

LR #2 TAX REFORM: Restructure the Earned Income Tax Credit and Related Family Status Provisions to Improve Compliance and Minimize Taxpayer Burden

TAXPAYER RIGHTS IMPACTED¹

- *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 Privacy*
- *The Right to a Fair and Just Tax System*

PROBLEM

A taxpayer's "family status" is central to the calculation of his or her taxable income and computation of tax. Despite several legislative improvements² and recommendations by the National Taxpayer Advocate and others,³ this fundamental component of taxation remains one of the most complex facing each and every taxpayer. The Family Status provisions include:

- Filing status (*i.e.*, single, married filing jointly, married filing separately, and head of household);⁴
- Personal and dependency exemptions;⁵
- Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC);⁶
- Earned Income Tax Credit (EITC);⁷

1 See Taxpayer Bill of Rights (TBOR), 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 Congress adopted a Uniform Definition of a Child (UDOC) in the Working Families Tax Relief Act of 2004, effective for tax years beginning after December 31, 2004. Pub. L. No. 108-311, §§ 201, 208, 118 Stat. 1166, 1169, 1178 (2004). Congress made further revisions to UDOC in Pub. L. No. 109-135, § 404(a), 119 Stat. 2577, 2632 (2005) and Pub. L. No. 110-351, § 501, 122 Stat. 3949, 3979 (2008). The National Taxpayer Advocate first recommended adoption of a UDOC in National Taxpayer Advocate 2001 Annual Report to Congress 82-100.

3 See, e.g., National Taxpayer Advocate 2005 Annual Report to Congress, 397-406; National Taxpayer Advocate 2008 Annual Report to Congress, 363-369; National Taxpayer Advocate 2012 Annual Report to Congress, 508-512; Steve Holt, *The Role of the IRS as a Social Benefits Administrator*, American Enterprise Institute (July 2016), <https://www.aei.org/publication/the-role-of-the-irs-as-a-social-benefit-administrator/>; Elaine Maag, *A Redesigned Earned Income Tax Credit Could Encourage Work By Childless Adults*, Tax Policy Center (TPC), <http://www.taxpolicycenter.org/taxvox/redesigned-earned-income-tax-credit-could-encourage-work-childless-adults>; The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* (November 2005); Adam Carasso, Jeffrey Rohaly, and C. Eugene Steuerle, *A Unified Children's Tax Credit*, National Tax Association Proceedings (May 15, 2005), <http://www.urban.org/uploadedPDF/1000790.pdf>; Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Sized Adjustment to the Minimum Wage*, 57 TAX LAW REV. 301 (Spring 2004); Max B. Sawicky, Robert Cherry and Robert Denk, *The Next Tax Reform: Advancing Benefits for Children*, Economic Policy Institute (2002).

4 IRC §§ 1-2.

5 IRC §§ 151-152.

6 IRC § 24.

7 IRC § 32.

- Child and Dependent Care Credit (CDCC);⁸ and
- Separated spouse rules.⁹

While literally every tax return involves at least two of these Family Status provisions, the IRS is hard-pressed to independently verify the accuracy of the status claimed. Over the years, it has used different government databases and developed “rules” that assist it in identifying questionable claims of filing status or credits. But these rules fail to account for the fluid nature of household composition. A recent study by the Tax Policy Center found that between 1996 and 2008 the number of households made up of “traditional” families (married parents with only biological children) has declined while alternative family types, such as families led by a single parent and cohabitating parents, has increased.¹⁰ Thus, a narrow conception of a “family” can deny Family Status benefits to many households with children. On the other hand, an overly expansive definition may be impossible for the IRS to administer without unacceptably intrusive inquiries.

Nowhere is this conflict more apparent than in EITC administration. Enacted as a work incentive in the Tax Reduction Act of 1975,¹¹ the EITC has become one of the government’s largest means-tested anti-poverty programs.¹² Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy “application” process by allowing an individual to claim the benefit on his or her tax return. This approach does not require an infrastructure of case workers and local agencies to make eligibility determinations. For tax year (TY) 2015, over 27 million taxpayers claimed nearly \$67 billion in EITC.¹³ Thus, the EITC enjoys a participation rate of between 75 and 79 percent¹⁴ — one of the highest participation rates of any federal government benefit program — and 87 percent of children claimed for the EITC were correctly claimed.¹⁵ However, the easy application process of the EITC is also associated with a high improper payment rate, which must be addressed in any efforts to improve the EITC.¹⁶

8 IRC §§ 21, 129.

9 IRC § 7703.

10 Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, Tax Policy Center (TPC), *Increasing Family Complexity and Volatility: the Difficulty in Determining Child Tax Benefits* 19 (Mar. 3, 2016). The TPC Study analyzed the December panel from the 1996 and 2008 Census Bureau Survey of Income and Program Participation (SIPP) data.

11 See Pub. L. No. 94-12, § 204, 89 Stat. 26, 30 (1975) (codified at IRC § 32).

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

13 IRS, *About EITC*, <https://www.etc.irs.gov/EITC-Central/abouteitc>. For tax year (TY) 2015, 27.3 million taxpayers had claimed \$66.9 billion in EITC (after math error processing, but prior to any audit of the tax return). IRS, Compliance Data Warehouse (CDW), *Individual Returns Transaction File* (includes TY 2015 returns posted as of cycle 47).

14 Dean Plueger, *Earned Income Tax Credit Participation Rate for Tax Year 2005 178-179*, IRS Research Bulletin (2009). See also Maggie R. Jones, *Changes in EITC Eligibility and Participation, 2005-2009*, U.S. Census Bureau.

15 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 5 (Pub. 5162, August 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf> (hereinafter referenced as *IRS EITC Compliance Study*). The 87 percent estimate was computed using the lower-bound estimate methodology, which assumes audit non-participants have similar compliance behavior to audit participants with similar characteristics (*i.e.*, in the same sampling strata). Upper-bound estimates assume audit non-participants are noncompliant (*i.e.*, the default exam exclusion is correct). The upper bound estimate for correctly-claimed children is 73 percent.

16 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 “includes any payment to an ineligible recipient.” Improper Payments Elimination and Recovery Act of 2010, Pub. L. No. 111–204, § 2(e), 124 Stat. 2224, 2227 (2010) (amending Improper Payments Information Act of 2002, Pub. L. No. 107-300, 116 Stat. 2350 (2002) by striking § 2(f) and adding (f)(2)). The IRS currently estimates that the EITC improper payment rate is about 24 percent (which accounts for an estimated \$16.8 billion in improper payments). Department of the Treasury, *Fiscal Year 2016 Agency Financial Report* 224 (Nov. 15, 2016).

The IRS National Research Program (NRP) is helpful in identifying the sources of EITC errors. The most common type of EITC error is income misreporting: 65 percent of EITC overclaim returns show some income misreporting and it is the *only* error on 50 percent of overclaim returns.¹⁷ Many of these improper payments should be eliminated by the recent enactment of accelerated due dates for Forms W-2 and 1099-MISC (reporting nonemployee compensation) and the delayed EITC refund issuance date, in effect for the 2017 Filing Season.¹⁸ What remains are some of the more factually complex sources of error, particularly the requirement that the child reside with the taxpayer for more than half the year. Other errors include competing claims for the same child, particularly by separated parents or by persons not having a required relationship with the child, and whether separated parents are considered “unmarried” under the tax code and thus able to file as single or head of household.¹⁹ These issues also arise under other Family Status provisions.

The EITC also provides an extremely small benefit to low income childless workers between the ages of 25 and 64. The participation rate for this benefit is extremely low, even though it is very easy to calculate, because it based on the earnings of a single taxpayer.²⁰ The IRS does not adjust a taxpayer’s return to claim this credit where the taxpayer has not done so and appears eligible.²¹

Finally, there are areas of EITC administration that can be vastly improved. For example, the IRS has not yet embraced its dual mission as a tax collection and benefits disbursement agency. This failure to acknowledge its role as an administrator of one of the largest anti-poverty programs in the federal government leads to enforcement-oriented compliance approaches that are particularly unsuitable and counter-productive, given the characteristics of the EITC population.²²

EXAMPLE

The Tax Court case of *Cowan v. Commissioner* illustrates the counterintuitive operation of the current Family Status rules.²³ In this case, the state of Ohio appointed Ms. Cowan to be the guardian of a child, Marquis, from 1991 until 2004. Under state law, the guardianship automatically terminated when Marquis turned 18, which occurred in 2004. However, Ms. Cowan continued to provide Marquis a home and provided his support after he turned 18, and they continued to regard themselves as a family unit. (The court noted “Ms. Cowan regards Marquis as her son, and Marquis regards Ms. Cowan as his mother.”) Ms. Cowan never adopted Marquis, the legal significance of which she did not understand. Ms. Cowan stipulated for trial that had she known of the importance of adoption, she would have adopted Marquis.

Later, Marquis had a daughter, and they both lived with Ms. Cowan. The court found Ms. Cowan provided most of the household’s support during 2011. In 2011, Ms. Cowan claimed Marquis’s daughter as her granddaughter for the EITC. The court disallowed this claim since Marquis’s daughter was not a qualifying child of Ms. Cowan for purposes of the EITC, *i.e.*, she did not meet the relationship test,

17 IRS EITC Compliance Study (known errors) IV.

18 Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 3040, 3076 (2015).

19 IRC § 32(d) requires taxpayers who are married to file jointly in order to receive the EITC; IRC §§ 7703(a) and (b) provide general and special rules for determining marital status.

20 One study estimates the childless worker participation rate at 55.6 percent. Dean Plueger, *Earned Income Tax Credit Participation Rate for Tax Year 2005* 179, IRS Research Bulletin (2009).

21 The IRS will send the taxpayer a notice, advising of the potential eligibility for the credit.

22 For a discussion of the implications of IRS Future State plans for the EITC population, see Most Serious Problem: *Earned Income Tax Credit (EITC): The Future State’s Reliance on Online Tools Will Harm EITC Taxpayers*, *supra*.

23 T.C. Memo. 2015-85. See also National Taxpayer Advocate 2015 Annual Report to Congress 242.

despite the fact that Ms. Cowan cared for Marquis's daughter as her own. Moreover, because Marquis's daughter only lived with Ms. Cowan for 11 months of the taxable year, she did not meet the test for Qualifying Relative, which requires the child to have the same principal place of abode as the taxpayer and live as a member of the taxpayer's household for the taxable year.²⁴

RECOMMENDATION

To provide the Code's Family Status provisions with the necessary flexibility to adapt to the evolving U.S. family composition, and to improve the administration of the EITC and other Family Status provisions, including reducing the EITC improper payment rate, the National Taxpayer Advocate reiterates below her 2005 and 2008 legislative recommendations for simplifying the family status provisions in the Internal Revenue Code, and further recommends that Congress:

1. Require the IRS to revise its mission statement to re-emphasize a service-oriented, non-coercive approach to tax administration, recognize the dual roles of revenue collector and benefits administrator, and explicitly affirm the role of the Taxpayer Bill of Rights as the guiding principle for tax administration.²⁵
2. Consolidate the numerous family status provisions into two: the refundable Family Credit, which would reflect the cost of maintaining a household and raising a family; and the refundable Earned Income Tax Credit, which would be awarded per individual worker and provide a work incentive and subsidy for low income workers.
3. Repeal the personal and dependency exemptions, Child Tax Credit/Additional Child Tax Credit, Head of Household filing status, and the family-size differential of the EITC, all of which would be replaced by the Family Credit.
4. Make the Family Credit available to all taxpayers regardless of income and refundable to low income taxpayers; the Family Credit would consist of a Personal Credit (for taxpayer and spouse) and a Child Credit available to eligible individuals claiming a "qualifying child" or "qualifying relative" (subject to tie-breaker rules).
5. Amend the Qualifying Relative test of IRC § 152(d)(2)(H) to provide a child must share the same principal place of abode as the taxpayer and be a member of the taxpayer's household for more than six months of the taxable year.
6. Provide for certain add-on credits under the Family Credit for child and dependent care, disabled taxpayers or family members, and consider providing for noncustodial parents of qualifying children who pay substantially all child support legally due for that tax year.
7. Amend IRC § 152(d)(1)(D) to provide the term "qualifying relative" includes an individual "who is not claimed as a qualifying child of such taxpayer or any other taxpayer for any taxable year in the calendar year in which such taxable year begins."
8. Amend IRC § 152(f) to provide a definition of "support" that excludes any means-tested federal, state, or local benefits paid on behalf of or for the benefit of the qualifying child or qualifying relative.
9. Expand the eligibility age for the modified refundable EITC to include workers 18 years of age and older, with no age cap.

²⁴ Treas. Reg. § 1.152-1(b) explains that the phrase "for the taxable year" means the *entire* taxable year.

