
***Earned Income Tax Credit (EITC)
Program Effectiveness and
Program Management FY 2002 – FY 2003***

August 8, 2003

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

Executive Summary

In 1997, Congress instructed the IRS to use a five-year, \$716 million Earned Income Tax Credit (EITC) appropriation “for expanded customer service and public outreach programs, strengthened enforcement activities, and enhanced research efforts to reduce EITC over claims and erroneous filings associated with the EITC.” The Internal Revenue Service (IRS) released the EITC Program Effectiveness and Program Management Fiscal Year (FY) 1998 - 2002 report in February 2002. This report addressed how the IRS used the FY 1998 through 2002 appropriation to improve administration of the EITC.

Last year, the House Appropriations Committee directed the IRS to provide a report on its EITC activities (per H.R. 107-575 p.37) to update the prior report and expand on its EITC compliance efforts. This report provides this update and focuses on addressing the following areas:

The trend analysis of EITC filing characteristics identified several significant factors important to program administration.

The turnover among EITC participants created opportunities and challenges for IRS in the areas of outreach, education and compliance.

Since its adoption in 1975, the amount of the EITC credit has increased, as well as the number of individuals and families benefiting from it. In Tax Year (TY) 2001 (generally corresponds to returns filed and processed in FY 2002), more than 19.5 million families and individuals filing federal income tax returns — roughly one out of every seven families who filed — claimed the EITC. These taxpayers represented over 15% of all Federal individual income tax returns filed.

Historically, the individuals comprising the EITC population change significantly from year-to-year. This trend continued as nearly 30% of the TY 2000 EITC claimants did not claim EITC in TY 2001.¹ However, approximately 20% of the new TY 2001 claimants had previously received the EITC in TY 1999. The amount claimed by EITC filers without qualifying children showed a greater percentage increase than the amount claimed by EITC with qualifying children. But EITC claims by taxpayers without qualifying children still make up a very small percentage of total EITC claims paid.

Below are some of the significant factors identified by the trend analysis.

¹ Analysis included a match of both primary and secondary SSN’s for EITC filers in both years.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

- EITC claimants remained more likely than the average filing population to use a paid preparer and many filed electronically.
- EITC dollars claimed prior to the application of IRS math error authority increased 3.4% from TY 2000 to 2001. EITC dollars received after math errors were resolved increased 3.3% from TY 2000 to 2001. The largest portion of the pre-math error increase was attributable to filers without qualifying children (22.3% increase totaling over \$249 million). However, an after math error increase of only \$33 million (5.1%) occurred from TY 2000 to 2001 in the amount of EITC claimed by filers without qualifying children.
- Approximately 73% of the TY 2001 EITC claimants had adjusted gross income of \$20,000 or less.

EITC initiatives were enhanced by a comprehensive Service- wide strategy that balanced compliance and outreach activities.

The IRS employed a multifaceted approach to compliance initiatives that included math error authority, audits, the use of Criminal Investigation's (CI) Fraud Detection Centers (FDC), and a comprehensive Return Preparer Program (RPP). During FY 2002, the IRS allocated approximately \$100.6 million for EITC compliance activities. As a result, the IRS realized significant results in FY 2002.

- The IRS prevented over 1.2 million questionable EITC claims from being processed electronically.
- The IRS protected approximately \$435 million in erroneous EITC claims using math error authority.
- IRS EITC audits protected \$850 million in revenue.
- Questionable Refund and Return Preparer programs resulted in 48 preparers and 137 other persons criminally convicted of income tax fraud for EITC schemes.

In summary, the Congressional Appropriation for the EITC program greatly advanced compliance initiatives. In addition to EITC revenue directly protected by math error authority and IRS audits from TY 1997 through 2001, enhanced EITC compliance actions have had a cascading effect; erroneous or fraudulent EITC claims disallowed in one year more than likely prevented the same filers from making similar claims in subsequent years.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

Overall, had the Congressional EITC appropriations not been available, IRS compliance efforts could not have protected and administered billions in government revenue. The IRS estimates that EITC compliance efforts have directly and indirectly protected an estimated \$9.6 billion in revenue for TY 1997 through TY 2001, consisting of:

- \$2.4 billion – Direct Math Error Authority (Actual)
- \$3.6 billion in Audits (Actual)
- \$3.0 billion – Indirect Math Error Authority (Estimated)
- \$.6 billion in Recertifications (Estimated)

See Appendix B, Attachment II for a chart showing the actual revenue protected as shown in the previous year's report dated February 28, 2002, and a reconciliation of the dollars from FY to TY.

The projected revenue protected from EITC compliance activities for TY 2002 is estimated at \$3.1 billion, consisting of :

- \$.3 billion – Direct Math Error Authority (Actual)
- \$1.4 billion – Indirect Math Error Authority (Estimated)
- \$.9 billion in Audits (Actual)
- \$.5 billion in Recertifications (Estimated)

Likewise, the IRS continued its efforts to increase EITC awareness:

- The IRS sent notices to approximately 958,000 taxpayers during FY 2002, who appeared to qualify for the EITC based on the tax returns filed.
- Partnerships were established with key stakeholders, external partners, and intermediaries that provided an overwhelming opportunity to educate taxpayers about EITC, offered free tax preparation, and provided information on financial literacy. As of March 24, 2003, the IRS had completed approximately 42 million EITC contacts.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

The IRS continued to expand program management approaches, and increased emphasis on strategic planning and performance measurement.

- In July 2002, the IRS realigned the EITC Program Office under its Office of Strategy and Finance (S&F) in the Wage and Investment Division (WI). This enhanced the EITC Program's strategic and tactical decision-making approaches.
- In August 2002, the IRS established the EITC Executive Advisory Council, a policy-setting body responsible for providing strategy, budget, and operational reviews and recommendations to the WI Commissioner. The Council includes executive level representation from each IRS function responsible for administering the EITC and ensures an integrated strategic approach to EITC issues.
- To better manage the EITC program, the IRS increased emphasis on strategic planning and performance measures.
- The IRS reduced taxpayer burden and erroneous EITC claims with research efforts aimed at more effectively using both internal and external data sources.

The IRS will continue to implement a balanced EITC initiative that provides better service to taxpayers and improves the Program's integrity.

The IRS is committed to further improving its administration of this important benefit program. The IRS participated in a joint task force with the Department of the Treasury that studied ways to reduce the EITC error rate. On June 13, 2003, Commissioner Mark Everson announced a five-point initiative to improve the administration of the EITC. The initiative builds on the work of the task force. The five-point initiative will:

- Reduce the backlog of pending EITC examinations to ensure that eligible taxpayers whose returns are being examined receive their refunds quickly;
- Minimize burden and enhance the quality of communications with taxpayers by improving the existing audit process;

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

- Encourage eligible taxpayers to claim the EITC by increasing outreach efforts and making the requirements for claiming the credit easier to understand;
- Ensure fairness by refocusing compliance efforts on taxpayers who claimed the credit but were ineligible because their income was too high; and
- Pilot a certification effort to substantiate qualifying child residency eligibility for claimants whose returns are associated with a high risk of error.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

Table of Contents

	Page Number
Background.....	1
The Trend Analysis of EITC Filing Characteristics Identified Several Significant Factors Important to Program Administration	2
EITC Initiatives were Enhanced by a Comprehensive Service-Wide Strategy That Balanced Compliance and Outreach Activities.....	7
Compliance Activities:.....	Page 7
Outreach Activities:.....	Page 19
The IRS Continued to Expand Program Management Approaches and Increase Emphasis on Strategic Planning and Performance Measurement.....	25
The IRS Will Continue to Implement a Balanced EITC Initiative that Provides Better Service to Taxpayers and Improves the Program’s Integrity.....	28
 Appendices	
A. EITC Strategic Plan for FY 2003 and 2004.....	32
B. Attachments	
I. Map of EITC Returns Filed/State TY – 2001.....	36
II. Reconciliation of Revenue Protected by Fiscal Year	37
III. EITC Related IRS Exam Processing Changes.....	38
IV. EITC Post Card Mailers.....	39

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

Background

The Internal Revenue Service (IRS) is responsible for administering the Earned Income Tax Credit (EITC), which is a refundable Federal income tax credit for low-income working individuals and families. Congress originally approved the tax credit legislation in 1975, in part to offset the burden of social security taxes and give these individuals an incentive to work. The credit reduces the amount of Federal income tax owed and can result in a refund if the amount of the credit exceeds the amount of taxes paid through the income tax system.

Information contained in an IRS compliance research study released in 1997 showed a high rate of noncompliance with the EITC. In response Congress enacted legislation in the Balanced Budget Act of 1997 (P.L. 107-152), that permitted budget authority for 5 years and a \$716 million appropriation beginning in Fiscal Year (FY) 1998 to 2002, to address this noncompliance. This appropriation provided for expanded customer service and public outreach programs, strengthened enforcement activities, and enhanced research efforts to reduce over claims and erroneous filing associated with the EITC. After the sunset of the five-year appropriation, Congress provided an EITC appropriation of \$145 million for FY 2003.

