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Report to the Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives

April 2002

EARNED INCOME CREDIT

Opportunities To Make Recertification Program Less Confusing and More Consistent

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Abbreviations

EIC	earned income credit
IRS	Internal Revenue Service
LITC	Low Income Taxpayer Clinic
TIGTA	Treasury Inspector General for Tax Administration
TRA97	Taxpayer Relief Act of 1997

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Accountability * Integrity * Reliability

United States General Accounting Office
Washington, DC 20548

April 25, 2002

The Honorable Amo Houghton
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

The earned income credit (EIC) is a refundable tax credit available to low-income, working taxpayers. From January through December 2001, according to IRS, about $31 billion was paid to about 19.0 million EIC claimants. While it is important to ensure that all persons eligible for the EIC receive it, equally important is the need to identify and deny erroneous claims, whether due to fraud, negligence, or confusion. Because of a concern about the extent of erroneous EIC claims, the Congress included provisions in the Taxpayer Relief Act of 1997 (TRA97)[1] that led to the Internal Revenue Service's (IRS) establishment of a compliance effort known as the EIC recertification program. Under the program, taxpayers who have been disallowed the EIC through an IRS audit are to substantiate their qualification for the EIC before IRS recertifies them to receive the credit again.

Because of the need to strike an appropriate balance between compliance and taxpayer burden, you asked us to assess the EIC recertification program. Our objectives were to determine whether (1) IRS's communications with taxpayers about recertification meet the needs of IRS and taxpayers, (2) information taxpayers are told to provide to prove their entitlement to the EIC is reasonably easy to obtain and consistent with what IRS examiners accept in making recertification decisions, and (3) examiners are consistent in how they assess supporting documentation provided by taxpayers.

Our assessment of the recertification program included analyses of IRS forms, correspondence, and guidance related to recertification; interviews of IRS examiners who worked on recertification cases; and interviews of representatives from organizations who provide assistance to low-income

[1]P.L. 105-34.

taxpayers in controversies with IRS. Although our assessment was directed at the EIC Recertification Program, many of our findings would also apply to other IRS enforcement efforts involving EIC claims.

Results in Brief

Administering the EIC is not an easy task for IRS. IRS has to balance its efforts to help ensure that all qualified persons claim the credit with its efforts to protect the integrity of the tax system and guard against fraud and other forms of noncompliance associated with the EIC.[2] While the recertification program provides a vehicle for combating EIC noncompliance, we believe that the program unnecessarily burdens taxpayers while not ensuring that IRS obtains a reasonable evidentiary basis for determining whether recertification applicants should be granted the EIC. As a consequence, legitimate taxpayers may be discouraged from claiming a credit to which they are entitled or IRS may make poorly supported decisions in allowing or disallowing the credit.

Although IRS made some changes to its correspondence, improved its examiner training, and expanded taxpayer outreach, certain aspects of the recertification process continue to cause problems for taxpayers. In particular, (1) one standard form that is an integral part of the recertification process is of questionable value to IRS while another is potentially confusing to taxpayers; (2) taxpayers are being asked to submit information that is either difficult to obtain or inconsistent with what many IRS examiners consider acceptable; and (3) IRS examiners' inconsistent assessment of documentation submitted by taxpayers can result in different recertification rulings for taxpayers in similar circumstances.

Since the inception of the EIC Recertification Program in 1998, IRS has taken steps to improve some of the letters and forms it uses to correspond with taxpayers about the program. However, two standard forms that IRS uses in corresponding with taxpayers as part of the recertification process can lead to unnecessary taxpayer burden. One form that all taxpayers seeking recertification must submit is a 2-page document that requires taxpayers to answer up to 37 questions and report detailed information about their children. According to IRS, taxpayers need an average of 2

[2]U.S. General Accounting Office, *Earned Income Tax Credit Eligibility and Participation*, GAO-02-290R (Washington, D.C.: Dec. 14, 2001) has an estimate of how many households are eligible for the EIC but do not receive it.

hours and 44 minutes to complete and file the form, yet 86 percent of examiners we surveyed said they do not use the form. The other form, which is used by examiners to tell taxpayers what information they need to provide to establish their eligibility for the EIC, is formatted in a way that can easily confuse taxpayers into believing that they must satisfy requirements that do not apply to the EIC. At the same time, the form provides insufficient guidance on what information taxpayers need to provide to prove that their relationship to the children listed on their EIC claim meets EIC requirements.

IRS asks taxpayers to submit certain information as part of the process that can be difficult for some EIC claimants to obtain or is inconsistent with what many examiners consider acceptable. According to representatives from 10 Low Income Taxpayer Clinics (LITC) and various Census Bureau studies, many low-income taxpayers move from location to location for job reasons, receive their medical care at hospital emergency rooms, and rely on relatives for free child care service.[3] For such taxpayers, obtaining the kind of school, medical, and child care records sought by IRS can be difficult. For example, many examiners told us that they would not accept child-care provider statements from relatives because of a concern that relatives might lie. While we understand the hesitancy to accept a relative's statement, refusing to accept child-care statements from relatives can pose a hardship for low-income taxpayers who use relatives for child care. IRS also tells taxpayers that the documentation they provide from their child-care provider should either be on company letterhead or notarized. However, many examiners told us that they would not accept a notarized letter because the notary only verifies the signature, not the content of the letter. Telling taxpayers that a notarized letter is acceptable and then refusing to accept it can frustrate taxpayers and cause them to unnecessarily pay whatever fee the notary public charged (as much as $10 according to information we obtained from an industry publication).

Examiners are inconsistent in how they assess supporting documentation provided by taxpayers. We asked 21 IRS examiners how they would evaluate 5 different sets of supporting documents submitted by potential taxpayers seeking recertification. For none of the 5 scenarios did all 21 examiners agree, and, in some cases, the examiners reached widely

[3]LITCs provide assistance to low-income taxpayers in controversies with IRS and/or taxpayers for whom English is a second language.

varying judgments about whether the evidence was sufficient to support an EIC claim.

We are making several recommendations that we believe will help make the recertification program less confusing to taxpayers and the decisions reached by IRS examiners more accurate and consistent. In commenting on a draft of this report, the commissioner of Internal Revenue mentioned various efforts underway to improve the EIC audit process and IRS's communications with EIC claimants, including the development of a decision support tool to help examiners make consistent EIC eligibility determinations and establishment of an IRS/Treasury task force to review the EIC program. The commissioner said that our report findings would be considered during deliberations of the task force and that the new decision support tool and revised IRS notices generally would incorporate our recommended changes.