²⁵ For a detailed discussion of the IRS Mission Statement, see *Special Focus: IRS Future State: The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

10. Amend IRC § 7703(b) to permit taxpayers who have a legally binding separation agreement and who live apart on the last day of the tax year to be considered “not married” for purposes of filing status.
11. Amend IRC § 6402 to limit offsets of refunds attributable to the Family Credit and EITC to 25 percent of the taxpayer’s refundable portion of these credits.
12. Amend IRC § 6402 to authorize the IRS to calculate overpayments and make refunds with respect to the new per-worker EITC refundable credit, where the taxpayer’s reported income demonstrates eligibility and the taxpayer has not claimed the credit on his or her return.
13. Mandate the IRS assign one employee to each audit involving a questionable Family Credit claim where the taxpayer has responded (by phone or in writing) to an IRS audit notice.
14. Mandate the IRS establish a dedicated, year-round toll-free help line staffed by IRS personnel to respond to Family Credit questions.

PRESENT LAW

The following discussion describes the uniform definition of a child as well as the eligibility requirements for the Family Status provisions of the Code.

Uniform Definition of a Child

In the Working Families Tax Relief Act of 2004, Congress created a uniform definition of child in IRC § 152(c) of the Code. Beginning in tax year 2005, the Code defines the term “dependent” as a qualifying child or a qualifying relative.²⁶ The single definition of qualifying child, with certain modifications, applies for purposes of claiming the EITC, CTC, CDCC dependency exemption, and head of household filing status.

²⁶ IRC § 152(a). If an individual does not meet the definition of a qualifying child under § 152(c), he or she may meet the definition of a qualifying relative under IRC § 152(d).

An individual must meet four tests in order to be a qualifying child under IRC § 152(c): relationship,²⁷ age,²⁸ residency,²⁹ and support.³⁰ If an individual can be claimed as a qualifying child by more than one taxpayer, IRS § 152(c)(4) establishes a tie-breaker rule to determine which taxpayer can claim the child.³¹

In order to be a qualifying relative of a taxpayer, an individual must: (A) bear a certain relationship to the taxpayer, (B) have gross income for the calendar year that is less than the exemption amount (as defined in IRC § 151(d)), and (C) derive over one-half of his or her support for the calendar year from the taxpayer.³² In addition, the individual cannot be a qualifying child of the taxpayer or of “any other taxpayer” for the taxable year.³³ A qualifying relative may include an individual who has the same principal place of abode as the taxpayer and who is a member of the taxpayer’s household.³⁴

Earned Income Tax Credit — IRC § 32

The Earned Income Tax Credit (EITC) entitles certain working low income taxpayers to claim a refundable credit of up to \$6,269 for 2016.³⁵ The EITC is available to taxpayers either with or without a qualifying child. To qualify for the EITC generally, a taxpayer must meet certain general eligibility requirements related to residency,³⁶ filing status,³⁷ certain foreign benefits,³⁸ and status as a qualifying child

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- 27 A qualifying child must be a taxpayer’s son, daughter, stepson, stepdaughter, brother, sister, half brother, half sister, stepbrother, stepsister, or a descendant of any of them. IRC § 152(c)(2), (f)(1)(A), and (f)(4). In the case of an adopted child, the child is treated as the child of the taxpayer. IRC § 152(f)(1)(B). In the case of an eligible foster child, the child is treated as the child of the taxpayer provided the child was placed with the taxpayer by an authorized placement agency or by the courts. IRC § 152(f)(1)(A)(ii) and (f)(1)(C).
- 28 A qualifying child must be under the age of 19 at the end of the year, under age 24 at the end of the year and a full-time student, or any age if permanently and totally disabled. IRC § 152(c)(3).
- 29 A qualifying child must have the same principal place of abode as the taxpayer for more than half of the taxable year. IRC § 152(c)(1)(B). The Code makes special exceptions for temporary absences, children who were born or died during the taxable year, kidnapped children, and children of divorced or separated parents. IRC § 152(e) and (f)(6); Treas. Reg. §§ 1.152-1(b), and 1.152-2(a)(2)(ii).
- 30 A qualifying child must not have provided more than one-half of his or her own support for the calendar year in which the taxable year begins. IRC § 152(c)(1)(D).
- 31 In cases where more than one taxpayer can claim an individual as a qualifying child, the taxpayers can decide who will treat the child as a qualifying child. The taxpayer who claims the qualifying child is entitled to the dependency exemption for the child, head of household filing status, the Child Tax Credit (CTC), the EITC and the Child and Dependent Care Credit (unless the rule for divorced or separated parents applies and assuming all other eligibility requirements are met). If, however the taxpayers cannot decide who will treat the child as a qualifying child, the tie-breaker rule in IRC § 152(c)(4) determines which taxpayer can claim the child. If only one of the taxpayers claiming a child is the child’s parent, then the child will be treated as the qualifying child of the parent. IRC § 152(c)(4)(A)(i). If both taxpayers claiming a child are the child’s parents, then the child will be treated as the qualifying child of the parent with whom the child resided for the longest period of time during the taxable year. IRC § 152(c)(4)(B)(i). If the child lived with both parents for the same amount of time during the taxable year, then the child will be treated as the qualifying child of the parent with the highest adjusted gross income. IRC § 152(c)(4)(B)(ii). If neither of the taxpayers claiming a child is the child’s parent, then the child is treated as the qualifying child of the taxpayer with the highest adjusted gross income for the taxable year. IRC § 152(c)(4)(A)(ii).
- 32 IRC § 152(d)(1)(A)-(C). The relationship between the qualifying relative and the taxpayer must meet one of the relationships set forth in IRC § 152(d)(2).
- 33 IRC § 152(d)(1)(D).
- 34 IRC § 152(d)(2)(H).
- 35 IRC § 32. The maximum amount of the credit is available to a taxpayer with three or more qualifying children. For tax years beginning in 2016, the maximum credit available for a taxpayer with one qualifying child is \$3,373, with two qualifying children is \$5,572, and with no qualifying children is \$506. Rev. Proc. 2015-53, 2015-44 I.R.B. 615. The actual amount of the EITC varies depending on the earned income of the taxpayer.
- 36 A taxpayer is not eligible for the EITC if he or she is a nonresident alien for any portion of the taxable year, unless the taxpayer files a joint return with a spouse who is a United States citizen or resident alien. IRC § 32(c)(1)(D).
- 37 A taxpayer is not eligible for the EITC if he or she is filing married filing separately. IRC § 32(d).
- 38 A taxpayer is not eligible for the EITC if he or she claims a foreign earned income exclusion or deducts or excludes a foreign housing amount. IRC § 32(c)(1)(C).

of another taxpayer.³⁹ The taxpayer must also have a taxpayer identification number,⁴⁰ earned income,⁴¹ and limited amounts of income.⁴² Taxpayers wishing to claim the EITC without a qualifying child must meet additional eligibility requirements, including being between the age of at least 25 and under 65.⁴³ To be considered a qualifying child for the EITC, an individual must meet the definition of a qualifying child in IRC § 152(c),⁴⁴ he or she must be unmarried at the end of the taxable year (unless the taxpayer is entitled to a deduction under IRC § 151 (or would be so entitled but for IRC § 152(e)) for the married individual),⁴⁵ and his or her principal place of abode must be in the United States.⁴⁶

Child Tax Credit — IRC § 24

The CTC entitles a taxpayer to claim a credit of up to \$1,000 for each qualifying child, as defined in IRC § 152(c), who is under age 17 at the end of the tax year.⁴⁷ The amount of the credit is applied to any taxes due and in some instances is refundable (known as the Additional Child Tax Credit, or ACTC).⁴⁸

Child and Dependent Care Credit — IRC § 21

The Child and Dependent Care Credit (CDCC) entitles a taxpayer to claim a credit for expenses incurred so the taxpayer (and spouse, if married) can work or look for work.⁴⁹ To qualify for the credit, a taxpayer

39 A taxpayer is not eligible for the EITC if he or she is the qualifying child of another taxpayer. IRC § 32(c)(1)(B).

40 A taxpayer cannot claim the EITC if he or she does not have a valid social security number. IRC § 32(c)(1)(E) and (m).

41 A taxpayer cannot claim the EITC unless he or she has earned income. IRC § 32(a).

42 A taxpayer's earned income, adjusted gross income, and investment income must all be within limits established annually. IRC § 32(a)(2) and (j).

43 A taxpayer is not eligible to claim the EITC without a qualifying child unless the taxpayer's principal place of abode is in the United States for more than half the taxable year, the taxpayer is at least 25 but under age 65 at the close of the taxable year, and the taxpayer does not qualify as a dependent of another taxpayer under IRC § 151 for the taxable year. IRC § 32(c)(1)(A)(ii).

44 IRC § 32(c)(3)(A). For purposes of the EITC, a qualifying child under IRC § 152(c) is determined without regard to IRC § 152(c)(1)(D) (requiring a qualifying child not have provided over one half of his or her own support for the taxable year) and IRC § 152(e) (describing special rules for divorced parents).

45 IRC § 32(c)(3)(B).

46 IRC § 32(c)(3)(C).

47 IRC § 24(a) and (c). The amount of the Child Tax Credit is reduced by \$50 for each \$1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds the threshold amount (\$110,000 in the case of a joint return, \$75,000 in the case of a taxpayer who is not married, and \$55,000 in the case of a married taxpayer filing separately). IRC §§ 24(b)(1) and (2).

48 IRC § 24(d).

49 IRC § 21. The amount of the credit is a percentage, based on adjusted gross income, of the amount of employment-related expenses paid by the taxpayer during the taxable year. IRC § 21(a)(2) and (c). A taxpayer may claim a credit of up to 35 percent of child and dependent care expenses paid during a taxable year, up to a maximum of \$3,000 for a taxpayer with one qualifying individual or \$6,000 for a taxpayer with two or more qualifying individuals. IRC § 21(a)(2) and (c). This percentage is reduced one percentage point for every \$2,000 (or fraction thereof) by which the taxpayer's adjusted gross income exceeds \$15,000. IRC § 21(a)(2). A taxpayer may not claim this credit based on household or care expenses paid to a relative who is a dependent of the taxpayer or the taxpayer's child who is not over 19. IRC § 21(e)(6).

must maintain a home for one or more qualified individuals.⁵⁰ Additionally, a taxpayer must have earned income,⁵¹ and must meet certain filing status requirements.⁵²

Dependency Exemption — IRC § 151

The dependency exemption entitles a taxpayer to claim an additional exemption for each dependent who is a qualifying child or qualifying relative of the taxpayer, as defined in IRC § 152. A qualifying child must be under the age of 19 at the close of the taxable year, under 24 and a full-time student, or be permanently or totally disabled.⁵³

Head of Household — IRC § 2(b)

Head of household filing status entitles a taxpayer to a larger standard deduction and a more favorable tax rate than a taxpayer filing single or married filing separately.⁵⁴ To qualify as a head of household, a taxpayer must be unmarried or “considered unmarried” at the end of the taxable year.⁵⁵ For more than half of the taxable year, a taxpayer must maintain, as the taxpayer’s home, a household that is the principal place of abode of a qualifying child⁵⁶ or a qualifying relative as defined under IRC § 152(d)(2)(A)-(H), for whom the taxpayer can claim a dependency exemption under IRC § 151.⁵⁷ Additionally, the taxpayer can qualify for head of household status if he or she maintains a household which is the principal place of abode of the taxpayer’s mother or father for whom the taxpayer can claim a dependency exemption under IRC § 151.⁵⁸

Separated Spouse Rule Under IRC § 7703(b)

Under IRC § 7703(a), the determination of whether an individual is married is generally made as of the last day of the individual’s tax year. IRC § 7703(a) prevents taxpayers from being considered as “not

50 IRC § 21(a)(1). A qualified individual is a dependent, defined as a “qualifying child” under IRC § 152(a)(1) who is under the age of 13, a dependent who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of the tax year, or a spouse of the taxpayer who is physically or mentally incapable of caring for himself or herself and who has the same principal place of abode as the taxpayer for more than one-half of the tax year. IRC § 21(b)(1). Special rules apply for children of divorced or separated parents, allowing only the custodial parent to claim the CTC even if the noncustodial parent claims the child as a dependent under the rules of IRC § 152(e). IRC § 21(e)(5).

51 IRC § 21(d)(1). Special rules apply for calculating the earned income with regard to the spouse of a taxpayer who is a student who is physically or mentally unable to care for himself or herself. IRC § 21(d)(2).

52 IRC § 21(e)(2).

53 IRC §§ 151(c)(1), 152(a) and (c). For tax year 2016, the dependency exemption amount is \$4,050. Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

54 For tax year 2016, the standard deduction for head of household is \$9,300. Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

55 IRC § 2(b). A taxpayer whose spouse died during the taxable year is considered married for that year. IRC § 2(b)(2)(C). A taxpayer is not considered as married if he or she is legally separated from his or her spouse under a decree of divorce or separate maintenance or if his or her spouse is a nonresident alien at any time during the taxable year. IRC § 2(b)(2)(A) and (B). A taxpayer is also considered unmarried if he or she is treated as unmarried under the provisions of IRC § 7703. IRC § 2(c).