The appropriation, an average of \$143 million per year for the past five years, represents an administrative cost of about 0.5% of the total annual EITC benefits distributed by the IRS. In comparison, the administrative costs of other federal benefit programs (as a percentage of benefits distributed) are approximately 20 times higher (i.e., between 9% and 13%).¹

As directed by Congress, the IRS provided a comprehensive report dated February 2002 on the management of the EITC program in addition to providing quarterly reports throughout the five-year appropriation. The report addressed areas of targeted EITC outreach/education, compliance, and research and how the five-year appropriation was allocated. Since this report was issued, the IRS has continued to make significant program improvements by maximizing educational outreach efforts to

¹ Source: EITC Program Office - Tax Year 1999 Compliance Study Data

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

notify eligible taxpayers of their right to claim EITC, while establishing research based compliance techniques to prevent over claims. Internally, the IRS reorganized program oversight by transferring that responsibility to the Strategy and Finance Office. In addition, the IRS created the EITC Advisory Council consisting of executive representatives from all IRS divisions that have EITC program responsibility.

This report updates the IRS' administration of the EITC program in FY 2002 and 2003 to date and specifically addresses the following key areas:

- *The trend analysis of EITC filing characteristics identified several significant factors important to program administration.*
- *EITC initiatives were enhanced by a comprehensive service wide strategy that balanced compliance and outreach activities.*
- *The IRS continued to expand program management approaches, and increase emphasis on strategic planning and performance measurement.*
- *The IRS will continue to implement a balanced EITC initiative that provides better service to taxpayers and improves the program's integrity.*

The Trend Analysis of EITC Filing Characteristics Identified Several Significant Factors Important to Program Administration

The turnover among EITC participants and the growth in the EITC population created opportunities and challenges for IRS in the areas of outreach, education and compliance. Since its adoption in 1975, the amount of the EITC has increased in dollar amount, as well as the number of individuals and families benefiting from it. In Tax Year (TY) 2001 (filed in 2002), more than 19.5 million families and individuals filing federal income tax returns — roughly one out of every seven families who filed — claimed the EITC. (See Appendix B, Attachment ¹.) These taxpayers represented over 15% of all Federal individual income tax returns filed.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

The EITC taxpayer population changed significantly in TY 2001

Historically, the individuals comprising the EITC population change significantly from year-to-year. This trend continued in TY 2001 as illustrated by the following:

- Nearly 30% of the TY 2001 EITC claimants were different from those who claimed the credit in TY 2000. However, approximately 20% of the new TY 2001 claimants had previously received the EITC in TY 1999.
- Approximately 2.2 million taxpayers who claimed the EITC in TY 2000 did not file a TY 2001 tax return.²
- Of the TY 2000 EITC claimants that filed a TY 2001 tax return but did not claim the EITC, over 32% were no longer eligible based on an increase in their Adjusted Gross Income (AGI).

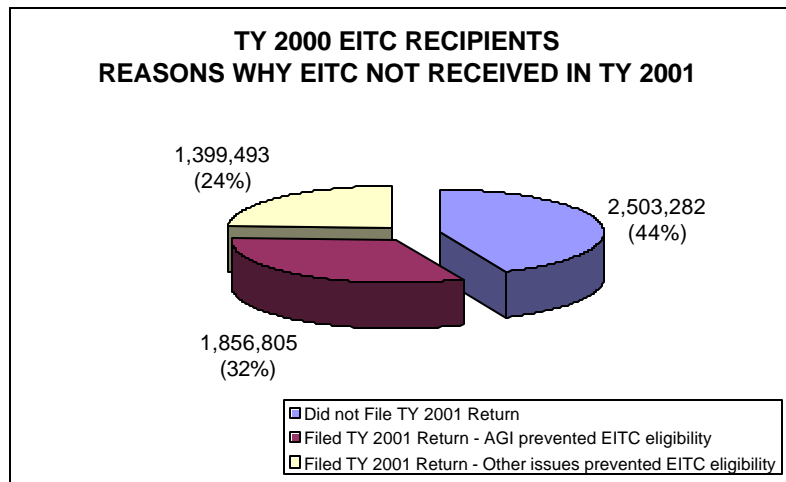


Figure 1

Source: Individual Returns Transaction File (IRTF)

² Analysis included a match of both primary and secondary SSN's for EITC filers in both years.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

Over half of the EITC claimants used paid tax preparers and filed their tax returns electronically

EITC claimants continued to rely on the use of paid preparers to file their tax returns, in greater percentages than the average filing population (67% EITC compared to 59.4% of the general population). In addition, approximately 61% filed electronically, as compared to 32% of the general taxpayer population.

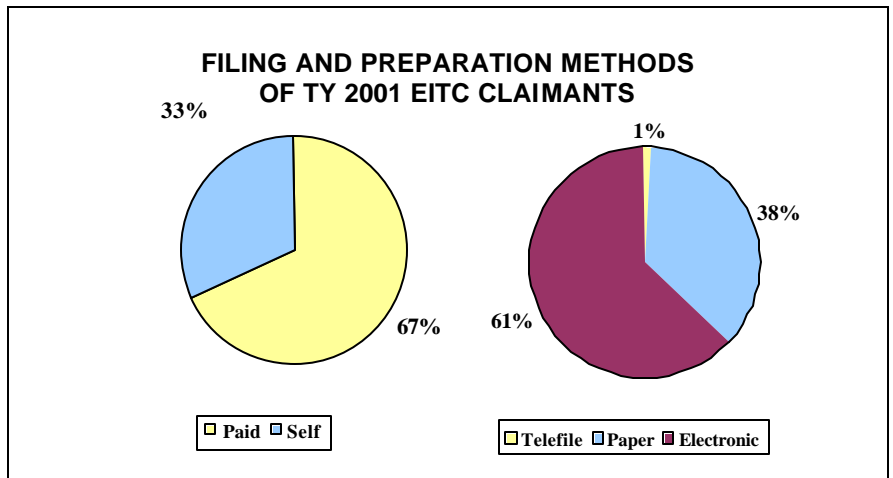


Figure 2

Source: IRTF TY 2001

The number of electronic (e-filed) tax returns has increased each year (10.7% from TY 2000 to TY 2001). In addition to the number of e-filed tax returns, 53% of paper returns are computer generated, even though the returns are not transmitted to the IRS in an electronic format.

The number of EITC claimants and dollars claimed is currently rising

Although the number of EITC claims had been decreasing since 1996, they increased slightly (.3%) from TY 2000 to 2001. In TY 2001, more than 19.5 million working families and individuals received total EITC benefits of approximately \$33.7 billion. The following chart shows a three-year trend of EITC returns by the number of qualifying children.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

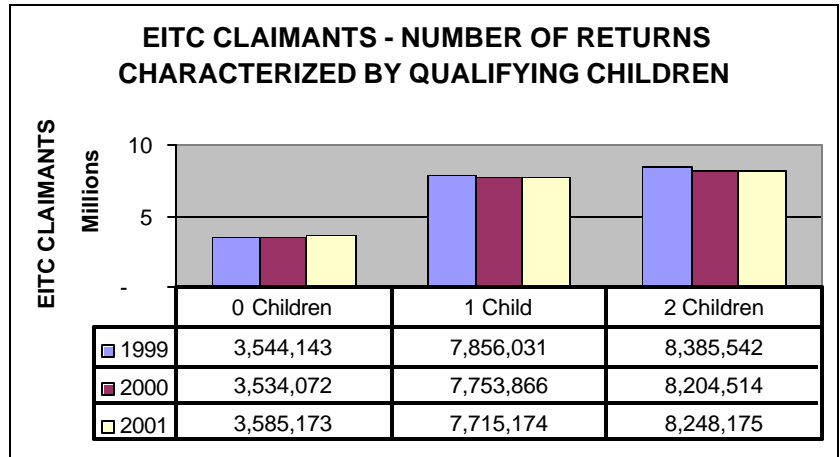


Figure 3

Source: Individual Returns Transaction File (IRTF) Extracts from the respective tax years.

EITC dollars claimed prior to the application of IRS math error authority increased 3.4% from TY 2000 to 2001. EITC dollars received after math errors were resolved increased 3.3% from TY 2000 to 2001. The largest portion of the pre-math error increase was attributable to filers without qualifying children (22.3% increase totaling over \$249 million). However, an after math error increase of only \$33 million (5.1%) occurred from TY 2000 to 2001 in the amount of EITC claimed by filers without qualifying children.

The amount claimed by EITC filers without qualifying children showed a greater percentage increase than the amount claimed by EITC with qualifying children. But EITC claims by taxpayers without qualifying children still make up a very small percentage of total EITC claims paid.

