

Volume 2

TAS RESEARCH AND RELATED STUDIES

**Study of Subsequent Filing Behavior of Taxpayers
Who Claimed Earned Income Tax Credits (EITC)
Apparently in Error and Were Sent an Educational
Letter From the National Taxpayer Advocate**

Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate

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EXECUTIVE SUMMARY

In January of 2016, the National Taxpayer Advocate sent 6,564 letters (the Taxpayer Advocate Service, or TAS letter) to taxpayers who appeared to have erroneously claimed the Earned Income Tax Credit (EITC) on their 2014 returns, whose 2014 returns were not audited. The express purpose of the TAS letter was “so that you can avoid an error in the future.” The TAS letter explained the requirements for claiming EITC, identified the specific requirement the recipient did not appear to meet, and suggested sources of additional information and assistance, including TAS. TAS then undertook a study to compare the level of compliance shown on taxpayers’ 2015 returns among three groups:

- Taxpayers who were sent the TAS letter;
- A representative sample of taxpayers whose 2014 returns had similar characteristics as those who received the TAS letter and whose 2014 returns were not audited, but who were not sent the TAS letter (the control group); and
- A representative sample of taxpayers whose 2014 returns had similar characteristics as those who received the TAS letter but were not sent the TAS letter and whose 2014 returns were audited.

The objective of the study is to ascertain the extent to which the opportunity to educate taxpayers may be followed by increased compliance. Unless otherwise noted, the study findings for the populations studied are statistically significant at least at the 95 percent confidence level.

- The TAS letter averted noncompliance on 2015 returns where:
 - The 2014 return appeared erroneous because the relationship test was not met. Taxpayers who were sent the TAS letter were less likely to repeat the same error on their 2015 returns than unaudited taxpayers who did not receive TAS letters. Sending the TAS letter to all taxpayers whose 2014 returns appeared to be erroneous because the relationship test was not met would have averted about \$47 million of erroneous EITC claims; and
 - The 2014 return appeared erroneous because another taxpayer claimed the same qualifying child. Taxpayers who were sent the TAS letter were less likely to claim EITC on their 2015 returns than unaudited taxpayers who did not receive the TAS letter. This averted noncompliance for these taxpayers and reduced the number of EITC returns the IRS would have included in its inventory of accounts potentially selected for audit. However, taxpayers who received the TAS letter and did file EITC returns were more likely to make a different mistake on the 2015 return than 2015 filers who did not receive the TAS letter. Thus, the extent to which the TAS letter prevented erroneous EITC claims in these instances is unclear.
- Audited taxpayers whose 2014 return appeared to contain a duplicate claim for EITC were more likely to make different errors on their 2015 returns than taxpayers in either of the other two groups; and
- Regardless of the apparent error on the 2014 return, audited taxpayers were less likely to file 2015 returns or to claim EITC on their 2015 returns, and less likely to repeat the error than taxpayers in either of the other two groups.

INTRODUCTION

Thirty-six percent of all IRS individual audits are of returns on which taxpayers claim EITC.¹ For 2014, the most recent year for which data is available, the average amount of EITC paid out was more than \$2,400.² Because taxpayers may claim the credit in more than one tax year, using the audit opportunity to educate them about the requirements for claiming EITC is of particular benefit to them and to the IRS. Taxpayers who understand why they erred in claiming the credit are not only able to become compliant but to remain compliant going forward. The same principles apply to EITC returns the IRS does not audit but identifies as containing an error. The IRS may not have the resources to audit these taxpayers, but by educating them about why they appear to have erroneously claimed EITC the IRS may avert future noncompliance.

TAS undertook a study of taxpayers who were not audited but appeared to have erroneously claimed EITC on their 2014 returns. The study was undertaken to determine whether the subsequent compliance of taxpayers who appear to have erroneously claimed EITC but were not audited is affected by an educational letter that explains the requirements for claiming the credit and identifies the error the taxpayers appear to have made on the earlier returns. Unless otherwise noted, our findings for the population studied are statistically valid at least at the 95 percent confidence level.

BACKGROUND

For eligible taxpayers whose incomes do not exceed certain amounts, Internal Revenue Code (IRC) § 32 provides for a refundable credit, calculated as a function of the number of the taxpayer’s “qualifying children.”³ A “qualifying child” is a person who among other things meets age requirements, bears a specified relationship to the taxpayer, and has the same principal residence as the taxpayer for more than half the year.⁴ The last two components of EITC eligibility — relationship and residency — can be particularly difficult to substantiate.⁵ According to a study of 2006 to 2008 of EITC returns, the IRS disallowed the most dollars of EITC because taxpayers did not substantiate that their qualifying children lived with them for over half of the tax year.⁶

The IRS selects for audit returns that claim EITC on the basis of information contained in the Dependent Database (DDb). As the IRS explains:

The [DDb] database is a combination of taxpayer return information from the IRS and child custody information from the Department of Health and Human Services (HHS) and the Social Security Administration (SSA) used to determine the validity of dependent and EITC claims. DDb is rule driven. If a rule condition is met as returns are processed through

- 1 IRS FY 2015 Data Book Table 9a, and note 5 to Table 9a, showing that out of 1,228,117 returns the IRS examined in fiscal year (FY) 2015, 445,594 were audits of returns on which Earned Income Tax Credit (EITC) was claimed.
- 2 IRS, *About EITC*, <https://www.etc.irs.gov/EITC-Central/abouteitc>.
- 3 Internal Revenue Code (IRC) § 32(c)(1) sets out the definition of “eligible individual” and IRC § 32(b) contains the calculation of the amount of allowable credit. The credit is also available to taxpayers who do not have qualifying children. IRC § 32(b)(1)(A).
- 4 IRC §§ 32(c)(3); 152 (c) (providing that a qualifying child is an individual who is the taxpayer’s son, daughter, stepchild, foster child, or a descendant of any of them (e.g., a grandchild), or a child who is a sibling, stepsibling, or half-sibling of the taxpayer, or a descendant of any of them).
- 5 National Taxpayer Advocate 2011 Annual Report to Congress 296, 304 (Most Serious Problem: *The IRS Should Reevaluate Earned Income Tax Credit Compliance and Take Steps to Improve Both Service and Compliance*).
- 6 IRS Pub. 5162, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 19 (Aug. 2014), <https://www.irs.gov/PUP/individuals/EITCComplianceStudyTY2006-2008.pdf>.

the DDb rule filtering process, the rule “fires” and the return is flagged for examination. ... Out of approximately 18 million EITC returns that are entered, the DDb identifies about 3 million as non-compliant. Out of the 3 million non-compliant returns, approximately 300,000 are examined or audited.⁷

In other words, the DDb operates as a workload selection tool.⁸ As the IRS processes a return on which a taxpayer claims EITC, information reported on the return is compared to data from external sources. To assist the IRS in selecting EITC returns to audit, a scoring system based on programmed algorithms applies points to returns that “break” DDb rules.⁹

RESEARCH QUESTIONS

The study explores the effect of the TAS letter on unaudited taxpayers by comparing the filing behavior of taxpayers who were sent the TAS letter with that of unaudited taxpayers who were not sent the TAS letter. The study also explores the effect of audits by comparing the filing behavior of taxpayers who were audited with that of the other two groups. We did not determine the extent to which taxpayers who did not file returns were actually required to do so.

