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#12****EARNED INCOME TAX CREDIT (EITC): The IRS Continues to Make Progress to Improve Its Administration of the EITC, But It Has Not Adequately Incorporated Research Findings That Show Positive Impacts of Taxpayer Education on Compliance****RESPONSIBLE OFFICIAL**

Kenneth Corbin, Commissioner, Wage and Investment Division

**TAXPAYER RIGHTS IMPACTED<sup>1</sup>**

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Retain Representation*
- *The Right to a Fair and Just Tax System*

**DEFINITION OF PROBLEM**

The Earned Income Tax Credit (EITC) is a tax credit targeted at low income workers (primarily workers with children).<sup>2</sup> It has become one of the government's largest means-tested anti-poverty programs.<sup>3</sup> For Tax Year (TY) 2015 returns filed during 2016, over 27 million taxpayers received about \$67 billion in EITC.<sup>4</sup> For the same time period, the average amount of EITC was more than \$2,455.<sup>5</sup> However, as the Department of Treasury recently reported, the EITC rules of eligibility are “complex and lead to high overclaim error rates.”<sup>6</sup> In addition to complex rules, the population eligible to claim the EITC is constantly churning, with approximately one-third of the eligible population changing every year.<sup>7</sup>

1 See Taxpayer Bill of Rights (TBOR), <https://www.TaxpayerAdvocate.irs.gov/taxpayer-rights>. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Pub. L. No. 94-12, § 204, 89 Stat. 26 (1975). The preference to provide Earned Income Tax Credit (EITC) benefits to families with children is seen in the stark difference between the amount of benefits available to childless workers and to workers with children. The most a married couple with no children could receive in EITC benefits for tax year (TY) 2016 was \$506. A married couple with three children was eligible for a maximum of \$6,269 in EITC benefits in TY 2016. IRS, Publication 596, *Earned Income Credit (EIC)* 31-33 (Dec. 21, 2016).

3 Congressional Budget Office, *Federal Means-Tested Programs and Tax Credits – Infographic* (Feb. 11, 2013), <https://www.cbo.gov/publication/43935>.

4 IRS, *About EITC*, <https://www.eitc.irs.gov/eitc-central/about-eitc/about-eitc>.

5 *Id.*

6 Department of Treasury, *Agency Financial Report Fiscal Year 2016* 160 (Nov. 2016).

7 IRS, *EITC Fast Facts*, <https://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff>. For a detailed explanation for how EITC eligibility and benefits calculation works, see National Taxpayer Advocate 2015 Annual Report to Congress 240-42.

As a result of the complex rules and the ever-changing population of eligible taxpayers, the EITC is associated with a high improper payment rate.<sup>8</sup> To its credit, the IRS has reached out to a broad array of experts via its two EITC Summits, resulting in many suggestions about how to improve EITC administration, education, and compliance. The IRS and TAS also work jointly on the EITC Audit Improvement team, which has worked to expand the list of acceptable documentation to substantiate an EITC claim and to allow the use of third-party affidavits during EITC audits. Nevertheless, while the IRS does conduct EITC taxpayer education initiatives, its primary tool to combat the improper payment rate thus far has been the audit process.<sup>9</sup>

Over the years, the National Taxpayer Advocate has encouraged a multi-pronged approach to reducing the number of improper claims for EITC while encouraging eligible claims. For example, the National Taxpayer Advocate has recommended enhancing taxpayer communication and education, using an examination process tailored to the needs of low income taxpayers, and strengthening the program overseeing EITC return preparers.<sup>10</sup> The National Taxpayer Advocate has the following concerns with how the IRS administers the EITC:

- The IRS has not adequately studied the impact of taxpayer education on EITC compliance;
- TAS research shows providing a dedicated helpline for EITC taxpayers during the tax season improves EITC compliance; and
- Progress is being made with the IRS joint EITC Audit Improvement team, but more can be done to help low income taxpayers, particularly in the area of acceptance of alternative documentation.

## ANALYSIS OF PROBLEM

### Background

Research has shown that the EITC can offer both short-term and long-term support to eligible taxpayers. One study of EITC claims between 1989 and 2006 found that sixty-one percent of taxpayers claimed the EITC for only a period of one or two years.<sup>11</sup> The study also found that 20 percent of taxpayers

<sup>8</sup> An improper payment is defined as “any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements” and “any payment to an ineligible recipient.” Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111–204, § 2(e) (2010), amending Improper Payments Information Act of 2002, Pub. L. No. 107–300 (2002) by striking § 2(f) and adding (f)(2). The IRS estimates that for fiscal year (FY) 2016, between 22.2 percent (\$15.5 billion) and 25.9 percent (\$18.1 billion) of the total EITC program payments of \$69.8 billion were improper. Department of Treasury, *Agency Financial Report Fiscal Year 2016* 49 (Nov. 2016).