The following chart shows the increase in EITC dollars claimed by number of qualifying children:

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

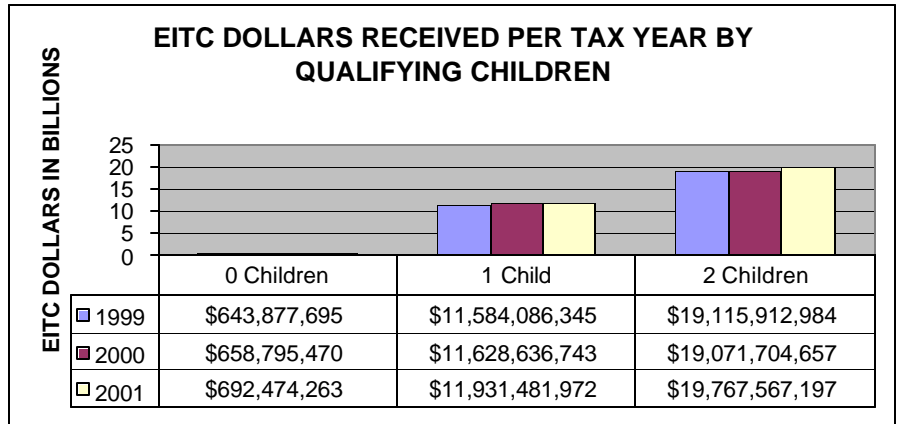


Figure 4

Source: Individual Returns Transaction File (IRTF) Extracts from the respective tax years.

The adjusted gross income of approximately 73% of the TY 2001 EITC claimants was under \$20,000.

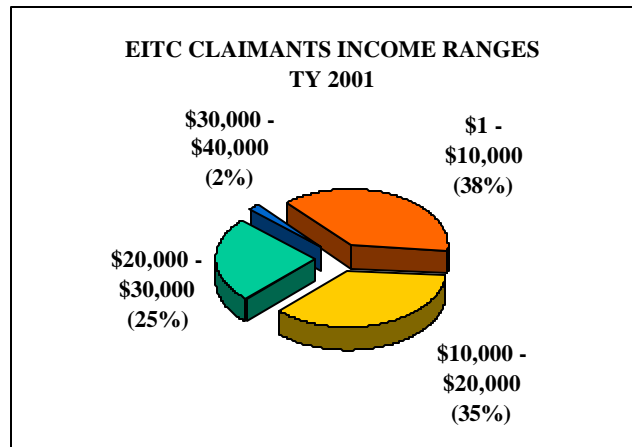


Figure 5

Source: Individual Returns Transaction File (IRTF)

Significant EITC legislative changes became effective for TY 2002

Legislation passed by the Congress in 2001, changed the eligibility rules for the EITC, simplifying the filing process and increasing refunds for many workers. Some workers who were previously ineligible for the credit may now qualify to claim it.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

**EITC Initiatives were
Enhanced by a
Comprehensive Service
Wide Strategy that
Balanced Compliance and
Outreach Activities**

Compliance Activities

The five-year Congressional Appropriation provided for expanded customer service and public outreach programs, strengthened enforcement activities, and enhanced research efforts to reduce over claims and erroneous filing associated with the EITC. The IRS' strategic plan provided for a balanced approach to address both EITC compliance and outreach activities.

The IRS took a multifaceted approach to compliance initiatives that included math error authority, audits, the use of Criminal Investigation's (CI) Fraud Detection Centers (FDC), a comprehensive Return Preparer Program (RPP), and a proactive initiative to implement recommendations from an EITC Task Force. During FY 2002, the IRS allocated approximately \$100.6 million for EITC compliance activities. As a result, the IRS realized significant results in FY 2002. In addition, IRS plans to spend \$102.6 million in 2003.

The IRS prevented over \$435 million in erroneous EITC claims through math error authority

The IRS can make a summary assessment of taxes owed if an error on the tax return is the result of a mathematical or clerical error. The IRS must also provide the taxpayer with an explanation of the error. The taxpayer has 60 days from the date of the notice to request that the tax be abated. If the taxpayer requests that the tax be abated, then the IRS must use normal deficiency procedures.

Because mathematical error procedures place a greater burden on taxpayers, Congress prescribes its use. Since 1996, Congress has expanded the use of mathematical error procedures for certain types of EITC errors that can be identified during returns processing through matching of returns to third-party data (e.g., social security numbers). This information includes, Invalid or Missing Primary, Secondary, or EITC Qualifying Child SSNs, as well as EITC Qualifying Child Dates of Birth (DOBs).

For FY 2002, the IRS issued math error notices on approximately 1.1 million tax returns claiming \$729 million in EITC. The five

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

most common EITC math errors made by taxpayers on TY 2001 tax returns are shown in Figure 6.

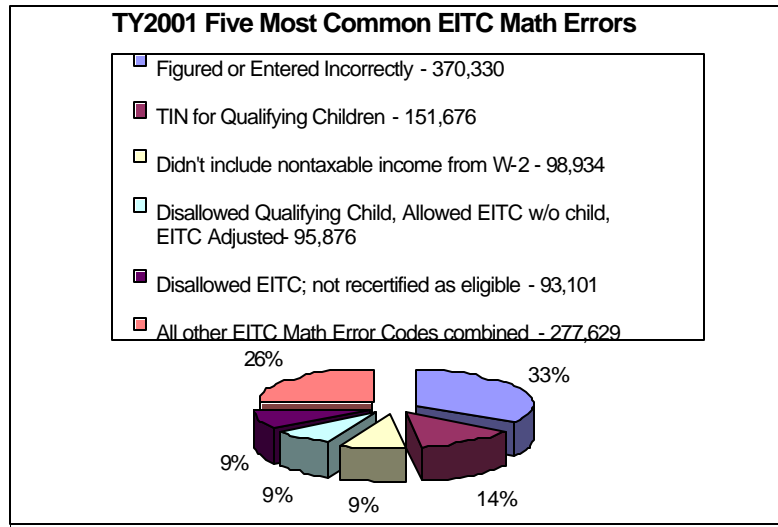


Figure 6

Source: Individual Returns Transaction File (IRTF) TY 2001.

In some instances, taxpayers subsequently provided the IRS with information that resolved the math error condition. When this occurred, the IRS adjusted the taxpayer's account and issued the correct amount of EITC. Figure 7 details the breakdown for the initially protected EITC by math error authority, and math error authority is broken down by Original and Expanded, as described above. Initial EITC refers to what was initially identified in processing, and Final EITC refers to what was ultimately protected after the math error issue(s) was resolved with the taxpayer.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

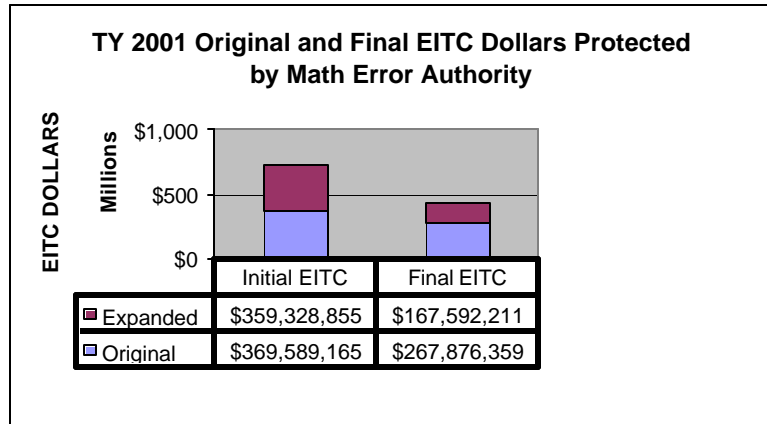


Figure 7

Source: Individual Returns Transaction File (IRTF) TY 2001.

**The IRS prevented numerous other EITC over claims
through its electronic tax administration system**

In TY 2001, the IRS prevented over 1.2 million questionable EITC claims from being processed electronically. We cannot readily determine the amount of associated monetary impact of these actions because these EITC claims were stopped before the IRS processed the tax returns. The most common reasons these returns were rejected are listed below:

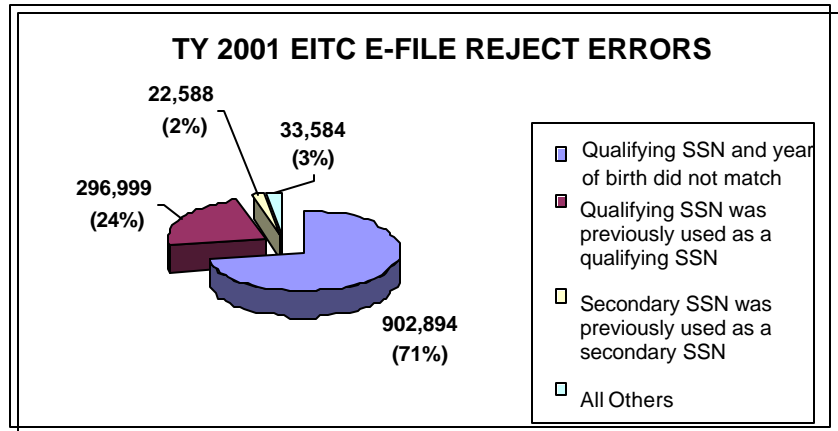


Figure 8

Source: Individual Returns Transaction File (IRTF) TY 2001.

E-File rejects a return that has a duplicate dependent or secondary SSN if the SSN has been used in the same manner on a

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

previously filed return in the same filing season. If the E-File rejected SSN is correct, a paper return has to be filed.