1. Compared to taxpayers who were not sent a TAS letter and whose 2014 returns were not audited, how often did a taxpayer who was sent a TAS letter:
 - a. File a 2015 return;
 - b. Claim EITC with respect to another person on the 2015 return;
 - c. Appear to erroneously claim EITC with respect to another person on the 2015 return; and
 - d. Appear to claim EITC in error on the 2015 return, with the apparent error the same as the apparent error on the 2014 return.
2. Compared to taxpayers who were not sent a TAS letter and whose 2014 returns were audited, how often did a taxpayer who was sent a TAS letter:
 - a. File a 2015 return;
 - b. Claim EITC with respect to another person on the 2015 return;
 - c. Appear to erroneously claim EITC with respect to another person on the 2015 return; and
 - d. Appear to claim EITC in error on the 2015 return, with the apparent error the same as the apparent error on the 2014 return.

7 Standard Form 115, *Request for Records Disposition Authority*, filed with the National Archives and Records Administration by the IRS Wage and Investment Division (W&I) (Dec. 2006), http://www.archives.gov/records-mgmt/rcs/schedules/departments/department-of-the-treasury/rg-0058/n1-058-07-004_sf115.pdf.

8 For a discussion of the drawbacks of using Dependent Database (DDb) as a workload selection tool, see National Taxpayer Advocate 2015 Annual Report to Congress 248-60 (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*).

9 See Wendy Handin and Scott Mendelson, W&I, *Dependent Database And Earned Income Tax Credit, Applicability For Development Of Risk-Based Examination Strategies* 3, presented at the 2002 IRS Research Conference, available at <https://www.irs.gov/pub/irs-soi/dedaeitc.pdf>.

METHODOLOGY

In fiscal year (FY) 2015, of the 28 million returns on which taxpayers claimed the EITC, the IRS selected 1.6 percent (nearly 450,000) for audit.¹⁰ The IRS selected about 300,000, or 67 percent, of EITC returns for audit because they broke DDb rules. There were nearly six million returns that broke the DDb rules but were not selected for audit.¹¹ Of these six million returns, 1,933,052 broke a single rule of the type indicated below:

- 680,550 returns tripped a DDb rule because the residency test did not appear to have been met;
- 1,197,374 returns tripped a DDb rule because the relationship test did not appear to have been met;¹² and
- 55,128 returns tripped a DDb rule because another taxpayer claimed the same qualifying child or children.¹³

TAS Research identified a random sample of taxpayers from each of these three groups. The initial sizes were equal among the groups, consisting of 2,400 returns each. TAS Research then adjusted the records in each sample to remove those with an inadequate address, those of deceased taxpayers, and those with undeliverable mail. The resulting data file included 6,564 returns:

- There were 2,173 returns in the representative sample of the group that tripped a DDb rule because the residency test did not appear to have been met;
- There were 2,202 returns in the representative sample of the group that tripped a DDb rule because the relationship test did not appear to have been met; and
- There were 2,189 returns in the representative sample of the group that tripped a DDb rule because another taxpayer claimed the same qualifying child or children.

The National Taxpayer Advocate sent one of three versions of a letter to each taxpayer (or taxpayers, for joint returns) who filed one of the 6,564 returns. The letters, which appear in the Appendices A, B, and C, informed the taxpayers that their 2014 returns may have contained an error and explained the error that appeared to have been made (residency test not met, relationship test not met, or another taxpayer claiming the same qualifying child or children). The letters were mailed in an envelope (which appears in Appendix D) that carried the notation, in red capital letters, “Important Tax Information.”

Taxpayers who were sent the TAS letter were in the sample group; taxpayers who were not sent a TAS letter and were not audited were in the control group. We ensured that the sample cases and control group cases had DDb scores at least as high as those audited by the IRS because of relationship, residency, or the claiming of an EITC dependent already claimed on another tax return. We only selected returns where the DDb rule break occurred in one of the aforementioned categories. However, the taxpayer could have incurred other DDb rule breaks related to other issues. The sample and control group initially had returns with nearly identical DDb scores. However, we did not send some taxpayers in the

10 IRS FY 2015 Data Book Table 9a, and note 5 to Table 9a, showing that 28,308,931 returns claiming EITC during calendar year 2014, 445,594 were audits of returns on which EITC was claimed during FY 2015.

11 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.

12 Returns that trip a DDb rule because the relationship test was not met also trip a DDb rule for the residency test because where there is no known relationship to the person for whom EITC was claimed, the IRS assumes that the taxpayer did not live with that person.

13 As discussed below, while there are other DDb rules that may be broken, the study is confined to these three types of rule breaks.

sample group the test letter because of issues associated with the taxpayer address or because the taxpayer was deceased. Of the original 7,200 sample taxpayers, we mailed 7,092 an educational letter regarding claiming the EITC. We adjusted the sample group accordingly. We analyzed all of the audited returns with corresponding rule breaks, regardless of the DDb score. The following figure depicts the average and median DDb scores and EITC (*i.e.*, the amounts allowed by the IRS after math error processing) for the three categories of returns in our study.

FIGURE 2.1, Overall Comparison of EITC Amounts and DDb Scores Among the Audit, Control, and Sample Groups

| | Group | | | | | | | | |
|----------------|-------|--------|-------|---------|--------|--------|--------|--------|-------|
| | Audit | | | Control | | | Sample | | |
| | Mean | Median | Count | Mean | Median | Count | Mean | Median | Count |
| Amount Of EITC | 1,951 | 1,511 | 5,926 | 2,436 | 2,473 | 14,194 | 2,476 | 2,536 | 7,092 |
| DDb Score | 51.04 | 47.00 | 5,926 | 53.86 | 47.00 | 14,194 | 54.12 | 47.00 | 7,092 |

The median DDb scores of each group were identical. The average DDb score for the test and control group were within .26 point and the test group, as a whole, claimed \$40 more EITC than the control group. The audit group had an average DDb score of slightly over 51; however, the average and median amount of EITC claimed was significantly lower than for the test group. Prior to beginning our analysis, we removed cases where the TAS educational letter was returned as undeliverable and cases where the IRS disposed of the audit as undeliverable. The following figure shows the comparison of the DDb scores and EITC claimed from the tax year (TY) 2014 return, after removing the undeliverables.