Background

Congress created the EIC to offset the impact of Social Security taxes and to encourage low-income workers to seek employment rather than welfare. Taxpayers earning income below a certain level may claim the credit.[4] The amount of the EIC increases with increasing income, plateaus at a certain level of earnings, and then decreases until it reaches zero when earned income exceeds the maximum earning level allowed for the credit. Taxpayers with children can claim the EIC if they (1) have at least one EIC qualifying child, (2) meet income tests, (3) file with any filing status except "married filing separately," and (4) were not a nonresident alien for any part of the year.[5] To claim the EIC without a qualifying child, taxpayers must meet requirements 2, 3, and 4; be at least 25 years old but less than 65 at the end of the year; have lived in the United States for more than half the year; and not be claimed as a dependent on another return.

Although the EIC has been credited with reducing welfare participation and lifting millions of low-income earners out of poverty, it has also been

[4]For tax year 2001, earned income had to be less than (1) $10,710 for taxpayers with no qualifying children; (2) $28,281 for taxpayers with one qualifying child; and (3) $32,121 for taxpayers with more than one qualifying child.

[5]A person qualifies as the taxpayer's qualifying child if the person (1) meets certain relationship requirements that are discussed later in the report; (2) was, at the end of the tax year, under age 19 or under age 24 and a student, or permanently and totally disabled at any time during the year regardless of age; and (3) lived with the taxpayer in the United States for more than half of the tax year.

susceptible to error and abuse. In a February 28, 2002, report on its study of tax year 1999 EIC claims, IRS said that of the estimated $31.3 billion in EIC claims for that tax year, between $9.7 billion and $11.1 billion (30.9 to 35.5 percent) was overclaimed.[6] Of the overclaims, the largest amount (about $2.3 billion) was caused by taxpayers claiming children who did not meet the qualifying child criteria. Most often, according to IRS, these errors were due to taxpayers claiming children who did not meet the residency requirements.

EIC eligibility, particularly related to qualifying children, is difficult for IRS to verify through its traditional enforcement procedures, such as matching return data to third-party information reports. Correctly determining whether a child claimed by the taxpayer for EIC purposes meets the qualifying tests requires IRS to have detailed knowledge of the taxpayer's household composition and living arrangements.[7] However, IRS does not have the necessary resources to visit taxpayers' homes and conduct the kind of interviews that would help it obtain that kind of detailed knowledge, and there is no certainty that the cost of such an effort would be worth the results.[8] Thus, IRS must rely on its ability to clearly communicate to taxpayers what information is needed to certify them for the EIC and on taxpayers' ability to produce documentation to substantiate their qualification for the EIC.

IRS began implementing the recertification process in 1998, when, through audits, it disallowed in whole or in part, the EIC claims on about 312,000 tax year 1997 returns and placed recertification indicators on its computerized accounts for those taxpayers. The indicators, which, in effect, tell IRS's computers not to allow payment of any EIC claim to the taxpayers, are to remain until the taxpayers successfully recertify. To

[6]It is not known how much of the overclaims was due to simple error versus negligence or fraud.

[7]This is not unique to the EIC. IRS faces similar problems, for example, in correctly determining whether a person claimed as a dependent meets the qualifying tests for a dependent.

[8]In August 1998, we reported that investigators in four states, which accounted for 35 percent of the nation's participants in the Food Stamp Program, said that even with the ability to visit homes and contact claimants' friends, neighbors, or landlords for information, these verification techniques are hit-or-miss, time-consuming, costly undertakings and provide information that is only as reliable as its source. (U.S. General Accounting Office, *Food Stamp Overpayments: Households in Different States Collect Benefits for the Same Individuals*, GAO/RCED-98-228 (Washington, D.C.: Aug. 6, 1998)).

begin the recertification process, taxpayers are to attach a Form 8862 (Information To Claim Earned Income Credit After Disallowance) to the next tax return they file that includes an EIC claim. If a taxpayer claims the EIC without attaching Form 8862, IRS is authorized to disallow the credit, process the return without considering the EIC claim, and inform the taxpayer why it denied the claim.

Upon receipt of Form 8862, IRS procedures call for freezing the entire refund claimed on the return (not just the portion related to the EIC) and determining whether the return should be selected for audit. IRS examiners are to select the return for audit unless the taxpayer is no longer claiming the EIC child(ren) previously disallowed and is not claiming a new EIC child.[9] Once the return has been selected for audit, the recertification process, with some minor differences, essentially follows IRS's normal procedures for correspondence audits. These procedures generally involve examiners (1) asking taxpayers to provide support, (2) reviewing any support provided, and (3) advising taxpayers of the audit results.

Since the EIC recertification program's implementation, IRS has, among other things, expanded the information on recertification available to taxpayers, revised some of the correspondence it sends to taxpayers, and improved examiner training. Many of these changes were in response to recommendations resulting from prior reviews by us and the Treasury Inspector General for Tax Administration (TIGTA). (See app. I for a detailed discussion of the changes in the EIC Recertification Program since 1999, and see app. II for information on prior recommendations by us and TIGTA and IRS's corrective actions.) There have also been some significant program developments since 1998. Most relevant to this report, (1) the definitions of qualifying child and eligible foster child for EIC purposes have changed and (2) starting with tax returns filed in 2001, IRS, as authorized by TRA97, began imposing a 2-year ban on credits to taxpayers who it determines negligently claimed the EIC through reckless

[9]Assume, for example, that a taxpayer, on the tax year 1997 return, claimed two EIC-qualifying children and that IRS, upon audit, disallowed child #1 but allowed child #2. Because part of the taxpayer's EIC claim would have been disallowed, the taxpayer would be required to recertify. If the taxpayer claimed the EIC again on the tax year 1998 return and showed child #1 and/or a new child as EIC-qualifying children, the return should be selected for audit as part of the EIC recertification program. However, if the taxpayer showed child #2 as the only EIC-qualifying child, the return should not be selected for audit as part of the recertification program.

or intentional disregard of the regulations. These developments are discussed in more detail later in the report.

Scope and Methodology

To determine whether IRS's communications with taxpayers about recertification meet the needs of IRS and taxpayers, we analyzed IRS's forms and correspondence related to recertification, interviewed a representative sample of IRS examiners (as described in the next paragraph) about certain forms, and reviewed the results of related work done by TIGTA.