IRS audits of EITC protected \$850 million in revenue from the Dependent Database (DDb) and other sources in FY 2002

The IRS DDb is an examination audit program that analyzes and scores EITC claims to identify those with the highest probability for error. The DDb was established in FY 2001 and uses a combination of Department of Health and Human Services and Social Security Administration data. This information provides custody information that is used to help determine the validity of dependent and EITC claims.

In FY 2001, the IRS Examination functions made assessments on 82% of the 94,400 EITC claimant returns that were selected for audit through the DDb. In FY 2002, the IRS continued to improve its return selection criteria resulting in assessments on 87% of the 168,364 EITC claimant returns selected for audit through the DDb. The IRS achieved significant results through the DDb. The IRS predicts that the EITC assessment rate for FY 2003 will approach 90% on 160,450 selections.

Overall in FY 2002, IRS EITC audits protected \$850 million in revenue due the Government. Through the audit process, the IRS assessed nearly \$4 billion from erroneous EITC claims during the five year EITC appropriation.

IRS improved the examination process to reduce taxpayer burden

In addition to improving its audit selection criteria, the IRS took steps to improve other components of the EITC examination process.

IRS revised the initial taxpayer contact letter, including documentation request forms, to clarify and simplify the requirements for EITC eligibility, dependents and filing status. A project team consisting of subject matter experts from Examination, Office of the Chief Counsel, Taxpayer Advocate Service, and notice clarity specialists designed the revisions,

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

incorporating TY 2002 tax law changes. (See Appendix B, Attachment III.) While the IRS plans to further clarify and simplify its EITC notices, this was an important first step.

Previously, taxpayers were sent information that did not necessarily pertain to their specific audit issue only. The revised notices now provide taxpayers with information that addresses the individual tax situation. The letter and notice simplification along with enhanced internal information gathering capabilities also allowed the IRS to reduce taxpayer burden by eliminating the need for most taxpayers to send in copies of social security cards and birth certificates.

In addition, the IRS developed an automated “decision tool” referred to as the Online Tax Advisory (OTA), to ensure better consistency and understanding by examiners of EITC tax law and related issues by examiners. The OTA allows all aspects of an EITC examination to be evaluated including Filing Status, Exemptions, and EITC. Determinations are automatically recorded in the IRS examination work papers.

IRS CI FDCs identified numerous instances of EITC fraud

In support of the overall IRS mission, CI’s FDCs detected fraudulent returns and prevented the issuance of related false refunds. The FDC also supported special agents in CI’s field offices in their investigations and efforts to build successful criminal cases to achieve voluntary compliance with the Internal Revenue tax laws.

The level of EITC fraud detected on electronically filed returns rose from 6,220 in 2000 to 16,908 in 2002. These increases are based on the actual volumes of false returns identified and verified by the FDC. We cannot determine the extent to which the increase in detected fraud reflects an increase in actual fraud or an improvement in our detection systems.

There were numerous EITC schemes investigated by CI in 2002 including:

- An erroneous claimant in Massachusetts who was convicted and sentenced to 12 months imprisonment

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

followed by two years of supervised release for his role in a large scheme consisting of fraudulent returns claiming EITC in excess of \$600,000. This scheme started in 1997 and involved the solicitation of welfare recipients in the Boston area to obtain their social security numbers and those of their children. The welfare recipients were told that their identities would be used to apply for a government program that would pay them \$200 for one child and \$500 for two children. In reality, the claimant and another individual prepared hundreds of false federal and state tax returns for TY 1996 – 1998 claiming the EITC. The returns reflected phony businesses and non-existent income.

- Another scheme, based in California, consisted of hundreds of false tax returns reporting fictitious wages and withholding amounts that totaled more than \$9 million in false refunds. A portion of the \$9 million was EITC. About \$1.2 million was paid prior to the identification of this scheme. Multitudes of refund checks were sent to the same addresses and post office boxes and enabled investigators to identify the scheme perpetrators. Multiple individuals involved in the perpetration of this scheme have been arrested and indicted.

During the course of detecting fraudulent returns, the FDCs also encountered trends of EITC abuse. One such trend may involve an increase in erroneous EITC claims received from prisoners. To systemically address this problem, CI worked with the Examination function, which quickly implemented programming changes.

A major step undertaken by CI relative to the EITC was to enter into an agreement with the New York State (NYS) Department of Taxation and Finance to facilitate information sharing in the identification of filers of fraudulent tax returns. NYS also offers an EITC for taxpayers with lower earned income levels. Early identification is beneficial to both IRS and NYS to prevent revenue loss due to fraudulent claims.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

Questionable Refund Program (QRP) - 137 were criminally convicted of income tax fraud for EITC Schemes

The purpose of the QRP is to detect and identify false returns, stop the payment of the false refunds, develop the full scope of identified schemes, and to prosecute scheme perpetrators. The QRP enforcement efforts around EITC involve both CI FDC personnel and field office special agents. The chart below, broken down by paper and electronic filing (ELF), reflects the percent of QRP individual income tax returns claiming EITC over the past three fiscal years. These statistics do not include fraudulent business returns or amended individual returns detected by QRP.

QUESTIONABLE REFUND PROGRAM (1/1/2000 through 12/31/2002)						
Year	Return Type	Returns Detected	Total Refunds Claimed	Returns Claiming EITC	Percent Claiming EITC	EITC \$ Claimed
2000	Paper	25,403	\$744,633,171	13,157	52%	\$31,091,114
	ELF	9,782	\$38,677,011	6,220	64%	\$17,302,855
2001	Paper	21,183	\$253,341,555	6,818	32%	\$20,241,031
	ELF	17,663	\$84,994,024	8,518	48%	\$23,333,330
2002	Paper	47,493	\$317,502,899	35,318	74%	\$129,191,995
	ELF	37,059	\$153,218,739	16,908	46%	\$46,197,295

Figure 9

Source: Questionable Refund Program – EITC Statistics for Paper and ELF

During the past three fiscal years, 196 subject criminal investigations were initiated on questionable refund schemes that related to potentially fraudulent EITC claims. These investigations identified a minimum of 20,095 questionable returns claiming a minimum of \$44,069,951 in potentially false EITC. During this same time period, 129 criminal investigations were recommended for criminal prosecution, and 137 persons were criminally convicted of income tax fraud for various fraudulent EITC schemes.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

Return Preparer Program (RPP) – 48 preparers were criminally convicted of income tax fraud for EITC schemes

In an effort to prevent losses due to fraudulent returns, CI administers the RPP. The purpose of the RPP is to identify the most non-compliant and unscrupulous return preparers for enforcement actions. EITC return preparers are an integral part of this program.

The RPP enforcement efforts around EITC involved both CI FDC personnel and field office special agents. During the past three fiscal years, 113 subject criminal investigations were initiated on return preparer schemes that related to fraudulent EITC. These investigations identified a minimum of 12,624 questionable returns claiming at least \$31,464,536 in false EITC. During this same time period, 54 criminal investigations were recommended for criminal prosecution and 48 preparers were criminally convicted of income tax fraud for the various EITC fraud schemes.

IRS outreach efforts continued to focus on reducing over claims by paid preparers

Data from the 1999 EITC Compliance Study indicates that paid preparers prepared 69% of EITC returns. These practitioners accounted for \$7.2 (70%) of the \$10.4 billion in 1999 EITC over claims.

In addition to CI's efforts to address paid preparer issues, the IRS used a comprehensive educational effort to reduce EITC errors made by paid preparers.

In FY 2002, the Small Business/Self Employed (SBSE) Taxpayer Education and Communication (TEC) function identified paid preparers responsible for the highest number of returns with errors in the areas of the DDb and Duplicate Taxpayer Identification Numbers (DUPTN) with a qualifying child. These paid preparers also prepared 75 or more Schedule C returns claiming EITC benefits in TY 2000. TEC specialists visited approximately 600 paid preparers and mailed over 700 letters to inform and educate them on 2001 EITC tax law requirements and tips on how to avoid making errors on EITC returns.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

The W&I Stakeholder Partnerships, Education and Communication (SPEC) function developed and mailed approximately 2,200 copies of “The Earned Income Tax Credit Brochure” (Publication 4138) with a bounce back card to preparers. This list included those who prepared more than 100 EITC returns, less than 75 Schedule C returns, and had a significant numbers of EITC processing errors. The EITC brochure provided information on significant EITC processing errors and instructions on how to avoid them. In addition, it included information on the 2002 Tax Law changes, the Recertification process, and Due Diligence requirements and where to find additional EITC information. The bounce back card provided the preparer with an opportunity to request additional information about the EITC or a personal contact from the IRS.

Two information postcards and a Professional Guide for Tax Practitioners (Publication 3107) were mailed to over 20,000 practitioners that had prepared over 100 EITC returns in 2001. One of the postcards addressed EITC filing requirements, including TY 2002 tax law changes, while the other provided information on common EITC errors. Copies of the postcards are in Appendix B, Attachment IV. The Professional Guide is included on the IRS Internet Website: <http://www.irs.gov/eitc>.