FIGURE 2.2, Overall Comparison of EITC Amounts and DDb Scores Among the Audit, Control, and Sample Groups

| | Group | | | | | | | | |
|----------------|-------|--------|-------|---------|--------|--------|--------|--------|-------|
| | Audit | | | Control | | | Sample | | |
| | Mean | Median | Count | Mean | Median | Count | Mean | Median | Count |
| Amount Of EITC | 1,954 | 1,547 | 5,523 | 2,436 | 2,473 | 14,194 | 2,443 | 2,490 | 6,564 |
| DDb Score | 50.96 | 48.00 | 5,523 | 53.86 | 47.00 | 14,194 | 53.78 | 47.00 | 6,564 |

When considering the rules stratified by the type of DDb rule break (relationship, residency, or the claiming of a duplicate dependent), the following figure shows the average and median DDb score and EITC claimed.

FIGURE 2.3, Comparison of EITC Amounts and DDb Scores among the Audit, Control, and Sample Groups by DDb Rule Break Category

| Residency | | | | | | | | | |
|----------------------|-------|--------|-------|---------|--------|-------|--------|--------|-------|
| | Group | | | | | | | | |
| | Audit | | | Control | | | Sample | | |
| | Mean | Median | Count | Mean | Median | Count | Mean | Median | Count |
| Amount Of EITC | 2,159 | 2,014 | 1,917 | 2,688 | 2,776 | 4,794 | 2,665 | 2,661 | 2,173 |
| DDb Score | 53.00 | 48.00 | 1,917 | 51.80 | 42.00 | 4,794 | 49.35 | 40.00 | 2,173 |
| Relationship | | | | | | | | | |
| | Group | | | | | | | | |
| | Audit | | | Control | | | Sample | | |
| | Mean | Median | Count | Mean | Median | Count | Mean | Median | Count |
| Amount Of EITC | 1,697 | 451 | 2,044 | 2,433 | 2,486 | 4,788 | 2,478 | 2,610 | 2,202 |
| DDb Score | 57.07 | 57.00 | 2,044 | 60.66 | 62.00 | 4,788 | 61.95 | 64.00 | 2,202 |
| Duplicate Dependents | | | | | | | | | |
| | Group | | | | | | | | |
| | Audit | | | Control | | | Sample | | |
| | Mean | Median | Count | Mean | Median | Count | Mean | Median | Count |
| Amount Of EITC | 2,030 | 1,760 | 1,562 | 2,135 | 2,039 | 4,650 | 2,160 | 2,134 | 2,189 |
| DDb Score | 38.96 | 35.00 | 1,562 | 43.43 | 42.00 | 4,650 | 46.15 | 45.00 | 2,189 |

The EITC claimed is generally less for the audit group; however, the amount of EITC claimed is relatively similar for the test and control group across the three categories of DDb rule breaks. Overall, the DDb scores are similar among all three groups. When comparing the sample group and the control group, the TY 2014 DDb score is slightly higher in the sample group, for residency and duplicate dependent issues, but slightly lower for relationship issues. The audit group has the highest DDb average score of the three groups when considering residence issues.

DATA COLLECTION

TAS Research reviewed IRS records to determine how many taxpayers whose letters were not returned as undeliverable filed a return for 2015.¹⁴ Of this group, TAS researched:

- How many taxpayers claimed EITC with respect to another person;¹⁵
- Of those who claimed EITC with respect to another person on their 2015 return, how many appeared to have done so erroneously (*i.e.*, the return broke a DDb rule); and
- Of the 2015 EITC returns, how many appeared to break the same DDb rule as appeared to have been broken on the 2014 return (*i.e.*, the reason for the apparent error was the same as that identified in the TAS letter).

14 As of June 30, 2016, out of 620 outreach letters returned to TAS as undeliverable, 528 could be matched to the names of taxpayers who were selected to receive a TAS outreach letter.

15 We have not yet determined the extent to which taxpayers claimed EITC with respect to the same person as on their 2014 returns.

TAS Research collected the same information about taxpayers:

- Who broke the same DDb rules as those who received the TAS letter but did not receive the TAS letter and were not audited; and
- Who broke the same DDb rules as those who received the TAS letter and were audited.

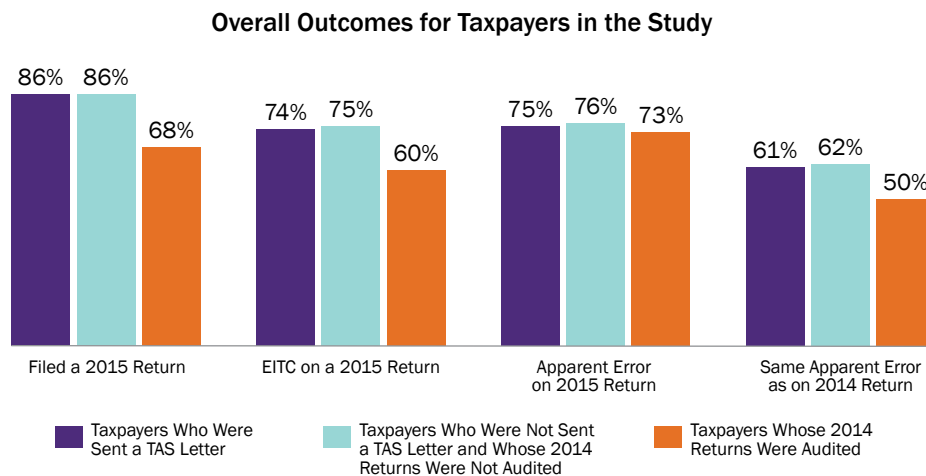
FINDINGS

I. Overall, the TAS letter averted erroneous EITC claims, mostly because taxpayers who were sent TAS letters were less likely to repeat on a 2015 return the same error that appeared to have been made on the 2014 return compared to unaudited taxpayers who did not receive a TAS letter

Compared to unaudited taxpayers who did not receive a TAS letter, taxpayers who received a TAS letter were less likely to repeat on their 2015 returns the same error they appeared to have made on their 2014 return. Taxpayers whose 2014 returns were audited were significantly less likely to file 2015 returns, and those who filed were significantly less likely to claim EITC, compared to the other two groups. Audited taxpayers' 2015 returns were much less likely to repeat the same error that appeared to have been made on their 2014 returns than 2015 returns filed by taxpayers in the other two groups.