56 IRC § 2(b)(1)(A)(i), which also contains specific rules for married children. Additionally, for purposes of head of household status, a qualifying child is determined under the rules of IRC § 152(c) but without regard to the rules for divorced or separated parents under IRC § 152(e).

57 IRC § 2(b)(1)(A)(ii). A taxpayer is considered as maintaining a household if the taxpayer provides over half of the cost of maintaining the household for the taxable year. IRC § 2(b).

58 IRC § 2(b)(1)(B).

married” even when they have separated from their spouses pursuant to a binding separation agreement.⁵⁹ It provides:

(a) General rule.--For purposes of part V of subchapter B of chapter 1 and those provisions of this title which refer to this subsection--

(1) the determination of whether an individual is married shall be made as of the close of his taxable year; except that if his spouse dies during his taxable year such determination shall be made as of the time of such death; and

(2) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

Neither the statute nor the regulations define the requirements for a “decree of separate maintenance,” but the term may encompass “bed and board” divorces, discussed below.

As an exception to the general rule, IRC § 7703(b) provides that certain married persons who are living apart from their spouses may be treated as unmarried. A married taxpayer (as determined under the general rule of IRC § 7703(a)) living apart with a dependent child will qualify as an unmarried person if each of the following conditions is met:

- The taxpayer must file a separate tax return;
- The taxpayer must pay more than half the cost of maintaining his or her household for the tax year;
- The taxpayer’s spouse must not be a member of the household during the last six months of the tax year; and
- The household must, for more than six months of the year, be the principal home of the taxpayer’s child (as defined in IRC § 152(f)(1)) for whom the taxpayer can claim a dependency exemption, or could claim such an exemption except for the special rules for divorced parents under IRC § 152(e).

Accelerated Information Reporting and Delay of Certain Refund Issuance

In 2015, Congress enacted two provisions that will assist the IRS enormously in ensuring that credits, deductions, and exclusions that are income-based are correctly claimed. Specifically, Section 201 of the Protecting Americans From Tax Hikes (PATH) Act of 2015 amended IRC § 6071 to require that certain information returns (Forms W-2 and 1099-MISC reporting nonemployee compensation) be filed by January 31, generally the same date as the due date for employee and payee statements, and are no longer

⁵⁹ IRC § 7703(b) also prevents taxpayers from being considered “not married” in two ways. First, the statute retains an outdated “cost of maintaining a household” test that disproportionately affects members of racial and ethnic minorities who work and have children. Second, it requires spouses to have lived apart for the last six months of the year even if they have a written, legally binding separation agreement by year’s end. In her 2012 Annual Report to Congress, the National Taxpayer Advocate recommended that Congress amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered “not married.” National Taxpayer Advocate 2012 Annual Report to Congress 513 (Legislative Recommendation: *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered “Not Married”*).

eligible for the extended filing date for electronically filed returns under section 6071(b).⁶⁰ Section 201 of the PATH Act further requires the IRS to hold all refunds that include EITC or the ACTC until February 15 for calendar year filers to allow the IRS more time to verify the validity of the refunds and detect fraud.

Overpayments and Refund Offsets

IRC § 6402 authorizes the Secretary to both offset a taxpayer's refund against certain liabilities and refund the balance of the overpayment to the taxpayer. The debts against which the refund can offset include outstanding federal tax liabilities, past due child support, debts owed to other federal agencies, state income tax obligations, and Old Age, Survivors and Disability Insurance (OASDI) payments. There is no provision for exclusion of the EITC portion of the overpayment from the offset provisions.⁶¹

REASONS FOR CHANGE

The above Present Law discussion demonstrates the mind-numbing complexity of the Code's Family Status provisions. In earlier Reports to Congress, the National Taxpayer Advocate laid out many reasons for amending these provisions.⁶² First and foremost, she believes that the tax law should not "entrap" taxpayers, by which she means the laws should not run counter to or disregard the ways taxpayers generally live their lives and conduct their business. Where the laws provide for refundable credits, they should be designed in a way that the IRS can effectively administer.⁶³ Thus, in the context of the Family Status provisions, we can minimize both IRS and taxpayer burden if we understand the structure of families and households in the U.S. However, the challenge for any simplification proposal relating to the family is how to accommodate evolving family structures without imposing undue burden on taxpayers or creating additional compliance risks. By studying both the demographics of the American family and the sources of error occurring with the current web of Family Status provisions, we can design a statutory scheme that is flexible enough to adapt to the evolution of the family while minimizing taxpayer burden and risk of fraud.

Demographic Changes in the American Family Unit

A recent paper by the Tax Policy Center (hereinafter TPC Study) found that the number of households made up of "traditional" families (married parents with only biological children) has declined while alternative family types, such as families led by a single parent or cohabitating parents, has increased.⁶⁴

60 See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 3040, 3076 (2015). This legislative change is consistent with prior National Taxpayer Advocate recommendations. See, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 45-55; National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 86-88; National Taxpayer Advocate 2012 Annual Report to Congress 180-91; National Taxpayer Advocate 2011 Annual Report to Congress 284-95; National Taxpayer Advocate 2009 Annual Report to Congress 338-45.

61 In *Sorenson v. Secretary of the Treasury*, 475 U.S. 851 (1986), the Supreme Court held that a refund involving EITC that was due to a taxpayer who had failed to meet his child support obligations, could be offset.

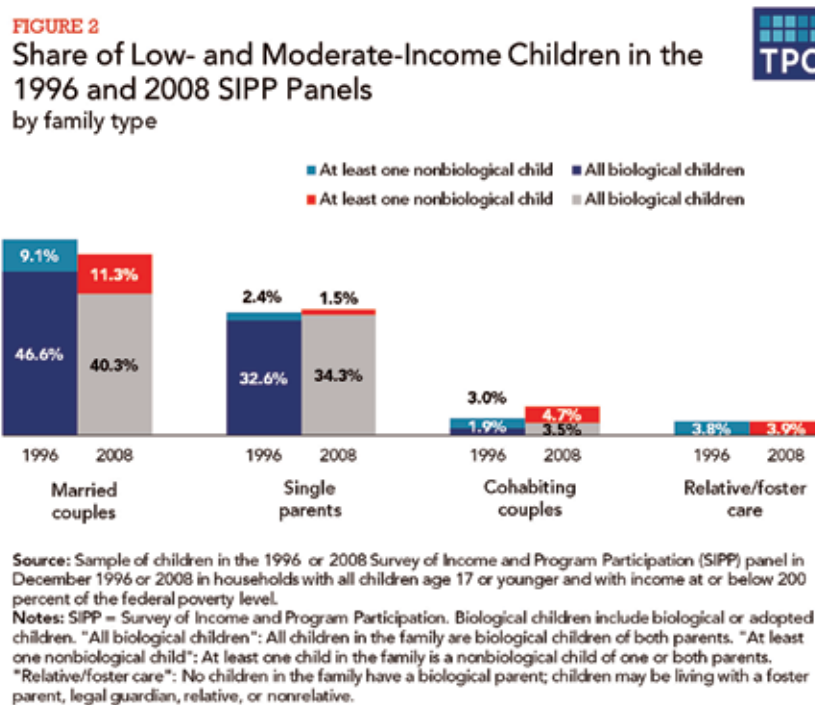
62 See, e.g., National Taxpayer Advocate 2005 Annual Report to Congress, 397-406; National Taxpayer Advocate 2008 Annual Report to Congress, 363-369; National Taxpayer Advocate 2012 Annual Report to Congress, 508-512.

63 The National Taxpayer Advocate previously articulated these and other principles in a presentation to the President's Advisory Panel on Federal Tax Reform. See Public Meeting of the President's Advisory Panel on Federal Tax Reform (Mar. 3, 2005) (statement of Nina E. Olson, National Taxpayer Advocate), http://govinfo.library.unt.edu/taxreformpanel/meetings/docs/olson_03032005.ppt. For more detail, see National Taxpayer Advocate 2005 Annual Report to Congress 375-380 (Key Legislative Recommendation: *A Taxpayer-Centric Approach to Tax Reform*).

64 Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, *Increasing Family Complexity and Volatility: the Difficulty in Determining Child Tax Benefits*, TPC 10 (Mar. 3, 2016), http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full_report. The TPC Study analyzed the December panel from the 1996 and 2008 Census Bureau Survey of Income and Program Participation (SIPP) data.

The TPC Study found that between 1996 and 2008, the proportion of children living with married couples dropped from 70.9 percent to 67.3 percent and the number living with cohabitating parents increased from 3.6 percent to 6.2 percent.⁶⁵ Furthermore, the TPC Study found that in 2008, nearly 20 percent of children living in single-parent households also lived in multigenerational households.⁶⁶ Only 51.6 percent of children living in families with income at or below 200 percent of the federal poverty level (FPL) were in families headed by married couples. The percentage of children living with cohabitating couples at or below 200 percent of FPL increased from just under five percent in 1996 to 8.2 percent in 2008.⁶⁷

FIGURE 2.1.1⁶⁸



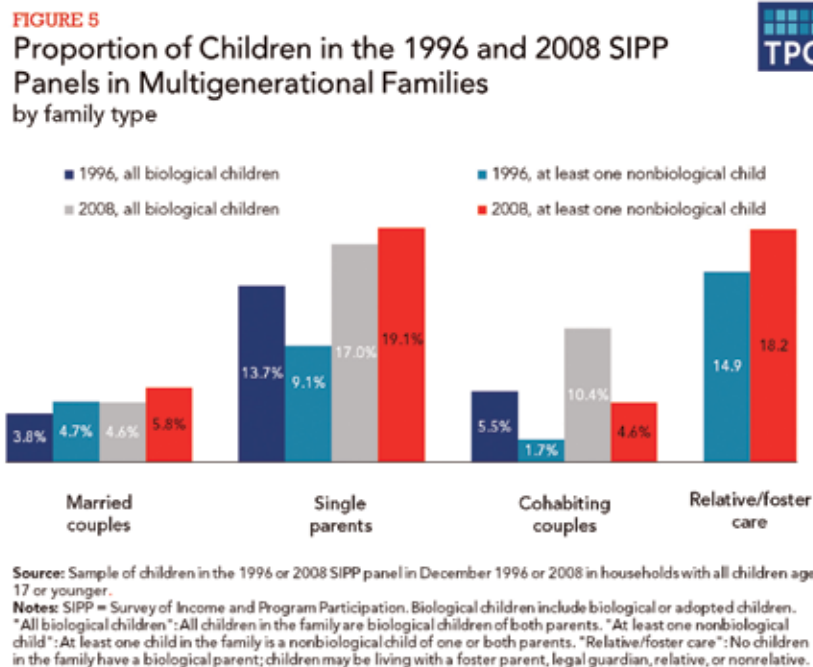
The percentage of children living in multigenerational households also increased from 1996 to 2008, across all household types. By 2008, almost one-fifth of children living with a single parent also lived in a multi-generational household, as was the case with households headed by non-parent relatives or foster parents.

65 Elaine Maag, H. Elizabeth Peters, and Sara Edelstein, *Increasing Family Complexity and Volatility: the Difficulty in Determining Child Tax Benefits*, TPC 10 (Mar. 3, 2016), http://www.urban.org/research/publication/increasing-family-complexity-and-volatility-difficulty-determining-child-tax-benefits/view/full_report. The TPC Study analyzed the December panel from the 1996 and 2008 Census Bureau Survey of Income and Program Participation (SIPP) data.

66 *Id.* at 18.

67 *Id.* at 11.

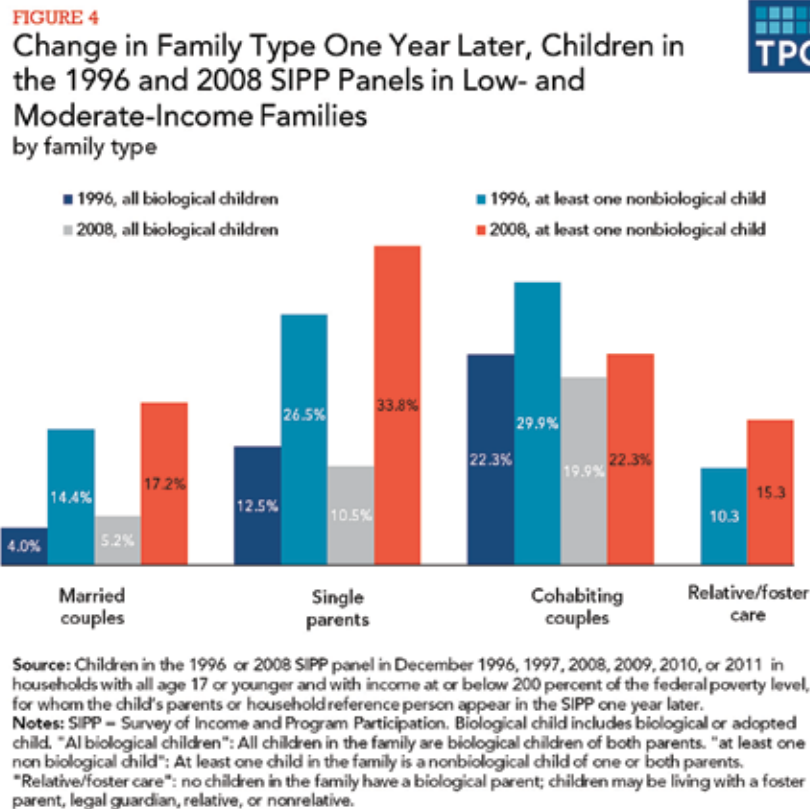
68 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

FIGURE 2.1.2⁶⁹

Children who lived in families with married parents and only biologically related children were unlikely to move to different family types from one year to the next, or within a given year, regardless of income level. However, children in low and moderate income single parent families, cohabiting couple families, and relative/foster care families all experienced greater change in family type from one year to the next. For example, in 2008, a third of low and moderate income children in single parent families with some biological children changed family type.⁷⁰

69 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

70 *Id.* at 12, 13.