To determine whether information taxpayers are told to provide to prove their entitlement to the EIC is reasonably easy to obtain and consistent with what examiners accept, we did the following:

- We surveyed, via telephone, a random sample of 90 tax examiners from a list of 323 tax examiners, which, according to IRS, represented the population of examiners in its 10 processing centers who were working on recertification cases as of April 2001. The purpose of our survey was to determine how examiners evaluated evidential support from taxpayers and to help identify aspects of the EIC eligibility criteria that taxpayers had the most difficulty documenting. More details on our survey methods, as well as the confidence intervals of the estimates for all examiners that we made from our sample are provided in appendix III.

- We talked with representatives from 10 LITCs about any problems taxpayers have in understanding IRS correspondence related to recertification and in complying with IRS's documentation requirements. We obtained a list from IRS's Taxpayer Advocate's Office of the 102 LITCs that were operating in 2001. From that list, we randomly selected 20 LITCs. After eliminating those LITCs that either chose not to participate or said that they did no EIC recertification work, we talked with representatives of 10 LITCs. Given our relatively small sample size and the relatively small proportion of the sample from which we were able to get useful information, we have no assurance that the results from this sample can be reliably generalized to all 102 LITCs. However, our sample does provide the views of about one-tenth of the listed 102 LITCs.

To determine whether IRS's treatment of similarly situated taxpayers is consistent, we analyzed IRS guidance and criteria related to the EIC and recertification; developed five scenarios involving various kinds of documentation that taxpayers might provide IRS in an attempt to prove their eligibility for the EIC; and held structured interviews with 21

examiners to determine, among other things, how they interpreted IRS's recertification guidance and how they assessed the documentation in our five scenarios. We obtained the documents for our scenarios from EIC recertification cases that we had reviewed, and we deleted taxpayer-identifiable information, such as Social Security numbers, from the documents before giving them to the examiners. We subjectively selected the 21 examiners, on the basis of their availability to meet with us, from the 187 EIC recertification examiners at 4 of IRS's 10 processing centers (Atlanta, Brookhaven, Kansas City, and Memphis).[10] As such, the results of this analysis cannot be generalized beyond the 21 examiners. We also reviewed IRS's plans for developing and implementing a decision support tool to be used by examiners working EIC cases, including those involving recertification.

We performed our work between February 2000 and January 2002 in accordance with generally accepted government auditing standards.

One Standard Form Used in the Recertification Process Is of Questionable Value to IRS; Another Is Potentially Confusing to Taxpayers

Although IRS has revised some of the correspondence it sends taxpayers as part of the recertification process, two standard forms that are an integral part of the process can lead to unnecessary taxpayer burden because they (1) are of questionable value to the recertification process and/or (2) provide the taxpayer with inadequate or confusing information. The forms are Form 8862 and Form 886-R (Supporting Documents). Copies of the two forms are in appendix IV.

Taxpayer confusion can have even more critical implications now that IRS has begun imposing a 2-year EIC ban on credits to taxpayers who it determines have negligently claimed the EIC through reckless or intentional disregard of the regulations. Accurately determining whether a taxpayer's erroneous claim is due to a simple mistake versus reckless or intentional disregard of the regulations can be complicated when the requirements for claiming the EIC are confusing.

[10]We selected these four centers because (1) Brookhaven is the site of the EIC Correspondence Exam National Office, (2) Memphis had the most recertification cases in 1999, and (3) we had staff available to do work in Atlanta and Kansas City.

Form 8862 Is of Questionable Value

Taxpayers begin the recertification process by filing Form 8862 with their tax return. In a 1999 report, we raised concerns about the usefulness of Form 8862 and its potential for misleading or confusing taxpayers.[11] We recommended that IRS stop using the form if it is not needed for recertification purposes. IRS did not eliminate the form because it said it relies on the form to "identify the type of action to be taken for taxpayers required to recertify." In that regard, IRS does use Form 8862 to decide whether or not to initiate the recertification process. If a taxpayer files a return claiming the EIC and does not attach a Form 8862, IRS is authorized to disallow the credit without going through the recertification process and inform the taxpayer that the disallowance is due to the failure to attach Form 8862.[12] If a taxpayer submits Form 8862, according to IRS's recertification guidelines, the taxpayer's return is to be forwarded for audit if the taxpayer is still claiming the previously disallowed EIC child or is claiming a new EIC child. However, Form 8862 does not assist in this determination, because the names and Social Security numbers of the taxpayer's children that IRS needs to match against the prior year's tax return do not appear on the form.

On the basis of our telephone survey of IRS examiners, we estimate that 86 percent of all examiners working in the recertification program do not find Form 8862 useful. A few examiners pointed out that Form 8862 is generally not part of the case file they receive when they begin recertification. Even when Form 8862 is in the case file, some examiners said that they do not use it because there are no supporting documents submitted with the form. Although the great majority of examiners do not find Form 8862 useful, IRS estimates that taxpayers need an average of 2 hours and 44 minutes to complete and file the form. In that regard, of the 10 LITC representatives we talked with, 7 said that Form 8862 is not easy for most of their clients to understand.

Thirteen of the examiners we surveyed did say that Form 8862 had some value. Some pointed out that the form gave them some initial information about the taxpayer before seeking additional information. Others said that the form would alert taxpayers to the kind of documentation they should expect to provide during the recertification process. However, taxpayers

[11]U.S. General Accounting Office, *Tax Administration: IRS' 1999 Tax Filing Season*, GAO/GGD-00-37 (Washington, D.C.: Dec. 15, 1999).

[12]If a taxpayer, after being informed of a disallowance for failure to submit Form 8862, sends IRS a Form 8862, IRS is to begin the recertification process.

would have to deduce the type of information needed because neither Form 8862 nor its instructions specifically tell taxpayers what, if any, documentation they may be asked to send IRS.

On the basis of our telephone survey, we determined that an estimated 16 percent of examiners believe that Form 8862 misleads taxpayers into thinking that IRS's final decision on their eligibility will be based on information in the form. Such a misconception seems understandable given the amount of information taxpayers are asked to provide on the Form 8862. Form 8862 is a 2-page form that requires taxpayers who are claiming the EIC with qualifying children to answer numerous questions and report information on such things as (1) the name of the school the child attended or the day care provider, (2) addresses where the child lived during the year, (3) the name and social security number of any other person the child may have lived with for more than half a year, and (4) the child's health care provider or social worker if the child was disabled and older than 18.