Figure 2.4 summarizes the overall data.

FIGURE 2.4



- A. Of the 6,564 taxpayers who were sent a TAS letter, and the letter was not returned as undeliverable:
1. 5,651, or 86 percent, filed a return for TY 2015;
 2. 4,175, or 74 percent, of the 2015 returns claimed EITC;
 3. Of the 4,175 returns filed for 2015 that claimed EITC, it appeared that 1,025, or 25 percent, qualified for the credit and it appeared that 3,150, or 75 percent, did not qualify for the credit, according to DDb rules; and
 4. Of the 4,175 EITC returns filed for 2015, for 2,543 returns, or 61 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules.
- B. Of the 14,194 taxpayers in the study who were not audited and were not sent the TAS letter, but who appeared not to have been eligible for the EITC claimed on their 2014 returns:
1. 12,159, or 86 percent, filed a return for TY 2015;
 2. Of the 12,159 returns filed for 2015, 9,172, or 75 percent, claimed EITC;
 3. Of the 9,172 returns filed for 2015 that claimed EITC, it appeared that 2,245, or 24 percent, qualified for the credit and it appeared that 6,927, or 76 percent, did not, according to the DDb; and
 4. Of the 9,172 EITC returns filed for 2015, for 5,727 returns, or 62 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules.

Thus, over 62 percent of taxpayers who were not sent a TAS letter repeated on their 2015 returns what appeared to be the same error as appeared to have been made on the 2014 return, compared to less than 61 percent where taxpayers were sent a TAS letter, a difference that is statistically significant at the 90 percent confidence level.

- C. Of the 5,523 taxpayers in the study whose 2014 returns were audited:
1. 3,758, or 68 percent, filed a return for TY 2015, a lower frequency than for taxpayers in the other two groups (who both filed at the rate of 86 percent) that is statistically significant;
 2. Of the 3,758 returns filed for 2015, 2,252, or 60 percent, claimed EITC, a lower frequency than for returns in the other two groups (74 or 75 percent) is statistically significant;
 3. Of the 2,252 returns filed for 2015 that claimed EITC, it appeared that 618, or 27 percent, qualified for the credit and it appeared that 1,634, or 73 percent, did not, according to DDb rules; and
 4. Of the 2,252 EITC returns taxpayers filed for 2015, for 1,120 returns, or 50 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules, a lower frequency than for taxpayers in the other two groups (61 or 62 percent) is statistically significant.

Thus, compared to the other two groups of taxpayers, taxpayers whose 2014 returns were audited were less likely to file a return the following year. Those who did file a return were less likely to claim EITC. Those who claimed EITC were also less likely to have done so erroneously as taxpayers in the other two groups, and the error was significantly less likely to have been the same error that appeared to have been made on the 2014 return.

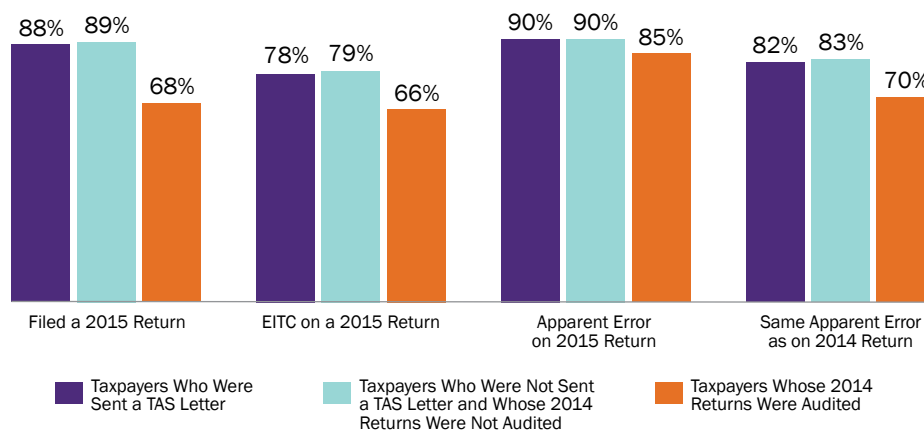
II. Audits were the most effective means of preventing noncompliance among taxpayers who appeared to not meet the residency test

There were no significant differences in outcomes between the group of taxpayers who received the TAS letter advising that the residency test appeared to not have been met and the group of unaudited taxpayers who did not receive the TAS letter. Taxpayers whose 2014 returns appeared to contain this error and who were audited were significantly less likely to file returns for 2015. Returns for 2015 filed by taxpayers in the audit group were less likely to contain any errors than 2015 returns filed by taxpayers in the other two groups. These taxpayers' returns were also less likely to contain the same error as was made on the 2014 return, compared to 2015 returns filed by taxpayers in the other two groups.

Figure 2.5 shows the outcomes for taxpayers whose 2014 returns appeared to erroneously claim EITC because the residency test was not met.

FIGURE 2.5

Outcomes for Taxpayers Whose 2014 Returns Appeared to Erroneously Claim EITC Because the Residency Test Was Not Met, According to Dependent Database Rules



- A. Of the 2,173 taxpayers who were sent a TAS letter advising them that the residency test did not appear to have been met with respect to EITC claimed on their 2014 return, and the letter was not returned as undeliverable:
- 1,915, or 88 percent, filed a return for TY 2015;
 - 1,499, or 78 percent, of the 2015 returns claimed EITC;
 - Of the 1,499 returns filed for 2015 that claimed EITC, it appeared that 148, or ten percent, qualified for the credit and it appeared that 1,351, or 90 percent, did not qualify for the credit, per DDb rules; and
 - Of the 1,499 EITC returns filed for 2015, for 1,235, or 82 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules.

- B. Of the 4,794 taxpayers in the study who were not audited and were not sent the TAS letter, but who appeared not to have met the residency test for EITC claimed on their 2014 returns:
1. 4,274, or 89 percent, filed a return for TY 2015;
 2. Of the 4,274 returns filed for 2015, 3,385, or 79 percent, claimed EITC;
 3. Of the 3,385 returns filed for 2015 that claimed EITC, it appeared that 333, or 10 percent, qualified for the credit and it appeared that 3,052, or 90 percent, did not, per DDb rules; and
 4. Of the 3,385 EITC returns filed for 2015, for 2,820, or 83 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules.

Thus, there were no significant differences in outcomes between the group of taxpayers who received the TAS letter and taxpayers who did not.