FIGURE 2.1.3⁷¹

Finally, across all income levels, “[t]he same types of families who were more likely to change across different tax years are also more likely to change within a tax year (children in cohabiting couple families, single parent families with at least one-biological child, and foster care families).”⁷²

71 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

72 *Id.* at 16. The TPC Study authors note that these results are likely a lower bound estimate, because families that experience a change within years are likely to drop out of the survey and thus the changes won't be observed. *Id.* at 15.

FIGURE 2.1.4⁷³

TABLE 4

Number of Parent Changes per Year, Children in the 1996 and 2008 SIPP Panels by family type



	1996 panel			2008 panel		
	0	1	2+	0	1	2+
Married couples						
All children are biological	97.3	2.3	0.4	97.3	2.3	0.5
At least one nonbiological child	84.5	13.8	1.7	84.4	12.6	3.0
Single parents						
All children are biological	95.1	4.2	0.7	95.5	3.8	0.8
At least one nonbiological child	76.2	17.9	5.9	72.0	24.4	3.7
Cohabiting couples						
All children are biological	88.7	10.6	0.8	87.4	9.5	3.1
At least one nonbiological child	88.3	9.6	2.2	87.7	9.4	3.0
Relative/foster care	86.4	11.8	1.8	86.7	11.1	2.2
All children	94.8	4.5	0.7	94.4	4.6	1.0

Source: Sample of children in the 1996 or 2008 SIPP panel in January 1997, 1998, 2009, 2010, 2011, or 2012 in households with all children age 17 or younger, for whom the child's parents or household reference person appear in the SIPP in the subsequent December.

Notes: SIPP = Survey of Income and Program Participation. Biological children include biological or adopted children. "All children are biological": All children in the family are biological children of both parents. "At least one nonbiological child": At least one child in the family is a nonbiological child of one or both parents. "Relative/foster care": No children in the family have a biological parent; children may be living with a foster parent, legal guardian, relative, or non-relative. A parent change is defined as any child in the family not living with the same parent or parents as in the next month. If a child was not observed but his or her parent or household reference person from January was observed, it is assumed that the child left the household and this is counted as a change. Changes may be underestimated for children who are not observed for all 12 months (or have lived with other children who are not observed all 12 months) because children may have additional parent changes in the months they are not observed. Changes may be underestimated for up to 13 percent of children in 2008 (13 percent if no parent changes, 54 percent if one change, and 57 percent if two or more changes); and up to 12 percent of children in 1996 (9 percent if no parent changes, 58 percent if one change, and 64 percent if two or more changes). Further, changes are underestimated for children with one biological parent who has a cohabiting partner because we only track whether the child is separated from the biological parent because of difficulty establishing the relationship between children and their parents' cohabiting partners that are not biological parents.

The above-described changes in family composition and mutation within and between years is reflected in the EITC data: about one-third of the EITC population changes from year to year.⁷⁴ Because the Family Status rules generally contemplate more "traditional" households and award tax benefits to only one person with respect to each child, the disconnect between the Code and the reality of many taxpayers' lives has led to mistakes on the part of taxpayers who misunderstand the rules; it also prevents some primary caregivers for children in certain low income households from receiving the EITC.

The IRS is not alone in facing these challenges. Tax administrations around the world are moving to incorporate some aspects of their benefits system into their tax codes. For example, Australia offers a similar tax credit to the EITC, called the Family Tax Benefit (FTB). The eligibility rules for the FTB are more expansive than for the EITC. For instance, a child qualifies for the FTB if he or she meets these general rules:

- Must be in the adult's care;
- Must meet citizenship requirements;
- Must not meet any exceptions; and

73 Elaine Maag, H. Elizabeth Peters, & Sara Edelstein, *Increasing Family Complexity and Volatility: The Difficulty in Determining Child Tax Benefits*, TPC 11 (Mar. 3, 2016).

74 IRS, *EITC Fast Facts*, <http://www.eitc.irs.gov/Partner-Toolkit/basicmaterials/ff> (last visited Dec. 30, 2015). For more information on the changing population of taxpayers eligible for EITC, see National Taxpayer Advocate 2013 Annual Report to Congress 109-10.

- When more than one adult is involved, the child must be in the adult's care for at least 35 percent of the time.⁷⁵

The act of caring for a child in Australia counts for more than just the amount of time the adult resides with the child. The “primary carer” is considered the “member of a couple” having the greater responsibility for the child. This is determined by identifying who has major daily responsibility for the child, looks after the child's needs (such as dressing and bathing), makes appointments for the child, is the primary contact for daycare or school, and transports the child to and from school.⁷⁶ When it is determined that more than one adult cares for a child, the percentage of FTB allocated to each individual is based on “issues of fairness and appropriateness, taking into account equity considerations and sharing and pooling within a family unit that can result in a 50:50 split in FTB.”⁷⁷ Under this system there is an acknowledgement that many families operate on a fluid, day-to-day basis where the care of a child does not fall on just one relative. There is also a provision for splitting the FTB between two primary carers, by agreement between the parties.⁷⁸

The Administrative Justification for Running Social Benefits Through the Tax System

Any analysis of Family Status benefits must confront the issue of whether the tax system is the appropriate entity for administering social benefit programs. As we discuss in this and earlier reports, running social programs through the Code requires the tax administrator to think differently about its mission and develop new approaches to compliance and education.⁷⁹ The IRS may be an appropriate conduit for social expenditures where it possesses significant data that are key components of eligibility determinations.

One area of tax administration that has both warranted and received a great deal of attention over the years is refundable credits, particularly the EITC.⁸⁰ Most credits merely reduce the amount a taxpayer owes, but in the case of *refundable* tax credits, the IRS may end up paying a taxpayer more than the taxpayer paid in tax, resulting in a “negative” tax. Refundable credits may have become familiar in the context of benefits to low income taxpayers and therefore may be viewed as a form of “welfare.” Nevertheless, these credits are no longer limited to this population but are now available to middle-income taxpayers and businesses as well.⁸¹

75 Australian Department of Social Services, *Family Assistance Guide*, 2.1.1.10, FTB Child, <https://guides.dss.gov.au/familyassistance-guide/2/1/1/10>.

76 Australian Department of Social Services, *Family Assistance Guide*, 1.1.P.120, Primary Carer (FTB, Baby Bonus), <http://guides.dss.gov.au/family-assistance-guide/1/1/p/120>.

77 Australian Department of Social Services, *Family Assistance Guide*, 2.1.1.25, Shared Care of an FTB Child, <http://guides.dss.gov.au/family-assistance-guide/2/1/1/25>.

78 Australian Department of Social Services, *Family Assistance Guide*, 2.1.1.10, <https://guides.dss.gov.au/family-assistance-guide/2/1/1/10>. Here is an example provided: Emily lives primarily with her parent Dave and his new partner Anthony. Emily is an FTB child of both Dave and Anthony. They agree that Anthony should receive FTB for Emily, as he is the stay-at-home parent.

79 See Legislative Recommendation: *Tax Reform: Simplify the Internal Revenue Code Now*, *supra*; National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, at 101-19 (*Evaluate the Administration of Tax Expenditures*). See National Taxpayer Advocate 2009 Annual Report to Congress, vol. 2, at 75-104 (*Running Social Programs Through the Tax System*).

80 For a comprehensive discussion of the challenges in administering the EITC, see *Improper Payments in the Administration of Refundable Credits*, *Hearing Before the H. Comm. on Ways and Means*, 112th Cong. (2011) (statement of Nina E. Olson, National Taxpayer Advocate).

81 See, e.g., the adoption credit (IRC § 36C) and the American Opportunity Tax Credit (IRC § 25A) for low and moderate income taxpayers and the fuel tax credit for purchasers of gasoline used on farms or local buses or of fuels for certain other purposes (IRC §§ 34, 4081(b)(2), 6420, 6421, 6427).

Enacted as a work incentive in the Tax Reduction Act of 1975,⁸² the Earned Income Tax Credit (EITC) has become one of the government's largest means-tested anti-poverty programs. Unlike traditional anti-poverty and welfare programs, the EITC was designed to have an easy "application" process by allowing an individual to claim the benefit on his or her tax return. This approach dramatically lowered administrative costs, since it did not require an infrastructure of caseworkers and local agencies. According to the IRS, EITC administration costs are less than one percent of benefits delivered, as compared to other non-tax benefits programs in which administrative costs related to determining eligibility can range as high as 42 percent of program expenditures, as shown in Figure 2.1.5 (see endnote in Appendix A). Moreover, a front-end application process would not eliminate improper payments. To assess how well the EITC stacks up against other social benefits programs, the sum of each program's overhead costs and improper payments should be considered (rather than just overhead costs or improper payments in isolation).

82 See Pub. L. No. 94-12, § 204, 89 Stat. 26, 30 (1975) (codified at IRC § 32).

FIGURE 2.1.5, Costs and Benefits of Federal Payment Programs

Program	SNAP	WIC	SSI	TANF	HUD	CHIP	Medicaid	School Lunch	EITC
Year	FY 2013	FY 2010	FY 2012	FY 2011	FY 2013	FY 2012	FY 2013	FY 2013	FY 2014
Number of Recipients	47.6 mil	9.1 mil	8.3 mil	4.6 mil	4.7 mil	8.1 mil	55.0 mil	30.7 mil	27.8 mil
Number of Eligible Persons	51.9 mil	14.6 mil	13.0-14.3 mil	12.2-14.4 mil	9.1 mil	11.8-12.2 mil	76.0-80.6 mil	49.2 mil	22.7 mil
Participation Rate (# of Recipients/ # of Eligible Persons)	79.0%	62.6%	58.0%	32.0%	49.3-51.5%	66.9 - 68.8%	68.2%	54.3-64.3%	78.8%
Year Participation Rate Measured	FY 2011	CY 2010	1998	2009	2013	FY 2012	2009	2012	TY 2009
Total Benefits Paid Out	\$76.1 bil	\$4.6 bil	\$51.1 bil	\$15.2 bil	\$30.9 bil	\$8.5 bil	\$248.3 bil	\$11.3 bil	\$60.3 bil
Average Benefit per Recipient	\$133.07	\$500.86	\$6,156.54	\$3,300.84	\$6,574.47	\$1,047.64	\$4,514.55	\$368.39	\$2,384.32
Overhead Costs	\$3.9 bil	\$1.9 bil	\$3.8 bil	\$1.5 bil	\$4.3 bil	\$3.1 bil	\$11.7 bil	\$1.2 bil	\$0.6 bil
Overhead Costs as % of Total Benefits Paid Out	5.1%	41.8%	7.4%	9.7%	13.8%	36.3%	4.7%	10.3%	1.0%
Improper Payments	\$2.6 bil	\$0.04 bil	\$4.7 bil	\$2.3 bil	\$1.3 bil	\$0.7 bil	\$14.4 bil	\$1.8 bil	\$14.5 bil
Improper Payments as a % of Total Benefits Paid	3.4%	1.0%	9.2%	15.0%	4.3%	8.2%	5.8%	15.7%	24.0%
Overhead Costs + Improper Payments	\$6.5 bil	\$1.9 bil	\$8.5 bil	\$3.8 bil	\$5.6 bil	\$3.8 bil	\$26.1 bil	\$3.0 bil	\$15.1 bil
Overhead Costs + Improper Payments as a % of Total	8.5%	42.8%	16.6%	24.7%	18.1%	44.5%	10.5%	26.0%	25.0%

See figure and related end notes in Appendix A following this Legislative Recommendation.

This table demonstrates that for a program of such significant size, administered at a federal level, the EITC reaches an extraordinary number and percentage of eligible taxpayers at a modest cost, when overhead and overclaims are considered together.⁸³ The Treasury Inspector General for Tax Administration has noted that for “other non-tax benefits programs ... administrative costs related to determining eligibility can range as high as 20% of program expenditures.”⁸⁴ The IRS reports that it paid \$66.7 billion in EITC claims for TY 2014. If this amount had been paid by another agency that spent 20 percent of program expenditures verifying eligibility, the administrative costs to the government would have been \$13.3 billion — more than 90 percent of the amount of improper payments that the IRS estimates were made.⁸⁵

However, ease of application and the absence of eligibility interviews result in greater overclaims for the EITC than traditional anti-poverty programs. In other words, the front-end administrative costs of traditional anti-poverty programs have shifted to the post-claim compliance costs of the EITC.

