unenrolled return preparers stem from differences in the behavior or ability of each type of preparer, or whether they stem from selection bias – differences in the characteristics of taxpayers who seek assistance from each kind of preparer.

⁴ The rate at which EITC claimants use paid preparers has declined measurably in the years since 2006-2008, so these figures should not be considered current.

This page intentionally left blank.

Introduction

The Earned Income Tax Credit (EITC) is a refundable tax credit that supplements the earned income of low-income workers. In the late 1990s, the IRS conducted a series of studies as part of special appropriations from Congress to better understand compliance issues specific to the EITC and to aid EITC administration. These studies culminated in the IRS report, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns*, known informally as the 1999 Compliance Study. In addition to providing estimates of EITC overclaims, that report was used to develop strategies for improving the administration of the credit. Since its release, it has been the authoritative source on the nature of EITC compliance.

This report updates the 1999 Compliance Study, providing new estimates of taxpayer compliance behavior related to the EITC. It uses data from the IRS National Research Program's (NRP) *Individual Income Tax Reporting Compliance Study* for Tax Years (TY) 2006 through 2008.

This report draws heavily from a technical paper produced by IRS staff in Research, Analysis and Statistics: *Taxpayer Compliance and Sources of Error for the Earned Income Tax Credit Claimed on 2006-2008 Returns*. That paper, Leibel (2014), contains additional detail on methodology.

IRS Enforcement and Activities

The IRS has made significant improvements in its administration of the EITC since 1999 and continues to devote substantial resources toward protecting and recovering revenue associated with erroneous EITC claims. For example, “pre-refund” exams have been introduced so that now more than half of examinations occur before the EITC portion of a refund is released to the taxpayer; the use of third-party data and updated exam filters have improved exam selection; and an income document matching program has been established specifically for EITC cases. In Fiscal Year (FY) 2006, roughly \$2.6 billion was protected or recovered through all EITC compliance and math error programs; in FY 2008, this total was \$3.7 billion.⁵

None of the estimates presented in this report is the same as the improper payment rate, which is estimated on an annual, fiscal year basis by a different methodology and accounts for amounts that are recovered by IRS enforcement activities. Because the estimate of the improper payment rate nets out these recovered amounts, it is lower than the dollar overclaim percentages presented

⁵ These figures include all tax and credit amounts protected or recovered as a result of the enforcement efforts described; they are not limited to EITC amounts. Estimates of EITC-only amounts protected or recovered on a tax year basis are constructed as part of annual improper payment reporting. For Tax Years 2006 and 2008, these are \$1.6 billion and \$2.1 billion, respectively.

in this report, which are based on gross overclaims. For Fiscal Years 2010 through 2013, the improper payment rate estimate averaged 24.2 percent annually.

The estimates in this report will generally not reflect the impact of IRS enforcement efforts. This study focuses on characterizing *taxpayer behavior*, specifically the behavior of those claiming the EITC as it is reported on tax returns that are successfully filed and processed. IRS enforcement described above occurs after returns have been filed and accepted and therefore does not describe or directly influence taxpayer behavior.

Some IRS programs actively prevent certain submitted tax returns from being successfully filed or processed; these IRS efforts affect what aspects of taxpayer behavior are measured in this report. For instance, some errors made on electronically filed returns cause the return to be rejected. This can happen when the Social Security Number, name, or birth date of a child claimed for EITC does not match with Social Security Administration data; it can also happen when a child claimed for EITC has already been claimed by another taxpayer.⁶ Other returns are not rejected up front, but are subsequently flagged as potential identity theft cases and are diverted out of the normal submission-processing pipeline. These two sets of tax returns represent potential areas of EITC compliance behavior that are not covered by the analysis in this paper, but may be worth incorporating in future studies.

To the extent that IRS enforcement and outreach activities influence compliance behavior by deterring or preventing erroneous EITC claims, those effects will be reflected in the estimates in this paper but they cannot be measured or separately identified from other factors influencing behavior.

The Earned Income Tax Credit Since 1999

Between the last compliance study for 1999 and the first year of this study, 2006, there were two major pieces of legislation concerning the EITC with the potential to affect compliance: the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA) and the *Working Families Tax Relief Act of 2004* (WFTRA). EGTRRA simplified the income concepts used in determining the credit, eliminated consideration of the Alternative Minimum Tax, and relaxed the tiebreaker rules, allowing eligible taxpayers with the same qualifying child to decide amongst themselves who would claim the child. By reducing the complexity of determining the credit, all of these provisions could have improved taxpayer compliance. The tiebreaker provision also redefined previously noncompliant behavior (the “wrong” taxpayer claiming the child) as compliant and could therefore have improved observed compliance by that fact alone.

WFTRA created a “uniform definition of a qualifying child” that went a long way toward consolidating eligibility requirements for various child-related tax benefits.⁷ Although some

⁶ When similar errors occur on paper-filed returns, the return is not rejected. Instead, the EITC is disallowed by math error authority and the return continues through processing without the credit. The taxpayer has the opportunity to correct the error at a later time.

⁷ These child-related tax benefits include the dependency exemption, child tax credit, head-of-household filing status, EITC, and credit for child and dependent care expenses.

differences across the different benefits remain, the movement toward uniformity could have decreased the errors arising from confusion.

A more subtle implication of the uniform definition is that taxpayers can no longer “split” these tax benefits to their advantage by using the same child to claim different benefits on different returns (e.g., one taxpayer claims the child for EITC and another claims the child for the dependent exemption). With the uniform definition, only one taxpayer can claim a qualifying child for any of the five named tax benefits.⁸ This aspect of WFTRA could have had some revenue-saving effects but may have led to additional noncompliance if taxpayers continued the same behavior.

Another development related to new legislation since the 1999 Compliance Study is the advent of annual reporting of an EITC “improper payment rate.” This measure of EITC error was developed in response to the *Improper Payments Information Act of 2002* (IPIA).⁹ It is reported by IRS annually on a fiscal year basis and is included in the Department of Treasury’s Agency Financial Reports. Although dollar overclaim percentages are presented in this report, it should be noted that these are not equivalent to the improper payment rate. The improper payment rate is estimated using a different methodology that, among other things, accounts for amounts that are recovered by IRS enforcement activities.

There have been some changes to the tax environment since 2008 that may have affected taxpayer compliance behavior, but any such effects will be reflected only in future studies of compliance. These changes include the following:

- Expanding the credit to a third child and increasing the income phase-out range for married-filing-jointly taxpayers, under the *American Recovery and Reinvestment Act of 2009*, effective in TY 2009;
- Establishment of new criteria governing who is allowed to claim a qualifying child when more than one person can claim the same child (creating complexity not present in the simplified tiebreaker rules under EGTRRA), under the *Fostering Connections to Success and Increasing Adoptions Act of 2008*, effective in TY 2009;
- Amending the “age test” for qualifying children, adding the requirement for the child to be younger than the taxpayer or spouse, also under the *Fostering Connections to Success and Increasing Adoptions Act of 2008*, effective in TY 2009;
- The IRS ending its practice of providing a taxpayer’s “debt indicator” to financial institutions and tax return preparation firms, effective in TY 2011; this is expected to severely restrict or eliminate refund anticipation loans (but not refund anticipation checks); and
- Elimination of the Advance Earned Income Tax Credit under Public Law 111-226, effective in TY 2011.

⁸ There are some exceptions to this for divorced or separated parents.

⁹ More recent legislation has revised the language and requirements of IPIA: the *Improper Payments Elimination and Recovery Act of 2010* and the *Improper Payments Elimination and Recovery Improvement Act of 2012*.

The Data

The data used for this analysis are collected through the IRS National Research Program's *Individual Income Tax Reporting Compliance Studies* for Tax Years (TY) 2006 through 2008, also known as the NRP 1040 Study.¹⁰ These data are available on the IRS Compliance Data Warehouse (CDW).¹¹ The purpose of NRP studies is to provide information about taxpayer reporting compliance behavior that can be projected to the tax filing population. Using a stratified random sample design, the NRP selects a sample of returns that can be weighted to reflect the tax filing population, then conducts audits on these taxpayers.¹²

Beginning in TY 2006, the NRP 1040 studies have included an explicit EITC subsample, incorporating strata for taxpayers claiming EITC in the sample design.¹³ Also new in TY 2006 is greater collection of detail regarding outcomes of the EITC audits. The design of the NRP 1040 Studies in TY 2006 and later is a "rolling sample," which means that although each annual sample is representative of the population, samples from consecutive tax years can be combined to achieve a greater level of statistical precision. Together these make it possible to use the TY 2006 and later NRP studies to conduct analyses of EITC compliance at a level of detail similar to or greater than the 1999 Compliance Study. The combined size of the EITC sample from the TY 2006-2008 study used in this analysis is 7,635 returns.¹⁴

As noted earlier, the NRP 1040 Study addresses the accuracy of reported return line items on filed returns. This makes it appropriate for a study of compliance behavior of taxpayers who claimed the EITC on their originally filed return. The NRP 1040 Study does not address individuals who do not file tax returns and, as a consequence, does not collect information from which to develop estimates of underclaims that arise when EITC-eligible taxpayers do not file a tax return. Although some estimates of underclaims are presented in this report, it should be noted that these only include cases where the taxpayer claimed some positive amount of EITC on

¹⁰ The National Research Program conducts studies for other taxes besides the individual income tax, including the corporate income tax (Form 1120 and 1120S) and the employment tax (Form 941). The NRP is the modern successor to the Taxpayer Compliance Measurement Program (TCMP), which conducted studies from the 1960s through 1988.

¹¹ The NRP data available on the CDW form the basis for the analysis, but certain additional information was obtained from the electronic case files of individual audits through the use of RGS (Report Generation Software) or CEAS (Correspondence Examination Automation Support). These data were accessed for purposes of ensuring data quality and accuracy; not all resulting adjustments have been incorporated in the NRP data on CDW so there may be some differences between the officially provided NRP 1040 data and the data used for this report.

¹² The NRP 1040 universe consists of original (not amended) income tax returns of taxpayers living in the United States who filed in the calendar year following the period of income reporting (e.g., TY 2006 returns filed in calendar year 2007).