<sup>9</sup> National Taxpayer Advocate 2015 Annual Report to Congress 248-60.

<sup>10</sup> For recent recommendations, see National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 61-69 (*TAS Continues to Pursue Improvements to the IRS’s Administration of the Earned Income Tax Credit (EITC), Particularly With Recent Changes to the Law*); National Taxpayer Advocate 2016 Annual Report to Congress 138-50 (*Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*); National Taxpayer Advocate 2015 Annual Report to Congress 240-47 (*Earned Income Tax Credit (EITC): The IRS Does Not Do Enough Taxpayer Education in the Pre-filing Environment to Improve EITC Compliance and Should Establish a Telephone Helpline Dedicated to Answering Pre-filing Questions From Low Income Taxpayers About Their EITC Eligibility*); National Taxpayer Advocate 2015 Annual Report to Congress 248-60 (*Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process As an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*); National Taxpayer Advocate 2015 Annual Report to Congress 261-83 (*Earned Income Tax Credit (EITC): The IRS’s EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*).

<sup>11</sup> Tim Dowd and John B. Horowitz, *Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support*, PUBLIC FINANCE REVIEW 29 (2011).

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The Earned Income Tax Credit (EITC) is a “temporary safety net during periods of either anticipated or unanticipated income or family structure shocks” but also a long-term assistance for taxpayers “with children who are entrenched in the lowest-income brackets.”

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claimed the EITC for five or more years.<sup>12</sup> Thus, the EITC is a “temporary safety net during periods of either anticipated or unanticipated income or family structure shocks” but also a long-term assistance for taxpayers “with children who are entrenched in the lowest-income brackets.”<sup>13</sup>

The EITC may be most beneficial during times of change in the taxpayer’s family structure or economic wellbeing. One study reviewed EITC claim rates according to the qualifying child’s age and found that in the year a child is born, there is a 43 percent chance of the EITC being claimed and then this number decreases over time.<sup>14</sup> Additionally, when a taxpayer’s financial situation deteriorates because of an unanticipated job loss or long-term illness, he or she may suddenly find him or herself eligible for the EITC. Indeed, tax credits such as the EITC played an important role in the financial safety net for taxpayers during the recent Great Recession.<sup>15</sup>

The EITC is critical in helping financially vulnerable families. While Social Security benefits provide support to the elderly and those with disabilities, tax credits including the EITC and the Child Tax Credit reduce the number of children in poverty by 6.7 percent.<sup>16</sup> The positive effects for children who live in families receiving the EITC are long-term: these children do better in school, mothers and infants have improved health, and the children have higher college attendance rates.<sup>17</sup>

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12 Tim Dowd and John B. Horowitz, *Income Mobility and the Earned Income Tax Credit: Short-Term Safety Net or Long-Term Income Support*, PUBLIC FINANCE REVIEW 3 (2011).

13 *Id.*

14 *Id.* The authors of this study surmise that “some of the decline likely represents the normal anticipated shock that having a newborn has on family labor income in the year of birth, thereby reducing income in the year of birth and increasing eligibility.”

15 For the period of time including the Great Recession, between 2007 and 2010, poverty rates only rose by 0.5 percent despite the largest rise in unemployment since the Great Depression. Credit for this is due to the expansion of Supplemental Nutrition Assistance Program (SNAP) and tax credits. The Council of Economic Advisers, *The War on Poverty 50 Years Later: A Progress Report* 22 (Jan. 2014).

16 The Council of Economic Advisers, *The War on Poverty 50 Years Later: A Progress Report* 27 (Jan. 2014).

17 Center on Budget and Policy Priorities, *EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children’s Development, Research Finds* (Oct. 1, 2015). One study built on the connection between those living in poor economic conditions and increased stress manifesting itself in higher blood pressure, higher cholesterol, and other physical effects. The study found that the expansion of EITC in the Omnibus Reconciliation Act of 1993 led to a decrease in the number of “reported bad mental health days for mothers with a high school degree or lower and two or more children compared to a similar woman with only one child” and “increased the probability of reporting excellent or very good health status.” William N. Evans and Craig L. Garthwaite, *Giving Mom a Break: the Impact of Higher EITC Payments on Mental Health*, AMERICAN ECONOMIC JOURNAL: ECONOMIC POLICY 286 (May 2014). Another study looked at the increased EITC available with the Omnibus Reconciliation Act of 1993 and found that larger EITC benefits led to positive impacts in children’s educational achievements both now and into the future. Michelle Maxfield, *The Effects of the Earned Income Tax Credit on Child Achievement and Long-Term Educational Attainment*, MICHIGAN STATE UNIVERSITY JOB MARKET PAPER 31 (Nov. 14, 2013).