A significant positive difference is that the EITC has far higher participation rates than other anti-poverty programs (*i.e.*, the percentage of eligible individuals and families who receive the benefit is much greater, at between 75 and 79 percent).⁸⁶ Assuming we want the intended beneficiaries to receive the benefits enacted by Congress, the EITC is a highly effective, and even efficient, method of delivery.

Understanding the Types of EITC Errors Will Improve the Design of Family Status Benefits

Notwithstanding the EITC’s effectiveness and efficiency, it has frequently been identified as a significant source of improper payments,⁸⁷ with Treasury estimating them as averaging about 25 percent of EITC claims over the last five years.⁸⁸ Although the improper payment rate is often presented as a worsening problem, it may actually be less severe than in TY 1999.⁸⁹ For context, EITC overclaims account for just 3.4 percent of the gross tax gap, 3.8 percent of the net tax gap, and 5.9 percent of gross individual income

83 Unless otherwise noted, the amount of benefits is taken directly from or imputed from the federal government’s improper payment website (see endnotes in Appendix A). Administrative costs were often difficult to determine, and it is not clear that they are computed uniformly by each agency. The figures in the chart were computed by TAS Research from publicly available sources. See Endnotes, *infra*, for more details on the sources of data for each program as well as other information and caveats regarding the data.

84 See TIGTA, Ref. No. 2011-40-023, *Reduction Targets and Strategies Have Not Been Established to Reduce the Billions of Dollars in Improper Earned Income tax Credit Payments Each Year 1* (2011) (IRS response).

85 Department of the Treasury, *Fiscal Year 2015 Agency Financial Report* 196 (Nov. 16, 2015). The lower bound estimate of improper EITC payments in FY 2015 is \$14.2 billion.

86 See IRS, *EITC Participation Rate by States*, <http://www.eitc.irs.gov/EITC-Central/Participation-Rate>. See also Dean Plueger, *Earned Income Tax Credit Participation Rate for Tax Year 2005 178-79*, IRS Research Bulletin (2009); Maggie R. Jones, *Changes in EITC Eligibility and Participation, 2005-2009*, U.S. Census Bureau.

87 See footnote 14, *supra*. See also GAO, GAO-09-628T, *Improper Payments: Progress Made but Challenges Remain in Estimating and Reducing Improper Payments*, App. I, at 20 (Apr. 22, 2009) (identifying EITC as the Treasury improper payment).

88 Department of the Treasury, *Fiscal Year 2016 Agency Financial Report* 197 (Nov. 15, 2016) (“The most recent projection is based on a tax year 2012 reporting compliance study that estimated the rate of improper over claims for fiscal year 2016 to range between 22.2 percent (lower bound) and 25.9 percent (upper bound). This amounts to between \$15.5 and \$18.1 billion of approximately \$65.2 billion in total program payments ... [these estimates are] consistent in magnitude with the five-year average 24 percent error rate.”). See also Government Accountability Office (GAO), *Government-Wide Estimates and Use of Death Data to Help Prevent Payments to Deceased Individuals*, GAO-15-482T 4 (Mar. 16, 2015) (suggesting that for FY 2014 there were \$17.7 billion in improper EITC payments, representing an error rate of 27.2 percent).

89 See IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* 3 (Feb. 28, 2002), https://www.irs.gov/pub/irs-utl/1999_compliance_study_022802.pdf (“Of the estimated \$31.3 billion in Earned Income Tax Credit (EITC) claims made by taxpayers who filed returns in 2000 for tax year 1999, it is estimated that between \$8.5 and \$9.9 billion (27.0 percent to 31.7 percent) should not have been paid.”).

tax noncompliance, while business income underreported by individuals accounts for 47.3 percent.⁹⁰ Improper EITC payments nonetheless continue to present a problem that cannot be ignored.

While the improper payment rate provides us with a consistent net measure of improper EITC payments (*i.e.*, improper payments actually made), it is important to understand the sources of error for total (gross) EITC overclaims in order to develop targeted strategies to reduce the Improper Payment rate. The most recent IRS National Research Program (NRP) EITC results are useful in this regard, because they provide a statistically representative sample from which to draw observations of taxpayer behavior and better understand the sources of EITC noncompliance and, by extension, identify opportunities for legislative reform of the Family Status provisions.⁹¹

As a threshold matter, the NRP Compliance Study found that *about 87 percent lower-bound estimate, or LBE, of the qualifying children claimed for EITC are claimed correctly.*⁹² Moreover, many EITC overclaims are less than \$500 (44 percent LBE), and relatively few overclaims are above \$3,000 (11 percent LBE). NRP data show that income misreporting is by far the most common type of EITC error.⁹³ Sixty-seven percent of EITC overclaim returns show some income misreporting, and it is the *only* error on 50 percent of overclaim returns. The average overclaim on income-error-only returns is \$673.⁹⁴ Although the average amount of this type of overclaim is relatively modest, if the IRS is able identify the income misreporting upfront, it will eliminate a significant number of overclaims. The recent legislative changes accelerating third-party information reporting and delaying EITC refund issuance until February 15 go a long way to addressing this source of error.

90 IRS, IR-2012-4, *IRS Releases New Tax Gap Estimates; Compliance Rates Remain Statistically Unchanged from Previous Study* (Jan. 6, 2012). The IRS estimates \$264 billion in individual income tax underreporting for tax year (TY) 2006 with \$125 billion of this amount attributable to business income underreported by individuals as sole proprietors on Schedule C (Profit or Loss from Business) or as farmers on Schedule F (Profit or Loss from Farming). Department of the Treasury, *Fiscal Year 2016 Agency Financial Report* 197 (Nov. 15, 2016). The IRS provided a lower bound estimate of \$15.5 billion in EITC overclaims for FY 2016 (\$15.5 billion / \$264 billion is about 5.9 percent).

91 The IRS created the National Research Program (NRP) in 2000 to “develop and monitor strategic measures of taxpayer compliance.” National Research Program, at [http://www.irs.gov/uac/National-Research-Program-\(NRP\)](http://www.irs.gov/uac/National-Research-Program-(NRP)) (last visited on Feb. 19, 2014). NRP is a comprehensive effort by the IRS to measure payment, filing, and reporting compliance for different types of taxes and various sets of taxpayers and to deliver the data to the Business Operation Divisions to meet a wide range of needs including support for the development of strategic plans and improvements in workload identification. Internal Revenue Manual (IRM) 4.22.1.3, *The National Research Program (NRP)* (Apr. 25, 2008). The NRP Compliance Study distinguishes between “known errors” and “unknown errors.” It estimates that 30 percent of total possible overclaim returns and 41 percent of total possible overclaim dollars stem from unknown errors (*i.e.*, cases where compliance and errors are unknown mostly because of audit non-participation). Nevertheless, based on audit participants, the IRS believes it can reliably project 8.4 million overclaim returns and \$11.4 billion overclaim dollars to the EITC population. IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 15 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

92 The 87 percent estimate was computed using the lower-bound estimate methodology, which assumes audit non-participants have similar compliance behavior to audit participants with similar characteristics (*i.e.*, in the same sampling strata). Upper-bound estimates assume audit non-participants are noncompliant (*i.e.*, exam exclusion is correct). IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 5 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

93 The IRS uses the NRP to meet its need for current compliance information. The IRS established the NRP office in 2000 as part of its efforts to develop and monitor strategic measures of compliance. The program seeks to increase public confidence in the fairness of the tax system by helping the IRS identify voluntary compliance problems. Information from NRP intranet site, <http://nrp.web.irs.gov/default.aspx>.

94 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 17 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

Qualifying child (QC) errors occur less than half as often and they are less likely to be the only error:

- About 30 percent of overclaim returns show a qualifying child error, and it is the *only* error on 15 percent of overclaim returns.
- The average overclaim on QC-error-only returns is \$2,327.⁹⁵

Finally, nine percent of overclaim returns have *both* QC errors and income misreporting, and twelve percent of overclaim returns have *neither* QC nor income errors.⁹⁶ Figure 2.1.6 shows the five *most costly* error types and their percentages of total overclaim dollars.

FIGURE 2.1.6, Most Costly EITC Errors⁹⁷

Error Type	Lower Bound Estimate
Qualifying Child Error	51.4%
Self-Employment Income Misreporting	22.9%
Filing Status Errors	16.4%
Income Reporting of Investment Income and AGI (excluding earned income)	7.9%
Wage Income Misreporting	5.7%

Figure 2.1.7 shows the four *least costly* error types and their percentages of total overclaim dollars. Note that “tiebreaker” errors — where more than one eligible person claims a qualifying child — are now trivial, compared with the 1999 Compliance Study, when tiebreaker errors accounted for 17 percent or more of overclaim dollars.⁹⁸ The tiebreaker rules were significantly modified and clarified in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA);⁹⁹ the NRP Compliance Study data show the positive impact legislative clarification can have on compliance.

95 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 17 (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

96 *Id.* at 16.

97 *Id.* at 19, Table 5.

98 See IRS, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* 21 (Feb. 28, 2002), https://www.irs.gov/pub/irs-utl/1999_compliance_study_022802.pdf.

99 Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 303, 115 Stat. 38, 55 (2001). Tiebreaker rules under EGTRRA stipulate that if a child is claimed by more than one eligible person, the credit would first go to the biological parent. If there are two claims between non-parental family members, the credit will go to the family member with the highest adjusted gross income. If two parents do not file a joint return, the credit will go to the parent with whom the child resided for the longest time during the tax year. If residency was split equally between two parents, the credit will go to the parent with the highest adjusted gross income.

FIGURE 2.1.7, Least Costly EITC Errors¹⁰⁰

Error Type	Lower-Bound Estimate
Rules for All Taxpayer Claiming the EITC Having a Valid SSN, Being a U.S. Citizen or Resident Alien All Year, Not Filing Form 2555 or Form 2555-EZ, Not Being a Qualifying Child of Another Person	5.0%
Errors Corrected in Processing Includes Math Errors and Other Adjustments Made Prior to NRP Exam	3.0%
Tiebreaker Errors	1.0%
Rules for Taxpayers Claiming EITC Without Children (Being Age 25-64, Not a Dependent of Another Taxpayer, and Having a Home in the U.S. for More Than Half the Year)	0.0%

As a practical matter, low income taxpayers have considerable difficulty documenting relationship and residence — principal components of the qualifying child test — because of a lack of clarity from the IRS as well as their personal circumstances.¹⁰¹ In the past, TAS has reported that the “two main problems are inconsistency as to which documents the IRS will accept (a document is accepted in one office, but not in another) and inflexibility in accepting proof (failure to accept other types of documents where the taxpayer cannot provide standard documentation).”¹⁰² On the low income taxpayers’ part, one of the biggest issues is “their tendency to be transient or even temporarily homeless” coupled with literacy challenges.¹⁰³ The TPC Study findings relating to changes in household composition add to these challenges in proving eligibility. The combination of byzantine requirements with the lack of a home in which to store documents, not to mention the skills needed to read or retain them, frequently results in a lack of documentation.

Of the 13 percent of “knowable” QC errors,¹⁰⁴

- 75 percent were attributable to the residency test;
- 20 percent were attributable to the relationship test;
- Seven to ten percent were each attributable to the age test, an invalid Social Security number, and the tiebreaker rules;
- One percent to a married child;
- One percent to errors corrected in processing; and
- 11 percent to unknown errors (*i.e.*, the taxpayer acknowledged the error but gave no detail, or it was an “operational exam”).

100 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Return* 19, Table 5, (Pub. 5162, Aug. 2014), <https://www.irs.gov/pub/irs-soi/EITCComplianceStudyTY2006-2008.pdf>.

101 See Leslie Book, *EITC Noncompliance: What We Don't Know Can Hurt Them*, 2003 TAX NOTES TODAY 121-27 (June 23, 2003); Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 KANS. L. REV. 1145 (2003), http://works.bepress.com/leslie_book/8; National Taxpayer Advocate 2002 Annual Report to Congress 50 (Most Serious Problem: *EITC Eligibility Determinations Can Be Made Less Burdensome*).

102 National Taxpayer Advocate 2005 Annual Report to Congress 106-07 (Most Serious Problem: *Earned Income Tax Credit Exam Issues*).

103 Leslie Book, *The IRS's EITC Compliance Regime: Taxpayers Caught in the Net*, 81 ORE. L. REV. 351, 393 (2002). See also National Taxpayer Advocate 2015 Annual Report to Congress, Introduction: *The IRS Can Do More to Improve Its Administration of the Earned Income Tax Credit and Increase Future Compliance Without Unduly Burdening Taxpayers and Undermining Taxpayer Rights* 235-39.