¹³ Of the 58 strata that comprise the sample design for TY 2006, 19 apply to tax returns claiming EITC. See Leibel (2014) for a full description of the EITC strata.

As with the EITC 1999 Compliance Study, the NRP EITC subsample contains only taxpayers who claimed the EITC on their original return; it does not include those who first claimed the credit on an amended return. Although not a part of the current analysis, in principle the NRP data should provide the ability to analyze the characteristics of taxpayers who first claim the credit on an amended return rather than their original return.

¹⁴ This includes audit non-participants and operational exam cases, but excludes 241 other cases that were originally selected into the sample but for which no exam took place. A case selected into the sample may be formally excluded if it meets certain criteria determined by the NRP. Of the 241 cases excluded from the sample, just one is excluded because the audit had not yet closed as of the latest release of NRP data.

their return. They do not include cases where eligible taxpayers did not file a tax return, nor do they include cases where the taxpayer did not originally claim the credit but whose eligibility was established during the course of the exam. The IRS separately conducts research on EITC participation (not to be confused with audit participation) that addresses these kinds of excluded underclaims (Plueger and O’Hara, 2009).

Similarly, the estimates in this report do not reflect offsetting errors. For instance, when a child is found to have been claimed incorrectly in the NRP sample, in some cases there may be another taxpayer who could have correctly claimed that child but did not do so. This analysis reflects these incorrect claims but does not adjust for the fact that the credit could have been rightfully claimed by another taxpayer. The latter part of this scenario should be covered by estimates of EITC participation rather than EITC compliance and so is not addressed here.

Since both the 1999 EITC Compliance Study and the current NRP studies were designed to provide a representative picture of compliance behavior within the EITC population, it is natural to want to compare findings from the two studies. However, there are a number of underlying differences in aspects of the studies, including differences in sample design, sample selection, and data collection methods. This means that one cannot make comparisons between the two sets of findings that are statistically definitive; that is, one cannot determine whether any apparent differences or similarities between the two studies arise from actual patterns of taxpayer behavior over time or whether they arise as a consequence of differences in the samples and methodology. Therefore, this analysis makes no attempt to quantify the statistical significance of comparisons between the two studies.

The nature of National Research Program EITC audits

In many respects, National Research Program audits are no different from other audits conducted by the IRS. They fall under IRS’ authority to examine taxpayers’ books and records to correctly determine tax liability. However, because NRP studies have the additional goal of providing a comprehensive picture of tax reporting compliance, NRP audits may differ from typical audits conducted by the IRS (referred to here as “operational exams”) in the scope of issues examined. Emphasis is placed on ensuring that the “right answer” is obtained for all line items under audit, even small dollar issues. NRP auditors also collect information of interest to researchers that would not otherwise be recorded, such as the nature of the errors made when EITC is claimed erroneously.

In the TY 2006-2008 NRP, 94.8 percent of returns with EITC are subject to either an office audit (58.1 percent) or field audit (36.7 percent) and therefore involve a face-to-face meeting with an IRS tax examiner.¹⁵ A small number (1.6 percent) are accepted as filed.¹⁶ The remaining 3.6 percent are worked by correspondence audit, with 1.0 percentage point accounted for by cases

¹⁵ In an office audit, the taxpayer meets with an IRS tax compliance officer (TCO) at an IRS office and brings certain documentation requested ahead of time by the TCO. A field audit is one where an IRS revenue agent (RA) travels to meet with the taxpayer out in the field, typically at the taxpayer’s place of business or residence – wherever the books or records to be examined are located.

¹⁶ Some of these returns have small adjustments made to them, but these are for NRP purposes only and do not affect the taxpayer’s account.

worked by standard IRS operational exam.^{17, 18} This latter group is subject to standard exam procedures and therefore may not cover the same breadth of issues that would be examined in an NRP audit; these cases are also not subject to NRP's additional data collection requirements. Nonetheless, cases selected for operational exams represent a particularly noncompliant group of taxpayers and are important to include in a study of EITC compliance.

Two alternative sets of estimates

While audit data are generally considered the best data source for studies of compliance, some uncertainty arises from the fact that not all taxpayers who are selected for audit comply with the requirement to meet with the examiner or provide documentation about the issues under audit. These taxpayers are referred to as “audit non-participants” or simply “non-participants” throughout this paper.¹⁹ While the IRS has standard procedures for handling a lack of response from the taxpayer in terms of adjusting particular line items and overall tax liability, these adjustments do not necessarily meet the research goals of accurately determining reporting noncompliance.²⁰ Some adjustments may be correct, but there is considerable uncertainty as to whether the entirety of these adjustments reflects the underlying truth for every line item. Thus, when taxpayers do not provide the examiner with any input, their audit outcomes may not reflect their true circumstances. This is a particular concern for taxpayers claiming EITC because the rate of audit non-participation is much higher for this subsample (14.6 percent, unweighted) than it is for all other taxpayers (2.9 percent, unweighted).

To address this uncertainty, we follow the approach taken by the 1999 Compliance Study, offering two sets of estimates (for most compliance measures) based on two different assumptions about the audit non-participants. The first assumption is that all audit non-participants have claimed the credit erroneously.²¹ Because this assumes a high degree of

¹⁷ In a correspondence audit, the taxpayer is sent a request to submit documentation through the mail, which is reviewed by an IRS tax examiner upon receipt. This may be followed up with written requests for additional information and occasionally phone contact.

¹⁸ This is an artifact of return submission processing. NRP return selection occurs after cases are selected for pre-refund exams but without regard to the outcome of the exam selection process. This means that some cases selected into the NRP sample are already “frozen” and claimed by operational exam before the NRP can begin working them. This conflict could be solved by incorporating the NRP sample selection directly into return processing and giving it priority, as was done for the TCMP and earlier EITC Compliance Studies.

¹⁹ In prior research, terms like “no shows” or “taxpayers who did not appear for audit” have been used to describe the situation where the taxpayer does not provide any information. But because NRP exams do not have to be conducted in person, either by design or in order to accommodate the taxpayer, “no show” becomes something of a misnomer. Moreover, the term “no show” means something specific in IRS terminology; it can include a taxpayer who does not provide the examiner with information during the audit but ultimately acknowledges and agrees to the examiner's proposed adjustments by signing the report (and sometimes submitting full payment). From a data collection perspective, the taxpayer's agreement with the proposed changes arguably constitutes a form of input or participation and should therefore be treated differently. The term “audit non-participant” seems broad enough to encompass any type of exam and cannot be confused with terms used internally by IRS for a slightly different purpose.

²⁰ Generally speaking, the procedures in the case of a taxpayer who does not respond to the notification for audit is to disallow any tax return line items that are advantageous to the taxpayer but require documentation or substantiation.

²¹ In practice, whether or not the credit is considered erroneous for purposes of this analysis depends on whether the auditor fully disallowed the credit, which is generally but not always the case.

noncompliance for these taxpayers, these estimates are referred to as the “higher” estimates.²² The second assumption is that the level of compliance of audit non-participants can be approximated by otherwise similar taxpayers who do participate in the audits. Estimates based on this assumption are termed “lower” estimates, because they assume a lower level of noncompliance among the audit non-participants than under the first assumption.²³

The “lower” and “higher” estimates are two distinct sets of estimates, rather than two ends of a range estimated concurrently or the lower and upper bounds of a statistical confidence interval. Thus, one should not interpret either set of estimates as limits or bounds. The higher estimates do not reflect the greatest possible noncompliance, nor do the lower estimates reflect the least possible noncompliance. Because each estimate is a point estimate with its own statistical confidence interval, actual values somewhat below the lower estimate or above the higher estimate may be within the confidence interval and therefore still somewhat likely.²⁴ Even aside from the question of statistical precision, true noncompliance could fall below the lower estimates if the “lower assumption” is incorrect and audit non-participants are in fact *more* compliant than the audit participants. At the other end of the range, because the estimates do not make any adjustments to account for income or other errors that are not detected by the auditor, true noncompliance could fall above the higher estimates if many EITC overclaims arise from these undetected errors.

The higher estimates can also be interpreted as reflecting hypothetical outcomes if the full EITC population were audited. In that case, some fraction of taxpayers would not be able or willing to participate in the audit and would have their EITC disallowed as a result. Because audit non-participation is a facet of taxpayer compliance behavior that has relevance for tax administration, the higher estimates contain information important for the IRS, even without making any assumptions about the “true” eligibility of the audit non-participants. However, gaining a better understanding of the true compliance of these taxpayers could lead to improvements in administration of the credit. On the one hand, if it can be shown that the audit non-participants are largely noncompliant, their lack of responsiveness would make them an especially cost-effective population for future enforcement. On the other hand, if audit non-participants are largely compliant but face barriers that prevent them from participating in the audit, then they are being disallowed the EITC to which they are entitled. In this circumstance, non-participants may form a population that would benefit from focused outreach efforts rather than enforcement. The differing treatments highlight an ongoing challenge of administering the EITC: balancing the goals of reducing noncompliance among those ineligible for the credit while ensuring that eligible taxpayers receive the credit.

²² The “higher” estimates are comparable to the “upper-bound” estimates in the 1999 Compliance Study.

²³ The “lower” estimates are comparable to the “lower-bound” estimates in the 1999 Compliance Study. They are constructed by attributing compliance behavior to the audit non-participants based on the behavior of the taxpayers who did participate in the audit and who share certain basic characteristics, reflected by the sample strata and the sample weights.

²⁴ Standard errors for each set of estimates are presented in the technical paper associated with this report (Leibel, 2014).

Reliability of National Research Program EITC audit data

For many reasons, one should expect a high degree of accuracy with respect to the outcomes of the NRP EITC audits. As previously noted, the vast majority of NRP audits involve a face-to-face meeting between the examiner and the taxpayer.²⁵ This meeting is often preceded and/or followed up by phone contact and, where necessary, additional meetings take place. Because the NRP audits are oriented toward generating high quality, accurate data, examiners are trained to make every accommodation to meet with taxpayers, to educate them about the necessary documentation for substantiating EITC eligibility, and to give them sufficient opportunity to obtain and supply the necessary information.