IRS delivered outreach to tax practitioners at CPE seminars and association meetings. For example, IRS presented two EITC related seminars and staffed an informational booth at the IRS Tax Forums held during 2002. Approximately 15,000 tax practitioners attend the forums annually.

Enhanced EITC compliance actions had a cascading effect.

The EITC appropriation for the EITC program provided by Congress greatly advanced compliance initiatives through a focused EITC program management. In addition to EITC revenue directly protected by math error authority and IRS audits, EITC claims disallowed in one year more than likely prevented the same filers from making similar claims in subsequent years.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

An estimated additional \$3.0 billion was indirectly protected through EITC math errors

We included the EITC population that submitted tax returns with EITC errors and the associated over claims by tax year in the table below. It shows how the appropriation helped to decrease the number of erroneous tax returns (with EITC errors), and a resulting estimated \$3 billion over claim amount not refunded to taxpayers. The funding helped to improve overall taxpayer-filing patterns by identifying EITC math errors. Dollars protected were reduced to account for filers committing EITC errors in multiple years and to account for the estimated number of filers not claiming EITC in subsequent years. In the table below Column (E) represents the estimated amount of EITC over claimed (the result of Column C multiplied by Column D) that may have occurred without the benefit of the appropriation.

EARNED INCOME TAX CREDIT MATH ERROR AUTHORITY ANALYSIS TAX RETURNS / UNPAID OVER CLAIMS - ACTUAL AND ESTIMATED				
Tax Year	Actual Number of Tax Returns With EITC Math Errors Related to Expanded Math Error Authority	Estimated Qualification EITC Over claims Not Credited to Taxpayers³	Estimated Number of Years Taxpayers Could Have Received Erroneous Refund(s) (Multiplier)	Estimated Accumulated Over claim Total Not Credited to Taxpayers by Multiplier (C x D)
(A)	(B)	(C)	(D)	(E)
1997	710,096	\$344,835,472	(4) 1998 – 2001	\$1,379,341,889
1998	804,122	\$317,347,063	(3) 1999 – 2001	\$952,041,188
1999	608,978	\$219,519,078	(2) 2000 – 2001	\$439,038,157
2000	558,313	\$225,547,329	(1) 2001	\$225,547,329
2001	545,250	\$435,468,570	(0)	\$0
Total	3,226,759	\$1,107,248,942		\$2,995,968,563

Figure 10

Source: Compliance Research Information System Models 2001 and 2002 for indicated Processing Years and IRTF Cycle 200252.

³ Column C discounts the amount originally protected by *expanded* math error authority to account for the number of EITC filers who commit EITC errors in consecutive years and to account for the number of EITC filers who do not claim EITC in consecutive years.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

EITC recertification protected as much as an additional \$557 million

In addition to the direct assessment of taxes from audits, in those instances where the audit changes the amount of EITC claimed, the filer must recertify with the IRS before being allowed to file a new EITC claim. Recertification efforts are estimated to have prevented nearly 500,000 erroneous EITC claimants from claiming EITC in the subsequent year, and protecting an estimated \$557 million in revenue protected in TY 2000 and 2001. The data analyzed does not provide us with the information to determine if taxpayers failed the requirements or simply did not apply for recertification.

EITC RECERTIFICATIONS AT A GLANCE		
TAX YEAR	ESTIMATED⁴ FILERS PREVENTED FROM RECEIVING EITC BECAUSE RECERTIFICATION REQUIREMENT NOT MET	ESTIMATED⁵ EITC DOLLARS PROTECTED BY EITC RECERTIFICATION PROCEDURES
TY 2000	115,632	\$ 46,246,843
TY 2001	373,477	\$ 510,767,765
Total	489,109	\$ 557,014,608

Figure 11

Source: Audit Inventory Management System Closed Database.

EITC audits protected \$3.6 billion

Figure 12 below shows the actual examination recommended assessments from EITC audits for TY 1997 through 2001. These assessments are in addition to the \$86 million of EITC protected from amended returns claiming EITC from FY 1999 through FY 2001.

EITC AUDITS AT A GLANCE

⁴ Estimate based on actual number of claimants required to recertify less claimants who recertified, reduced by the number of claimants not likely to claim EITC in subsequent years.

⁵ Estimated dollars protected computed as the product of estimated filers not recertified and average EITC dollars claimed for indicated TY.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

TAX YEAR	EITC AUDITS	RECOMMENDED ASSESSMENTS FROM EITC AUDITS
TY 1997	360,101	\$ 515,443,057
TY 1998	603,375	\$ 1,150,135,887
TY 1999	257,501	\$ 393,843,589
TY 2000	406,135	\$ 963,919,284
TY 2001	367,288	\$ 934,517,271
Total	1,999,440	\$ 3,957,859,088

Figure 12

Source: Audit Inventory Management System Closed Database.

Typically, the IRS has protected and collected approximately 92% of the dollars recommended from EITC audits. Accordingly, audits have preserved about \$3.6 billion from TY 1997 through 2001 (dollars protected may include non-EITC dollars. For example, the disallowance of an EITC qualifying child may also include the disallowance of that child as a dependent that generates additional protected tax).

The IRS is projecting approximately 372,000 new examinations to address EITC related issues in FY 2003.

In addition to the actual dollars attributed to the EITC appropriation, the IRS is now estimating indirect revenue protected from EITC appropriations consisting of indirect savings from math error authority and recertification. Overall, had the Congressional EITC Appropriations not been available, IRS compliance efforts could not have protected and administered billions in government revenue. IRS EITC compliance efforts have directly and indirectly protected an estimated \$9.6 billion in revenue for TY 1997 through 2001, consisting of:

- \$2.4 billion – Direct Math Error Authority (Actual)—see Appendix B, Attachment II
- \$3.6 billion in audits (Actual)
- \$3.0 billion – Indirect Math Error Authority (Estimated)

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

- \$.6 billion in Recertifications (Estimated)

See Appendix B, Attachment II for a chart showing the actual revenue protected as shown in the previous year's report dated February 28, 2002, and a reconciliation of the dollars from FY to TY.

The projected revenue protected from EITC compliance activities for TY 2002 is estimated at \$3.1 billion, consisting of :

- \$.3 billion – Direct Math Error Authority (Actual)
- \$.9 billion in Audits (Actual)
- \$1.4 billion – Indirect Math Error Authority (Estimated)
- \$.5 billion in Recertifications (Estimated)

The IRS leveraged a number of innovative initiatives to ensure that taxpayers, who were eligible for the EITC, filed an accurate claim. The IRS allocated \$19 million in FY 2002 and \$16.9 million in FY 2003 to outreach activities.

Outreach Activities

IRS identified taxpayers who appeared to qualify for EITC

As part of its FY 2002 outreach efforts, the IRS sent notices to approximately 958,000 taxpayers who, based on their tax return, appeared to qualify for the EITC. As a result, 26.6% of taxpayers with children receiving a notice alerting them to their potential eligibility for the EITC (the CP-09, "Entitlement to Money from IRS") claimed the credit. Among taxpayers who did not appear to have children receiving a CP-27 notice ("EITC Potential for Taxpayer Without Qualifying Children), about 44% subsequently claimed the credit. The IRS will continue its efforts to increase EITC awareness.

IRS efforts to partner with key stakeholders, external partners and intermediaries reaped tremendous rewards

The SPEC organization focused on providing EITC education and outreach to taxpayers. Building partnerships with key stakeholders, external partners, and intermediaries provided an

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

overwhelming opportunity to educate taxpayers about EITC, offer free tax preparation and provide information on financial literacy.

Currently, SPEC has approximately 140 established coalitions. Members of these coalitions include city leaders such as mayors, other government agencies, non-profit organizations such as United Way, National League of Cities, Annie E Casey Foundation, National Association of Community Action Agencies, Welfare to Work, and many others.

These partners provide a means to deliver the EITC message to millions of taxpayers. Extensive EITC awareness campaigns include newspapers, radio and television, as well as mailings by utility companies, educational institutions, Social Service agencies, and many others.

Through these coalitions the IRS was able to participate in radio interviews and talk shows, television appearances to talk about EITC and newspaper articles on EITC, including USA Today. Unique initiatives conducted by SPEC and their partners included:

- The Idaho Food Bank and Tax-Aide worked with SPEC to measure the effectiveness of adding a coupon offering free tax preparation assistance to food boxes distributed in three locations in Idaho. The coupon had information on EITC on one side and information on locating free tax preparation on the reverse.
- The McDonald's Corporation printed 600,000 placemats containing EITC information. These placemats contained EITC qualifying information for income, children, and a contact phone number for the coalition. These placements became available for use by all of the 187 McDonald's restaurants in New York City. Another restaurant in Baltimore placed tray liners with the EITC message in their carry trays.
- Posters on EITC were placed in 1,300 subway cars (20%) of the 6,500 subway cars in the New York City Subway system.