Form 886-R Provides Confusing and Incomplete Information

Form 886-R is the vehicle IRS examiners use to tell taxpayers what information they need to provide to prove their eligibility for the EIC as well as to gather information on two other tax issues—whether the taxpayer can also claim dependents and whether the taxpayer qualifies as a head of household.[13] That form is confusing and incomplete.

Confusing Information

Of the 10 LITC representatives we interviewed, 8 did not believe that IRS adequately explained to taxpayers how EIC recertification is achieved and what documentation is needed to achieve recertification. We believe that Form 886-R contributes to that confusion.

The format of Form 886-R could easily confuse taxpayers. For example, in addition to listing documents and information needed to prove eligibility for the EIC, the form lists documents and information needed to prove eligibility for dependent exemptions and the head of household filing status. Requesting documentary evidence to support a dependency claim and head of household filing status could confuse or mislead taxpayers about the requirements they need to meet for EIC recertification. To claim

[13]Because other IRS audits of EIC claims have the same basic purpose as recertification audits (proving that the claimant meets the EIC eligibility requirements), IRS has a similar form (886-H) that it sends to claimants who are being audited outside of the Recertification Program.

a person as a dependent, for example, a taxpayer must generally prove, among other things, that he or she provided more than one-half of the person's total support during the calendar year. Therefore, the evidence IRS asks taxpayers to submit to prove that a child is their dependent includes documentation relating to financial support. However, the law does not require that taxpayers meet a financial support test to claim the EIC, and, thus, taxpayers can qualify for the EIC even if they cannot meet the financial support requirement for the dependency exemption. Form 886-R does not make clear that persons can still qualify for the EIC even if they cannot prove that their child qualified as a dependent, and there are no instructions sent to taxpayers along with the Form 886-R that provide that clarification. Thus, persons might incorrectly assume that because they cannot substantiate a child as a dependent, they do not qualify for the EIC.

Taxpayers might also be confused by the references in Form 886-R to school records. The form tells taxpayers that one acceptable form of proof that a child lived with them is a school record or transcript containing, among other things, "dates of attendance for the entire tax year." Since a tax year generally runs from January to December of the same year and a school year typically runs from September of one year to May or June of the next, some taxpayers may not easily discern that they need to obtain school records for 2 school years in order to provide adequate documentation for 1 tax year. In that regard, an IRS taxpayer advocate and an IRS lead examiner in one field office both told us that school year versus tax year is a difficult concept for taxpayers to understand, and examiners we interviewed said that school records submitted by taxpayers often relate to a school year rather than a tax year. The lack of more specific guidance on Form 886-R about the need for 2 years of school data increases the risk that a taxpayer will submit incorrect information, which, at a minimum, could (1) cause extra work for the examiner, (2) cause the taxpayer to contact the school again, and (3) delay a final decision on the taxpayer's eligibility for the EIC.

Incomplete Information

With a trend toward more nontraditional family units and recent changes in the definitions of qualifying child and foster child for EIC purposes, taxpayers must clearly understand what evidence IRS requires to substantiate the EIC relationship requirement. Form 886-R does not satisfy that need. In listing the documentation needed to prove eligibility for the EIC, Form 886-R includes (1) the child's birth certificate and (2) the name, address, and Social Security number of the child's mother and father (if other than the taxpayer and the taxpayer's spouse). That documentation would be insufficient, however, to prove, for example, that a person is the

taxpayer's adopted child, grandchild, stepchild, or foster child—all of whom meet the definition of an EIC qualifying child. For example, as described by one examiner, a grandmother raising a grandchild with a different last name would have to prove her relationship to the child's parents.

Some examiners we interviewed said that they would accept various official documents that established the relationship requirement between a nonparental taxpayer and the EIC-qualifying child. The official documents they mentioned included birth certificates of the various parties, an adoption paper, some social program's paperwork that states the relationship between child and taxpayer, or some insurance or medical record that states the relationship. None of these documents is mentioned on the Form 886-R. Although an examiner may eventually obtain the necessary documentation through follow-up correspondence with the taxpayer, the need for additional correspondence leads to extra work for examiners and taxpayers and can lengthen the time needed to close the audit and pay the EIC, if the taxpayer is found eligible.

Census Bureau statistics provide an indication of the prevalence of nontraditional family units. According to 1997 Census Bureau statistics, there were 3.9 million children living in homes maintained by their grandparents. Of this number, 1.27 million lived with their grandparents without the presence of either parent, 1.77 million had only a mother present, 0.57 million had both parents present, and 0.28 million had only a father present. According to Census Bureau statistics, the greatest growth between 1992 and 1997 occurred among grandchildren living with grandparents with no parent present. The Census Bureau attributed the increase in grandchildren in these "skipped generation" living arrangements to the growth in drug use among parents, teen pregnancy, divorce, the rapid rise of single-parent households, mental and physical illness, AIDS, crime, child abuse and neglect, and the incarceration of parents.

In addition to children living with grandparents without the presence of either parent, the Census Bureau found, as of Fall 1996, that 688,000 children without parents were living with other relatives and 622,000 children without parents were living with nonrelatives.

Recent changes in the definitions of qualifying child and foster child for EIC purposes further highlight the need for IRS to make clear what evidence it requires to substantiate the EIC relationship requirement. To qualify as a taxpayer's qualifying child in tax year 1999, a person had to be

the taxpayer's son, daughter, adopted child, grandchild, stepchild, or foster child, with a foster child defined as any child that (1) the taxpayer cared for as if it were the taxpayer's own child and (2) lived with the taxpayer for the whole year, except for temporary absences. Those definitions were revised first by the Ticket to Work and Work Incentives Improvement Act of 1999 (P.L. 106-170) and then by the Economic Growth and Tax Relief Act of 2001 (P.L. 107-16).

As a net result of those two laws, the current definition of a qualifying child is (1) a son, daughter, stepson, or stepdaughter, or a descendant of any such individual; (2) a brother, sister, stepbrother, or stepsister, or a descendant of any such individual, who the taxpayer cares for as the taxpayer's own child; or (3) an eligible foster child of the taxpayer. An eligible foster child is now defined as an individual who is placed with the taxpayer by an authorized placement agency and cared for as the taxpayer's own child. Also, a child who is legally adopted or is placed with the taxpayer by an authorized placement agency for adoption is considered the taxpayer's child by blood for purposes of the EIC relationship test.

With these definitional changes, for example, a taxpayer claiming a nephew as an EIC-qualifying child would have to provide documentation to prove that the child is a descendant of the taxpayer's sibling. Before the definitional changes, the taxpayer would not have had to prove a blood relationship to the child but only that the taxpayer cared for the child as if it were the taxpayer's own child.