### The IRS Made Great Strides By Following Up With Its Second Earned Income Tax Credit (EITC) Summit This Year

The IRS hosted its first EITC Summit (Summit) June 29–30, 2016. The objective of the Summit was to “obtain perspectives from an array of stakeholders on improving compliance while fostering participation.”<sup>18</sup> The Summit opened a constructive dialog between the IRS and people from various sectors, such as the tax profession industry, state and federal agencies, consumer advocates, research institutes, volunteer site coordinators, and Low Income Tax Clinics (LITCs). Overall, the Summit addressed the following issues:

- Reducing overclaims;
- Improving participation; and
- Improving administration.

As a result of the Summit, the IRS received many useful suggestions to pursue going forward. For instance, to increase participation, the participants suggested a strong outreach program that would focus on how changes to the traditional family structure can impact EITC eligibility and how such taxpayers can substantiate their EITC claims. Additionally, outreach and education was a major component of the group’s suggestions for improving EITC participation. Specifically, participants suggested the IRS create partnerships with non-tax parties, including child service workers, pediatricians, veterans’ organizations, and divorce attorneys.<sup>19</sup> To improve administration of the EITC, participants suggested ways to ease taxpayer burden during an audit. For example, the IRS could look at prior year returns to see if income levels and qualifying children were the same (or similar). Second, if a qualifying child is not claimed by anyone else in that tax year, the IRS could require the taxpayer to send only “minimal documentation” to substantiate the residency test.<sup>20</sup>

The IRS held another EITC Summit in September 2017 and identified some outreach “concepts.”<sup>21</sup> For 2018, the IRS intends to include messaging geared to childless workers.<sup>22</sup> The IRS will also devote resources to veterans and rural taxpayers.<sup>23</sup> While vague, this response shows that the IRS is at least aware of the need for greater outreach and education.

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18 IRS, *Earned Income Tax Credit Summit, Identifying New Approaches for Administration of the EITC* 3.

19 *Id.* at 10.

20 *Id.* at 15.

21 IRS response to TAS information request (Nov. 14, 2017).

22 *Id.*

23 *Id.*

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### The IRS Has Not Adequately Studied the Impact of Taxpayer Education on EITC Compliance

The National Taxpayer Advocate consistently advocates that low income taxpayers need services specifically tailored to their unique needs.<sup>24</sup> Most recently, TAS studied how taxpayers' service preferences, usage patterns, and usage effectiveness vary by demographic group within the taxpayer population.<sup>25</sup> This study found that vulnerable populations (including low income taxpayers) are less equipped to rely on the internet for services. In particular, vulnerable groups, including low income taxpayers, are less likely to have broadband access at home, feel less skilled doing internet research, and feel less secure sharing personal financial information over the internet.<sup>26</sup> This type of research should be driving the IRS's approach to EITC compliance. However, the IRS is taking the opposite approach, by relying on automation and self-help modules to educate low income taxpayers.<sup>27</sup>

The National Taxpayer Advocate's position that greater education is connected to improved compliance is supported by research. The current approach used by the IRS may be considered a "neoclassical economic approach," meaning a taxpayer is driven by "profit-maximizing motives" when he or she considers tax compliance.<sup>28</sup> For instance, what are the odds the taxpayer will be audited? How much will the fine be if the taxpayer is audited?

However, research shows that instead, tax administration generally (and EITC administration in particular) could benefit from adopting a "slippery slope" framework. Under this theory, voluntary tax compliance is achieved by "taking actions to increase power and build trust," not just by using an iron fist.<sup>29</sup> As explained in one study, "A synergistic climate is characterized by high mutual trust between taxpayers and authorities. Taxpayers are willing to comply, and tax administration provides customer-oriented services."<sup>30</sup>

The IRS is already taking some action to move from a system reliant on audits to one that provides customer-oriented services for EITC taxpayers. As noted above, it has engaged in a conversation with a diverse group of people who work with the EITC and it has attempted to fine-tune its EITC outreach and

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24 National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 1-87 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*); National Taxpayer Advocate 2007 Annual Report to Congress 222-41 (*EITC Examinations and the Impact of Taxpayer Representation*); National Taxpayer Advocate 2015 Annual Report to Congress 240-47 (*Earned Income Tax Credit (EITC): The IRS Does Not Do Enough Taxpayer Education in the Pre-filing Environment to Improve EITC Compliance and Should Establish a Telephone Helpline Dedicated to Answering Pre-filing Questions From Low Income Taxpayers About Their EITC Eligibility*).