104 IRS, *Compliance Estimates and Sources of Errors for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 23 (Pub. 5162, Aug. 2014).

Thus, not surprisingly in light of the demographic data presented above, the residency test appears to present the greatest challenge to EITC claimants. Reform efforts should focus on improving otherwise eligible families' ability to satisfy this requirement while minimizing opportunities for error or fraud. By combining the "family" component of the EITC with the other Family Status provisions, the "qualifying relative" definition will apply. Households that were previously ineligible because the primary caregiver did not have the requisite relationship under IRC § 32 will now be eligible for family benefits. Moreover, by requiring the IRS to utilize a Household/Residency Affidavit(s) as an attachment to the tax return where a non-biological primary caregiver is claiming the EITC, Congress can minimize the risk of error or fraud in such claims.¹⁰⁵

Age Eligibility for Childless Worker EITC or Reformed Worker Credit

In TY 2017, the maximum amount of EITC benefits available to taxpayers without children will be \$510, whereas the maximum amount of benefits for taxpayers with just one child will be \$3,400.¹⁰⁶ This is a troubling disparity, considering that a little over 20 percent of Millennials with only a high school education are living in poverty.¹⁰⁷ Additionally, 4.2 million people aged 65 and older were living in poverty in 2015 (representing a poverty rate of 8.8 percent among people age 65 and over).¹⁰⁸ Yet, the childless worker portion of the EITC is limited to workers between the ages of 25 and 64.¹⁰⁹ As the data discussed below show, this age limitation harms significant segments of the population that could benefit from this income supplement.

For example, the allocation of benefits provided to childless workers does not address the recent trend in delaying the decision to start a family. The birth rate for women ages 20–24 has fallen to approximately 77 percent, a measurement which has steadily declined since 2007.¹¹⁰ One report ties this trend to the increased cost of childrearing and the bleak financial situation for many taxpayers in this age bracket (referred to as Millennials).¹¹¹

When Congress initially implemented the EITC, one explanation for not making EITC universally available to everyone was that students and retired individuals "often have low amounts of earned income because they work part-time or for short periods of time and may receive most of their support from family relatives or through social security or private pension plans."¹¹² However, only 33 percent of Americans have a Bachelor's degree or higher, meaning it is a mistake to assume taxpayers under age 25

105 For a discussion on the use of affidavits and EITC cases, see National Taxpayer Advocate 2015 Annual Report to Congress 253-54.

106 See Rev. Proc. 2016-55, 2016-45 I.R.B. 707. See also IRS, *2017 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates*, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-income-limits-maximum-credit-amounts-next-year> (last visited Dec. 31, 2016).

107 Pew Research Center, *The Rising Cost of Not Going to College* (Feb. 11, 2014), <http://www.pewsocialtrends.org/2014/02/11/the-rising-cost-of-not-going-to-college/>.

108 U.S. Census Bureau, *Income and Poverty in the United States: 2015* 14 (Sept. 2016).

109 IRC § 32(c)(1)(A)(ii)(II).

110 Center for Disease Control, *National Vital Statistics Report 2* (June 6, 2016).

111 Jessica Grose, *For Many Millennials, Children Are Out of Reach*, N.Y. TIMES, Dec. 25, 2014.

112 *Tax Reduction Act of 1975: Report of the Sen. Comm. on Finance Together with Supplemental Views on H.R. 2166*, S. REP. NO. 94-36 at 33 (1975).

are primarily students.¹¹³ Furthermore, ignoring the needs of this population may go against the intent of the EITC since earnings can be tied to level of education, meaning those with less education will earn less.¹¹⁴

It is also no longer realistic to assume older taxpayers can safely rely on pensions and Social Security. One survey by the Board of Governors of the Federal Reserve System found that 31 percent of non-retired respondents had no retirement savings or pension.¹¹⁵ Congress's original rationale for age limits results in the EITC being unavailable for younger taxpayers who do not obtain a college education and who work lower-paying jobs, as well as elderly taxpayers who have little or no savings or pension.

Figure 2.1.8 shows the number of workers eligible for the childless worker EITC under current income eligibility rules, if the age limits were expanded as recommended.

FIGURE 2.1.8, Workers Eligible for the Childless Worker EITC Under Current Income Eligibility Rules, If Age Limits Were Expanded As Recommended¹¹⁶

Category	Count	Average	Sum
Single no child filers <25 or >64	3,131,980	\$291.52	\$913,043,008.00
Married no child filers <25 or >64	319,354	\$308.36	\$98,475,444.00
Total	3,451,334	\$293.08	\$1,011,518,452.00

Expansion of the childless worker EITC credit appears to have bipartisan support.¹¹⁷ In addition to expanding the age eligibility for the EITC, Congress should also consider converting the work incentive component of the EITC to a per person credit. One policy aspect of this reform is whether the amount of the “worker” credit should be increased, with a requisite adjustment to the amount of the bifurcated

113 U.S. Census Bureau, *Educational Attainment in the United States: 2015* 1 (Mar. 2016), <http://www.census.gov/content/dam/Census/library/publications/2016/demo/p20-578.pdf>. Education levels vary among race and other characteristics. For instance, 36.2 percent of non-Hispanic Whites aged 25 years and older had a Bachelor's degree or more, whereas only 22.5 percent of Blacks and 15.5 percent of Hispanics aged 25 years and older attained a Bachelor's degree or more. U.S. Census Bureau, *Educational Attainment in the United States: 2015* 2 (Mar. 2016), <http://www.census.gov/content/dam/Census/library/publications/2016/demo/p20-578.pdf>.

114 While many factors affect a worker's lifetime earnings, workers with an education to eighth grade can expect to earn \$936,000 in life-time earnings, compared to \$4,159,000 in life-time earnings for a worker with a professional degree. U.S. Census Bureau, *Work-Life Earnings by Field of Degree and Occupation for People With a Bachelor's Degree: 2011* 4 (Oct. 2012), <http://www.census.gov/prod/2012pubs/acsbr11-04.pdf>.

115 Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2014* 38-39 (May 2015). According to the survey, the rate of retirement savings is tied directly to an individual's income. Eighty-two percent of the respondents making over \$100,000 per year had at least some retirement savings or pension. Meanwhile, among respondents making under \$40,000 per year, only 42 percent had any retirement savings. Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2014* 38-39 (May 2015).

116 Figure 2.1.8 is based on Tax Year 2015 data from the Individual Returns Transaction File (returns posted through week 47 of 2016) for single filers without children under age 25 or over age 64 and returns for married filers without children where both taxpayers are under age 25 or over age 64.

117 Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2017* 48 (2016) (including a proposal to double the childless worker credit). See also Richard Rubin and Eric Morath, *Obama, Ryan See Potential for a Tax-Policy Compromise*, WALL ST. J., Feb. 2, 2016; and Center on Budget and Policy Priorities, *Reports Bolster Calls to Expand EITC For Childless Workers* (Sept. 6, 2016), <http://www.cbpp.org/blog/reports-bolster-calls-to-expand-eitc-for-childless-workers>.

Family Credit.¹¹⁸ Now that the IRS has access to the majority of earned income information returns during the early part of the filing season, the IRS can easily verify eligibility for an income-based, per-person credit in real time, thereby minimizing improper payments. Because the revised EITC would be granted on a per-worker basis (and no longer a function of family composition), the IRS should adjust returns (post-income verifications) that appear eligible for the credit but did not claim it, and issue refunds in the appropriate cases.

The Definition of “Not Married” Under IRC § 7703(a) Should Be Amended to Reflect 21st Century Family Law

As noted above, IRC § 7703(a) prevents taxpayers from being considered as “not married” even when they have separated from their spouses pursuant to a binding separation agreement. Specifically, it provides an individual legally separated from his spouse on the last day of the taxable year under a “decree of divorce or of separate maintenance” shall not be considered as married. Neither the statute nor the regulations define the requirements for a “decree of separate maintenance.”

Judicially-sanctioned separations generally may have arisen due to the historical unavailability in Anglo-American law of decrees of absolute divorce.¹¹⁹ Some Southern colonies — Virginia, Maryland, North Carolina, South Carolina, and Georgia — that did not permit absolute divorce did allow divorce *a mensa et thoro*, or bed and board divorce.¹²⁰ Bed and board divorce, still available in some jurisdictions, refers to spousal separation in which the parties do not live together, but the marriage itself, with attendant support obligations, is left undisturbed.¹²¹

Judicial separation is now available in at least 40 States.¹²² However, judicial separation is not necessarily a prerequisite to divorce. Some form of no-fault divorce is now available in all States, and is the *sole* ground for divorce in at least 17 States. The need for decrees of legal separation (or, to the extent they differ, decrees of separate maintenance) is presumably lessened. At the same time, separation agreements executed by spouses, who may serve the same purpose as a “decree of separate maintenance,” are encouraged as a matter of public policy.¹²³ Thus, amending IRC § 7703(a)(2) to clarify that the term “decree of separate maintenance” includes a separation agreement entered into by spouses and in existence as of the last day of the calendar year (or adding a separation agreement clause to the statute), would align the Code’s Family Status determinations to present-day family law practice and reclassify some EITC claimants as eligible, thereby reducing the improper payment rate.

118 See Elaine Maag, *A Redesigned Earned Income Tax Credit Could Encourage Work By Childless Adults*, TPC, <http://www.taxpolicycenter.org/taxvox/redesigned-earned-income-tax-credit-could-encourage-work-childless-adults> (estimating a 15.3 percent per worker benefit up to \$1,500 would reach almost 42 million workers currently not eligible for today’s childless worker EITC). See also Steve Holt, *The Role of the IRS as a Social Benefits Administrator*, American Enterprise Institute (July 2016), <https://www.aei.org/publication/the-role-of-the-irs-as-a-social-benefit-administrator/>.

119 See Mary Frances Lyle and Jeffrey L. Levy, *From Riches to Rags: Does Rehabilitative Alimony Need to be Rehabilitated?* 38 FAM. L.Q. 3, 4-5 (Spring 2004).

120 See Michelle L. Evans, *Wrongs Committed During A Marriage: The Child That No Area of the Law Wants to Adopt*, 66 Wash. & Lee L. Rev. 465 n 47 (Winter 2009) (citing Nelson Manfred Blake, *THE ROAD TO RENO: A HISTORY OF DIVORCE IN THE UNITED STATES* 34-47 (Greenwood Press 1977) (1962)).

121 See Mary Frances Lyle and Jeffrey L. Levy, *From Riches to Rags: Does Rehabilitative Alimony Need to be Rehabilitated?* 38 FAM. L.Q. 3, 4-5 (Spring 2004). See also, e.g., Va. Code § 20-95, providing that “A divorce from bed and board may be decreed for cruelty, reasonable apprehension of bodily hurt, willful desertion or abandonment.”

122 Some statutes refer to decrees for maintenance. See, e.g., Ark. Code § 9-12-313. Others refer to legal separation. See, e.g., Conn. Gen. Stat. § 46b-40; 750 Ill. Comp. Stat. 5/402; Mont. Code § 40-4-104; Vt. Stat. tit. 15 § 555. Yet others refer to bed and board. See, e.g., DC Code § 16-904; Ky. Rev. Stat. § 403.050; NJ Stat. § 2A:34-6; NC Gen. Stat. § 50-7; Va. Code Ann. § 20-95. For details about judicial separation in the 50 states, see http://www.americanbar.org/content/dam/aba/publications/family_law_quarterly/vol45/4win12_chart4_divorce.authcheckdam.pdf.

123 See, e.g., Uniform Marriage and Divorce Act, § 306, <http://www.uniformdivorce.com/UMDA.pdf>.

IRC § 7703(b) also prevents separated taxpayers from being considered “not married” in two ways. First, the statute retains an outdated “cost of maintaining a household” test that disproportionately affects members of racial and ethnic minorities who work and have children.¹²⁴ Second, it requires spouses to have lived apart for the last six months of the year even if they have a written, legally binding separation agreement by year’s end. The National Taxpayer Advocate previously recommended that Congress amend IRC § 7703(b) to remove the cost of maintaining a household test and permit taxpayers living apart on the last day of the tax year who have a legally binding separation agreement to be considered “not married.”¹²⁵

IRS Mission Statement and Administration of Family Status Provisions

The IRS has not fully embraced its role as a public benefits administrator. Presently, the roles of tax collector and benefits administrator create tension because of the differences present in agency culture, mindset, skills sets, and training. By explicitly stating the IRS’s benefits administration role as a separate agency mission in the context of service and non-coercive compliance, the IRS will be required to align its procedures, goals, and measures with those of other agencies serving similar populations.¹²⁶

Toward this end, for years the National Taxpayer Advocate has recommended to the IRS that it reform its audits of EITC taxpayers (and other Family Status provisions) so that one employee is assigned to work the audit if the taxpayer calls or writes the IRS in response to the IRS audit notice.¹²⁷ The importance of this approach cannot be understated — family matters are some of the most personal matters a taxpayer can discuss. Thus, a single employee working the taxpayer’s case would gain familiarity with the taxpayer’s issues, be able to suggest alternate sources of documentation given that familiarity, and reassure the taxpayer who may be understandably apprehensive and anxious, incorporating some of the skills and traits associated with social workers. Such an arrangement may reduce the number of default assessments in EITC exams (where the EITC was denied because the taxpayer did not respond or stopped responding). Default assessments currently constitute over half of all assessments and are the primary type of audit closure.¹²⁸

A single assigned employee is even more important where a taxpayer is *not* entitled to a Family Status benefit. An audit should result in a taxpayer being educated and knowledgeable about the rules governing the audit issues — and since EITC eligibility and family composition change so frequently (with

124 See The Ohio State University Research and Innovation Communications, *Marital Separations an Alternative to Divorce for Poor Couples* (Aug. 13, 2013), describing research by Dmitry Tumen and Zhenchao Qian, <http://researchnews.osu.edu/archive/maritalsep.htm>. This study found couples in prolonged separations tended to be racial and ethnic minorities have young children, and have low family income and education.