The NRP also conducts an extensive battery of consistency tests on the data and devotes resources to data perfection efforts. Additional evaluation of the data quality of EITC cases was conducted specifically for this report. Care was taken to ensure that the final EITC amounts could be calculated from their underlying factors (income, qualifying children, filing status, eligibility criteria), and that the NRP-reported amounts align with IRS Master File data. Discrepancies discovered during this process were resolved by looking back at the electronic versions of case file documents to see what was recorded in the examiner's workpapers. In some cases, this led to correcting the EITC amount in the data.

For these reasons, readers should have confidence that the NRP EITC audit data used for this report are very high quality. However, no data will be perfect. One limitation is that auditors may not detect all unreported income in every audit, which may lead to an understatement of noncompliance for some taxpayers. There may be other cases in which the EITC is incorrectly denied or reduced to some taxpayers, which would lead to an overstatement of noncompliance for those taxpayers. Despite these potential data concerns, there is no evidence suggesting that the NRP data systematically either overstate or understate EITC overclaims. We believe that the lower and higher estimates together present a reasonable range for estimates of behavior.

Sample weighting and related methodological considerations

Sample weights were constructed for this analysis to ensure the estimates are representative of the EITC population. The weights are similar but not identical to those provided by the NRP 1040 Study. More discussion about the methodology used to create the weights is provided in Leibel (2014).

Statistical precision of the estimates

Although not presented in this report, standard errors have been calculated for all estimates using replicate weights. For all but a few estimates, the sample size is large enough so that consideration of the standard errors does not affect the conclusions that can be drawn. Tables with the standard errors can be found in Leibel (2014).

²⁵ In practice, some of the office or field audits designed to take place in person end up being conducted by phone, mail and/or fax instead, but this is not the norm, and is only done to accommodate the taxpayer if the taxpayer cannot or will not meet in person.

Combining across years

The method for combining the data into one representative year is simple: the sample weight for each return is divided by three – the number of annual samples being combined. This is an accepted approach, taken, for instance, by the American Community Survey for its multi-year estimates to produce averages over the period of study (Census, 2009, Page 11-16). Fortunately, the tax law relevant to the EITC remained largely the same across these three years, with the exception of adjustments for inflation. The only other exception is that the extended phase-out range for married-filing-jointly taxpayers increased from being \$2,000 beyond those for single and head-of-household filers in 2006 and 2007 to being \$3,000 higher in 2008. Since this is a fairly subtle change, it does not preclude estimating averages across the three years by combining the annual samples and reducing the sample weights to one-third their original value.

Adjusting for inflation

In order to have measures of dollar amounts and overclaims that are consistent across the three years, dollar figures have been adjusted for inflation to reflect constant 2008 dollars, the most recent year of the study. The index used to adjust for inflation is the same one used to make cost-of-living adjustments to the parameters defining the EITC. This is legislated to be the average Consumer Price Index for All Urban Consumers (CPI-U) from the 12-month period ending on August 31 of the calendar year preceding the tax year in question.²⁶ Accordingly, the index for TY 2006 is the average CPI-U from September 2004 through August 2005 and the indexes for the other years are calculated in a similar manner.

The next section presents the results of the analysis.

²⁶ See 26 USC § 32 (j) (2012).

Results

This section first provides an overview of compliance behavior before examining how returns and overclaim dollars are distributed by type of error, with a particular focus on qualifying child errors. The section concludes with analysis of tax return preparers.

Overview of compliance

An overview of population estimates of EITC compliance, averaged across TY 2006-2008, is provided in Table 1.

Dollars of overclaims in this period are estimated to be \$14.0 billion (lower estimate) and \$19.3 billion (higher estimate) in 2008 dollars.²⁷ Comparable figures from the 1999 Compliance Study, after adjusting for inflation, are \$12.3 and \$14.0 billion.²⁸ The increased dollar amounts largely reflect growth in the EITC program, shown by an increase in total dollars of claims since 1999.

The dollar overclaim percentage can provide a better indication of whether compliance has changed in relative terms.²⁹ In the 1999 Compliance Study, the “lower-bound” and “upper-bound” estimates, which are conceptually similar to the lower and higher estimates, were 30.9 percent and 35.5 percent, respectively, with a gap of 4.6 percentage points between the estimates. The current figures for the lower and higher estimates are 28.5 percent and 39.1 percent, respectively, which are 10.6 percentage points apart. With movement at both ends of the gap (i.e., the lower overclaim percentage is lower and the higher overclaim percentage is higher), we cannot conclude that overall compliance has changed between the two studies.

Mechanically, the widening of the gap between the lower and higher estimates is caused by the higher rate of audit non-participation in the more recent NRP EITC sample: 16 percent of the weighted EITC population compared with 7 percent in the 1999 study.³⁰ With greater audit non-participation comes greater uncertainty, which leads to a larger gap between the two estimates.

According to Table 2a, which summarizes compliance by number of children claimed, the most overclaim dollars are associated with taxpayers claiming two children (\$8.4 billion lower estimate, \$11.4 billion higher estimate).³¹ This appears to be due to the larger credit available with two children rather than a greater tendency toward noncompliance: the dollar overclaim percentage does not appear to vary by number of children claimed.

²⁷ Recall that these are not the same as annual EITC improper payment amounts.

²⁸ These were reported to be \$9.7 and \$11.1 billion in current dollars (Compliance Study, 1999, Table 1).

²⁹ The dollar overclaim percentage is defined as EITC overclaims divided by total EITC claims.

³⁰ The unweighted audit non-participation rates are 14.6 percent and 5.5 percent, respectively.

³¹ In this period, two children at most can be claimed; the increase to three children happened in the following year.

Table 1. Summary of EITC Compliance Estimates
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP
(Dollar amounts in billions of constant 2008 dollars)

<i>Higher estimates</i>				
	Overclaim returns	Correct returns	Underclaim returns¹	Total
Number of returns (millions)	11.9	10.4	1.4	23.7
Percent of total returns	50%	44%	6%	100%
Amount claimed	\$26.0	\$20.9	\$2.3	\$49.3
Correct amount	\$6.7	\$20.9	\$2.8	\$30.5
Amount overclaimed	\$19.3	\$0.0	\$0.0	\$19.3
Amount underclaimed	\$0.0	\$0.0	\$0.5	\$0.5
Dollar overclaim percentage ²	--	--	--	39.1%
<i>Lower estimates</i>				
	Overclaim returns	Correct returns	Underclaim returns¹	Total
Number of returns (millions)	10.1	12.1	1.6	23.7
Percent of total returns	43%	51%	7%	100%
Amount claimed	\$21.8	\$24.7	\$2.7	\$49.3
Correct amount	\$7.8	\$24.7	\$3.4	\$35.8
Amount overclaimed	\$14.0	\$0.0	\$0.0	\$14.0
Amount underclaimed	\$0.0	\$0.0	\$0.6	\$0.6
Dollar overclaim percentage ²	--	--	--	28.5%

Note: Figures may not sum due to rounding.

1 Underclaim returns are limited to returns where EITC was initially claimed by the taxpayer on his/her filed return, consistent with the definition of underclaim returns used in the 1999 Compliance Study. This excludes returns where EITC was not claimed, but the taxpayer was found to be eligible for the credit during the audit.

2 The dollar overclaim percentage is not the same as the improper payment rate, which is calculated on an annual, fiscal year basis by a different methodology and accounts for amounts that are recovered by IRS enforcement activities.

Table 2. EITC Compliance Estimates by Number of Qualifying Children Claimed
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP

Table 2a. Dollar Amounts That Were Reported vs. Dollar Amounts That Should Have Been Reported
 (Billions of constant 2008 dollars)

	Number of Qualifying Children Claimed						Total	
	None		One		Two		Reported	Should Have Reported
	Reported	Should Have Reported	Reported	Should Have Reported	Reported	Should Have Reported	Reported	Should Have Reported
	<i>Higher estimates</i>							
EITC Correct	\$0.6	\$0.6	\$8.2	\$8.2	\$12.2	\$12.2	\$20.9	\$20.9
EITC Overclaim	0.6	0.1	9.1	1.8	16.2	4.8	26.0	6.7
<i>Taxpayers ineligible for credit</i>	0.4	0.0	6.6	0.0	9.5	0.0	16.4	0.0
<i>Taxpayers eligible for smaller credit</i>	0.2	0.1	2.6	1.8	6.7	4.8	9.5	6.7
EITC Underclaim	0.1	0.2	0.8	1.0	1.4	1.7	2.3	2.8
Total EITC	\$1.3	\$0.9	\$18.1	\$11.0	\$29.8	\$18.7	\$49.3	\$30.5
Total amount overclaimed		\$0.5		\$7.4		\$11.4		\$19.3
	<i>Lower estimates</i>							
EITC Correct	\$0.7	\$0.7	\$9.8	\$9.8	\$14.2	\$14.2	\$24.7	\$24.7
EITC Overclaim	0.5	0.1	7.4	2.1	13.9	5.5	21.8	7.8
<i>Taxpayers ineligible for credit</i>	0.3	0.0	4.5	0.0	6.2	0.0	11.0	0.0
<i>Taxpayers eligible for smaller credit</i>	0.2	0.1	2.9	2.1	7.6	5.5	10.8	7.8
EITC Underclaim	0.1	0.2	0.9	1.2	1.7	2.0	2.7	3.4
Total EITC	\$1.3	\$1.0	\$18.1	\$13.1	\$29.8	\$21.7	\$49.3	\$35.8
Total amount overclaimed		\$0.4		\$5.2		\$8.4		\$14.0

Note: Figures may not sum due to rounding.