25 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 3-30 (*Taxpayers' Varying Abilities and Attitudes Toward IRS Taxpayer Service: The Effect of IRS Service Delivery Choices on Different Demographic Groups*).

26 *Id.* at 4.

27 National Taxpayer Advocate 2016 Annual Report to Congress 138-50.

28 Erich Kirchler, Christoph Kogler, and Stephan Muehlbacher, *Cooperative Tax Compliance: From Deterrence to Deference*, *Current Directions in Psychological Science* 87-88 (Apr. 2014).

29 *Id.* at 88.

30 *Id.* at 89.

education program. The National Taxpayer Advocate encourages the IRS to expand its customer service by offering a dedicated toll-free helpline for EITC questions, discussed below.<sup>31</sup>

### *TAS Research Shows Pre-Filing Season Letters Can Improve EITC Compliance*

In 2016, the National Taxpayer Advocate sent 6,564 letters to taxpayers who appeared to have erroneously claimed the EITC on their 2014 returns, whose 2014 returns were not audited, but who appeared to be as noncompliant as those who were audited.<sup>32</sup> The TAS letter explained the requirements for claiming EITC in plain language, identified the specific requirement the recipient did not appear to meet, and suggested sources of additional information and assistance, including TAS. TAS then conducted a study to compare the level of compliance shown on taxpayers' 2015 returns among three groups:

- Taxpayers the IRS identified as appearing to have erred in claiming EITC on their 2014 return but whose 2014 returns were not audited, and were sent the TAS letter;
- Taxpayers whose 2014 returns were not audited and had similar characteristics as the returns of taxpayers who received the TAS letter, but who were not sent the TAS letter; and
- Taxpayers whose 2014 returns had similar characteristics as those who received the TAS letter but were not sent the TAS letter and whose 2014 returns were audited.<sup>33</sup>

Key findings of this study include:

- The TAS letter averted noncompliance on 2015 returns where the 2014 return appeared erroneous because the relationship test was not met. Taxpayers who were sent the TAS letter were less likely to repeat the same error on their 2015 returns than unaudited taxpayers who did not receive TAS letters. In fact, sending the TAS letter to all taxpayers whose 2014 returns appeared to be erroneous because the relationship test was not met would have averted about \$47 million of erroneous EITC claims.
- Audited taxpayers whose 2014 return appeared to contain a duplicate claim for EITC were less likely to claim the EITC on their 2015 returns than taxpayers in either of the other two groups.<sup>34</sup>

TAS continued this study in 2017.<sup>35</sup> This year's results show that when it comes to the relationship test, the sample group broke the same rule 72 percent of the time compared to 77 percent of taxpayers in the

31 National Taxpayer Advocate 2016 Annual Report to Congress 138-50.

32 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 33-52 (*Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*). See also National Taxpayer Advocate, *Earned Income Tax Credit (EITC): TAS Study Finds that Sending an Informative, Tailored Letter to Taxpayers Who Appear to Have Erroneously Claimed EITC Can Avert Future Noncompliance* (Oct. 11, 2017), <https://taxpayeradvocate.irs.gov/news/nta-blog-eitc-TPLetters-avert-noncompliance?category=TaxNews>; National Taxpayer Advocate 2017 Annual Report to Congress, vol. 2, (*Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC*), *infra*.

33 The IRS selects returns that claim EITC for audit using the Dependent Database (DDb). It is a tool that combines data from IRS and third-party sources such as the Social Security Administration. When a return is filed, the IRS compares the return against these data and scored for a probability of noncompliance. Dept. of Treasury, *Report to Congress on Strengthening Earned Income Tax Credit Compliance Through Data Driven Analysis* 14 (July 5, 2016).