Accomplishments from Partnering Initiatives:

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

As of March 24, 2003, SPEC had completed approximately 42 million EITC contacts:

- Approximately 23 million of the 42 million received information via TV, radio or newspapers.
- Mailing of EITC information through utility bills, school report cards, W-2, 1099 statements, company newsletters, direct mailings by Housing Authorities and Social Service Agencies have accounted for over 13 million taxpayers being provided with EITC information.
- The remaining 5.4 million taxpayers received EITC information through other efforts such as workshops, outreach seminars, brochures at conventions and other unique methods of communication.

IRS focused on limited English proficient (LEP) taxpayers to heighten EITC awareness

Many of SPEC's efforts focused on providing EITC education and assistance to the LEP taxpayer. SPEC used available research resources to identify targeted areas to reach out to with EITC information as well as establish free tax preparation sites staffed by volunteers who spoke the targeted language.

Unique initiatives around LEP by SPEC and their partners have enabled the EITC message to be delivered directly to the community in need. For example:

- One partner printed EITC posters in English and Spanish while another non-profit agency funded the cost. The poster included a tear-away sheet with VITA sites listed.
- An IRS Tax Specialist provided a workshop to 15 Lao Family Community Development counselors. The counselors will make EITC presentations as part of their counseling services to low-income LEP customers.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

- Partnering with Univision television networks across the country provided EITC and free tax preparation information to Spanish speaking taxpayers.
- New York City's official website now contains EITC information in nine languages other than English.
- The Department of Human Assistance (DHS) in San Francisco developed an EITC flyer and translated it into four different languages. This flyer was sent to low-income taxpayers, community based organizations that cater to low-income customers, family shelter sites, single adult community shelters, childcare centers, job program offices, and other DHS offices. Hotlines have been initiated for taxpayers who speak Spanish only. Partners answer the calls, provide information, and direct the caller to free tax preparation sites.

Migrant farmers benefited from IRS outreach efforts

Migrant farmers are one of the many groups of transient taxpayers that SPEC focused outreach efforts on. SPEC has begun building partnerships with organizations that help or provide services to this population in order to provide EITC information.

- SPEC attended the Farm Workers Appreciation Day in Calexico California to provide EITC brochures to the over 1,500 farm workers and to connect with the farm worker community.
- EITC information was shared with the South County Coalition in the Miami/Dade area. This coalition deals with the needs of migrant workers. The coalition includes representatives from credit counseling, a low income tax clinic, welfare caseworkers, planning commission, and Hispanic services.

An additional 400,000 military personnel may now qualify for EITC

The EITC tax law changes for 2002 had a significant impact on Military personnel as approximately 400,000 additional enlisted

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

military personnel may now qualify for EITC. SPEC took a proactive approach to providing EITC information to the military. Initiatives were coordinated with the military channels to more effectively deliver the EITC messages.

- SPEC assisted the military in the creation of EITC TV spots for overseas EITC audiences.
- Various EITC articles were written specifically for military members. Training was provided to military instructors to provide EITC tax preparation assistance.
- SPEC created and then disseminated a military fact sheet for EITC.
- An IRS news release entitled “More People, Especially Military, Eligible for EITC; Volunteers, IRS.GOV Stand Ready to Help” was provided to the military for distribution.
- All standard EITC products were provided to the various military channels. EITC information was included in military base newsletters.

The IRS developed an EITC Press Kit

An EITC Electronic Press Kit was developed this year and distributed to the media. The kit contains frequently asked questions, eligibility requirements, and news releases.

SPEC Research Initiatives

SPEC relies on EITC compliance studies, research and internal and external data sources to determine specific EITC issues, to identify appropriate SPEC outreach and assistance communities, define its performance metrics and to evaluate the effectiveness of its initiatives. Understanding future trends, issues and problems allows SPEC to prioritize and plan for the future needs of EITC filers as SPEC enhances existing programs and builds new ones.

SPEC is utilizing and expanding internal and external data sources. In the area of volunteer filing assistance, SPEC developed two new CDs with WI Research: (1) TY 2001

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

profiling database CD-ROM which could be a valuable tool for trend analysis, local issue identification, such as highest concentration of low-income taxpayers and lowest EITC penetration; and (2) the 1999-2000 U.S. Census CD-ROM which provides for demographic analysis at various geographic levels. It will be the only source of information to allow for identifying the LEP and disabled segments.

SPEC has also addressed EITC compliance issues by:

- Conducting reviews of surveys (for example Notices CP-09 and CP-27) and reports to assess issues on potentially eligible EITC non-claimants and propose solutions to improve participation rate. SPEC used these results to identify the geographic locations of these taxpayers to improve marketing, outreach and education efforts;
- Completing TY 2001 EITC Claimant CD that contains return information for all EITC claimants as well as total errors and error type on the zip code level to assist SPEC employees in identifying areas for tailored education and outreach initiatives;
- Using the TY 2001 LEP profile, recommending that SPEC identify EITC communities for education and outreach on eligibility of the EITC;
- Requesting WI Research to determine the estimated claimed and unclaimed EITC amounts by zip code using internal and external data sources; and,
- Identifying specific EITC compliance issues that can be addressed through pre-filing activities with other IRS offices.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

The IRS Continued to Expand Program Management Approaches, and Increased Emphasis on Strategic Planning and Performance Measurement

The IRS restructured the EITC Program Office and increased executive oversight

In July 2002, the IRS realigned the EITC Program Office under its Office of Strategy & Finance, WI. This close association to the Office of Strategy and Finance enhanced the EITC Program's strategic and tactical decision making approaches that are directly linked to the budget formulation and execution.

In August 2002, the IRS also established the EITC Executive Advisory Council, a policy-setting body responsible for providing strategy, budget, and operational reviews and recommendations to the WI Commissioner. Since its inception, the Council has established an EITC strategic plan, reviewed each function's allocation method, and established performance and diagnostic measures. The Council includes executive level representation from each IRS function responsible for administering the EITC and ensures an integrated strategic approach to EITC issues and program management.

IRS increased emphasis on strategic planning and performance measures

To successfully manage the EITC program, the IRS recognized the need to strengthen and develop strategic planning and performance measures.

The IRS continued to focus on strategic planning and performance measures through the IRS' Strategic Planning, Budgeting, and Performance Management (SPB&PM) process. Strategic Planning establishes the long-term direction of the program, its unique mission, the specific set of goals, objectives, and policies developed in response to customer requirements, external mandates, and the external and internal environments. Because the EITC is administered throughout the IRS, the EITC Executive Advisory Council developed a comprehensive cross-functional strategic plan that encompasses EITC operational priorities for FY 2003 and 2004. See Appendix A for a copy of the plan.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

The key components of the EITC Strategic Plan for FY 2003 and 2004 are:

- The delivery of the EITC initiatives will be enhanced by a comprehensive service wide EITC strategy that balances compliance and outreach activities.
- The EITC Program will be enhanced by implementing the 5-point initiative, which builds on the EITC task force recommendations.
- The program structure can be enhanced by improving the budget development process and reporting procedures.

Performance management in the EITC program emphasizes accomplishing specific results against plans, and linking these results to the achievement of the overall mission and strategic goal. As the primary tool for deploying strategies, performance measures evaluate what is important and how well objectives are being achieved.

The IRS developed new measures for all related functions within the EITC program. To successfully manage the program, these integrated measures will clarify program strategies: drive change, focus action, and support decisiveness and balanced judgments.

IRS partnered with the Intergovernmental Erroneous Claims Group

The IRS is partnering with the Intergovernmental Erroneous Claims Group composed of both Chief Financial Office (CFO) and Office of Inspector General (OIG) staff from more than a dozen federal agencies and departments. This joint working group, the Erroneous & Improper Payments Joint Initiative, assisted Congress in drafting the Erroneous Payments Information Act of 2002, now Public Law 107-300. The mission is to facilitate the reduction of erroneous and improper payments throughout the federal government.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

Advancements in research improved EITC administration

The IRS continued to engage in a variety of research endeavors to promote fair and accurate administration of the EITC program. The IRS is committed to reducing taxpayer burden and erroneous EITC claims, with ongoing research efforts aimed at more effectively using both internal and external data sources.

The IRS is currently researching the feasibility of using Federal Case Registry of Child Support Orders (FCR) data in a math error authority environment. The FCR contains data on child support arrangements – linking children to both the payer of child support (generally the non-custodial parent) and the receiver of child support (generally the custodial parent). The Economic Growth and Tax Relief Act of 2001 requires the Treasury Department (in consultation with the National Taxpayer Advocate) to study (1) the accuracy and timeliness of the data in the Federal Case Registry; (2) the efficiency of using math error authority in this instance in reducing costs to erroneous and fraudulent claims; and (3) the implications of using math error authority in this instance, given the findings on the accuracy and timeliness of the data. The IRS WI Research Division is currently collecting the data that will enable the Treasury Department to respond to the first issue listed above. The FCR data has been an important component in selecting EITC returns for audit and this research will help determine if the data can be used even more efficiently and cost effectively in the math error authority environment.

The National Research Program (NRP) is a comprehensive effort by the IRS to measure compliance for different types of taxes and various sets of taxpayers. NRP will provide a statistically valid representation of the compliance characteristics of taxpayers. This will give the IRS current and reliable data for use in developing its compliance strategy, and conserve resources and minimize taxpayer contact and burden.