- C. Of the 1,917 taxpayers in the study whose 2014 returns were audited because they appeared to not meet the residency test for EITC claimed on their 2014 returns:
1. 1,309 or 68 percent, filed a return for TY 2015, a lower frequency than for taxpayers in the other two groups (who filed at the rate of 88 or 89 percent) is statistically significant;
 2. Of the 1,309 returns filed for 2015, 856, or 66 percent claimed EITC, a lower frequency than for returns in the other two groups (78 or 79 percent) is statistically significant;
 3. Of the 856 returns filed for 2015 that claimed EITC, it appeared that 129, or 15 percent, qualified for the credit and it appeared that 736, or 85 percent, did not (according to the DDb), a lower frequency than for taxpayers in either of the other two groups (90 percent) is statistically significant; and
 4. Of the 865 EITC returns taxpayers filed for 2015, for 527, or 70 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules.

Thus, compared to the other two groups of taxpayers, taxpayers whose 2014 returns were audited because they did not appear to meet the residency test for claiming EITC were less likely to file a return the following year. Those who did file a return were less likely to claim EITC. Those who claimed EITC were less likely than taxpayers in the other two groups to have done so erroneously, and they were less likely to make the same mistake that appeared to have been made on the 2014 return as taxpayers in the other two groups.

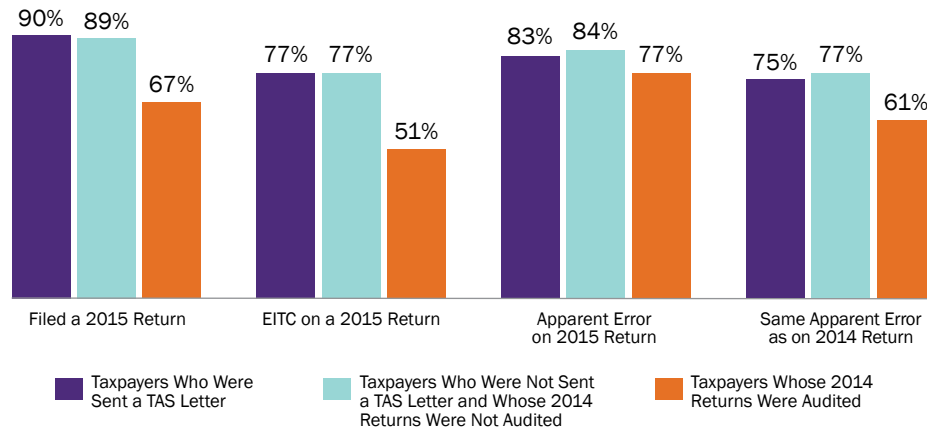
III. Because the TAS letter prevented taxpayers who appeared to not meet the relationship test on their 2014 returns from repeating that error on their 2015 returns, sending the TAS letter to all taxpayers whose 2014 returns appeared to be erroneous because the relationship test was not met would have averted about \$47 million of erroneous EITC claims

Taxpayers who were sent a TAS letter were less likely to file a 2015 return that repeated the apparent error of not meeting the relationship test, compared to unaudited taxpayers who were not sent a TAS letter. Taxpayers whose 2014 returns were audited were significantly less likely to file 2015 returns, and those who filed were significantly less likely to claim EITC, compared to the other two groups. A taxpayer whose 2014 return was audited was less likely to file a 2015 return that appeared to contain an error, or to contain the same error as appeared to have been made in 2014, compared to 2015 returns filed by taxpayers in either of the other two groups.

Figure 2.6 shows the outcomes for taxpayers whose 2014 returns appeared to erroneously claim EITC under the DDb rules because the relationship test was not met.

FIGURE 2.6

Outcomes for Taxpayers Whose 2014 Returns Appeared to Erroneously Claim EITC Because the Relationship Test Was Not Met, According to Dependent Database Rules



- A. Of the 2,202 taxpayers who were sent a TAS letter advising them that the relationship test did not appear to have been met with respect to EITC claimed on their 2014 return, and the letter was not returned as undeliverable:
 1. 1,981, or 90 percent, filed a return for TY 2015;
 2. 1,517, or 77 percent of the 2015 returns claimed EITC;
 3. Of the 1,517 returns filed for 2015 that claimed EITC, it appeared that 265, or 17 percent, qualified for the credit and it appeared that 1,252, or 83 percent, did not qualify for the credit (according to DDb rules); and
 4. Of the 1,517 EITC returns filed for 2015, for 1,133, or 75 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules.

- B. Of the 4,788 taxpayers in the study who were not audited and were not sent the TAS letter, but who appeared not to have met the relationship test for EITC claimed on their 2014 returns:
 1. 4,281, or 89 percent, filed a return for TY 2015;
 2. Of the 4,281 returns filed for 2015, 3,282, or 77 percent, claimed EITC;
 3. Of the 3,282 returns filed for 2015 that claimed EITC, it appeared that 510, or 16 percent, qualified for the credit and it appeared that 2,772, or 84 percent, did not, according to DDb rules; and
 4. Of the 3,282 EITC returns filed for 2015, for 2,538, or 77 percent, the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules. This rate is higher than for taxpayers who were sent the TAS letter (75 percent) and is statistically significant.

Thus, taxpayers who were sent the TAS letter because they appeared to not meet the relationship test on their 2014 returns were less likely to repeat that error on their 2015 returns. Those who did not receive the TAS letter repeated their error 77.3 percent of the time, compared to 74.7 percent for the TAS group, an improvement of 2.6 percent.

Projecting these results to the relevant population, there were about 1.2 million returns for 2014 that appeared to erroneously claim EITC because the relationship requirement had not been met.¹⁶ Whether they were sent the TAS letter or were unaudited taxpayers who were not sent the TAS letter, taxpayers who in 2014 appeared to not meet the relationship test filed 2015 EITC returns at the rate of 69 percent, which amounts to about 826,000 returns.¹⁷ Taxpayers who were sent the TAS letter, however, made the same mistake on their 2015 return less frequently than did taxpayers who were not sent the TAS letter (74.7 percent of the time vs. 77.3 percent of the time, a difference of 2.6 percent). Thus, of the 826,000 returns, the TAS letter would have averted about 21,500 erroneous EITC claims.¹⁸

However, based on sample results, about eight percent of these 21,450 taxpayers, or 2,000 taxpayers, could be expected to file EITC returns on which they would make a *different* error.¹⁹ Thus, the number of erroneous claims the TAS letter would have averted, 21,450, is reduced by about 1,700, the number of erroneous claims the TAS letter would not have prevented, leaving nearly 20,000 averted erroneous claims.²⁰ Because the average amount of EITC paid to 2014 claimants was more than \$2,400, sending the TAS letter to all taxpayers who did not appear to meet the relationship test would have averted about \$47 million of erroneous EITC claims.²¹ We did not quantify the cost of sending letters to all 1.2 million taxpayers who appeared to have made this error, but even if the cost was \$2 per letter, for a total cost of \$2.4 million, the cost of sending the letter would be far outweighed by the increased compliance.