125 National Taxpayer Advocate 2012 Annual Report to Congress 513 (Legislative Recommendation: *Amend IRC § 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to be Considered “Not Married”*).

126 For a detailed discussion of the need to amend the IRS Mission Statement, see Special Focus: *IRS Future State: The National Taxpayer Advocate’s Vision for a Taxpayer-Centric 21st Century Tax Administration*, *supra*.

127 See *generally*, National Taxpayer Advocate 2014 Annual Report to Congress 134-44; National Taxpayer Advocate 2012 Annual Report to Congress, vol. 2 78; National Taxpayer Advocate 2011 Annual Report to Congress, vol. 2 63-90 (Research Study: *An Analysis of the IRS Examination Strategy: Suggestions to Maximize Compliance, Improve Credibility, and Respect Taxpayer Rights*); National Taxpayer Advocate 2008 Annual Report to Congress 232.

128 National Taxpayer Advocate 2015 Annual Report to Congress 252-53 (Most Serious Problem: *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*).

one-third of the EITC population shifting each year), an ineligible taxpayer today may be an eligible taxpayer tomorrow.¹²⁹

Instead of catching incorrect claims after the fact, in certain cases the IRS could rely on determinations by federal or state agencies that are already making eligibility decisions for similar public benefits. Although none of the federal or state administered benefit programs, including Temporary Assistance for Needy Families (TANF),¹³⁰ Supplemental Nutrition Assistance Program (SNAP),¹³¹ and Section VIII housing assistance,¹³² fully overlap with the EITC, state workers arguably have the knowledge and experience to understand the needs of low income applicants. Additionally, the state workers determining eligibility for TANF are investigating many of the same elements as EITC audits: U.S. citizenship, family structure, and household finances. In particular, because children must not be absent from the household for more than 45 days for TANF benefits, the state employees are also familiar with determining the residency of children.¹³³ This is important to consider because IRS data show that of the known errors involving qualifying children on EITC claims, 75 percent of the errors resulted from the residency test.¹³⁴

The IRS Dependent Database (DDB) data show that almost 31 percent of the EITC claimants who broke a DDB rule were Title IV recipients.¹³⁵ It is unclear from this data whether these taxpayers received Title IV benefits with respect to the particular child claimed on the return, or for themselves or another child. But the law creates a complexity trap where the EITC definition of qualifying child differs from basic household requirements in other federal or state benefit programs. For a taxpayer, it seems irrational and incorrect for a person to receive federally funded benefits for a child from one anti-poverty program and not be eligible with respect to that same child for another anti-poverty program.

By combining the “family” component of the EITC with other Family Status provisions, resulting in a single Family Credit, refundable at lower income levels, taxpayers will be able to prove eligibility under either the Qualifying Child or the Qualifying Relative provision. Moreover, expanding the Qualifying Relative definition to include non-biological primary caregivers who are required to submit with their return a third-party affidavit(s) verifying their caregiver role and the residency requirements, will simplify the documentation process that snags so many low income taxpayers and protect against improper payments. The IRS has previously tested the use of an official IRS form whereby third parties with either personal or official knowledge of a child’s residence can so attest, under penalties of perjury. The 2005

129 In response to the National Taxpayer Advocate’s recommendations, the IRS maintains its current correspondence exam system is sufficient. It questions what would happen if a taxpayer called and the employee assigned the case is unavailable. The National Taxpayer Advocate finds this objection unconvincing. Taxpayers can be provided the option of receiving a call-back from the assigned employee, or speaking with the next available representative. Moreover, the National Taxpayer Advocate’s proposal promotes individual employee accountability in the correspondence exam program, which is sorely lacking. National Taxpayer Advocate Fiscal Year 2016 Report to Congress vol. 2, 48-51.

130 42 U.S.C. §§ 601-679c.

131 42 U.S.C. § 1786.

132 42 U.S.C. § 1437f.

133 42 U.S.C. § 608(a)(10)(A)

134 IRS, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 22 (Pub. 5162, Aug. 2014).

135 IRS Dependent Database (DDB) for processing year (PY) 2015. In particular, 1,753,285 taxpayers broke DDB rules associated with Title IV whereas 5,701,546 taxpayers broke some DDB rule.

test found the affidavit was more reliable than other forms of documentation traditionally accepted by the IRS.¹³⁶

EXPLANATION OF RECOMMENDATION

Our proposals attempt to redefine the eligibility rules for the Code's Family Status provisions in a way that allows the tax system to get to "yes" in most instances without imposing intolerable compliance burdens on taxpayers. They build on improvements accomplished with the enactment of the Uniform Definition of a Child. The proposals also incorporate and improve upon the IRS's current technology and revenue protection strategies, and establish eligibility requirements based on the IRS's ability to verify those requirements either systemically or with minimal burden to the taxpayer. They are designed to accommodate the reality of U.S. family structures while minimizing compliance risk. They also recognize that family structures are inherently complex, and some element of "good enough" is required for a program like this to be perceived as fair and just.

In making our proposals, we do not flesh out all relevant rules, nor do we take a position on the distribution of family or work benefits. We expect that Congress will hear from many sources on these very points, and indeed, there are many studies to guide one in making these decisions.¹³⁷ However, as Congress works through reform of these family tax provisions, it should keep in mind that in the family status area, a trade off exists between rigidity, complexity, and taxpayer burden on the one hand, and flexibility, simplicity, and taxpayer compliance on the other.

A multitude of rules that focus on the perceived abuse-of-the-day ends up creating traps and burdens for *all* taxpayers. By combining several provisions into one Family Credit, we eliminate complex and often contradictory eligibility requirements still extant in the Code today. The Family Credit includes a basic credit for the taxpayer, another credit for the taxpayer's spouse (although under our earlier proposal for repealing Joint and Several Liability,¹³⁸ each spouse would claim his or her own credit), and a credit for each qualified child or qualified relative. By retaining the UDOC provisions of Qualifying Child and Qualifying Relative, we bring consistency to tax reform. However, we expand the definition of Qualifying Relative by clarifying that non-relatives meet the "principal place of abode" test if the child and the taxpayer share the same home as a member of the household for more than six months of the year. Moreover, we update the archaic "decree of separate maintenance" provision in IRC § 7703(a)

136 IRS, *IRS Earned Income Tax Credit (EITC) Initiative Final Report to Congress* (Oct. 2005). This study found that affidavits had the highest rate of acceptance at 82%, compared to an overall acceptance rate of 64% for all substantiation types (letters, documents, notarized statements). *Id.* at 33. The IRS recently published a report about a later study of residency requirement affidavits. TAS raised significant concerns about the design of this test and the first draft of the study. While we continue to have concerns, the final report has revised some of its conclusions and entered more caveats. Nevertheless, we believe the study is flawed because, unlike the 2005 study, it only tested the "accuracy" of affidavits and did not test the accuracy of other forms of documentation. Therefore, unlike the 2005 study, it cannot conclude that affidavits are more or less accurate than other forms of documentation currently accepted by the IRS. See IRS, *EITC Third-Party Affidavit Study* (Aug. 2016).

137 See, e.g., Steve Holt, *The Role of the IRS as a Social Benefits Administrator*, American Enterprise Institute (July 2016), <https://www.aei.org/publication/the-role-of-the-irs-as-a-social-benefit-administrator/>; Elaine Maag, *A Redesigned Earned Income Tax Credit Could Encourage Work By Childless Adults*, TPC, <http://www.taxpolicycenter.org/taxvox/redesigned-earned-income-tax-credit-could-encourage-work-childless-adults>; The President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System* (November 2005); Adam Carasso, Jeffrey Rohaly, and C. Eugene Steuerle, *A Unified Children's Tax Credit*, National Tax Association Proceedings (May 15, 2005), <http://www.urban.org/uploadedPDF/1000790.pdf>; Lawrence Zelenak, *Redesigning the Earned Income Tax Credit as a Family-Sized Adjustment to the Minimum Wage*, 57 *Tax L. Rev.* 301 (Spring 2004); Max B. Sawicky, Robert Cherry and Robert Denk, *The Next Tax Reform: Advancing Benefits for Children*, Economic Policy Institute (2002).

138 See National Taxpayer Advocate 2005 Annual Report to Congress 407-32 (Key Legislative Recommendation: *Another Marriage Penalty: Taxing the Wrong Spouse*).

by including a written separation agreement by year end as proof of being “not married.” We modify the “principal place of abode” rule under IRC § 7703(b) to require only “more than six months” of cohabitation with the qualifying child or relative, so that families like that headed by Ms. Cowan can receive the benefit of Family Status provisions.

We reduce burdens associated with the residency requirement by requiring the IRS to publish and accept an affidavit form on which third parties can certify periods of residence. Similarly, the IRS would be authorized to develop data-matching applications for Title IV and Title VIII benefits, and accept a proxy for the residency and relationship tests and public agency certifications that a taxpayer received public benefits with respect to a child for more than half the year.

Because there is no cap on the number of children who can be claimed by a taxpayer and the Family Credit is refundable at lower income levels but also available to taxpayers with higher incomes, taxpayers will not find themselves having to “lend” or “borrow” children. Where there are no “dueling” claims for children, the IRS will pay out the Qualifying Child or Qualifying Relative component of the credit so long as the IRS verifies that the child exists and is of the requisite age (via the Social Security database). Where there are competing claims, Congress can refine the current EITC tie-breaker rules to address these concerns.

The new credit for noncustodial parents who pay their entire child support obligations for the calendar year addresses the fundamental concept of taxing persons based on their ability to pay. The credit will also reduce many of the current competing claims for dependency exemptions, child credit, head of household filing status, and EITC.¹³⁹ Taxpayers can demonstrate child support payment compliance through affidavits from the payee or from the appropriate child support enforcement agency.

Repeal of head of household filing status eliminates some tax benefits for persons maintaining a home for parents or other persons who are not the taxpayer’s child. Thus, we propose to allocate some of the tax benefits associated with head of household filing status to the proposed add-on credit for dependent care, which would be available to taxpayers who provide primary care for members of their extended family either inside or outside of their homes.

Taxpayers will be eligible for the modified EITC on a per-worker basis. Expanding the age eligibility will extend important work incentives and income supplements to currently underserved populations. Clarifying the IRS’s authority to adjust a return and issue a refund where the income data demonstrates the taxpayer is eligible will ensure an almost 100 percent participation rate for this important program. Moreover, because the presence or absence of a child is not an eligibility factor, the IRS can check eligibility on the basis of income reporting in real time during the filing season, given the accelerated reporting of Forms W-2 and 1099-MISC (NEC). The proposal retains the refund issuance date of February 15 as a compliance mechanism.¹⁴⁰

139 For processing year 2016, 69.7 percent of the returns which had a DDb duplicate dependent rule break had the relationship for all children established. Another 8.9 percent of the taxpayers had the relationship for some children established. Data is from a Business Object interface with the DDb, showing returns claiming EITC scored by the DDb for processing year 2015, which generally corresponds to returns filed for tax year (TY) 2014. By recognizing the child support contribution of noncustodial parents through the proposed add-on credit, we reduce the incentive to file duplicate claims.

140 For a recommendation that the Department of Treasury utilize the Direct Express debit card and payroll debit cards as low-cost electronic refund delivery options, see Most Serious Problem: *Payment Cards: Payment Cards Are Viable Options for Refund Delivery to the Unbanked and Underbanked, But Security Concerns Need to Be Addressed, supra.*

The proposed per-person EITC retains its purpose of incentivizing work for low and middle income taxpayers and minimizing the regressivity of the Social Security payroll tax. Similarly, the Family Credit reflects an acknowledgment of the minimum cost of basic living expenses by household size. Thus, the National Taxpayer Advocate recommends that Congress consider limiting the offset provisions under IRC § 6402 to 25 percent of the overpayment attributable to the refundable EITC as well as the refundable Family Credit.¹⁴¹

The net effect of these proposals is to take the IRS out of the business of looking intrusively into taxpayers' family situations. The tax provisions relating to family status will be subject to common sense rules that recognize the variety of family circumstances in the United States. While there are winners and losers (as with all reform proposals), these proposals eliminate conflicting, counter-intuitive eligibility rules (thereby converting currently noncompliant taxpayers into compliant ones), remove the IRS from custody and divorce contests, and focus much of its compliance work in this area on data that can be verified through third-party reporting, other government and private databases, and in a relatively few instances, from the taxpayer him or herself, with a minimum of taxpayer burden.

