

**Management Advisory Report:  
Improvements Are Needed to Assess  
the Use and Impact of the  
Earned Income Credit Appropriation**

**March 2001**

**Reference Number: 2001-40-064**

**This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

March 30, 2001

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

A handwritten signature in black ink that reads "Pamela J. Gardiner".

FROM: Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Management Advisory Report - Improvements Are  
Needed to Assess the Use and Impact of the  
Earned Income Credit Appropriation

This report presents the results of our review of the Internal Revenue Service's (IRS) process to assess the use and impact of the Earned Income Credit (EIC) appropriation.

In summary, we found the IRS does not adequately validate EIC results information, causing the inaccurate reporting of the use of EIC appropriation funds to the Congress. Also, although establishment of some compliance initiatives and a process to track the spending of funds have improved the application of the credit, the IRS has been unable to measure improvements in EIC compliance for the approximately \$297 million spent on improving the application of the EIC. We recommended that the Wage and Investment Division measure the impact of EIC initiatives in improving EIC compliance and ensure the information reported to the Congress is complete, accurate, and reliable.

Management agreed to the recommendations we presented. Management's comments have been incorporated into the report where appropriate, and the full text of their comments is included as an appendix.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Walter Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs), at (770) 936-4590.

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# Management Advisory Report: Improvements Are Needed to Assess the Use and Impact of the Earned Income Credit Appropriation

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## Executive Summary

The Earned Income Tax Credit (EIC)<sup>1</sup> is a refundable credit created in 1975 to offset the impact of Social Security taxes on low-income families and encourage them to seek employment rather than welfare. The Congress assigned responsibility to the Internal Revenue Service (IRS) to administer the EIC. The IRS defined this role as ensuring the efficient administration of the law; achieving full participation<sup>2</sup> of eligible taxpayers; and reducing overclaims<sup>3</sup> and fraud, waste, and abuse.

The EIC is technically treated as a payment and is refundable even if no tax liability exists. This has led to significant compliance problems. An IRS study using Tax Year (TY) 1994 tax returns estimated taxpayers overclaimed \$4.4 billion in EIC, or 25.8 percent of the total EIC amount claimed in TY 1994. The Congress has been concerned with the effectiveness of the IRS to both achieve full participation by taxpayers who qualify for the credit and reduce EIC overclaims. In 1997, the Congress provided the IRS with a special 5-year, \$716 million appropriation for the improved application of the EIC. The objective of this audit was to determine if the IRS had an effective process to assess the use and impact of the EIC appropriation.

## Results

The IRS needs to improve its process for reporting on the use and measuring the impact of the \$297 million<sup>4</sup> already spent and the remaining EIC appropriation funds it plans to spend on initiatives designed to improve EIC compliance. However, we found that the IRS has implemented some initiatives aimed at improving compliance and established a process to track the expenditure of funds from the EIC appropriation. The IRS also created the EIC Program Office in May 1998 to coordinate its EIC compliance initiatives.

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<sup>1</sup> The Earned Income Tax Credit will be referred to as the Earned Income Credit (EIC) in future references in this report.

<sup>2</sup> Full participation is defined as having all taxpayers who are entitled to the EIC claim it.

<sup>3</sup> EIC overclaims involve both intentional and unintentional (mistakes) attempts to file returns with EIC claims that fail to meet eligibility requirements.

<sup>4</sup> The IRS reported spending approximately \$136 million in Fiscal Year (FY) 1998, \$141 million in FY 1999, and \$20 million in the first quarter of FY 2000.

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### **Inadequate Validation of Information Causes Inaccurate Reporting of the Use of Earned Income Credit Appropriation Funds to the Congress**

The IRS does not have procedures to validate the accuracy of the information it provides quarterly to the Congress. Specifically, the EIC Program Office does not validate the information it receives from other IRS functions to ensure it is accurate and reliable.

The information reported on workload results in the *IRS Tracking Earned Income Tax Credit Appropriation Annual Report - FY 1999* was inaccurate and unreliable. Without validating the accuracy and reliability of the information, IRS management cannot reasonably assure the information reported to the Congress is complete, accurate, and reliable for assessing how the IRS is spending the EIC appropriation funds or for making future budget decisions.