34 National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 33-52.

35 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC*, *infra*.

control group, a statistically significant reduction of five percentage points that, if projected to the entire 2015 population, would result in a savings of over \$53 million in erroneous EITC claims.<sup>36</sup>

### TAS Research Shows Providing a Dedicated Helpline for EITC Taxpayers During The Tax Season Improves EITC Compliance

In the 2017 study, TAS added an additional sample of 1,197 taxpayers who were offered in the letter the availability of a dedicated “Extra Help” telephone line staffed by TAS employees trained to answer taxpayer questions about the letter and the EITC eligibility rules.<sup>37</sup> Taxpayers who received the TAS letter with the available Extra Help telephone line broke the same rule related to residency 67 percent of the time; this is seven percentage points less than the 74 percent of the taxpayers in the control group who broke the same rule, and is statistically significant at the 95 percent confidence level. If projected to the entire 2015 population who only broke a Dependent Database (DDb) rule indicating the child may not have resided with the taxpayer, sending the TAS letter with the available Extra Help telephone line would result in a savings of over \$44 million in erroneous EITC claims.<sup>38</sup> Taxpayers who received the TAS residency letter without the Extra Help line number, broke the same residency rules 74 percent of the time, which was not statistically different from the control group.<sup>39</sup>

Offering the Help line could be particularly helpful since the IRS could talk to the taxpayer directly and identify areas of confusion. Based on the data referenced above, just offering the Help line may help reduce repeat EITC errors. The IRS could then apply this knowledge and improve EITC outreach, education, and procedures for all EITC taxpayers. Based on a review of calls received on the Help line, TAS has been able to identify two areas that received repeat questions: the rules of claiming a dependent versus the EITC, and the rules that are involved when parents have shared custody of a qualifying child.

This approach is similar to that of the United Kingdom’s tax authority, Her Majesty’s Revenue and Customs (HMRC), which provides a hotline for general tax credit questions and a hotline dedicated

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36 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC*.

37 *Id.* Only 967 of those letters were deliverable and the study is based on that group. TAS received 35 calls to the Extra Help telephone line during this study.

38 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC*, *infra*.

39 *Id.*

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solely to child benefit credits.<sup>40</sup> This approach helps meet HMRC’s strategy to promote compliance and prevent noncompliance “as early as possible.”<sup>41</sup>

### **Progress is Being Made with the IRS Joint EITC Audit Improvement Team But More Can Be Done to Help Low Income Taxpayers, Particularly in the Area of Acceptance of Alternative Documentation**

#### *Improvements to Internal Revenue Manual (IRM) 4.19.14-1 will allow acceptance of documents likely to be used by low income taxpayers*

TAS is an active participant on a collaborative IRS team dedicated to identifying ways to improve the audit process for taxpayers claiming the EITC. One area of improvement includes the identification of acceptable documents for substantiating EITC claims, which are particular to the circumstances of low income taxpayers. This is something for which the National Taxpayer Advocate has consistently advocated.<sup>42</sup> Previous internal guidance provided a list of acceptable documentation to substantiate an EITC claim; however, the list was very narrow and did not reflect the types of documentation and methods of proof that would most likely be available or best-suited for taxpayers claiming the EITC. Through the work of the EITC Audit Improvement Team, the IRS added IRM 4.19.14-1 in July 2016. This IRM section will foster acceptance of substantiating documentation outside of the traditional EITC documentation, which typically includes letters from schools and doctor offices. In addition to listing various “new” documents for Examination employees to consider, such as paternity test results, eviction notices, and statements from homeless shelters, the internal guidance informs Examination employees that this list is not all-inclusive. The National Taxpayer Advocate applauds the IRS for expanding acceptable documentation and she will continue to advocate for a wide range of additional documents to be added to IRM 4.19.14-1.

The EITC Audit Improvement Team has also identified employee training as a concern with the revisions to IRM 4.19.14-1. While the intent behind enhancing the list of documents in the IRM was to foster a mindset that would be open to considering alternatives for substantiating an EITC claim, it appears the additional documents, while helpful, have not created an environment where employees feel they can consider a multitude of documents. The EITC Audit Improvement Team will also work to tackle this obstacle.

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40 Her Majesty’s Revenue and Customs (HMRC), *Child Tax Credit and Working Tax Credit: Why Overpayments Happen* 10 (Apr. 2017).

41 HMRC, *Our Strategy* 4 (June 2017).

42 National Taxpayer Advocate 2015 Annual Report to Congress 253-54; National Taxpayer Advocate 2011 Annual Report to Congress 305; National Taxpayer Advocate 2007 Annual Report to Congress 222, 225; National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 20.