Table 2b. Dollar Overclaim Percentages and Distribution by Taxpayer Eligibility

(Billions of constant 2008 dollars)

	Number of Qualifying Children Claimed			Total
	None	One	Two	
	<i>Higher estimates</i>			
Total amount overclaimed	\$0.5	\$7.4	\$11.4	\$19.3
Percent of overclaim dollars attributable to:				
<i>Taxpayers ineligible for credit</i>	85%	89%	83%	85%
<i>Taxpayers eligible for smaller credit</i>	15%	11%	17%	15%
Total	100%	100%	100%	100%
Dollar overclaim percentage¹	37.8%	40.6%	38.3%	39.1%
	<i>Lower estimates</i>			
Total amount overclaimed	\$0.4	\$5.2	\$8.4	\$14.0
Percent of overclaim dollars attributable to:				
<i>Taxpayers ineligible for credit</i>	83%	85%	74%	79%
<i>Taxpayers eligible for smaller credit</i>	17%	15%	26%	21%
Total	100%	100%	100%	100%
Dollar overclaim percentage¹	30.2%	29.0%	28.1%	28.5%

¹ The dollar overclaim percentage is not the same as the improper payment rate, which is calculated on an annual fiscal year basis by a different methodology and accounts for amounts that are recovered by IRS enforcement activities.

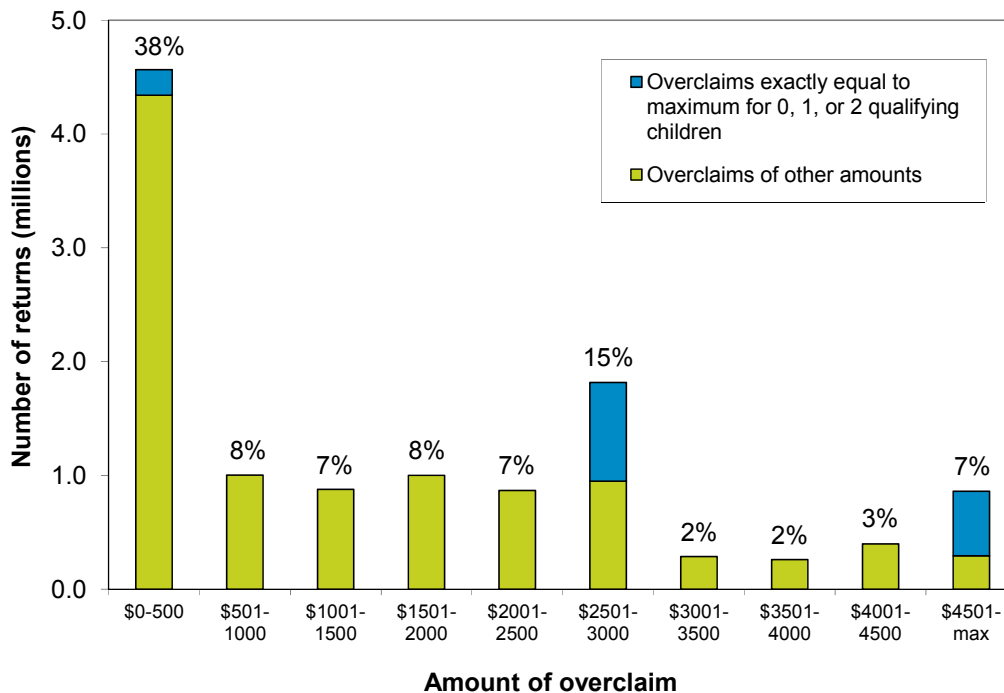
Table 2b indicates that most overclaim dollars are attributed to taxpayers who are in fact ineligible for the credit. According to the higher estimate, ineligible taxpayers account for 85 percent of total overclaim dollars, with just 15 percent due to those who were eligible for a smaller credit amount. The comparable figures for the lower estimate are 79 percent and 21 percent.

To provide a sense of how large overclaims are at the individual taxpayer level, Figure 1 shows the distribution of overclaim returns by size of the overclaim. Figure 2, which shows the distribution of original EITC claims by size, is provided for comparison. A large percent of overclaims are less than \$500: 38 percent according to the higher estimates and 44 percent according to the lower estimates.³² This compares with 27 percent of the original claims. At the other end of the spectrum, the percent of overclaims that are greater than \$3,000 is disproportionately low: 15 percent according to the higher estimates and 11 percent according to the lower estimates, compared with 23 percent of original claims.

³² Recall that the terms “higher” and “lower” refer to the level of noncompliance rather than the numeric value of the estimate, so that here the “higher” estimate produces a lower number, indicating a lower proportion of overclaims in this low-dollar range.

Figure 1: Distribution of Overclaim Returns by Size of Overclaim
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP
 (Constant 2008 dollars)

Higher estimates



Lower estimates

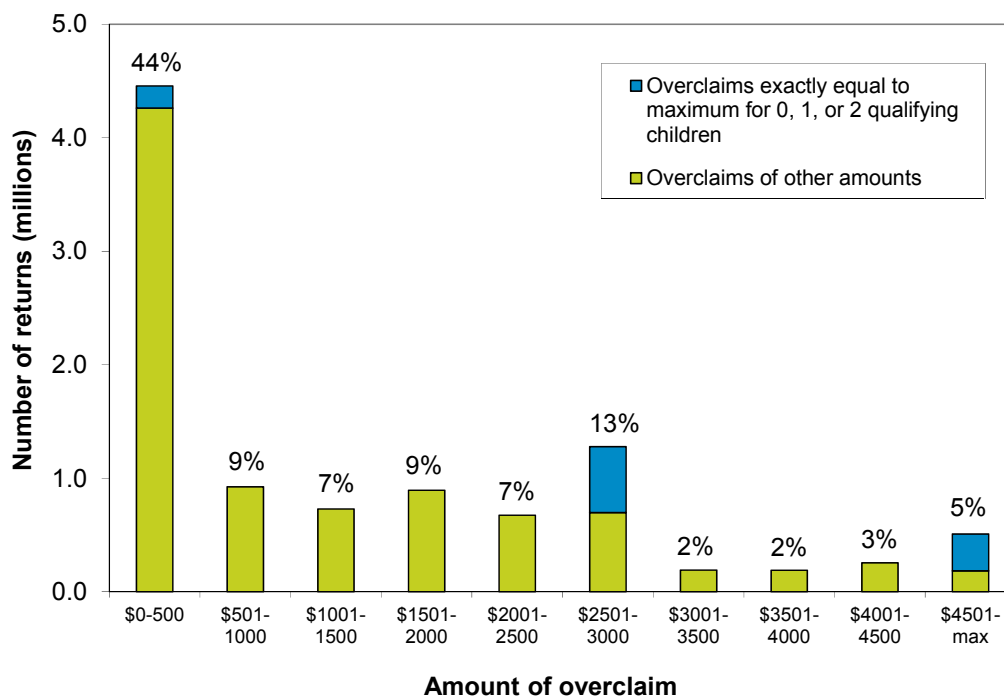
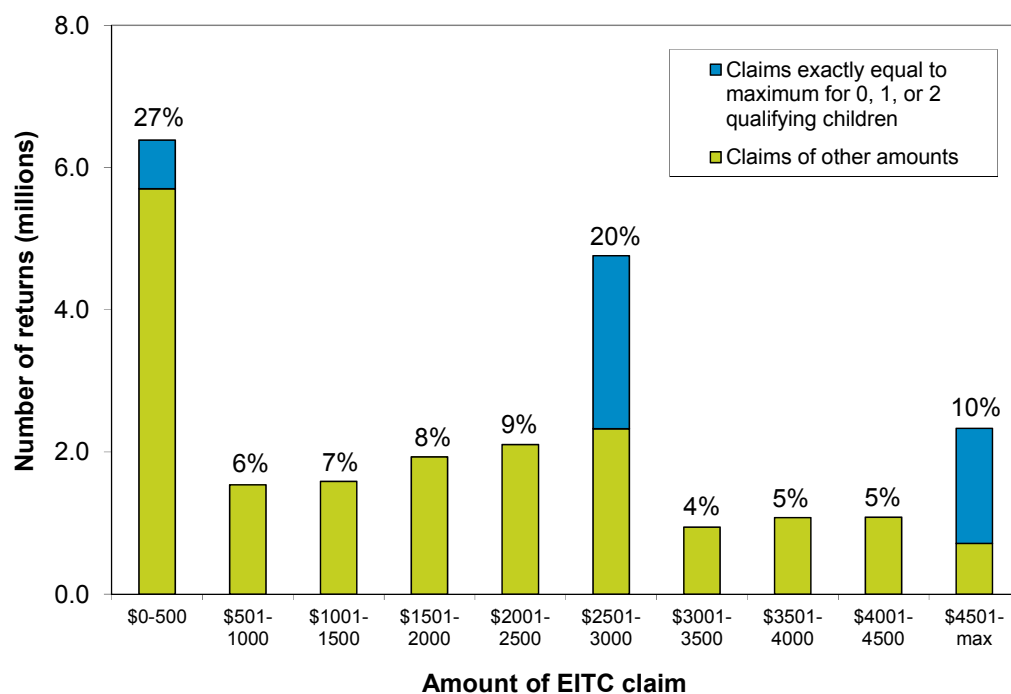


Figure 2: Distribution of EITC Claims by Size of Claim
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP
 (Constant 2008 dollars)



Sources of errors

This section focuses on the frequency and magnitude of particular errors that are associated with the overclaim of EITC.³³ As with the earlier 1999 Compliance Study, this analysis distinguishes overclaims arising from *known* errors, which were determined during an audit in which the taxpayer fully participated, and *unknown* errors, for taxpayers who did not participate in the audit.³⁴ The category of unknown errors also includes cases where the taxpayer did not meet with the examiner or supply documentation, but eventually participated in the audit by agreeing to the changes proposed by the examiner and signing the final report. The breakdown between known and unknown errors is shown in Table 3. Roughly 8.4 million returns are estimated to have an overclaim with a known error, for a total of \$11.4 billion in overclaims. Up to another 3.6 million returns have an overclaim with an unknown error, for another \$7.9 billion in overclaims, or 41 percent of the total.