### **Incomplete Measurement of Initiative Results Leaves the Internal Revenue Service Unable to Determine Its Impact on Compliance**

The Congress directed the IRS to measure the effect of the expenditure of funds on improving EIC compliance and report quarterly on the rate of change. The IRS has conducted several studies to measure EIC compliance, but none has established a reliable baseline. The IRS is currently developing a baseline using TY 1997 returns and has begun a compliance study on TY 1999 returns.

As of April 2000, the IRS was unable to measure improvements in EIC compliance for the approximately \$297 million it had spent on improving the application of the EIC. It can report results only on the amount of revenue protected or collected and workload completed. Without a process to assess the impact of EIC initiatives, neither the IRS nor the Congress can determine if the IRS' use of the \$716 million EIC appropriation is improving EIC compliance.

### **Some Compliance Initiatives and a Process to Track the Spending of Funds Have Improved the Application of the Earned Income Credit**

The IRS has implemented several initiatives aimed at improving the application of the EIC. These efforts include improving taxpayers' awareness of EIC eligibility and continuing efforts to identify and stop inappropriate EIC claims before refunds are issued.

The IRS tracks the expenditures for EIC-related work in various information systems. The expenditure data are rolled up monthly to the IRS' financial system<sup>5</sup> and are included in the IRS' quarterly report to the Congress. During our review of the expenditures reported by the IRS to

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<sup>5</sup> The Automated Financial System (AFS) is a computer-based financial accounting system used by the IRS to track appropriations and expenditures.

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the Congress for the first quarter of FY 2000,<sup>6</sup> we found a \$9 million discrepancy between the expenditures reported and those posted to the AFS as of January 31, 2000. IRS management was aware of the discrepancy, which was caused by a delay in posting due to modifications being made to the AFS. These expenditures were eventually posted to the AFS. While there was no apparent negative impact caused by this delay in posting EIC expenditures to the AFS, future delays in posting of expenditures could result in the IRS making poor financial management decisions.

### **Summary of Recommendations**

The Wage and Investment Division should measure the impact of EIC initiatives in improving EIC compliance and ensure the information reported to the Congress is complete, accurate, and reliable.

Management's Response: IRS management agreed with our recommendations and concurred with the outcome measures presented in Appendix IV. In its response, the IRS pointed out that the then-pending IRS reorganization last fiscal year made it difficult to manage the multi-functional, cross-divisional EIC program. In response to our recommendation to establish a process to ensure workload results reported to the Congress are complete, accurate, and reliable, the IRS plans to require and review supporting documentation from all functions for all workload results reported. Because several studies and reports have been completed relative to the EIC filing population since the end of our work on this audit, and one of these studies is a series intended to measure changes in filing behavior, the IRS does not plan to take additional corrective action to our second recommendation (that it should effectively measure the impact of the EIC initiatives on improving EIC compliance).

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<sup>6</sup> The IRS reported spending 345 staff years and \$20 million during the first quarter of FY 2000.

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## Objective and Scope

*The overall objective of the audit was to determine if the IRS had an effective process to assess the use and impact of the EIC appropriation.*

The overall objective of the review was to determine if the Internal Revenue Service (IRS) had an effective process to assess the use and impact of the Earned Income Tax Credit (EIC)<sup>1</sup> appropriation. To accomplish this objective, we:

- Identified the various initiatives funded out of the EIC appropriation and determined if they met Congressional intent.
- Evaluated the methods used to track the expenditure of funds from the EIC appropriation.
- Determined whether the IRS developed an effective process for tracking the results of the EIC initiatives.

We performed our work at the IRS National Headquarters between January and June 2000. Our review was performed in accordance with the President's Council on Integrity and Efficiency's *Quality Standards for Inspections*.

Details of our objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

## Background

*The EIC encourages low-income families to seek employment rather than welfare and assists them by offsetting the impact of Social Security taxes.*

The EIC is a refundable credit created by the Congress in 1975 to offset the impact of Social Security taxes on low-income families and encourage them to seek employment rather than welfare. This credit provides a major source of assistance to low income families. Since the inception of the credit, EIC law and administration have grown increasingly complex. For example, the IRS has gone from the use of a single line on the individual income tax return for the EIC to a

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<sup>1</sup> The Earned Income Tax Credit will be referred to as the Earned Income Credit (EIC) in future references in this report.