Imposition of 2-Year Ban for Negligence Makes Clear Communication with Taxpayers Even More Important

TRA97 authorizes IRS to ban a taxpayer from receiving the EIC for 2 years if it determines that the taxpayer negligently claimed the EIC through reckless or intentional disregard of the regulations. In addition to being banned for 2 years from receiving the EIC, taxpayers may be penalized an amount equal to 20 percent of their tax liability underpayment. IRS began imposing the 2-year ban starting with tax year 1999 returns (i.e., returns filed in 2000). During calendar year 2000, IRS imposed the ban on 7,608 taxpayers. IRS imposed another 14,432 bans during calendar year 2001.

IRS provided guidance to its examiners on how to determine whether a 2-year ban should be imposed. Included in the guidance is the following criterion:

"The taxpayer's EIC in a prior year was disallowed by audit because the taxpayer could not demonstrate the child was the taxpayer's qualifying child. The taxpayer files a subsequent

return claiming EIC and again cannot demonstrate that the child was the taxpayer's qualifying child. You can consider that the taxpayer intentionally disregarded the EIC rules and regulations and impose the two-year ban."

No doubt some taxpayers seeking recertification are intentionally disregarding the EIC rules and regulations. However, accurately differentiating between negligence and simple error can be hampered when taxpayers are faced with evidentiary requirements that are difficult to understand and/or comply with.

IRS Asks for Information That Can Be Difficult for Taxpayers to Obtain or Is Inconsistent with What Examiners Accept

Providing documentation to show that a child lived with the taxpayer has consistently been identified as the toughest EIC eligibility requirement to substantiate. This is true for EIC claimants in general, not just those who have to recertify. With respect to the Recertification Program, 80 percent of examiners said that when a taxpayer failed to be recertified, most or all of the time the taxpayer's inability to substantiate that a child lived with the taxpayer led to the failure.

As noted in the following excerpt from Form 886-R, IRS provides taxpayers with several examples of acceptable documents to establish a child's living arrangement. The quoted excerpt clearly indicates that taxpayers only need to submit one of the three types of documentation listed (school, child care, or medical).[14]

"School records or transcripts or an administrative statement from a school official on school letterhead containing the child's name, address, and dates of attendance for the entire tax year, and the name and address of the child's parent or guardian, or

A statement on company letterhead or a notarized statement from a child care provider containing the child's name, address, and dates of care for the entire tax year, the name and address of the child's parent or guardian, and the name and taxpayer identification number of the child care provider, or

Medical records or an administrative statement from a health care provider containing the child's name, address, and dates of medical care during the tax year, and the name and address of the child's parent or guardian."

[14]This same language is in Form 886-H, which IRS sends to EIC claimants who are being audited outside of the Recertification Program.

Our interviews with LITC representatives and IRS examiners indicated that each of these three types of documentation could pose problems for EIC claimants. In discussing EIC recertification with LITC representatives, we heard of various circumstances facing low-income taxpayers that complicate the ability of these taxpayers to obtain documents that might not seem so difficult for other taxpayers. Our interviews with IRS examiners also indicated that the evidentiary requirements related to child care are not consistent with what most examiners consider acceptable.

School and Medical Records

In order for school records to be accepted, they must include an address for the child and an address for the taxpayer and, as discussed earlier, must be for 2 school years in order to cover the tax year in question. According to some IRS examiners we interviewed, the school records submitted by taxpayers often do not have both the child's and the taxpayer's addresses and often relate to a school year rather than a tax year. Earlier in this report, we discussed the problems taxpayers might encounter in distinguishing between a school year and a tax year.

Another potential problem related to school records was raised by IRS's National Taxpayer Advocate in a December 31, 2001, report to the Congress.[15] In the report, the Advocate noted that examiners sometimes disallow the EIC because school records submitted by taxpayers reflect the addresses of the taxpayers' relatives or friends. As explained by the Advocate, parents may provide school authorities with a relative's or friend's address, instead of their own, "in order for their child to attend a particular school for purposes of busing and facilitating before-school or after-school care."

Medical records can also cause problems for EIC claimants. According to some examiners we interviewed, many taxpayers submit their child's immunization records as the medical record to prove residency. Of the 21 examiners we interviewed, 18 did not accept immunization records as proof of residency. Some examiners explained that immunization records do not include the addresses of either the child or the taxpayer and, as such, cannot be accepted as proof of residency. Some of the 18 examiners said that they would accept a letter from a physician or an official record from a medical center showing the child's address as well as the taxpayer's address as proof that the taxpayer and child have the same address.

[15] *National Taxpayer Advocate FY2001 Annual Report to Congress* (Dec. 31, 2001).

However, according to the LITC representatives we interviewed, many low-income taxpayers have no ongoing medical care. In that regard, we reported in 1997 that 10.6 million children, living generally in lower-income working families, were uninsured in 1996.[16] We further reported that, according to various national studies,

- a high proportion of these children's parents worked for small employers that most likely did not offer health insurance;
- even when employers offered medical coverage, the amount that employees had to pay toward it to cover their families could have made health insurance unaffordable;
- these uninsured children were less likely to (1) have a usual source of care, (2) see a specific physician, (3) receive care from a single site, (4) have had a visit to a physician in the past year, and (5) ever have had routine care; and
- medical care for uninsured children was more likely to be sporadic and fragmented.

Considering the medical coverage of low-income taxpayers, obtaining medical records that provide enough information to demonstrate that the taxpayer's and child's addresses were the same for at least one-half a year may not be easy.

LITC representatives said that getting documentation, such as medical records or school records, to prove residency or living arrangements is not easy. For example, migrant workers would have a tough time getting school records from the schools their children attended throughout the year. As we reported in October 1999, during 1993-94, 78 percent of migrant crop worker families lived in two or more locations.[17]

Of the 10 LITC representatives we interviewed, 5 said that IRS should develop a standard form on which it could indicate the specific period of time for which IRS needed support. A taxpayer could then take the form to a school or a medical office, which could just write in the child's and taxpayer's address for the specific tax year IRS wanted. A few of the examiners we surveyed also said that they would benefit from such a

[16]U.S. General Accounting Office, *Health Insurance: Coverage Leads to Increased Health Care Access for Children*, GAO/HEHS-98-14 (Washington, D.C.: Nov. 24, 1997).