³³ Consider the various types of errors that can lead to an overclaim of the EITC. The size of the credit is determined by earned income, AGI, number of qualifying children, and filing status; therefore, misreporting any of these items can result in claiming the wrong amount of the credit, including claiming a positive credit when the correct amount is \$0. Beyond these factors, there are a number of eligibility criteria that may cause the full amount of the EITC to be disallowed, either during return processing or during an audit. Qualifying child errors – where a child claimed is not the taxpayer’s qualifying child for purposes of EITC – seem to straddle these two categories of error in that there is both an element of eligibility and an element that contributes to the size of the credit.

³⁴ Although IRS may be able to determine some errors made by the audit non-participants by using internal or third-party data, no such information is presented since it would be an incomplete and potentially skewed analysis.

Table 3. EITC Overclaims: Known and Unknown Errors
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP
 (Constant 2008 dollars)

	Returns with EITC Overclaim		Total Dollars of EITC Overclaims		Average Estimated Overclaim
	Number (millions)	Percent (%)	Dollars (billions)	Percent (%)	
Total returns with EITC overclaims	11.9	100%	\$19.3	100%	\$1,614
Type of error unknown ¹	3.6	30%	\$7.9	41%	\$2,214
Type of error known	8.4	70%	\$11.4	59%	\$1,360

Note: Figures may not sum due to rounding.

¹ Unknown errors are those where taxpayer did not participate in audit or participated only by signing final audit report.

Table 4. Distribution of Overclaims With Known Error By Presence of
Income Misreporting¹ and Qualifying Child (QC) Errors
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP
 (Constant 2008 dollars)

Error type	Returns with EITC Overclaim		Total Dollars of EITC Overclaims		Average Estimated Overclaim
	Number (millions)	Percent (%)	Dollars (billions)	Percent (%)	
Total overclaim returns with known error	8.4	100%	\$11.4	100%	\$1,360
Income misreporting but no QC errors	4.9	58%	\$3.9	35%	\$807
Income misreporting alone ²	4.3	51%	\$2.9	25%	\$673
In combination with other errors ³	0.6	7%	\$1.1	9%	\$1,737
QC error(s) but no income misreporting	1.8	21%	\$4.3	38%	\$2,384
Qualifying child error(s) alone ⁴	1.3	15%	\$3.0	26%	\$2,327
In combination with other errors	0.5	6%	\$1.3	11%	\$2,529
Both income misreporting and QC error(s)	0.7	9%	\$1.7	15%	\$2,451
Income misreporting and QC error(s) only	0.5	6%	\$1.3	12%	\$2,513
In combination with other errors	0.2	2%	\$0.4	4%	\$2,275
All other errors (no income or QC errors)	1.0	12%	\$1.4	12%	\$1,447

Note: Figures may not sum due to rounding.

¹ Income misreporting includes both misreporting of the amounts used to calculate the credit (i.e., earned income or AGI) as well as underreporting of investment income below the maximum threshold. Cases where the taxpayer filed as single or head-of-household but should have filed jointly with their spouse and reported the combined income are considered "other errors" (filing status errors) rather than income misreporting, unless the income of the taxpayer or spouse was also misreported.

² This category includes returns where the number of qualifying children was actually increased during audit, so to some extent the underclaim of the qualifying children offsets the effect of income misreporting; however these are all net overclaim cases.

³ For purposes of this table, "other errors" includes the following: filing status errors, errors corrected in processing, tiebreaker errors, and violations of one of these eligibility criteria: invalid Social Security Number (SSN) for taxpayer, lack of U.S. citizenship or resident alien status for the full year, filing of Form 2555 or 2555-EZ, and these errors specifically for taxpayers claiming EITC with no children: age other than 25-64, being the dependent or qualifying child of another person. "Other errors" also includes claiming the credit while a ban was in place and claiming the credit without recertifying if EITC was denied in a previous year. IRS Publication 596 details the EITC eligibility criteria.

⁴ This category includes returns where there was some income misreporting but it was not in the taxpayer's favor and it was not enough to offset the effect of claiming children that were not eligible. This category also includes some operational exam cases where there is limited information about the errors that occurred; what is known is that these cases had EITC fully disallowed and there was no audit adjustment to income or filing status.

The 1999 Compliance Study demonstrated that income misreporting and qualifying child errors were the two most frequent errors with the largest dollar impact on overclaims for returns filed in tax year 1999.³⁵ Table 4 shows that this remains true in TY 2006-2008. The Appendix provides a side-by-side comparison of the sources of errors summarized in Tables 3 and 4 with findings from the 1999 Compliance Study. For purposes of Table 4, returns with known EITC errors are split into four distinct groups: those with income misreporting, those with qualifying child errors, those with both of these errors and those with neither. The first three of these groups are further broken down by whether additional errors are present.

As Table 4 indicates, income misreporting is the most commonly made error, occurring on about 67 percent of overclaim returns with a known error.³⁶ In most of those cases – roughly half of overclaim returns with a known error – income misreporting is the *only* error. Overclaim dollars associated with income misreporting (only) are disproportionately much lower, at 25 percent. The average overclaim associated with income misreporting alone is estimated to be \$673.

Qualifying child errors (excluding those that occur alongside income misreporting) show this pattern in reverse: these errors represent a much higher percent of overclaim dollars (38 percent) than overclaim returns (21 percent). Where the only error is a qualifying child error, the average estimated overclaim is \$2,327.

The chances are relatively low that a return with an error will have neither income misreporting nor a qualifying child error – just 12 percent. There is also a fairly low chance that a return will have both types of errors; this happens on only 9 percent of returns with known errors. “Other errors” – those aside from income misreporting and qualifying child errors – are nontrivial as a group: adding together the relevant rows in Table 4 indicates that these appear on 27 percent of returns, and these returns account for 37 percent of overclaim dollars.

Table 5 considers a wider set of errors than Table 4 and provides insight into how much each type of error by itself contributes to total overclaimed dollars. The estimated frequency of each category of error is also shown.³⁷ In this table, income misreporting errors are separated by whether the misreported amount involves earned income or AGI or investment income.³⁸ Earned

³⁵ See Table 2, page 13 in the IRS report *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns*.

³⁶ The 67 percent is arrived at by summing the row labeled “Income misreporting but no QC errors” (58 percent) and the row labeled “Both income misreporting and QC error(s)” (9 percent).

³⁷ This column only counts those errors that actually result in an overclaim on net overclaim returns. An example of a fairly common error not included here is when a taxpayer files as head-of-household but should have filed as single; since this particular filing status error does not affect the amount of the credit due the taxpayer, it is not counted in this column. Likewise, some earned income errors do not affect the amount of the credit if the reported and corrected amounts are both within a certain range. Also excluded are errors that appear on returns that do not have a net overclaim; for example, if a processing (math) error reduces the credit but this is offset by another correction during audit that yields a net increase to the EITC, that processing error will not be included here.

³⁸ The misreporting of AGI and investment income can affect the amount of the EITC in two ways: first, there are maximum thresholds for AGI and investment income above which the taxpayer is ineligible, irrespective of earned income. Second, in some cases the calculation of the credit amount is actually based on AGI rather than earned income, so changes to AGI that are below the threshold can still affect the amount of the credit. Note that misreported amounts of AGI that correspond to misreported earned income are excluded from the category of “other

income misreporting is then further separated into whether the source is self-employment income or wage income, to reflect expected differences in misreporting by income type.³⁹ The known errors referred to as “other errors” in Table 4 are separated into five categories: filing status errors, tiebreaker errors, errors corrected during processing, and two categories of additional eligibility criteria. The first of these two latter categories is a combined set of the remaining rules for all taxpayers (having a valid Social Security Number, being a U.S. citizen or resident alien all year, not filing Form 2555 or Form 2555-EZ to exclude foreign earned income, not being a qualifying child of another person); the second category is the set of rules for taxpayers not claiming qualifying children (being age 25 to 64 years, not being a dependent of another taxpayer, having a home in the U.S. more than half the year).⁴⁰ Table 5 does not separate qualifying child errors into more specific error types; this is done in a subsequent table.

Attributing overclaim dollars to each error type is straightforward when there is only one error on the return, but can be challenging when returns have multiple errors. This is because the outcome depends on the order in which one attributes the overclaims to the various errors made. The approach taken in Table 5 is to treat errors in isolation and estimate how many dollars of overclaims would be prevented or recovered if, hypothetically, the IRS were to eliminate every instance of that error. Taken together, the estimates will overstate total overclaims because this method implies some overclaim dollars will be attributed to more than one error. Alternative estimates, which attribute overclaim dollars to each error type by assuming that all other error types are accounted for first, are provided in the technical paper associated with this report (Leibel, 2014). As a group, these alternative estimates understate total overclaims. Although the alternative estimates are not presented in this report, they are used to provide the low end of the ranges of percentage contributions of total overclaims in the following discussion.

Unlike Table 4, which summarizes only the known errors (\$11.4 billion in overclaims), Table 5 incorporates the unknown errors as well: an additional \$2.6 billion for the lower estimates and an

types of income misreporting.” Likewise, when misreported AGI corresponds dollar-for-dollar to misreported investment income, it is treated as a single error.

³⁹ Income misreporting is known to be strongly associated with the extent to which income information is reported to the IRS by a third party. Self-employment income has very little information reporting while wage income is subject to heavy information reporting as well as withholding. Tax gap research conducted by IRS Office of Research has demonstrated the link between third-party information reporting and reporting noncompliance. For example, according to the Individual Income Tax Underreporting Gap Estimates for Tax Year 2001, the net misreporting percentage (NMP) for wages is 1.2 percent and for self-employment (nonfarm proprietor) income, the NMP is 57.1 percent (http://www.irs.gov/pub/irs-utl/tax_gap_update_070212.pdf). The NMP is the amount of income misreported divided by the amount that should have been reported.

⁴⁰ These eligibility criteria are described thoroughly in IRS Publication 596. The two sets of eligibility criteria largely follow two chapters in that publication: Chapter 1, “Rules for Everyone,” and Chapter 3, “Rules If You Do Not Have a Qualifying Child.” There are two exceptions to this: first, Chapter 1 includes rules involving the thresholds of earned income and AGI, but for purposes of this analysis those are considered with income misreporting; second, the rule that the taxpayer cannot be the qualifying child of another person is included separately in both Chapter 3 and in Chapter 2, “Rules If You Have a Qualifying Child.” For purposes of this analysis, that criterion is considered along with the rules for all taxpayers. Note that IRS Publication 596 is published annually, so one should refer to the 2006, 2007 or 2008 version. These three are essentially the same aside from dollar amounts that are adjusted annually.

additional \$7.9 billion for the higher estimates.⁴¹ The additional errors and overclaim dollars are attributed to the audit non-participants based on the patterns of errors made by audit participants within the same stratum. This is done for both the higher and lower estimates.