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publication and schedule devoted to EIC instructions and computations for claiming the credit. The amount of the allowable credit has expanded from a maximum of \$400 in Tax Year (TY) 1975 to \$3,816 in TY 1999. The number of taxpayers claiming the EIC increased from 6.2 million in TY 1975 to 19.4 million in TY 1998 (\$1.25 billion in EIC claimed in TY 1975 to over \$30 billion in 1998). During the same period, the average credit increased from \$202 to \$1,577.

*The Congress gave the IRS the authority to administer the EIC.*

The Congress gave the IRS the authority to administer the EIC. The IRS has defined this role as ensuring the efficient administration of the law; achieving full participation<sup>2</sup> of eligible taxpayers; and reducing overclaims<sup>3</sup> and fraud, waste, and abuse.

The EIC is technically treated as a payment and is refundable even if no tax liability exists. This has led to significant compliance problems. A study conducted by the IRS, using TY 1994 tax returns, estimated taxpayers overclaimed \$4.4 billion in EIC, or 25.8 percent of the total EIC amount claimed in TY 1994. The Congress has been concerned with the effectiveness of the IRS to both achieve full participation by taxpayers who qualify for the EIC credit and reduce EIC overclaims. In 1997, the Congress provided the IRS with a special 5-year, \$716 million appropriation for the improved application of the EIC. Starting in Fiscal Year (FY) 1998, the funding was to be appropriated as follows:

*The Congress provided the IRS with a special 5-year appropriation to address EIC compliance problems.*

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<sup>2</sup> Full participation is defined as having all taxpayers who are entitled to the EIC claim it.

<sup>3</sup> EIC overclaims involve both intentional and unintentional (mistakes) attempts to file returns with EIC claims that fail to meet eligibility requirements.



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Not more than:

- \$138 million for FY 1998.
- \$143 million for FY 1999.
- \$144 million for FY 2000.
- \$145 million for FY 2001.
- \$146 million for FY 2002.

### Results

The IRS needs to change its process for reporting on the use and measuring the impact of the \$297 million<sup>4</sup> already spent and the remaining EIC appropriation funds it plans to spend on initiatives designed to improve EIC compliance.

However, we found that the IRS has implemented some initiatives aimed at improving compliance and established a process to track the expenditure of funds from the EIC appropriation.

*The EIC Program Office was established in May 1998 to oversee and coordinate the IRS' compliance initiatives.*

The IRS created the EIC Program Office in May 1998 to coordinate the IRS' EIC compliance initiatives. This office oversees the EIC Program budget and Program planning process; monitors the execution of all EIC activities; ensures the multidimensional aspects of this program are consistent, accurate, and comprehensive; and provides recommendations and decisions to enhance the EIC Program. In FY 2000, the IRS budgeted approximately \$775,000 for the operation of the EIC Program Office.

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<sup>4</sup> The IRS reported spending approximately \$136 million in FY 1998, \$141 million in FY 1999, and \$20 million in the first quarter of FY 2000.

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**Inadequate Validation of Information Causes  
Inaccurate Reporting of the Use of Earned  
Income Credit Appropriation Funds to the  
Congress**

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*The IRS does not have procedures to validate the accuracy of the information that it provides quarterly to the Congress.*

The IRS does not have procedures to validate the accuracy of the information it provides quarterly to the Congress. Specifically, the EIC Program Office does not validate the information it receives from other IRS functions to ensure it is accurate and reliable.

We found that the information on workload results in the *IRS Tracking Earned Income Credit Appropriation Annual Report - FY 1999* was inaccurate and unreliable. For example, three of the five IRS functions either overstated or understated the workload results reported in the FY 1999 report. One function overstated the number of EIC cases by approximately 29 percent (1,015 of 3,498 cases). A second function overstated the number of notices sent to taxpayers by approximately 23 percent (155,000 of 680,000 notices). A third function did not report the fourth quarter workload results, and the third quarter results were incorrectly repeated in the fourth quarter. The functional areas provided inaccurate information because they did not validate their workload results prior to sending them to the EIC Program Office.