### *The IRS will introduce the use of third-party affidavits in EITC audits*

The National Taxpayer Advocate believes that a third-party affidavit should be incorporated into the EITC audit process as a tool for any taxpayer to use for substantiating his or her claim, and will help reduce the improper payment rate. TAS advanced this objective during its participation on the EITC Audit Improvement team and recently the IRS announced that it will allow the use of third-party affidavits as proof of residency for a limited population of taxpayers, beginning in TY 2018.<sup>43</sup> The use of affidavits will be limited to those taxpayers who “appear to meet the relationship requirement for claiming EITC based on information available to the IRS from the U.S. Department of Health and Human Services’ Federal Case Registry and information from the Social Security Administration.”<sup>44</sup> The IRS will add the affidavit to the initial audit mailing for the limited population, but those taxpayers will be allowed to use the affidavit at all stages of the audit.<sup>45</sup> While the option to use affidavits will be known to taxpayers and representatives who receive this audit notice, it does not appear that the IRS will be broadly advertising this tool.

The National Taxpayer Advocate applauds the IRS’s decision to adopt the limited use of third-party affidavits and looks forward to seeing how this decision will improve the audit process for taxpayers. However, TAS will continue to work to expand the use of affidavits to all EITC taxpayers because affidavits are a tool proven to help taxpayers. In 2005, the IRS studied the use of affidavits as part of its EITC Qualifying Child Residency Certification Study.<sup>46</sup> The study found that affidavits had the highest rate of acceptance at 82 percent, compared to an overall acceptance rate of 64 percent for all document types.<sup>47</sup> The study concluded that this outcome was reasonable because affidavits had dedicated lines for all of the information, explaining “as long as the affidavit was filled out completely, it would contain all the required information to be accepted.”<sup>48</sup> If the affidavit became available to all EITC taxpayers, it would help educate claimants about EITC eligibility rules and further the public perception that the IRS is trying to help taxpayers correctly claim the EITC. It will also honor the taxpayers’ *right to a fair and just tax system*.<sup>49</sup>

### *Templates are available on irs.gov to make traditional documentation easier to obtain*

Some taxpayers cannot use traditional documentation to substantiate their case. For instance, if a taxpayer is relying on school records, which are maintained by school year, the information may not be enough for IRS purposes, which is needed by calendar year. In other instances, a doctor’s office may have adequate records but might not prepare the letter on letterhead in a way that meets IRS standards. In order to make it easier for taxpayers to use traditional documentation, the EITC Audit Improvement Team developed templates for several traditional sources of substantiation: school records, medical records, and childcare provider records. These templates provide language for the taxpayer to provide directly to the school, doctor’s office, or childcare provider. These templates will eliminate guesswork for offices helping taxpayers and will provide an easy tool for taxpayers to use. However, one downside is that

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43 IRS response to TAS information request (Nov. 14, 2017).

44 *Id.*

45 *Id.*

46 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress 7* (Oct. 2005).

47 *Id.* at 33.

48 *Id.*

49 IRC §7803(a)(3)(J).

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the templates are not easily accessible on [irs.gov](https://www.irs.gov).<sup>50</sup> These templates are also available on the TAS website as part of the TAS Tax Toolkit, EITC educational material.<sup>51</sup>

## CONCLUSION

The EITC is a powerful tool to improve the financial status of low income families. TAS's most recent research shows that an educational letter sent in the pre-filing season had a positive impact on EITC compliance and taxpayer education. A dedicated Help line may provide targeted assistance to the particular taxpayers who need it and give the IRS a better sense of what taxpayers find particularly confusing. Given the complexity of the EITC and the numerous ways in which eligibility can be affected, education will be the key to improving EITC compliance. The EITC Summits hosted by the IRS will go a long way in improving EITC claims. However, the IRS should be utilizing research, such as that conducted by TAS, to improve its efforts as well.

## RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Send out pre-filing season letters to taxpayers who break certain return filters. These letters should be written in plain language and be tailored to the taxpayer's particular needs.
2. Provide a dedicated toll-free Help line for EITC taxpayers during the filing season.
3. Expand the list of acceptable documentation under IRM 4.19.14-1 and train employees on the importance of this list.
4. Continue to expand the use of third-party affidavits, thereby making them available to all EITC taxpayers.

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50 The template for school records is found at: <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/school-template>. The template for medical records is found at: <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/healthcare-template>. The template for childcare providers is available at: <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/childcare-template>.

51 TAS, *Claiming the Earned Income Tax Credit (EITC)*, <https://taxpayeradvocate.irs.gov/get-help/claiming-the-eitc>.