Table 5. Total Dollars of EITC Overclaims Attributable to Common Types of EITC-Related Errors
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP
 (Constant 2008 dollars)

Error type	Number of returns with error ¹ (millions)	Total overclaim dollars ² (billions)	
		Higher estimate	Lower estimate
Error corrected in processing ³	0.5	\$0.5	\$0.4
All income misreporting ⁴	6.5	\$5.6	\$4.5
<i>Earned income misreporting</i>	4.5	\$4.5	\$3.7
<i>Wage income</i>	1.7	\$1.1	\$0.8
<i>Self-employment income</i>	3.1	\$3.8	\$3.2
<i>AGI, investment income misreporting</i>	3.1	\$1.5	\$1.1
Qualifying child error	3.0	\$10.4	\$7.2
Tiebreaker error	0.1	\$0.3	\$0.2
Filing status error	1.0	\$3.3	\$2.3
Rules for all taxpayers claiming EITC ⁵	0.3	\$1.0	\$0.7
Rules for the EITC without children ⁶	0.3	\$0.1	\$0.0 ⁷
Total overclaims	11.9⁸	\$19.3	\$14.0

1 This is limited to errors that contribute to overclaims on net overclaim returns.

2 These estimates of overclaim dollars treat each error type in isolation. They rely on the hypothetical assumption that the error would be eliminated in its entirety from the EITC-claiming population, and it would be the *only* error eliminated. Summing the columns would exceed the estimates of total overclaims in the final row due to the double-counting that arises when more than one error occurs on a tax return. The body of the report and Appendix Table A3 provide ranges for how much each error type contributes to total overclaims in percentage terms. The upper ends of the ranges are based on information in this table, while the lower ends of the ranges come from alternative estimates provided in the technical paper associated with this report (Leibel, 2014). The alternative estimates attribute overclaim dollars to each error type by assuming that all other error types are accounted for first and as a group understate total overclaims.

3 This category primarily consists of math error but includes other adjustments made before the NRP exam.

4 The values for all income misreporting are not equal to the sum of the values for wage income, self-employment income, and AGI and investment income for the same reason one would not expect the column totals for the full table to match the estimates for the population provided in the final row. Similarly, the values for earned income misreporting do not equal the sum of the values for wage income and self-employment income.

5 This category consists of eligibility rules not previously listed that apply to all taxpayers regardless if they are claiming children. It includes having a valid SSN, being a U.S. citizen or resident alien all year, not filing Form 2555 or Form 2555-EZ, and not being a qualifying child of another person. These rules are outlined in detail in IRS Publication 596.

6 This category consists of eligibility rules that apply to taxpayers claiming EITC without qualifying children. It includes being age 25-64, not a dependent of another taxpayer, and having a home in the U.S. for more than half the year. These are outlined in detail in IRS Publication 596.

7 Less than \$50 million.

8 This figure is the higher estimate of the number of returns with at least one error leading to an overclaim, which can also be seen in Table 1. The comparable lower figure is 10.1 million.

⁴¹ Adding these additional overclaim dollars produces the lower and higher estimates of total overclaim dollars: \$11.4 plus \$2.6 or \$7.9 equals \$14.0 or \$19.3, respectively, the totals shown in Table 1 and again in the bottom row of Table 5 here.

Table 5 confirms what was already demonstrated in Table 4: the biggest contributors to overclaims are income misreporting and particularly qualifying child errors. If all qualifying child errors, and *only* qualifying child errors, were prevented or detected, an estimated \$10.4 billion (higher estimate) or \$7.2 billion (lower estimate) in overclaims would be prevented or recovered. Taking these estimates together with the alternative estimates in Leibel (2014), we find that qualifying child errors account for 42 to 54 percent of total overclaims. Table A3 in the Appendix provides similar percentages for all error types; some of these are also referred to in the discussion below.

Income misreporting is the second biggest contributor to overclaims, accounting for 24 to 32 percent of total overclaims. Among income types, self-employment income misreporting is the most significant contributor to overclaims (15 to 23 percent), with wage income misreporting being the least significant (3 to 6 percent). This is the reverse of how these sources of earned income are represented in the EITC-claiming population, where wage income is far more common: 76 percent of taxpayers claiming EITC earn only wage income, while the remaining 24 percent earn at least some self-employment income (10 percent report both wages and self-employment income).⁴²

Filing status errors emerge as the third-largest contributor to overclaims, accounting for 9 to 17 percent of overclaims and falling somewhere between self-employment income misreporting and other types of income misreporting in relative importance. Most of these overclaims come from married taxpayers who file separately from their spouse and incorrectly claim either single or, more frequently, head-of-household filing status. This practice tends to overstate the amount of the credit on one or both returns by splitting household income. Five percent of all EITC claimants (2 percent of those filing single and 9 percent of those filing as head-of-household) are estimated to have the correct status of married-filing-separately, making them ineligible for the credit.⁴³

One may also observe from Table 5 that tiebreaker errors appear negligible in comparison with other error types (1 to 2 percent of all overclaims). This contrasts with the findings of the 1999 Compliance Study, in which tiebreaker errors were shown to be one of the most common errors, accounting for 17 percent of overclaims (\$1.6 billion, 1999 Compliance Study, Table 2, page 13). This difference reflects the change in tiebreaker rules that were part of EGTRRA and took effect in 2002, which simplified the tiebreaker rules and redefined a form of noncompliance as compliant behavior.⁴⁴

⁴² For these percentages, the type of earned income is based on the correct type of income determined during audit, not what was reported on the original tax return, although the differences are slight: reported wage-only earners are 77 percent of the EITC population, with 12 percent reporting both wages and self-employment income.

⁴³ Roughly one-fifth of these, or 1 percent of the total EITC sample, chose to change their filing status to married-filing-jointly as part of the resolution of the audit rather than maintain two married-filing-separately returns. In some cases this made the taxpayers eligible for a smaller amount of the EITC than was originally claimed, rather than fully ineligible.

⁴⁴ The remaining type of tiebreaker error reflected in the NRP TY 2006-2008 sample and in Table 5 is when more than one person actually claims the child, so that at least one taxpayer must have claimed the child in error. The 1999 Compliance Study points out that it does not account for offsetting errors when more than one taxpayer resided with the child but the wrong person (i.e., the one with lower modified AGI) claimed the child. Given the legislative change allowing taxpayers to choose who claims the child, this type of offsetting error no longer exists. However,

New legislation effective in TY 2009 removes taxpayers' discretion to decide who claims a child when more than one person has the same qualifying child.⁴⁵ According to the Joint Committee on Taxation, the new provision was estimated to save just under \$200 million in revenue per year through FY 2018 (Joint Committee on Taxation, 2009). This change may lead to a rise in tiebreaker errors, which may be reflected in future studies of EITC compliance.

Qualifying child errors

This section presents additional detail about the nature of qualifying child errors. The first table, Table 6, provides a summary of outcomes at the tax-return level (as opposed to the qualifying-child level). As shown, at least 70 percent of returns claiming EITC with qualifying children claimed the correct number of children, with up to another 15 percent possibly claiming the correct number. This translates into between 13 and 27 percent of children being claimed in error, shown in Table 7.⁴⁶

**Table 6. Summary of Outcomes for Returns Claiming Qualifying Children (QC)
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP**

	Number of returns (millions)	Percent of returns claiming QC	Number of QC (millions)	Percent of QC initially claimed
Total returns claiming QC	18.6	100%	28.2	100%
Returns represented by audit non-participants	2.8	15%	4.1	15%
Returns represented by audit participants	15.8	85%	24.0	85%
Who claimed correct number of QC	13.0	70%	19.8	70%
Who claimed at least 1 QC in error	2.8	15%	4.2	15%
Number of QC correctly claimed on those returns			0.4	2%
Number of QC claimed in error			3.8	13%

Note: Figures may not sum due to rounding.

Table 7 explores the nature of the qualifying child errors. During this period, there were three “tests” for qualifying child eligibility: the relationship, age, and residency tests, all of which are still applicable in 2013.⁴⁷ Failure of any of these tests results in a qualifying child error.

there may remain situations where a child that was claimed incorrectly for the EITC for reasons other than the tiebreaker rules could have been claimed correctly by another taxpayer.

⁴⁵ This was a provision of the *Fostering Connections to Success and Increasing Adoptions Act of 2008*, entitled “Clarification of Uniform Definition of a Qualifying Child” (Joint Committee on Taxation, 2009). With the new provision in place, the law essentially restricts qualifying child tax benefits to the parents of the child, with the exception that if no parent claims the child, another individual can claim the child only if that individual has a higher AGI than any parent and/or any other individual who is also eligible to claim the child.

⁴⁶ This excludes the few children who were claimed in error, but where another child in the family was established as a qualifying child during the audit, meaning the taxpayer claimed the correct *number* of qualifying children, if not the right children themselves. The figures in Table 7 suggest that the 27 percent referred to here should be 28 percent instead, but this is due to rounding; 27 percent is the correct figure.

⁴⁷ To meet the relationship test, the child has to be the taxpayer’s son/daughter, niece/nephew, sibling, foster child, or a descendant of any of these. In TY 2006-2008, the relationship test also required the child to be unmarried,

Although not considered part of the definition of a qualifying child, in order to be eligible for EITC, the child must also have a valid Social Security Number (SSN). Tiebreaker errors are not technically qualifying child errors but are included in this table.⁴⁸

Two additional types of error are included in this analysis: errors corrected during processing and unknown errors. The first group consists primarily of math errors that are specific to qualifying children: qualifying children can be disallowed during return processing if third-party information suggests that the age requirement is not met or the child's SSN is not valid, or if information reported on the Schedule EIC suggests the child is not eligible for the credit.⁴⁹ There are typically a few cases each year where the EITC amount is adjusted prior to the start of the NRP exam, such as when the taxpayer files an amended return and removes the child from the return. When the adjustment implies a qualifying child error on the original return, it is included under "errors corrected during processing."