- C. Of the 2,044 taxpayers in the study whose 2014 return was audited because they appeared to not meet the relationship test for EITC claimed on their 2014 returns:
1. 1,367, or 67 percent, filed a return for TY 2015, a lower frequency than for taxpayers in the other two groups (who filed at the rate of 89 or 90 percent) is statistically significant;
 2. Of the 1,367 returns filed for 2015, 691 or 51 percent, claimed EITC, a lower frequency than for returns in the other two groups (77 percent) that is statistically significant;
 3. Of the 691 returns filed for 2015 that claimed EITC, it appeared that 160, or 23 percent, qualified for the credit and it appeared that 531, or 77 percent, did not, according to DDb rules, a lower frequency than for taxpayers in the other two groups is statistically significant; and
 4. Of the 691 EITC returns taxpayers filed for 2015, for 421, or 61 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules, a lower frequency than for taxpayers in the other two groups (75 or 77 percent), that is statistically significant.

16 There were 1,197,374 returns processed in 2015 (which generally equates to returns filed for TY 2014) that appeared to contain this error. 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 TY 2014.

17 69 percent of 1,197,374 is 826,188.

18 826,188 times 2.6 percent is 21,481.

19 Eight percent of 21,481 is 1,718.

20 21,481 minus 1,718 = 19,763.

21 19,763 x \$2,400 = \$47.4 million. This number represents the midpoint of our 95 percent confidence interval. Dollar values are significantly different at both ends of the confidence interval.

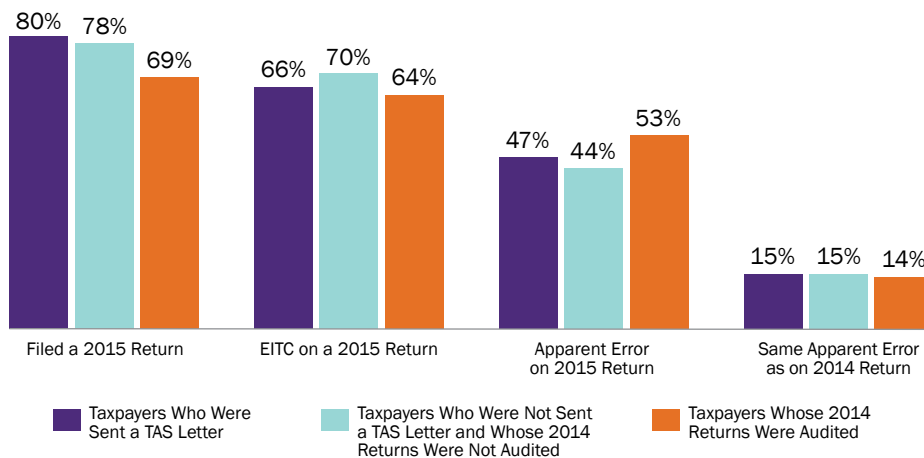
IV. The TAS letter to taxpayers who appeared to claim the same qualifying child as another taxpayer impeded taxpayers from claiming EITC, thus reducing the IRS's inventory of potential EITC audits, compared to unaudited taxpayers who were not sent the TAS letter

Where the 2014 return appeared to contain a duplicate claim for EITC, the TAS letter impeded taxpayers from claiming EITC on a 2015 return, an outcome that did not occur where the apparent error on the 2014 return was that the residency or relationship tests were not met.

Figure 2.7 shows the outcomes for taxpayers whose 2014 returns appeared to erroneously claim EITC because another taxpayer claimed the same qualifying child.

FIGURE 2.7

Outcomes for Taxpayers Whose 2014 Returns Appeared to Erroneously Claim EITC Because Another Taxpayer Claimed the Same Qualifying Child, According to Dependent Database Rules



- A. Of the 2,189 taxpayers who were sent a TAS letter advising them that another taxpayer appeared to have claimed the same qualifying child on their 2014 return, and the letter was not returned as undeliverable:
1. 1,755, or 80 percent, filed a return for TY 2015;
 2. 1,159, or 66 percent, of the 2015 returns claimed EITC;
 3. Of the 1,159 returns filed for 2015 that claimed EITC, it appeared that 612, or 53 percent, qualified for the credit and it appeared that 547, or 47 percent, did not qualify for the credit, according to DDb rules; and
 4. Of the 1,159 EITC returns filed for 2015, for 175, or 15 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules.

- B. Of the 4,650 taxpayers in the study who were not audited and were not sent the TAS letter, but another taxpayer appeared to have claimed the same qualifying child on a 2014 return:
1. 3,634, or 78 percent, filed a return for TY 2015;
 2. Of the 3,634 returns filed for 2015, 2,524, or 70 percent, claimed EITC, a higher rate than for those who received the TAS letter (66 percent) is statistically significant;
 3. Of the 2,524 returns filed for 2015 that claimed EITC, it appeared that 1,405, or 56 percent, qualified for the credit and it appeared that 1,119, or 44 percent, did not, according to DDb rules. The lower frequency with which taxpayers appeared to not qualify for the credit compared to those who received the TAS letter (47 percent) is statistically significant; and
 4. Of the 2,524 EITC returns filed for 2015, for 383, or 15 percent, it appeared the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules.

Thus, the TAS letter resulted in taxpayers not claiming EITC on their 2015 returns, compared to taxpayers who were not sent the TAS letter and who were not audited, thereby averting potential noncompliance and reducing the IRS's potential audit inventory. However, compared to taxpayers who were not sent the TAS letter and who were not audited, taxpayers who were sent the TAS letter and did claim EITC on a 2015 return were more likely to make a different error. Thus, it is not clear that the TAS letter produced net gains in terms of averting erroneous EITC claims.

- C. Of the 1,562 taxpayers in the study whose 2014 return was audited because they appeared to have claimed the same qualifying child as another taxpayer on their 2014 returns:
1. 1,082 or 69 percent, filed a return for tax year 2015, a lower frequency than for taxpayers in the other two groups (who filed at the rate of 78 or 80 percent) is statistically significant;
 2. Of the 1,082 returns filed for 2015, 696, or 64 percent, claimed EITC, a lower frequency than for returns in the other two groups (66 and 69 percent) is statistically significant;
 3. Of the 696 returns filed for 2015 that claimed EITC, it appeared that 329, or 47 percent, qualified for the credit and it appeared that 367, or 53 percent, did not, according to DDb rules. The higher rate at which the credit appeared unavailable compared to the other two groups (47 and 44 percent) is statistically significant; and
 4. Of the 367 EITC returns taxpayers filed for 2015, for 97, or 14 percent, EITC the taxpayer was not eligible for EITC for the same reason as in 2014, according to DDb rules, a lower frequency than for taxpayers in the other two groups (15 percent) which is not statistically significant.