TY 2001 EITC compliance will be measured as part of the NRP. Previously, EITC compliance was measured by conducting in depth examinations of a stratified random sample of the returns claiming EITC, referred to as the EITC Compliance Study. Since NRP and the EITC Compliance Study methodologies are significantly different, an “analytical bridge” or “comparability

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

factor” will be developed to maintain a time series of EITC compliance data.

Other research endeavors include a study of the effectiveness of the EITC recertification process, a study of amended tax returns that claim EITC or increase the amount of EITC already claimed, and a study of EITC audit results to determine the amount of audit assessment which may be subsequently abated. Through this variety of research projects, the IRS balanced EITC education and outreach with compliance to ensure fair and comprehensive oversight of the EITC.

The IRS Will Continue to Implement a Balanced EITC Initiative that Provides Better Service to Taxpayers and Improves the Program’s Integrity.

Although the EITC has been successful in lifting millions of low-income taxpayers and their children above the poverty line, there are continuing problems of administration and erroneous payments that must be addressed. In 2002, a Treasury-IRS joint task force was formed to study ways to improve the administration of the EITC. On June 13, the IRS announced a five-point initiative, which builds on the findings of the task force.

Reduce the Backlog of EITC Examinations

The IRS completes about 350,000 pre-refund EITC examinations each year. Currently, about 7% of pending EITC examinations have been open for more than one year and are, under the agency’s own guidelines, unacceptably old. The agency will begin a review of current EITC examination inventories to determine how to reduce this backlog.

Review the Existing Audit Process and Improve the Quality of Communications

Currently, an average EITC pre-refund examination takes 225 days to resolve. During an EITC examination, a taxpayer will receive a minimum of two different notices and can receive up to six different notices. Nearly 30% of claimants selected for EITC pre-refund examinations fail to respond. The agency will review the notices and letters sent to taxpayers to ensure that they are clear and tell taxpayers exactly what they must do to prove their eligibility. In addition, the IRS will look for other ways to

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

improve the examination process and make it less burdensome for taxpayers.

Increase Outreach Efforts

Currently, the IRS undertakes extensive EITC outreach and education efforts. The National Taxpayer Advocate and SPEC are working to develop additional partners and methods for increasing awareness of the EITC and to ensure that eligibility rules are clearly understood. The IRS also intends to expand its media campaign and increase its efforts to educate return preparers.

Increase Focus on Taxpayers Who Circumvent EITC Income or Claim Limitations

Taxpayers who circumvent the EITC income or claim limitations include (1) taxpayers who fail to report all of their income; (2) married taxpayers who each file as single or head of household because their combined income is above the EITC limit; and, (3) married taxpayers with two or more children who each file as single or head of household and split the children claimed, thereby receiving up to about \$8,000—twice the maximum EITC claim limit. Taxpayers with income or filing status errors are responsible for approximately \$4 billion in annual erroneous payments.

The IRS will identify returns with the highest risk of income misreporting by using its document matching systems (Form W-2 and Form 1099 information). The IRS will also identify returns with the highest probability of filing status error by enhancing its error detection technology, using third-party data, and requiring EITC claimants to submit limited additional information about their marital status and, where applicable, about their spouse or former spouse. In 2004, IRS will expand its compliance efforts involving at least 300,000 taxpayers who have chronically misreported their income or have misreported their filing status.

Qualifying Child Residency Certification Pilot

Individuals can claim a child for EITC only if the child has one of the legally specified relationships with the claimant and the child has lived with the claimant for more than half the year. Qualifying child errors cause about \$3.0 billion in annual

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

erroneous payments. The vast majority of qualifying child over claims are caused by residency errors—either alone or in combination with relationship errors. For this reason, the IRS will pilot a certification program in the 2004 Filing Season to establish residency. In the 2004 Filing Season, the IRS will ask 25,000 EITC claimants to certify when they file that the eligible child claimed for EITC purposes resided with them for more than half a year as required by law. The pilot will start during the 2004 Filing Season, with the first notices going out shortly before the end of 2003.

To establish residency, the IRS will ask claimants to provide documentation from third parties, such as clergy, healthcare providers, child care providers, community-based organizations, social service agencies, Indian Tribes, landlord or property managers, and schools who have information about the residency of the claimant and child—either through their records or personal experience. Claimants who cannot obtain the suggested documentation can seek help at an IRS Taxpayer Assistance Center or through a special toll-free number to speak with IRS personnel specializing in the EITC qualifying child certification process. Additionally, claimants will be assigned one of the qualifying child specialists who will be responsible for handling the claimant's qualifying child issues from start to finish.

The goal of the certification pilot is to evaluate high-risk EITC claims before they are paid, using a process that is less burdensome to taxpayers and less costly to the government than an audit. In addition, the certification program will enable eligibletaxpayers to receive their refunds faster than if their refunds were to be held pending an examination

Following the 2004 certification pilot, the IRS will carefully assess the pilot's results and performance before deciding on how to proceed with the program.

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

APPENDIX A. EITC STRATEGIC PLAN FOR FY 2003 AND 2004

TRENDS ISSUES & PROBLEMS	MAJOR STRATEGY	OPERATIONAL PRIORITY	FY-03	FY-04
TIP 1 Delivery of the EITC initiatives will be enhanced by a comprehensive service wide EITC strategy that balances compliance & outreach activities, including initiatives 1 through 3 of the EITC 5-point initiative.	1. Develop enhanced initiatives to reduce EITC over claims	1) Develop a more robust Paid Preparer Program that includes sufficient efforts to educate & enforce due diligence requirements. <ul style="list-style-type: none"> • Analyze • Implement 	X	X
		2) Develop cross Divisional examination strategies that quickly react to changing EITC compliance trends, such as increased Schedule C filers.	X	X
		3) Analyze EITC “non - response” to pre-refund audit notices to determine potential causes.	X	
		4) Partner w/NRP to collect data for use in formulating EITC compliance strategies.	X	X
		5) Develop a strategy for addressing EITC claims on amended returns (i.e. Form 1040X).	X	X
		6) Develop & implement a strategy to determine the optimal mix of inventory in a post refund environment	X	X
		7) Establish a specific threshold in the Under Reporter Program (UR) <ul style="list-style-type: none"> • Planning • Implementation 	X	X
		8) Analyze/Implement results from FCR Examination Study for expanded math error authority.	X	X

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

TRENDS ISSUES & PROBLEMS	MAJOR STRATEGY	OPERATIONAL PRIORITY	FY-03	FY-04
		9) Analyze the EITC process including associated taxpayer notices to identify and implement systematic process improvements.	X	X
	2. Develop initiatives to review the existing audit process and improve the quality of communications.	1) Reduce the backlog of pending EITC examinations to ensure that eligible taxpayers whose returns are being examined receive their refunds quickly.	X	X
		2) Minimize burden and enhance the quality of communications with taxpayers by improving the existing audit process.	X	X
	3. Develop focused initiatives to educate the diverse EITC taxpayer population on EITC initiatives.	1) Develop a more focused outreach campaign that targets areas of significant, potential nonparticipation.	X	X
		2) Develop a more focused outreach campaign that educates taxpayers & practitioners on EITC compliance issues.	X	X
		3) Continue to implement multilingual strategies to provide appropriate EITC products that assist taxpayers in languages other than English.	X	X
		4) Enhance IRS internal & external web sites to provide improved EITC information & customer access. (For example Tax Trails)	X	X
	4. Identify new ways to administer EITC by partnering with state, federal & private organizations & through the use of proactive research initiatives.	1) Identify States w/EITC Programs & explore partnership opportunities.	X	X

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

TRENDS ISSUES & PROBLEMS	MAJOR STRATEGY	OPERATIONAL PRIORITY	FY-03	FY-04
		2) Explore new data sources to enhance Dependents Database usability i.e. Prisoner Data, Food Stamp.	X	X
		3) Incorporate operational & service improvements identified through partner/customer feedback.	X	X
		4) Partner w/TAS to test changes in “process” to reduce re-work.	X	X
		5) Encourage eligible taxpayers to claim the EITC by increasing outreach efforts and making the requirements for claiming the credit easier to understand.		
TIP 2 The EITC Program will be enhanced by implementing the 5-point initiative, which builds on the EITC task force recommendations focusing on taxpayers who circumvent EITC income and qualifying child requirements, as originally recommended by the EITC task force, and included as initiatives 4 and 5 of the EITC 5-point initiative.	1. Develop initiatives to increase focus on taxpayers who circumvent EITC income and qualifying child requirements.	1) Ensure fairness by refocusing compliance efforts on taxpayers who claimed the credit but were ineligible because their income was too high.	X	X
		2) Pilot a certification effort to substantiate qualifying child residency eligibility for claimants whose returns are associated with a high risk for error.	X	X