The unknown errors are reported separately as either "not substantiated" or "unknown error." Neither of these are the same as errors that come from audit non-participants, reported separately in this analysis. For these unknown errors there is good reason to believe that a qualifying child error was made, but there is no information about the nature of the error. The "not substantiated" errors reflect cases where the taxpayer did not meet with the auditor or supply documentation, but ultimately agreed to and signed the auditor's report disallowing the children. Thus, the taxpayer acknowledged that the children were not eligible, but it cannot be determined which eligibility criteria were violated. The second "unknown" category is primarily made up of returns that were audited by operational exam, so no detail was collected about the specific errors.⁵⁰ It also includes a handful of NRP exams where the audit is not documented well enough to determine which error was made.

Table 7 presents the estimated population frequency of each of these qualifying child error types. This table does not indicate when errors overlap, although it can be seen that substantial overlap exists. Of the known errors, the largest error is a failure to meet the residency test. At least 75 percent of the children known to be claimed in error fail the residency test; this is roughly 10

unless certain special conditions were met. Beginning in TY 2009, the requirement that the child not be married was instead incorporated into a fourth test, the joint return test. To meet the age test, the child has to be either younger than 19, younger than 24 and a full-time student, or any age and permanently and totally disabled. Beginning in TY 2009, the age test added the requirement that the child also has to be younger than the taxpayer or taxpayer's spouse. To meet the residency test, the child has to live with the taxpayer in the U.S. for more than half the year.

⁴⁸ By definition, a tiebreaker error can only occur if the claimed child meets the criteria to be a qualifying child of more than one taxpayer.

⁴⁹ In the NRP sample, some math error adjustments are reinstated before the start of the NRP exam based on additional information provided by the taxpayer; those amounts are not included here unless the case has other errors yielding a net EITC overclaim at the end of the audit.

⁵⁰ Recall that NRP sample selection occurs after other steps in the return processing pipeline, and in particular after returns are selected for pre-refund exam. These operational exam cases are audited according to standard procedures and are not subject to the additional data collection requirements of the NRP. The operational exam cases that are assumed to be qualifying child errors fall into one of two camps: the larger of the two consists of exams where the full amount of the EITC was disallowed, but no income error or filing status error is observed. It may therefore be somewhat overstated because there may be other eligibility criteria violated aside from the eligibility of the children. However, even the number of cases involved in this "larger camp" is small. The smaller camp consists of cases where the final EITC amount is positive and consistent with the amount of the credit that would be due the taxpayer with the audit-corrected level of income and no qualifying children.

percent of all children claimed for EITC. The relationship test is the second most frequent error: of those children known to be claimed in error, 20 percent fail to meet the relationship test, which is roughly 3 percent of all children claimed. The remaining errors each affect 10 percent or less of children claimed with known error, or roughly 1 percent or less of all children claimed.

Table 7. Frequency of Specific Qualifying Child (QC) Errors
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP

	Number of qualifying children (millions)	Percent of all QC claimed	Percent of all QC claimed in error by audit participants
Total QC claimed	28.2	100%	
QC claimed (possibly in error) by audit non-participants	4.1	15%	
QC claimed in error by audit participants	3.8	13%	
Frequency of errors estimated from audit participants			
Relationship	0.8	3%	20%
Age	0.4	1%	10%
Residency	2.8	10%	75%
Invalid SSN	0.3	1%	8%
Married child	0.0 ³	0%	1%
Tiebreaker	0.3	1%	7%
Error corrected in processing	0.0	0%	1%
Not substantiated ¹	0.2	1%	4%
Unknown error(s) ²	0.3	1%	7%

Note: Columns will not sum to total given occurrence of multiple errors on returns.

1 This category of errors consists of those where the taxpayer does not initially respond to communication from the examiner, but ultimately signs and agrees to the examiner's final report that disallowed the child(ren).

2 This category of errors includes cases worked by standard operational exam (non-NRP) where no change to income or filing status is observed; a qualifying child error is presumed, but no detail is available. This category also includes cases where the specific error made cannot be determined from typical data collection instruments for NRP or exam documentation in electronic form.

3 Less than 50 thousand.

Tax return preparers

One area of interest to the IRS is the relationship between tax return preparation services and EITC errors made on filed returns. The NRP study collects more detail on preparer type than what is typically available, which provides an opportunity to begin comparing EITC errors across preparer types.

Table 8 shows how frequently EITC claimants use different preparer types, compared with preparer usage for returns not claiming EITC. There is a sizable difference in the tendency to self-prepare the return, with 43 percent of non-claimants preparing their own returns and 29 percent of EITC claimants self-preparing.⁵¹ Among those who reported using a particular type of paid preparer, shown in the third and sixth columns of Table 8, EITC claimants are more likely to use an unenrolled return preparer (43 percent) or a preparer from a national tax return preparation firm (35 percent) than non-claimants (28 percent and 14 percent, respectively). In contrast, non-claimants for EITC are much more likely to use a CPA to prepare their return: 44 percent do so. This compares with just 10 percent for EITC claimants.

Table 9 shows how EITC errors differ across preparer types. The first three rows compare outcomes between self-prepared returns, paid-preparer returns, and returns prepared by the IRS or IRS-sponsored programs.⁵² There is no statistical difference between self-prepared and paid-preparer returns in either the frequency of overclaims or the dollar overclaim percentage.

Returns prepared by the IRS or its sponsored programs, Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE), have much lower overclaim percentages than other types of preparers. However, this does not necessarily imply that taxpayers or other kinds of preparers are either less capable or more unscrupulous. It may instead reflect the effect of selection bias arising from taxpayers' choice of preparer.

Unenrolled return preparers are at the other end of the spectrum, with the highest frequency and percentage of EITC overclaims.⁵³ For these preparers, the dollar overclaim percentage is 40 percent (higher estimate) or 33 percent (lower estimate). Again, due to the problem of selection bias, one cannot conclude anything about the relative ability or integrity of unenrolled preparers without further study.

⁵¹ According to more recent data, the rate of self-preparation among EITC claimants has increased over the last several years and the rate of paid preparation has declined.

⁵² The IRS sponsors programs that offer free tax return preparation services and counseling to seniors, individuals with low to moderate incomes, those with disabilities, and those for whom English is a second language; the programs are the Volunteer Income Tax Assistance (VITA) program and the Tax Counseling for the Elderly (TCE) program, both of which are staffed by specially trained volunteers.

⁵³ The group of paid preparers where preparer type is not known has even higher error rates, but this is accounted for by the high rate of audit non-participation in that group and other similar reasons.

**Table 8. Number of Returns By Preparer Type and EITC Claim Status
Weighted Population Estimates, Annual Average, TY 2006-2007 NRP¹**

Preparer Type	Returns Not Claiming EITC			Returns Claiming EITC		
	Number of returns (millions)	Percent of all returns not claiming EITC	Percent of those using a preparer where type is known	Number of returns (millions)	Percent of all returns claiming EITC	Percent of those using a preparer where type is known
Self-prepared ²	49.8	43%	--	6.9	29%	--
IRS/VITA/TCE ³	2.4	2%	--	0.6	3%	--
Paid preparer	63.7	55%	--	16.2	68%	--
Attorney	0.7	1%	2%	0.0 ⁵	0%	0%
CPA	19.0	16%	44%	1.5	6%	10%
Enrolled agent	4.6	4%	11%	1.3	6%	9%
Employee of taxpayer	0.0 ⁵	0%	0%	0.0 ⁵	0%	0%
Friend/relative-paid	0.7	1%	2%	0.3	1%	2%
National tax return preparation firm	6.0	5%	14%	5.0	21%	35%
Unenrolled return preparer	12.1	10%	28%	6.3	26%	43%
Preparer used, type unknown ⁴	20.5	18%	--	1.8	8%	--
Total	115.9	100%	100%	23.7	100%	100%

Note: Figures may not sum due to rounding.

1 Due to an inconsistency between TY 2006-2007 and TY 2008 in NRP data collection methods regarding preparer types, this analysis is limited to TY2006 and TY 2007 only. Cases are reweighted to reflect the three-year population totals for EITC claimants and EITC non-claimants.

2 Self-prepared returns include those where the taxpayer reported receiving uncompensated assistance from another individual. For the self-preparers claiming the EITC, 28 percent received this kind of informal assistance; for the self-preparers not claiming EITC, the percent receiving informal assistance is just 9 percent.

3 Returns in this category were mainly prepared at IRS-sponsored Volunteer Income Tax Assistance (VITA) or Tax Counseling for the Elderly (TCE) sites, although 3 percent were prepared or reviewed by IRS employees through other venues.

4 The majority of returns in this category are cases where the return was accepted as filed, so no detail on type of preparer was able to be collected during an audit. There are also a large number of audit non-participants in this group.