Thus, taxpayers whose returns were audited because their 2014 returns contained a duplicate claim for EITC were less likely to file 2015 returns and those who filed returns were less likely to claim EITC, compared to taxpayers in the other two groups. However, the 2015 returns of audited taxpayers were more likely to contain an error than taxpayers in the other two groups.

CONCLUSION

The TAS letter, intended to educate taxpayers about the requirements for claiming EITC, appeared to help taxpayers avoid repeating their mistakes. The TAS letter sent to taxpayers who appeared not to have met the relationship test was particularly effective. Had all taxpayers whose returns appeared to contain this error been sent a TAS letter, \$47 million of erroneous EITC claims could have been averted, a compliance gain that far outweighed the cost of sending the letters.

Sending a TAS letter to taxpayers who submitted duplicate EITC claims in 2014 helped them avoid claiming EITC on 2015 returns they filed. However, those who did claim EITC were just as likely as taxpayers in the other two groups to make the same mistake of claiming EITC with respect to a person claimed on another taxpayer's return. The TAS letter did prevent these taxpayers from making other mistakes, compared to audited taxpayers, but not compared to unaudited taxpayers who did not receive the TAS letter. The same is true of audited taxpayers: they were less likely to repeat this mistake, but they made other mistakes on their returns. Audited taxpayers actually made other mistakes more frequently than taxpayers in the other two groups. The TAS letter was not as effective in educating taxpayers who did not meet the residency test, suggesting that the letter could be modified to provide more details about the residency requirement, or that the availability of "Extra Help" phone assistance for EITC taxpayers might avoid future errors, where household arrangements and EITC rules are too complex to address in a simple letter. TAS will test the effectiveness of an "Extra Help" line in its iteration of this research study during the 2017 Filing Season.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Send letters similar to the TAS letter to EITC claimants the IRS does not have current plans to audit, particularly where:
 - a. The EITC claimant does not appear to meet the relationship requirement for claiming EITC, because such a letter appears to prevent taxpayers from repeating the error of not meeting the relationship test; or
 - b. Another taxpayer claimed EITC with respect to the same qualifying child or children, because such a letter appears to prevent taxpayers from claiming EITC on a later return, thus averting noncompliance for those taxpayers and reducing the IRS's potential audit inventory.
2. Conduct a study to determine why audits of taxpayers whose 2014 return appeared to contain a duplicate claim for EITC do not prevent taxpayers from making different errors on a subsequent return.
3. Explore how letters similar to the TAS letters can help educate taxpayers about the requirements for claiming EITC. For example, the National Taxpayer Advocate will continue to try and measure the educational effect of such letters by revising the TAS letters to include a telephone number taxpayers can call for assistance and repeating this study in future years.

APPENDIX A: TAS LETTER, VERSION ONE: RESIDENCY AT ISSUE



YOUR VOICE AT THE IRS



THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE.

January 20, 2016

INSERT ADDRESS

Dear Taxpayer:

My office, the Taxpayer Advocate Service, is an independent organization within the IRS. Our job is to ensure that every taxpayer is treated fairly, and that you know and understand your rights as a taxpayer. I am writing to you today to help you understand the rules for claiming the Earned Income Tax Credit (EITC) so you don't make a mistake on your 2015 Form 1040.

Your 2014 Form 1040 shows you claimed the EITC for that year. The IRS has noticed that your 2014 return may have contained an EITC error. This letter provides you some helpful information so that you can avoid an error in the future. **This is not an audit and the IRS is not auditing your 2014 return at this time.**

You may claim the EITC for a child but only if **all** of the following statements are true:

1. The child is your child **or** a descendant of your child, **or** is your brother, sister, stepbrother, or stepsister, **or** a descendant of any such relative. This is the **relationship test**.
2. Your principal place of abode — the place where you live — is in the United States.
3. The child lived with you in your principal place of abode for more than half the year. **This is the residency test**.

It appears that the child or children claimed on your 2014 Form 1040 may not have lived with you for more than six months of the year. Before you file your 2015 Form 1040, you should review the relationship and residency tests and how they apply to you, especially if the child did not live with you the entire year. Please note that the rules for claiming a child for the EITC are different from the rules for receiving benefits like Temporary Assistance to Needy Families (TANF) and Section 8 Housing Assistance. So you could receive benefits for the child but not be eligible for the EITC.

I hope this letter has been helpful. If someone is assisting you in preparing your return, please show this letter to him or her. You can find out more information about the EITC at <https://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit> or in Publication 596 *Earned Income Credit*. If you need assistance with an IRS problem that is causing you financial harm or isn't getting solved, the Taxpayer Advocate Service may be able to help you. You can find a list of our local offices at <https://www.irs.gov/Advocate/Local-Taxpayer-Advocate>, or you can call us at 1-877-777-4778.

Sincerely,

Nina E. Olson
National Taxpayer Advocate

APPENDIX B: TAS LETTER, VERSION TWO: RELATIONSHIP AT ISSUE



YOUR VOICE AT THE IRS



THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE.

January 20, 2016

INSERT ADDRESS

Dear Taxpayer:

My office, the Taxpayer Advocate Service, is an independent organization within the IRS. Our job is to ensure that every taxpayer is treated fairly, and that you know and understand your rights as a taxpayer. I am writing to you today to help you understand the rules for claiming the Earned Income Tax Credit (EITC) so you don't make a mistake on your 2015 Form 1040.

Your 2014 Form 1040 shows you claimed the EITC for that year. The IRS has noticed that your 2014 return may have contained an EITC error. This letter provides you some helpful information so that you can avoid an error in the future. **This is not an audit and the IRS is not auditing your 2014 return at this time.**

You may claim the EITC for a child but only if **all** of the following statements are true:

1. The child is your child **or** a descendant of your child, **or** is your brother, sister, stepbrother, or stepsister, **or** a descendant of any such relative. This is the **relationship test**.
2. Your principal place of abode — the place where you live — is in the United States.
3. The child lived with you in your principal place of abode for more than half the year. **This is the residency test.**

It appears that you may not have an eligible relationship with the child or children claimed on your 2014 Form 1040. Before you file your 2015 Form 1040, you should review the relationship and residency tests and how they apply to you, especially if the child did not live with you the entire year. Please note that the rules for claiming a child for the EITC are different from the rules for receiving benefits like Temporary Assistance to Needy Families (TANF) and Section 8 Housing Assistance. So you could receive benefits for the child but not be eligible for the EITC.