Several IRS functional areas (e.g., Customer Service, Criminal Investigation, District Office Examination, Office of Research, and Appeals) participating in EIC initiatives produce the workload results, such as the volume of EIC telephone calls received, tax returns prepared, and taxpayers assisted. This information is provided to the EIC Program Office monthly by the various IRS functions and is rolled into the IRS' quarterly report to the Congress without validation of the information reported. Based on the Standards for

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Internal Control in the Federal Government,<sup>5</sup> control activities should ensure that all transactions are completely and accurately recorded.

Without validating the accuracy and reliability of the information, IRS management cannot reasonably assure the information reported to the Congress is complete, accurate, and reliable for assessing how the IRS is spending the EIC appropriation funds. This could also cause errors in future budget decisions such as the under- or over-funding of EIC activities based on cost/result assessments of the activities.

### Recommendation

1. The Wage and Investment Division should establish a process to ensure the workload results information reported in the *IRS Tracking Earned Income Tax Credit Appropriation* report to the Congress is complete, accurate, and reliable.

Management's Response: The IRS pointed out that the then-pending IRS reorganization last fiscal year made it a difficult time for managing the multi-functional, cross-divisional EIC program. To address our concern, the IRS responded that, "On a monthly basis, the EITC Program Office will request from all appropriate functions copies of the supporting documentation the functions have gathered to support their EITC workload results. EITC Program Office staff will review this documentation to ensure the results reported by the functions are accurate."

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<sup>5</sup> *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-2115, dated November 1999).

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**Incomplete Measurement of Initiative Results  
Leaves the Internal Revenue Service Unable to  
Determine Its Impact on Compliance**

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*The IRS has not been able to measure the improvements in EIC compliance.*

As of April 2000, the IRS was unable to measure improvements in EIC compliance for the approximately \$297 million it had spent on improving the application of the EIC. It can report results only on the amount of revenue protected or collected and workload completed. For example, in the first quarter of FY 2000's *IRS Tracking Earned Income Tax Credit Appropriation* report<sup>6</sup> to the Congress, the IRS reported \$75.7 million in revenue.

*The Congress directed the IRS to submit quarterly reports to identify the expenditures and the change in the rate of compliance.*

The Congress directed the IRS to measure the effect of the expenditure of funds on improving EIC compliance and report quarterly on the rate of change. However, the IRS has been unable to provide this information. The General Accounting Office (GAO) stated in a report on an IRS TY 1994 EIC Compliance Study<sup>7</sup> that the IRS could be into its fourth year of the 5-year appropriation before it has study data for establishing a baseline and is able to conduct a follow-up study against which to measure change.

The IRS has conducted several studies to measure EIC compliance, but none has established a reliable baseline. The IRS is currently developing a baseline using TY 1997 returns and has begun a compliance study on TY 1999 returns.

Without an effective process for assessing the impact of the EIC initiatives on compliance, neither the IRS nor the Congress can determine if the IRS' use of the \$716 million EIC appropriation is improving EIC compliance.

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<sup>6</sup> IRS. April 2000. *IRS Tracking Earned Income Tax Credit Appropriation* (First Quarter – FY 2000) (Document 9383).

<sup>7</sup> Page 33 of the report entitled, *Earned Income Credit: IRS' Tax Year 1994 Compliance Study and Recent Efforts to Reduce Noncompliance* (GAO/GGD-98-150, dated July 1998).

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### Recommendation

2. The Wage and Investment Division should effectively measure the impact of the EIC initiatives on improving EIC compliance.

Management's Response: The IRS pointed out that, since the end of our audit work and the issuance of this report, two significant reports have been issued relative to the entire EITC population. One of these is an ongoing series intended to provide a measurement of taxpayer's changed filing behavior. As a result, the IRS does not believe additional corrective action is necessary.

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### Some Compliance Initiatives and a Process to Track the Spending of Funds Have Improved the Application of the Earned Income Credit

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The EIC Program Office has a strategic planning process that entails evaluating recommendations for initiatives submitted by IRS functions. The process also includes evaluating taxpayer return filing history and the results of IRS research. The EIC Program Office, along with the Commissioner, Wage and Investment Division, determines whether to fund the initiatives out of the EIC appropriation based on the results of their evaluation. The initiatives agreed upon are included in the EIC Strategic Plan.