5 Less than 50 thousand.

Table 9. Overclaims and Underclaims on EITC Returns by Preparer Type
Weighted Population Estimates, Annual Average, TY 2006-2007 NRP¹
 (Constant 2008 dollars)

Preparer Type	Number of returns (millions)			Percent with over-claim	Billions of constant 2008 dollars			Dollar overclaim percentage by preparer type
	Under claims	Correct claims	Over claims		Under claims	Over claims	Total claims	
<i>Higher estimates</i>								
Taxpayer self-prepared ²	0.4	3.3	3.3	47%	\$0.1	\$4.6	\$12.0	39%
IRS/VITA/TCE ³	0.1	0.4	0.2	26%	\$0.0 ⁶	\$0.1	\$0.8	13%
Paid preparer	0.9	6.9	8.3	51%	\$0.4	\$14.1	\$36.4	39%
Attorney	0.0 ⁵	0.0 ⁵	0.0 ⁵	35%	\$0.0 ⁶	\$0.0 ⁶	\$0.1	28%
CPA	0.1	0.7	0.7	49%	\$0.1	\$0.8	\$2.6	31%
Enrolled agent	0.1	0.6	0.6	46%	\$0.0 ⁶	\$0.8	\$2.8	29%
Employee of taxpayer	0.0 ⁵	0.0 ⁵	0.0 ⁵	58%	\$0.0 ⁶	\$0.0 ⁶	\$0.0 ⁶	5%
Friend/relative-paid	0.0 ⁵	0.1	0.1	37%	\$0.0 ⁶	\$0.1	\$0.5	19%
National tax return prep firm	0.3	2.5	2.2	44%	\$0.2	\$3.6	\$11.8	30%
Unenrolled return preparer	0.4	2.5	3.4	54%	\$0.2	\$5.8	\$14.5	40%
Preparer used, type unknown ⁴	0.0 ⁵	0.5	1.3	72%	\$0.0 ⁶	\$3.0	\$4.1	73%
Total—Higher estimates	1.3	10.7	11.7	49%	\$0.5	\$18.8	\$49.1	38%
<i>Lower estimates</i>								
Taxpayer self-prepared	0.4	3.8	2.7	39%	\$0.1	\$3.4	\$12.0	28%
IRS/VITA/TCE	0.1	0.5	0.1	20%	\$0.0 ⁶	\$0.1	\$0.8	11%
Paid preparer	1.0	8.0	7.1	44%	\$0.5	\$10.5	\$36.4	29%
Attorney	0.0 ⁵	0.0 ⁵	0.0 ⁵	35%	\$0.0 ⁶	\$0.0 ⁶	\$0.1	28%
CPA	0.1	0.7	0.7	47%	\$0.1	\$0.7	\$2.6	27%
Enrolled agent	0.1	0.7	0.6	42%	\$0.0 ⁶	\$0.7	\$2.8	24%
Employee of taxpayer	0.0 ⁵	0.0 ⁵	0.0 ⁵	58%	\$0.0 ⁶	\$0.0 ⁶	\$0.0 ⁶	5%
Friend/relative-paid	0.0 ⁵	0.1	0.1	37%	\$0.0 ⁶	\$0.1	\$0.5	19%
National tax return prep firm	0.4	2.9	1.8	36%	\$0.2	\$2.4	\$11.8	20%
Unenrolled return preparer	0.4	2.8	3.1	49%	\$0.2	\$4.7	\$14.5	33%
Preparer used, type unknown	0.1	0.8	0.9	51%	\$0.0 ⁶	\$1.9	\$4.1	47%
Total—Lower estimates	1.5	12.2	10.0	42%	\$0.6	\$14.0	\$49.1	29%

Note: Figures may not sum due to rounding.

1 Due to an inconsistency between TY 2006-2007 and TY 2008 in NRP data collection methods regarding preparer types, the analysis in this table is for combined TY2006 and TY 2007 only. Cases are reweighted to replicate the three-year population totals for EITC claimants and EITC non-claimants. As a result, the summary information presented in this table about overclaims, underclaims, and dollar overclaim percentages differs slightly from that describing the full three-year sample presented in Table 1.

2-4 See the notes under Table 8 for more description of these categories.

5 Less than 50 thousand.

6 Less than \$50 million.

Conclusion

The NRP TY 2006-2008 data indicate that many aspects of EITC compliance are qualitatively unchanged from the 1999 Compliance Study, despite developments in the interim that include overall growth in the EITC program, new EITC-related legislation, and enhanced enforcement efforts by the IRS. The lower and higher estimates of the dollar overclaim percentage in TY 2006-2008 fall below and above the respective estimates from the 1999 Compliance Study, so that no change in overall compliance can be detected without making strong assumptions about the compliance behavior of audit non-participants. Income misreporting and qualifying child errors are the errors most frequently made and account for the highest dollar amounts of overclaims. The residency test is the most frequent qualifying child error. One notable change since the 1999 Compliance Study is that tiebreaker rules are no longer a major source of overclaims, due to provisions of EGTRRA.

This study provides some new information about return preparers and EITC errors. Of EITC claimants who use a paid preparer where preparer type is known, 43 percent seek preparation services from unenrolled preparers. These preparers as a group have the highest overclaim percentages among known preparer types. Returns prepared by the IRS-sponsored programs VITA and TCE have the lowest overclaim percentages, but these constitute a very small percent of returns with EITC.

The data underlying the analysis in this report are from the IRS' National Research Program TY 2006-2008 1040 Studies. These data provide the opportunity to study many aspects of EITC compliance beyond the overview presented here. Research questions regarding errors that occur infrequently may require a larger sample in order to draw statistically valid conclusions, but with ongoing annual NRP 1040 Studies that continue to have an EITC subsample, this should be possible in the future.

References

Internal Revenue Service, *Publication 596, Earned Income Credit*, 2006-2008 and various years.

_____, *Tax Year 2001 Federal Tax Gap*, February 2007, available at http://www.irs.gov/pub/irs-utl/tax_gap_update_070212.pdf

_____, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns*, February 28, 2002.

Leibel, Kara, *Taxpayer Compliance and Sources of Error for the Earned Income Tax Credit Claimed on 2006-2008 Returns*, Research, Analysis & Statistics Technical Paper, Internal Revenue Service, Publication 5161, Washington, DC: August 2014.

Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 110th Congress*, March 2009.

Plueger, Dean and Amy O’Hara, “Earned Income Tax Credit Participation Rate for Tax Year 2005.” Presented at the 2009 IRS Research Conference and available at <http://www.irs.gov/pub/irs-soi/09resconeitcpart.pdf>

U.S. Census Bureau, *American Community Survey, Design and Methodology*, April 2009.

Appendix

Comparison of 1999 and 2006-2008 EITC Compliance Studies

The two tables in this section of the Appendix provide a side-by-side comparison of some of the major findings from the 1999 Compliance Study and the 2006-2008 Compliance Study. Table A1 presents information about the frequency of particular errors, while Table A2 focuses on the dollars of overclaims accounted for by returns with certain errors or combinations of errors. In both tables, the figures for 1999 are taken from Table 2 of the 1999 Compliance Study. Figures for 2006-2008 are taken in part from Tables 3 and 4 of this report and include some additional work not otherwise presented. Because a major change since 1999 is the virtual elimination of tiebreaker errors (due to legislation), the tables include an additional breakdown of the 1999 errors that excludes the tiebreaker errors, for better comparison with 2006-2008. The rise of multiple errors reflected in the last row makes problematic any comparisons across time of individual error types.

Table A1. Frequency of errors in 1999 and 2006-2008

	1999			2006-2008	
	Number of returns (millions)	Percent of returns	Percent of returns excluding tiebreaker errors	Number of returns (millions)	Percent of returns
Total returns with error	9.3	100.0%		11.9	100.0%
Type of error unknown ¹	1.2	13.3%		3.6	30.3%
Type of error known	8.1	86.7%		8.4	70.6%
Subtotal: Type of error known	8.1	100.0%		8.4	100.0%
Qualifying child (QC) error only	1.3	16.3%	18.3%	1.3	15.4%
Income reporting errors only	3.4	41.7%	46.7%	4.3	51.0%
"Tiebreaker error" only	0.9	10.8%	--	0.0	0.5%
Filing status error only	0.7	8.7%	9.7%	0.4	5.0%
Filing status & QC error	0.3	3.4%	3.8%	0.1	1.7%
Errors corrected in processing only	0.7	9.1%	10.2%	0.2	2.9%
All other errors and combinations	0.8	10.1%	11.3%	2.0	23.6%

¹ Taxpayer unwilling or unable to appear for audit

Table A2. Dollars of overclaims in 1999 and 2006-2008

	1999			2006-2008	
	Dollars (billions)	Percent	Percent of dollars excluding tiebreaker errors	Dollars (billions)	Percent
Total returns with error	\$11.1	100.0%		\$19.3	100.0%
Type of error unknown ¹	\$2.1	18.5%		\$7.9	40.8%
Type of error known	\$9.1	81.5%		\$11.4	59.2%
Subtotal: Type of error known	\$9.1	100.0%		\$11.4	100.0%
Qualifying child (QC) error only	\$2.3	24.9%	30.0%	\$3.0	26.3%
Income reporting errors only	\$1.9	21.4%	25.9%	\$2.9	25.3%
"Tiebreaker error" only	\$1.6	17.2%	--	\$0.1	0.7%
Filing status error only	\$1.0	10.7%	12.9%	\$0.8	7.4%
Filing status & QC error	\$0.6	6.7%	8.1%	\$0.3	2.9%
Errors corrected in processing only	\$0.6	6.5%	7.8%	\$0.1	1.3%
All other errors and combinations	\$1.1	12.6%	15.3%	\$4.1	36.2%

¹ Taxpayer unwilling or unable to appear for audit

EITC-Related Errors and Contributions to Total EITC Overclaims

Table A3 provides summary estimates of how each type of error contributes to total overclaims. Because there is no simple way to disaggregate overclaims into separate error types due to returns with multiple errors, ranges of estimates are presented. These ranges incorporate two different approaches for handling multiple errors, as reflected by the estimates in Table 5 and alternative estimates presented in Leibel (2014). Thus, the pairs of numbers do not reflect different assumptions about audit non-participants; rather, the two numbers reflect approaches that attribute more or fewer overclaim dollars to each error type based on the order of attribution.

Table A3. EITC-Related Errors as Percentage of Total Overclaim Dollars
Weighted Population Estimates, Annual Average, TY 2006-2008 NRP

Error type	Percentage of Total Overclaim Dollars
Qualifying child error	42% — 54%
Income misreporting (all types combined)	24% — 32%
<i>Self-employment income alone</i>	15% — 23%
<i>AGI and investment income alone</i>	5% — 8%
<i>Wage income alone</i>	3% — 6%
Filing status error	9% — 17%
Error corrected in processing	3% — 3%
Rules for all taxpayers claiming EITC	1% — 5%
Tiebreaker error	1% — 2%
Rules for taxpayers claiming EITC without children	0% — 1%

Note: See Table 5 for more detail on error categories.