I hope this letter has been helpful. If someone is assisting you in preparing your return, please show this letter to him or her. You can find out more information about the EITC at <https://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit> or in Publication 596 *Earned Income Credit*. If you need assistance with an IRS problem that is causing you financial harm or isn't getting solved, the Taxpayer Advocate Service may be able to help you. You can find a list of our local offices at <https://www.irs.gov/Advocate/Local-Taxpayer-Advocate>, or you can call us at 1-877-777-4778.

Sincerely,

Nina E. Olson
National Taxpayer Advocate

APPENDIX C: TAS LETTER, VERSION THREE: THE SAME CHILD OR CHILDREN CLAIMED BY ANOTHER TAXPAYER



YOUR VOICE AT THE IRS



THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE.

January 20, 2016

INSERT ADDRESS

Dear Taxpayer:

My office, the Taxpayer Advocate Service, is an independent organization within the IRS. Our job is to ensure that every taxpayer is treated fairly, and that you know and understand your rights as a taxpayer. I am writing to you today to help you understand the rules for claiming the Earned Income Tax Credit (EITC) so you don't make a mistake on your 2015 Form 1040.

Your 2014 Form 1040 shows you claimed the EITC for that year. The IRS has noticed that your 2014 return may have contained an EITC error. This letter provides you some helpful information so that you can avoid an error in the future. **This is not an audit and the IRS is not auditing your 2014 return at this time.**

You may claim the EITC for a child but only if **all** of the following statements are true:

1. The child is your child **or** a descendant of your child, **or** is your brother, sister, stepbrother, or stepsister, **or** a descendant of any such relative. This is the **relationship test**.
2. Your principal place of abode — the place where you live — is in the United States.
3. The child lived with you in your principal place of abode for more than half the year. **This is the residency test.**

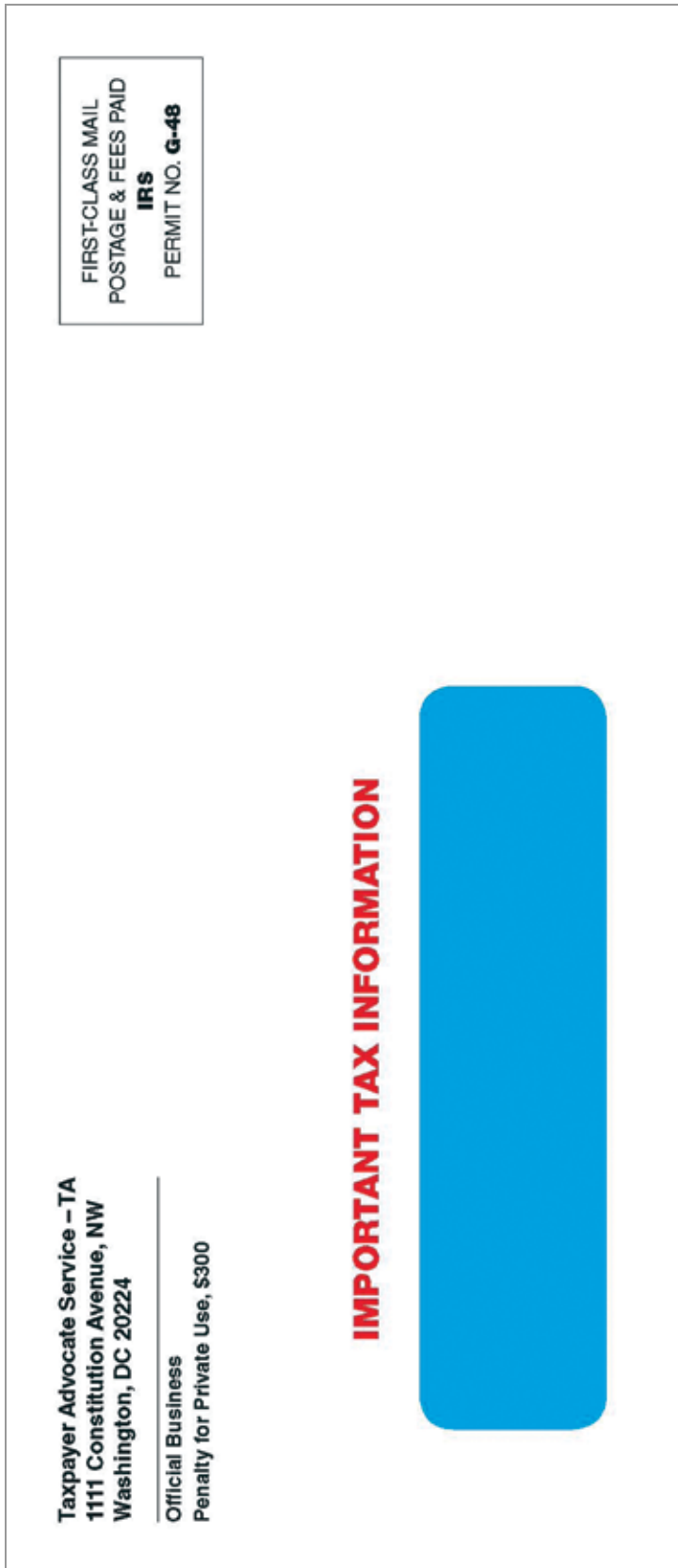
It appears that the child or children claimed on your 2014 Form 1040 were also claimed on another person's tax return for that year. Before you file your 2015 Form 1040, you should review the relationship and residency tests and how they apply to you, especially if the child did not live with you the entire year. Please note that the rules for claiming a child for the EITC are different from the rules for receiving benefits like Temporary Assistance to Needy Families (TANF) and Section 8 Housing Assistance. So you could receive benefits for the child but not be eligible for the EITC.

I hope this letter has been helpful. If someone is assisting you in preparing your return, please show this letter to him or her. You can find out more information about the EITC at <https://www.irs.gov/Credits-&-Deductions/Individuals/Earned-Income-Tax-Credit> or in Publication 596 *Earned Income Credit*. If you need assistance with an IRS problem that is causing you financial harm or isn't getting solved, the Taxpayer Advocate Service may be able to help you. You can find a list of our local offices at <https://www.irs.gov/Advocate/Local-Taxpayer-Advocate>, or you can call us at 1-877-777-4778.

Sincerely,

Nina E. Olson
National Taxpayer Advocate

APPENDIX D: ENVELOPE USED TO SEND TAS LETTERS



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