The IRS has implemented several initiatives aimed at improving the application of the EIC. These efforts include:

- Improving taxpayer awareness of EIC eligibility by enhancing the national EIC campaign to support local offices' marketing and promotional efforts.
- Assisting taxpayers in determining if they are eligible for the EIC by providing them with quality customer service through toll-free telephone assistance 24 hours a day, 7 days a week.

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- Continuing efforts to identify and stop inappropriate EIC claims before refunds are issued.
- Sending pre-filing season letters to taxpayers who made errors on their 1998 returns by either claiming a dependent who was also claimed by another taxpayer or providing information on their returns that indicated their qualifying child exceeded the age limit.
- Identifying questionable EIC claims, EIC-based refund schemes, and tax return preparers who prepare questionable EIC returns.

These initiatives are funded out of the EIC appropriation. The IRS established guidelines for identifying and recording the expenditures. To track how the funds are spent, specific codes are assigned to the work performed by personnel conducting the EIC-related work. IRS functions input the costs incurred for the month to their various information systems. The expenditure data are rolled up monthly to the IRS' financial system<sup>8</sup> and are included in the IRS' quarterly report to the Congress.

During our review of the expenditures reported by the IRS to the Congress for the first quarter of FY 2000,<sup>9</sup> we noted a \$9 million discrepancy between the expenditures reported for 1 IRS function and the expenditures posted to the AFS for that function as of January 31, 2000. IRS management was aware of the discrepancy and informed us that the understatement occurred at the time because the AFS was being modified. This caused a delay in posting some data.

As a result, over 200 staff years and \$9 million that were expended by the function did not timely post to the AFS. These expenditures were eventually posted to the AFS by

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<sup>8</sup> The Automated Financial System (AFS) is a computer-based financial accounting system used by the IRS to track appropriations and expenditures.

<sup>9</sup> The IRS reported spending 345 staff years and \$20 million during the first quarter of FY 2000.

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March 31, 2000. Although there was no apparent negative impact caused by this delay in posting EIC expenditures to the AFS, future delays in the posting of expenditures could result in the IRS making poor financial management decisions.

### **Conclusion**

The IRS and the Congress do not have a clear and accurate picture of the return on investment for the \$297 million spent through December 31, 1999, on improving the administration of the EIC. Without complete, accurate, and reliable information on the results, neither the IRS nor the Congress can make informed decisions about the effective use of the EIC appropriation.

This could also affect how well the appropriation funds are being managed in terms of assessing resource and budgetary needs to effectively implement both current and future initiatives.

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**Appendix I**

**Detailed Objective, Scope, and Methodology**

The overall objective of this audit was to determine if the Internal Revenue Service (IRS) had an effective process to assess the use and impact of the Earned Income Tax Credit (EIC)<sup>1</sup> appropriation. Specifically, we:

- I. Identified the various initiatives funded out of the EIC appropriation and determined if they met Congressional intent.
  - A. Reviewed the appropriation law and determined the Congressional intent for the EIC appropriation.
  - B. Reviewed policies, procedures, and other documentation relating to the establishment of the EIC initiatives and determined if these initiatives met Congressional intent.
  - C. Reviewed available documentation to determine the functional areas involved in implementing the EIC appropriation and their respective roles and responsibilities.
  - D. Reviewed completed compliance research projects to determine if a baseline had been established and if compliance had improved as a result of the EIC initiatives.
  - E. Interviewed IRS personnel (within and outside the EIC Program Office) to identify specific roles and responsibilities.
- II. Evaluated the methods used to track the expenditure of funds from the EIC appropriation.
  - A. Reviewed the EIC Program Office policies and guidelines for tracking the expenditure of funds to determine whether the methodology was consistent and appropriate.
  - B. Reviewed reports and other documentation establishing the expenditures for EIC initiatives and validated the data to determine whether it was accurate and reliable.
  - C. Interviewed IRS personnel involved with the EIC (within and outside the Program Office) to determine what processes were used to track expenditures to ensure accurate accounting of funds.

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<sup>1</sup> The Earned Income Tax Credit will be referred to as the Earned Income Credit (EIC) in future references in this report.