[17]U.S. General Accounting Office, *Migrant Children: Education and HHS Need to Improve the Exchange of Participant* Information, GAO/HEHS-00-4 (Washington, D.C.: Oct. 15, 1999).

standard form because it would give them the exact information they are looking for to recertify taxpayers.

In 1998, examiners in one processing center started using a locally devised form that essentially served the purpose of the standard form suggested by the LITC representatives. Use of the form by examiners at the center was optional. Although no study was done of its effectiveness, anecdotal information indicates that examiners found it effective. One examiner who used the form estimated that one-half of the taxpayers to whom she sent the form were able to secure verification compared with the very few taxpayers who were able to secure verification without the form.

Child-Care Statements

Form 886-R states that a notarized statement from a child-care provider with certain detailed information about the child and the child-care provider would be considered acceptable evidence for residency. In our telephone survey, we asked examiners if they would accept a notarized statement from babysitters. We estimate that 62 percent of recertification examiners would not accept a notarized statement from a babysitter as evidence. The nonacceptance rate went up to 79 percent if the notarized letter was from a relative, such as a grandparent, who claimed to be the child's babysitter.

Several examiners said that they would not accept the notarized letter because the notary public verifies the signature but not the content of the letter. These examiners are correct in their understanding of the purpose of the notary public. However, a notarized letter from a child-care provider is a document listed on Form 886-R as acceptable proof of residency. We do not know how many taxpayers failed to recertify for the EIC because examiners would not accept a notarized letter from their babysitter. However, telling taxpayers that a notarized letter is acceptable and then refusing to accept it can frustrate taxpayers and subject them to unnecessary burden. Not only would those taxpayers have spent unnecessary time and effort writing the letters and locating a notary public, but they would have had to pay for the notary public's service.[18]

Perhaps the more problematic issue related to evidence of child care is the general unwillingness of examiners to accept statements from relatives.

[18]According to *The National Notary* (May 2001), notaries public charge anywhere from $0.50 to $10.00 for each notarized signature.

Some examiners told us, for example, that they would accept child-care provider statements if they were from child-care centers, but expressed the belief that relatives would lie to help a taxpayer get the EIC. While we understand the hesitancy to accept a relative's statement, refusing to accept child-care statements from relatives can pose a hardship for low-income taxpayers who use relatives for child care. The problem is compounded by the clear implication on Form 886-R that a "notarized statement from a child care provider" containing certain information, such as the child's name, address, and dates of care for the entire tax year, is acceptable documentation to verify that a child lived with the taxpayer. Form 886-R says nothing to alert taxpayers that additional documentation may be needed if the child-care provider is a relative.

Grandparents and other relatives play an especially large part in the care of poor preschoolers. In a March 1996 report entitled, Who's Minding Our Preschoolers?, and an update issued in November 1997, the Census Bureau found that, in 1993 and 1994, relatives provided care for 62 percent of preschoolers in poor families while their mothers were working. This reliance on relatives, and especially grandparents, for child care was noted again in Census' October 2000 report entitled Who's Minding the Kids? Child Care Arrangements. Among other things, the report concluded, using Fall 1995 data, that "Fifty percent of preschoolers were cared for by a relative, with grandparents being the single most frequently mentioned care provider (30 percent)."

In reports issued in May 1997 and November 1999, we discussed three major barriers that confront low-income persons in trying to find child care: availability; accessibility; and cost, especially for infants and toddlers.[19] As discussed in these reports,

- many parents of low-income families are likely to obtain work at low-skill jobs, such as janitor or cashier, that operate on nonstandard schedules at workplaces that often do not offer child care during hours outside the traditional "9 to 5" work schedule;
- according to a 1999 Urban Institute paper, more than a quarter of low-income mothers work night hours;

[19]U.S. General Accounting Office, *Welfare Reform: Implications of Increased Work Participation for Child Care*, GAO/HEHS-97-75 (Washington, D.C.: May 29, 1997) and U.S. General Accounting Office, *Education and Care: Early Childhood Programs and Services for Low-Income Families*, GAO/HEHS-00-11 (Washington, D.C.: Nov. 15, 1999).

- accessibility, such as transportation to get to providers, was especially problematic in rural or remote areas; and
- child care consumes a high percentage of poor families' income.

Regarding the cost of child care, the Census Bureau, in its October 2000 report, said that poor families, in 1995, who paid for child care "spent 35 percent of their income on child care, compared with 7 percent spent by nonpoor families." Asking relatives to serve as child-care providers may be one way for poor families to limit the cost of child care. In that regard, the Census Bureau noted in its March 1996 report that preschoolers in poor families were 50 percent more likely to be cared for by their grandparents or other relatives than were preschoolers in nonpoor families.

Low-Income Taxpayers Face Problems That Complicate Their Ability to Comply with EIC Evidentiary Requirements

As noted in several places throughout the preceding discussion, low-income taxpayers face many problems that complicate their ability to satisfy the evidentiary requirements associated with the EIC recertification program. For example, many low-income taxpayers

- move from location to location for job reasons,
- have children who receive their medical care at hospital emergency rooms and have no medical insurance, and
- rely on relatives for free child-care service instead of taking their child to a child-care center.

In a December 31, 2001, report to the Congress, IRS's National Taxpayer Advocate identified the 23 most serious problems faced by taxpayers. Fifth on that list was "documenting [EIC] eligibility." In discussing this problem, the Advocate said the following:

"Low-income taxpayers usually cannot afford to take time off from work to gather the documentation required. They often do not maintain financial records. Many have moved several times, making it even more difficult to provide what is asked of them. Obtaining such documentation may therefore involve long-distance calls, which are beyond the financial means of these taxpayers."

In general, the 10 LITC representatives who we talked with said that the recertification process was confusing to their clients and difficult to comply with. Some representatives noted that these problems had caused clients to give up on EIC recertification. One LITC representative said that for migrant workers, getting documentation might include writing to Mexico for birth certificates and other information. According to the representative, (1) some agencies or companies may charge a fee for

documents; (2) requesting information through the mail would be difficult since many low-income taxpayers are illiterate; and (3) it takes time to gather support, and many taxpayers get discouraged and give up. Another LITC representative said his client gave up on the EIC because he had moved to another city for a new job and getting the records IRS wanted would require him to take time off from work and travel back to his old home town, neither of which he could afford to do.