¹⁴¹ For processing year 2015, 1,308,146 (4.8%) refunds associated with returns claiming EITC were offset against other IRS tax liabilities.

APPENDIX A

FIGURE 2.1.5, Costs and Benefits of Federal Payment Programs

Program	SNAP	WIC	SSI	TANF	HUD	CHIP	Medicaid	School Lunch	EITC
Year	FY 2013	FY 2010	FY 2012	FY 2011	FY 2013	FY 2012	FY 2013	FY 2013	FY 2014
Number of Recipients	47.6 mil	9.1 mil	8.3 mil	4.6 mil	4.7 mil	8.1 mil	55.0 mil	30.7 mil	27.8 mil
Number of Eligible Persons	51.9 mil	14.6 mil	13.0-14.3 mil	12.2-14.4 mil	9.1 mil	11.8-12.2 mil	76.0-80.6 mil	49.2 mil	22.7 mil
Participation Rate (# of Recipients/ # of Eligible Persons)	79.0%	62.6%	58.0%	32.0%	49.3-51.5%	66.9 - 68.8%	68.2%	54.3-64.3%	78.8%
Year Participation Rate Measured	FY 2011	CY 2010	1998	2009	2013	FY 2012	2009	2012	TY 2009
Total Benefits Paid Out	\$76.1 bil	\$4.6 bil	\$51.1 bil	\$15.2 bil	\$30.9 bil	\$8.5 bil	\$248.3 bil	\$11.3 bil	\$60.3 bil
Average Benefit per Recipient	\$133.07	\$500.86	\$6,156.54	\$3,300.84	\$6,574.47	\$1,047.64	\$4,514.55	\$368.39	\$2,384.32
Overhead Costs	\$3.9 bil	\$1.9 bil	\$3.8 bil	\$1.5 bil	\$4.3 bil	\$3.1 bil	\$11.7 bil	\$1.2 bil	\$0.6 bil
Overhead Costs as % of Total Benefits Paid Out	5.1%	41.8%	7.4%	9.7%	13.8%	36.3%	4.7%	10.3%	1.0%
Improper Payments	\$2.6 bil	\$0.04 bil	\$4.7 bil	\$2.3 bil	\$1.3 bil	\$0.7 bil	\$14.4 bil	\$1.8 bil	\$14.5 bil
Improper Payments as a % of Total Benefits Paid	3.4%	1.0%	9.2%	15.0%	4.3%	8.2%	5.8%	15.7%	24.0%
Overhead Costs + Improper Payments	\$6.5 bil	\$1.9 bil	\$8.5 bil	\$3.8 bil	\$5.6 bil	\$3.8 bil	\$26.1 bil	\$3.0 bil	\$15.1 bil
Overhead Costs + Improper Payments as a % of Total	8.5%	42.8%	16.6%	24.7%	18.1%	44.5%	10.5%	26.0%	25.0%

End Notes for Cost and Benefits of Federal Payment Programs

SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM (SNAP)

The number of recipients, benefits paid, average benefit, and overhead costs are from *Supplemental Nutrition Assistance Program Participation and Costs* (March 6, 2015). The number of improper payments and their percent of benefits paid are from <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The participation rate is from *Supplemental Nutrition Assistance Program Participation Rates: Fiscal Years 2010 and 2011* (Feb. 2014).

WOMEN, INFANTS, AND CHILDREN (WIC)

WIC recipients, eligible, and participation rate are from *Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) Eligibles and Coverage – 2010: National and State Level Estimates of the Population of Women, Infants, and Children Eligible for WIC Benefits Executive Summary* (Jan. 2013). Benefits are from: WIC Program Food Cost (March 6, 2015). Overhead costs are from: *WIC Program: Nutrition Service and Administrative Costs* (March 6, 2015). Improper payments: *Nutritional Assistance Program Report Series, Special Supplemental Nutrition Program for Women, Infants, and Children (WIC). Erroneous Payments to Vendors: Annual Estimates for FY 2010 Office of Research and Analysis Report No. WIC-12-EP2010WIC*.

TEMPORARY ASSISTANCE FOR NEEDY FAMILIES (TANF)

The recipients, overhead costs (includes administration and systems costs), and participation rate are taken from U.S. Department of Health and Human Services, Administration for Children and Families Office of Family Assistance, *Temporary Assistance for Needy Families Program (TANF) Tenth Report to Congress*. The benefits are from the report to Congress, Appendix Table 1:1. HHS has not estimated TANF improper payments because the program is administered by the various states that distribute federal funds and the states have not performed improper payment reviews. The improper payment rate shown has been estimated by the *Federal Safety Net*, available at: <http://federalsafetynet.com/tanf.html>. HHS claims there is a statutory prohibition against requiring states to report improper payments. In 2007, HHS did a study in three states with the improper payment rate ranging from 11.5 percent to 40 percent. The 15 percent estimate is from a private source (Federal Safety Net). The participation rate is based on families, not individuals. Overhead costs do not include other expenditures on non-assistance, which are defined as, “benefits are those that do not fall within the definition of assistance, and include expenditures such as child care, transportation, and other work supports provided to employed families, non-recurrent short-term benefits, work subsidies to employers, and services such as education and training, case management, job search, and counseling.” The administrative expenses portion of non-assistance was tabulated as the overhead expense of the program.

SUPPLEMENTAL SECURITY INCOME (SSI)

Recipients are from *Table IV.B9.—SSI Recipients with Federally-Administered Benefits in Current-Payment Status as of December, 1974-2036*. The benefits are imputed from the FY 2012 improper payments and improper payment rates at <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The participation rate is from Kathleen McGarry, University of California, Los Angeles and NBER, and Robert F. Schoeni University of Michigan, *Understanding Participation in SSI*, Prepared for the 16th Annual Joint Meeting of the Retirement Research Consortium (Aug. 7–8, 2014). The range of eligibles is computed at the lower bound by dividing the improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the participation rate. Conversely, all participants

are assumed eligible and are thus divided by the participation rate to form the upper bound. Overhead costs are from the Social Security Administration's 2012 Annual Report of the SSI Program Table IV.E1., available at http://www.ssa.gov/OACT/ssir/SSI12/IV_E_AdminCosts.html.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD)

The number of recipients (households) is taken from HUD, *Rental Assistance Reform Frequently Asked Questions* (Mar. 2013). The total benefits are from improper payments and improper payment rate for FY 2013 from the federal government's improper payment website, <https://paymentaccuracy.gov/about-improper-payments>. The overhead costs are from the National Health Care for the Homeless Council compilation of items in the *Enacted Funding Levels FY2011–FY2013* (Mar. 2013). The number of households in poverty is used as a benchmark to compute the participation rate; however, the actual formula to compute eligible families involves the determination of average income and housing prices on a county-by-county basis. The number of 2013 households in poverty is from a U.S. Census Bureau Current Population Survey report, Carmen DeNavas-Walt and Bernadette D. Proctor, *Income and Poverty in the United States: 2013* (Nov. 2014). The lower bound of the participation rate is determined by reducing the number of participants by the estimated improper recipients (determined by dividing the improper payments by the average benefit amount) and dividing by the eligible children (see above). The upper bound assumes all participants are eligible and divides this amount by the number of eligible. Therefore, this is only an estimated participation rate range.

CHILDREN'S HEALTH INSURANCE PROGRAM (CHIP)

The total benefits are imputed from improper payments and improper payment rate for FY 2012 from the federal government's improper payment web site, <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The recipients and participation rate are taken from "CHIPRA Mandated Evaluation of the Children's Health Insurance Program: Final Findings Harrington and Kenney, *et al.* 2014 ..." Mathematica Policy Research, report submitted to the Office of the Assistant Secretary for Planning and Evaluation. Ann Arbor, MI (Aug. 2014). This report shows benefits paid as \$9.2 billion instead of the \$9.1 billion imputed from the federal improper payment website. All participants are assumed eligible and are thus divided by the sum 48 of the participants and the number of children eligible, but still uninsured (3.7 million: see *CHIPRA Mandated Evaluation* report cited above) to form the upper bound estimate of the participation rate. The lower bound participation rate estimate reduces the number of participants by the quotient obtained from dividing improper payments by the average benefit to obtain the average number of ineligible participants and the result is divided by the estimated eligible participants and the number of eligible, but uninsured children. The range of eligibles is computed at the lower bound by dividing the number of participants by the sum of the number of participants and the number of eligible, but uninsured children (see above). At the upper bound, the number of participants is reduced by the quantity of the dividing improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the lowest estimated participation rate. The Overhead Costs are taken from *Medicaid Financial Management Report net CHIP Expenditures FY 2012* and include the National Health Insurance Technology (HIT). The HIT costs for FY 2012 were divided by the FY 2012 imputed benefits.

MEDICAID

The numbers of recipients is from the Kaiser Family Foundation, *Medicaid Enrollment: June 2013 Data Snapshot*, <http://kff.org/report-section/medicaid-enrollment-june-2013-data-snapshot-total-enrollment>. The paper goes on to state that Medicaid enrollment is expected to increase as a result of the Affordable

Care Act. In fact, Medicaid enrollment has increased to over 60 million in 2014, according to *Medicaid/CHIP Participation Among Children and Parents*, Medicaid / CHIP FY 2014 September enrollment data, with the number of CHIP participants subtracted from the total. The participation rate is from the highest recent rate cited in *Understanding Participation Rates in Medicaid: Implications for the Affordable Care Act*: Ben Sommers, Rick Kronick, Kenneth Finegold, Rosa Po, Karyn Schwartz, and Sherry Glied (Mar. 2012), <http://aspe.hhs.gov/health/reports/2012/MedicaidTakeup/ib.shtml>. The range of eligibles is computed at the lower bound by dividing the improper payments by the average benefit to obtain the average number of ineligible participants and subtracting this number from the actual participants and then dividing this result by the participation rate. Conversely, all participants are assumed eligible and are thus divided by the participation rate to form the upper bound. The improper payments, total benefits paid, and improper payment rate are from the Federal government website: <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The overhead costs are from *Medicaid's National Health Expenditures* administrative costs for FY 2013.

SCHOOL LUNCH PROGRAM

The recipients are from *National School Lunch Program: Total Participation* (FY 2013). The total benefits, improper payments, and improper payment rate for FY 2013 are from the federal government's improper payment website: <https://paymentaccuracy.gov/about-improper-payments>. The amount of improper payments and the improper payment rate also come from this source. There is a slight discrepancy between the amount of imputed payments and the amount in a 2014 GAO report (\$0.1 billion difference). The eligibles are determined from the National Center for Educational Statistics, Table 216.60 *Number and Percentage of public school students eligible for free or reduced price lunch by school level, locale and student race/ethnicity 2011-12*, https://nces.ed.gov/programs/digest/d13/tables/dt13_216.60.asp (last visited April 9, 2015). The lower bound of the participation rate is determined by reducing the number of participants by the estimated improper recipients (determined by dividing the improper payments by the average benefit amount) and dividing by the eligible children (see above). The upper bound assumes all participants are eligible and divides this amount by the number of eligible. Census data indicate more children may receive free lunches than are entitled to do so, but this should be reflected in improper payments. Overhead costs are determined from the Federal Register's *National School Lunch Program: School Food Service Accounts Revenue Amendments Related to the Healthy-Hungry Free Kids Act* (2010), <https://www.federalregister.gov/articles/2011/06/17/2011-14926/national-school-lunch-program-school-food-service-account-revenue-amendments-related-to-the-healthy#t-7>. The report is from school year 2005 and 2006 and reports a percentage only. The percentage is applied to the benefits paid in FY 2013.

EARNED INCOME TAX CREDIT (EITC)

The number of EITC recipients is from IRS Compliance Data Warehouse, *Individual Returns Transaction File for Tax Year 2013*. The benefits are from the FY 2014 improper payments and improper payment rates at <https://paymentaccuracy.gov/about-improper-payments> (last visited April 3, 2015). The amount of improper payments and the rate of improper payments are also from this source. The EITC participation rate and number of eligibles is from the CARRA Working Paper Series, *Working Paper #2014-04 Changes in EITC Eligibility and Participation, 2005-2009*, Maggie R. Jones, U. S. Census Bureau Center for Administrative Records Research and Applications (2009), <http://www.eitc.irs.gov/EITC-Central/Participation-Rate>. This site only provides the percent eligible. The overhead costs are from GAO testimony, GAO/T-GGD-97-105, *Tax Administration Earned Income Noncompliance* (May 8, 1997).