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- III. Determined whether the IRS developed an effective process for tracking the results of the EIC initiatives.
  - A. Reviewed the EIC Program Office's policies and guidelines for capturing data reporting results to determine whether the methodology was consistent and appropriate.
  - B. Reviewed documentation regarding the EIC to determine whether appropriate long-term goals, objectives, and measurements had been established.
  - C. Reviewed available documentation to determine the process used to develop the EIC initiatives and evaluated the results to determine whether the process was effective.
  - D. Interviewed IRS personnel involved with the EIC (within and outside the Program Office) to determine what processes were used to monitor and validate initiatives and gathered information on the significance, relevance, and accuracy of any results provided.

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**Appendix II**

**Major Contributors to This Report**

Walter E. Arrison, Associate Inspector General for Audit (Wage and Investment Income Programs)

Michael Phillips, Director

Debra Gregory, Audit Manager

Patricia Lee, Audit Manager

Dan Adams, Senior Auditor

S. Kent Johnson, Senior Auditor

Sharon Summers, Senior Auditor

Thomas Dori, Auditor

Bobbie Draudt, Auditor

Eleonor Lindner, Auditor

Peter Stoughton, Auditor

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**Appendix III**

**Report Distribution List**

Commissioner N:C  
Chief Financial Officer N:CFO  
Earned Income Tax Credit Project Manager W:EITC  
Director, Legislative Affairs CL:LA  
National Taxpayer Advocate TA  
Office of Management Controls N:CFO:F:M  
Office of the Chief Counsel CC  
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O  
Director, Strategy and Finance W:S  
Audit Liaison:  
    Earned Income Tax Credit Program Office W:EITC

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**Appendix IV**

**Outcome Measures**

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure: Reliability of Information – Actual; 1,015 Earned Income Credit (EIC) cases and 155,000 notices; see page 4.

Methodology Used to Measure the Reported Benefit:

We computed the 1,015 over-reported EIC closed cases by recalculating the number of EIC cases closed by one function for Fiscal Year 1999, using its management information system. We identified these cases based on the period they were closed and the EIC project code associated with the case. We compared these results, 2,483 EIC closed cases, to the number of EIC closed cases (3,498) reported by the function to determine the overstatement.

We computed the 155,000 overstated notices sent to taxpayers by another function as follows. First, we took 35 percent (the approximate EIC portion) of the total number of Duplicate Social Security Number (SSN) notices mailed in January 1999 (1.5 million). We then compared this amount, 525,000, to the 680,000 Duplicate SSN notices reported by the function. The difference totaled 155,000 notices, the amount overstated by that function.

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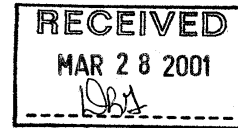
**Appendix V**

**Management's Response to the Draft Report**



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
ATLANTA, GA 30308

March 27, 2001



MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

*John M. Dalrymple*  
John M. Dalrymple  
Commissioner, Wage and Investment Division

SUBJECT:

Draft Management Advisory Report – Improvements  
Are Needed to Assess the Use and Impact of the  
Earned Income Credit Appropriation  
(Audit # 200040015)

We appreciate the opportunity to respond to your draft management advisory report, "Improvements Are Needed to Assess the Use and Impact of the Earned Income Credit Appropriation." We are pleased that you acknowledge that the IRS has implemented initiatives aimed at improving Earned Income Tax Credit (EITC) compliance and established a process to track the expenditure of funds from the special 5-year EITC appropriation. With oversight provided by the EITC Program Office, the IRS has implemented many programs in recent years to improve EITC compliance. As a result, IRS has denied about \$1.5 billion in erroneous EITC claims over the past two years. These programs include:

- The introduction of Form 8867, Paid Preparer's Earned Income Credit Checksheet, which ensures that preparers meet "due diligence" requirements;
- The redesign of Schedule EIC, EITC instructions in the Form 1040 package, and related publications;
- Additional EITC education and outreach efforts, in particular, partnerships with local, state, and Federal agencies, faith-based organizations, and other groups that are advocates for low-income taxpayers;
- Expanded customer service, e.g., EITC Awareness Days, toll-free phone numbers for taxpayers to call Remote Examination with questions regarding their EITC audits, etc.;
- A revamped EITC media campaign with an emphasis on eligibility criteria for the EITC;
- Implementation of an integrated EITC education and compliance strategy directed at tax return preparers;
- Expanded math error authority;
- Implementation of the EITC Recertification program; and
- Implementation of the Dependent Database.