Examiners Are Inconsistent in How They Assess Taxpayer Documentation

Some LITC representatives told us that some examiners were more lenient than others in assessing supporting documents and that third-party statements were not always treated the same. Four of the 10 LITC representatives we interviewed said that they have seen some of their client's EIC claims denied because they could not substantiate that the child was a dependent. However, an EIC child does not have to be a dependent of the taxpayer to qualify that taxpayer for the EIC. As such, financial support, which is a factor in determining if a child qualifies as a taxpayer's dependent, should not be a factor in determining if the child is a qualifying child for EIC purposes.

Because we did not review any LITC client case data, we cannot be certain whether IRS examiners denied the EIC because a taxpayer could not substantiate that the child was a dependent or if the denial was for other reasons. However, our interviews of examiners provided significant evidence to support the statements by LITC representatives. Fifty-three percent of examiners said that a least some of the taxpayers who failed to be recertified failed because they could not provide documentation of the eligible child's financial support. Also, although we did not do any systematic review of recertification audit case files, we did look at some cases to get a better understanding of the recertification audit process. In one case, we found correspondence from an examiner to a taxpayer that exemplified the dependent exemption versus EIC problem. The correspondence said:

"Since you have not verified that you are entitled to the exemption(s) claimed on your return, we have disallowed the deduction. Since the exemption for your child (or children) has been disallowed, you are not entitled to the earned income credit and/or child tax credit; therefore we have disallowed it/them."

Contrary to those statements, denial of a dependency exemption does not automatically mean that a taxpayer is not entitled to the EIC.

Case Scenarios Indicate Variance in Recertification Decisions

In an effort to see how consistently IRS examiners assess evidence submitted by taxpayers, we presented 21 examiners at the four processing centers we visited with five scenarios involving differing sets of supporting documents. We obtained these documents from EIC recertification cases that we had reviewed. We deleted taxpayer-identifiable information, such as names, Social Security numbers, and addresses, from the documents before giving them to the examiners.

The five scenarios were as follows:

- Case A—a single mother sending in copies of Social Security cards, the child's birth certificate, and a school record listing the child's address.
- Case B—a married couple, filing jointly, sending in copies of Social Security cards, the child's birth certificate, and a locally devised IRS form signed by a school official verifying the child's address.
- Case C—a single father sending in copies of Social Security cards, the child's birth certificate, an immunization certificate showing the taxpayer as the parent and that the child received shots throughout the tax year, and a formal lease listing the taxpayer as the leasee but with no reference to the child. This case also included a notarized letter from the taxpayer's grandmother stating that she provided child care for the taxpayer's daughter while the taxpayer worked. The grandmother gave her own address and Social Security number.
- Case D—a single father sending copies of Social Security cards, the child's birth certificate, an immunization record that did not have either the child's or the taxpayer's name, various monthly rental receipts not showing the full dates, and a letter from someone (without a title) written on apartment letterhead.
- Case E—a single father sending in copies of Social Security cards, the child's birth certificate, a lease agreement not listing the child's name, and a non-notarized letter from a babysitter stating that she cared for the taxpayer's child throughout the year while the taxpayer was at work. The babysitter mentioned the salary she received from the taxpayer, but did not give her address, telephone number, or Social Security number.

As seen in table 1, in no case did all examiners agree and, in some cases, their decisions varied significantly.

Table 1:Recertification Decisions in Five Case Scenarios

Decision	Case A	Case B	Case C	Case D	Case E
Documents support EIC	13	19	3	7	4
Documents do not support EIC	8	2	18	14	17

Source: GAO's analysis of the results of 21 examiner interviews.

Cases B, C, and E showed the most consistent decisions. Of the 19 examiners who accepted the Case B documentation, 7 said that they did so because the taxpayer was married and filed jointly and because the child lived with both parents and 1 said that he was swayed by the school verification (the other 11 did not explain their reasoning). Case C was almost unanimously rejected because examiners would not accept a notarized letter from the taxpayer's grandmother who claimed to be the child-care provider. Although the grandmother's letter had met all the specifications listed on Form 886-R, examiners still did not accept it as adequate proof of living arrangement. This is consistent with the results of our examiner interviews, which, as discussed earlier, showed that 79 percent of examiners would not accept such a letter. In Case E, we included a nonrelative babysitter's letter as evidence of residence. Although the babysitter's letter was not notarized and did not have the babysitter's Social Security number or address, more examiners were willing to accept this letter than the notarized letter in Case C from a grandmother who gave her Social Security number as required by IRS.

Examiners' decisions varied significantly in Cases A and D. For Case A, three examiners pointed out that they would not accept the school record submitted because it pertained to a school year and not the tax year. A taxpayer would have to submit school records for 2 school years to cover the tax year in question. Some examiners who decided that the documents in Case D did not support recertification thought that the apartment letterhead on the letter saying that the taxpayer lived there looked too simplistic or fake to be trusted. They pointed out that almost anyone with a computer could easily come up with such a letterhead.

IRS is aware of the need for more consistency in the evaluation and determination of EIC cases. According to the Director of Reporting

Compliance in IRS's Wage and Investment Division,[20] IRS is in the process of developing a decision support tool to be used by examiners working EIC cases. Because all EIC audits involve the same basic issue—proving that the EIC claim satisfies all eligibility tests—the decision tool is to be used for all EIC cases, including those involving recertification. The goals of this project are to (1) automate the decision process examiners go through when performing audits, (2) reduce inconsistency in how EIC audits are conducted nationwide and subsequently improve the quality of examinations, and (3) decrease the time spent on EIC audits since the logic will be built into the tool to determine the appropriate questions for the individual case. IRS is planning to implement the first phase of this project and deliver training to examiners by May 2002.

As described to us by the Director of Reporting Compliance, the first phase basically involves automating the current process. As such, it does not include a reconsideration of the documentation requirements discussed in this report. In that regard, for example, we noted, in reviewing preliminary information on the tool, that it included information to suggest that documentation of financial support was necessary to determine EIC eligibility. We advised the Director of our concerns in that regard, and he agreed to look into the matter. According to the Director, the project team is expected to take on the issue of what documentation taxpayers need to submit to prove their eligibility for the EIC during phase 2 of the project.

In a related move, an IRS/Treasury task force was formed in February 2002 to comprehensively review the EIC program in general. The task force's objective is to develop recommendations for achieving the objectives of the EIC program "while reducing taxpayer confusion and increasing the accuracy of the administration of benefits." The task force was to complete its work within 4 months.