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

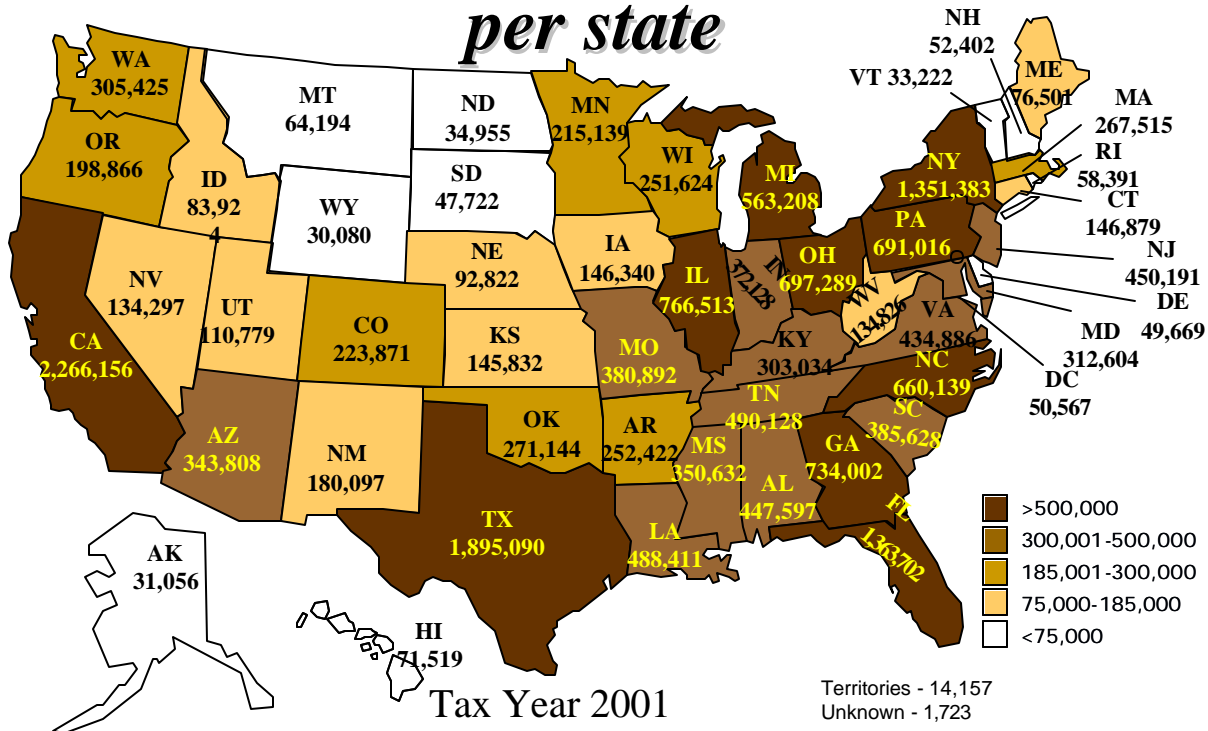
TRENDS ISSUES & PROBLEMS	MAJOR STRATEGY	OPERATIONAL PRIORITY	FY-03	FY-04
TIP 3 Program structure can be enhanced by improving the budget development process & reporting procedures.	1. Implement a more standardized budget allocation methodology that allows for the efficient delivery & measurement of EITC services, while meeting operational priorities.	1) Review each function's allocation methodologies to ensure that funds are accurately distributed for only EITC specific projects.	X	
		2) Establish priority of activities so that we can more proactively respond to budget changes.	X	
	2. Establish sound management controls to account for & report EITC expenditures.	1) Integrate Balanced Measures, workload analysis & inventory management controls (note: strategy should delineate between performance measure, diagnostic & GPRA measures).	X	X
		2) Develop a more comprehensive, standardize reporting process to track all aspects of the EITC Program.	X	X

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

APPENDIX B

Attachment
I

***Number of EITC returns filed
per state***



Total number of TY 2001 EITC returns = 19.5 Million

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

APPENDIX B

Attachment II

RECONCILIATION OF REVENUE PROTECTED						
Prior Report to Congress					Current Report to Congress	
	Program	Revenue Protected/Collected*		Period	Program	Revenue Protected/Collected*
FY-98	Audit	\$612		TY-97	Audit	\$474
	Math Error	\$385			Math Error	\$597
	Total	\$997			Total	\$1,071
FY-99	Audit	\$740		TY-98	Audit	\$1,058
	Math Error	\$383			Math Error	\$550
	Total	\$1,123			Total	\$1,608
FY-00	Audit	\$408		TY-99	Audit	\$362
	Math Error	\$291			Math Error	\$380
	Total	\$699			Total	\$742
FY-01	Audit	\$885		TY-00	Audit	\$887
	Math Error	\$283			Math Error	\$391
	Total	\$1,169			Total	\$1,277
FY-02	Audit	\$865		TY-01	Audit	\$860
	Math Error	\$213			Math Error	\$436
	Total	\$1,078			Total	\$1,295
Subtotal	Audit**	\$3,510		Subtotal	Audit	\$3,641
	Math Error***	\$1,556			Math Error***	\$2,353
Grand Total		\$5,066				\$5,994
* In Millions						
** Difference in Audit totals attributable to use of Fiscal Year accounting versus Tax Year.						
*** Prior Report to Congress limited Math Error Saving to only certain EITC math error codes.						
This report includes all EITC math errors where EITC was disallowed.						
# Estimate of split between Audit and Math Error						

**Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003**

APPENDIX B

Attachment III

EITC Related IRS examination processing changes:

Correspondence – Letter 566B and Form 886H have been replaced by simplified Letter 566B-EZ and Form 886H-EITC (for Earned Income Credit).

Procedure Change – Additional information to Taxpayer Response -- When a taxpayer replies to a Statutory Notice of Deficiency as defined in IRC Section 6212, we will inform the taxpayer specifically what information is still needed to conclude the examination, before the 90-day period expires. This is intended to protect the taxpayer's right to petition Tax Court, by reminding them of the pertinent timeframes.

Assisted Limited English Proficient Taxpayers – The multilingual Task Force has worked diligently in translating English letters into Spanish. In 2003, a pilot test will be conducted. A staffer will be included in the initial contact package offering Spanish translated letters to the taxpayers. Also, IRS examiners will distribute envelopes with an optional notation to receive Spanish correspondence.

Documentation – Because of new automation, Social Security Cards and Birth Certificates for a son or daughter and citizenship information, which were previously requested from taxpayers, will no longer be requested. This information will be secured internally from Social Security records.

EITC claimed with no qualifying children – Form 886H-EITC has a new feature for taxpayers who are denied EITC with qualifying children. The taxpayer can receive EITC for no qualifying children if they appropriately answer the questions on the Form 886H-EITC and sign the affirmation.

We are projecting approximately 372,000 new examinations to address EITC related issues in fiscal year 2003.

Earned Income Tax Credit (EITC) Program Effectiveness and Program Management FY 2002 – FY 2003

APPENDIX B

Attachment IV

Post Card Mailers

We can help you prove them right.

Get the latest on the Earned Income Tax Credit and get your clients the refunds they've earned. At www.irs.gov/eitc you'll find Publication 596, *Earned Income Credit*, as well as valuable information, including due-diligence requirements and the important changes listed below. Or call **1-800-829-3676** for a free copy of the publication.

2002 General Requirements:

- Earn under \$33,178 and have two or more qualifying children (\$34,178 if married, filing jointly)
- Earn under \$29,201 and have one qualifying child (\$30,201 if married, filing jointly)
- Earn under \$11,060 and have no qualifying children (\$12,060 if married, filing jointly)

2002 EITC Changes:

- New definition of earned income
- Elimination of modified adjusted gross income (MAGI)
- New rules for people with same qualifying child (tie-breaker rule)
- New abode requirement for certain children
- Reduction of EITC by alternative minimum tax (AMT) eliminated

IRS
WAGE AND INVESTMENT DIVISION
WICM (04-92)
5000 ELLIN ROAD
LARGAN, MD 20716

Prescribed
First-Class Mail
Postage and Fees Paid
Internal Revenue Service
Permit No. G-48

MR JAMES A SAMPLE
TITLE
ANY COMPANY
123 MAIN STREET
ANY TOWN USA 00000-0000



Your clients assume you're up-to-date with EITC requirements.



Earned Income Tax Credit (EITC) Program Effectiveness
and Program Management FY 2002 – FY 2003

Attachment
IV

Post Card Mailers



What common mistakes can prevent your clients from getting their EITC refund?

- Taxpayers claim a child who is not a qualifying child
- Married taxpayers who should file as married filing separately, file as single or head of household instead
- Income-reporting errors
- Taxpayers or qualifying children with mismatched or incorrect Social Security numbers

Visit www.irs.gov/eitc to get Publication 596, *Earned Income Credit*, and other important information, including due-diligence requirements. Or call **1-800-829-3676** for a free copy of the publication.



The Internal Revenue Service

Presorted
First-Class Mail
Postage and Fees Paid
Internal Revenue Service
Permit No. G-48

DIMEKX

MR JAMES A SAMPLE
TITLE
ANY COMPANY
123 MAIN STREET
ANY TOWN USA 00000-0000

A2