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Your recommendations provide the following measurable benefit on tax administration: improved reliability of information. We concur with this outcome measure.

Our comments on your specific recommendations are as follows:

### **IDENTITY OF RECOMMENDATION 1**

The Wage and Investment Division should establish a process to ensure the workload results information reported in the *IRS Tracking Earned Income Tax Credit Appropriation* report to the Congress is complete, accurate, and reliable.

### **ASSESSMENT OF CAUSE**

Due to the then-pending IRS reorganization, the last fiscal year was a difficult year for managing a multi-functional, cross-divisional program. More important, many of the EITC budget and program contacts were reassigned to other programs, thus leaving the EITC coordinating positions vacant. Internal systems, e.g., the Automated Financial System, were being modified to accommodate the reorganization; in some cases, this caused delays in the posting of data. As a result, obtaining and reporting complete, accurate, and reliable EITC results was a challenge.

### **CORRECTIVE ACTION**

On a monthly basis, the EITC Program Office will request from all appropriate functions copies of the supporting documentation the functions have gathered to support their EITC workload results. EITC Program Office staff will review this documentation to ensure the results reported by the functions are accurate.

### **IMPLEMENTATION DATE**

Proposed: June 1, 2001

### **RESPONSIBLE OFFICIAL**

National EITC Program Manager

### **CORRECTIVE ACTION MONITORING PLAN**

The EITC Program Office will receive monthly supporting documentation packages from the functions.

### **IDENTITY OF RECOMMENDATION 2**

The Wage and Investment Division should effectively measure the impact of the EIC initiatives on improving EIC compliance.

### **ASSESSMENT OF CAUSE**

TIGTA's draft report states on page ii that "as of April 2000, the IRS was unable to measure improvements in EIC compliance for the approximately \$297 million it had spent on improving the application of the EIC." This should not be surprising. The EITC

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appropriation began in FY 1998. Tax year (TY) 1997 returns filed in 1998 form the basis for measuring the effects of the EITC appropriation spending because so little could have been accomplished by the IRS between the initiation of the EITC appropriation and the filing of these returns. TY 1999 returns were still being filed in April 2000; thus, there was no ability to measure impact for the second year of implementation. The only returns that could have been used for measurement were those for TY 1998. These returns were filed barely one year into the program, prior to the implementation of many of the initiatives expected to have the greatest impact on compliance, and too early to observe the long term impact of focused and consistent IRS effort.

As indicated in their draft management advisory report, TIGTA conducted their audit between January and June 2000. Between the end of the audit period and the issuance of this draft report, two significant reports have been issued relative to the entire EITC population:

1. The TY 1997 Compliance Study establishing the baseline for EITC compliance was issued in September 2000.
2. The first in a series of Subsequent Year Tracking Reports was issued in July 2000. The report provides a measurement of taxpayers' changed filing behavior (from non-compliant to compliant) on returns filed subsequent to a direct IRS contact, i.e., soft-notice, math error notice, or examination.

In addition, a number of individual reports have been issued which provide insight into the impact the IRS is having on taxpayer filing behavior within smaller segments of that population. One example is the series of reports on the use of duplicate Social Security numbers (SSNs) to claim EITC benefits for qualifying children. These reports trace the reduction in the number of taxpayers duplicating the SSNs of EITC qualifying children from 505,600 for TY 1995 (461,006 for TY 1997) to 367,392 for TY 1999. Because the vast majority of these taxpayers duplicate the SSN for only one year, the reduced number of taxpayers making such claims for benefits is particularly significant.

### **CORRECTIVE ACTION**

No corrective action is necessary. The IRS has been measuring and continues to measure the impact of EITC appropriation initiatives on improving EITC compliance.

### **IMPLEMENTATION DATE**

Not applicable

### **RESPONSIBLE OFFICIAL**

Not applicable

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**CORRECTIVE ACTION MONITORING PLAN**

Not applicable

If you have any questions or need additional information regarding this response, please contact me, or your staff may contact Candice Cromling, National EITC Program Manager, at (202) 622-5994.