Conclusions

Administering the EIC is not an easy task for IRS. IRS has to balance its efforts to help ensure that all qualified persons claim the credit with its efforts to protect the integrity of the tax system by guarding against fraud and other forms of noncompliance associated with the EIC. Furthermore,

[20]As a result of a recent reorganization, IRS has four main operating divisions, each responsible for a distinct group of taxpayers. The Wage and Investment Division is responsible for taxpayers whose only income comes from wages and investments. That Division is responsible for audits done under the EIC Recertification Program.

as with other provisions of the tax code, IRS must minimize the burden imposed on taxpayers yet ensure that it has a reasonable basis for judging whether taxpayers have properly claimed the credit. Although the recertification program provides a vehicle for combating EIC noncompliance, we believe that the program unnecessarily burdens taxpayers and provides inadequate assurance that IRS has a reasonable evidentiary basis for determining whether recertification applicants should be granted the EIC. As a consequence, taxpayers may be discouraged from claiming credits to which they are entitled or IRS may make poorly supported decisions in allowing or disallowing the credit.

We identified several opportunities to make the recertification program less confusing to taxpayers and the decisions reached more accurate and consistent, without adversely affecting IRS's ability to protect against EIC noncompliance.

Two important forms used in the recertification process are problematic. Form 8862 is required of all taxpayers seeking recertification, yet 86 percent of IRS examiners who audit recertification cases say they do not use it. Since IRS is basically using Form 8862 only as a trigger for initiating the recertification process, we believe that a simpler version of Form 8862 could serve that same purpose. Form 886-R, which tells taxpayers what documentation they need to submit to prove their eligibility for the EIC, says nothing about documentation that taxpayers in nontraditional childrearing arrangements—which are likely common among the EIC recipient population—need to provide to demonstrate that they meet the EIC relationship test. At the same time, Form 886-R lists documentation that substantial majorities of examiners said they would not accept. The form states that a notarized statement from a child-care provider is acceptable evidence that a child lived with the claimant. However, 62 percent of examiners said that they would not accept such statements generally and 79 percent said that they would not accept such statements from relatives who provide child care.

Other documentation listed on Form 886-R, while useful in gauging a taxpayer's eligibility for the EIC, can lead to unnecessary taxpayer burden. IRS could minimize that burden and increase the probability of obtaining useful information by clarifying Form 886-R itself or providing simple supplemental forms that serve the same purpose. For instance, taxpayers would be less likely to submit school year attendance information rather than tax year attendance information if IRS were to develop a simple form that specified the period (e.g., January through December 2000) for which

taxpayers must provide information. A taxpayer could then take the form to the school(s) for completion.

When IRS has gathered information to judge whether a taxpayer should be recertified, examiners reviewing the information are likely to reach differing conclusions. The 21 examiners who reviewed five case scenarios we developed based on actual case files did not all agree on any scenario and, in some cases, reached widely varying judgments about whether the evidence was sufficient to support an EIC claim. Furthermore, 53 percent of the examiners we interviewed said that they have sometimes denied recertification because taxpayers did not provide documentation of financial support for the EIC-qualifying child—reflecting a fundamental misunderstanding of the law since financial support is not a criterion for the EIC.

The results of our review suggest that IRS needs to reassess the evidentiary requirements for recertification and take steps to better ensure that examiners understand and more consistently apply the criteria for recertification. The inability to prove that qualifying children have lived with taxpayers for the requisite period of time—the residency requirement—has historically been a major reason why taxpayers are judged not eligible for the EIC. IRS examiners will continue to exercise discretion in determining whether documentation is sufficient even when using IRS's proposed new decision support tool. Furthermore, each of the three types of acceptable documentation cited on Form 886-R for establishing residency can prove problematic for an EIC claimant. Therefore, the chances of a claimant being able to prove to an examiner's satisfaction that a child's living arrangement meets EIC requirements might be enhanced if taxpayers were encouraged to send IRS various types of documentation. Form 886-R, as currently worded, encourages taxpayers to send in just one type of documentation—be it school records, medical records, or statements from a child care provider—which can leave an examiner with less than conclusive evidence. If taxpayers provided more than one document, an examiner could disregard a document that seemed questionable but possibly find one or more of the other documents persuasive. Also, a pattern of evidence across several corroborating documents may provide a more meaningful basis for examiners to judge residency.

Although our review was directed at the EIC Recertification Program, many of our findings would also apply to other IRS audits of EIC claims because IRS's requirements for proving eligibility for the EIC apply to all EIC claimants, not just those who have to recertify. In that regard, while

we understand that it is not possible, and probably not desirable, to eliminate all subjectivity from examiners' decisions about EIC eligibility, there is room to bring more consistency to that process—not only consistency among examiners but also consistency between the requirements of the tax law (e.g., no financial support test to claim the EIC) and examiners' practices. IRS recognizes the need for more consistency and is working to develop a decision support tool for EIC audits. More broadly, an IRS/Treasury task force has been charged with developing recommendations for making the overall EIC program less confusing to taxpayers and easier for IRS to administer. The results of our work should be useful to IRS in developing the decision support tool and to the task force in deliberating on possible changes to the EIC program.

Recommendations for Executive Action

We recommend that the commissioner of Internal Revenue reassess the evidentiary requirements for recertification. As part of that reassessment, we recommend that the commissioner do the following:

- Revise Form 8862 to make it a simple request for recertification that IRS can use to trigger the recertification process and eliminate all of the information that taxpayers are now asked to provide on the form.
- Revise Form 886-R (and similar forms used for other EIC audits) to
  - clarify that taxpayers who are seeking EIC recertification do not have to demonstrate that their EIC-qualifying child is a dependent to qualify for the EIC;
  - help taxpayers understand what documentation they must provide (such as birth certificates, adoption papers, etc.) to establish their relationship with the EIC-qualifying child, especially when the child is not their natural born son or daughter;
  - eliminate the need to have the statement from a child-care provider notarized, since a notary public does not verify the content of the statement and most examiners placed no validity on the notary stamp; and
  - encourage taxpayers to submit more than one type of document to demonstrate that the EIC-qualifying children lived with them.
- If IRS is not willing to accept a relative's child-care statement as evidence that a child lives with the taxpayer, make that clear on Form 886-R, on similar forms used for other EIC audits, and in the EIC decision support tool and suggest additional evidence that a taxpayer might provide.
- Whatever IRS's official position on statements from relatives, ensure that examiners are aware of that position and apply it consistently.
- Develop a standard form that taxpayers can give to a school or health-care provider that specifies the information needed and on which examiners can indicate the period of time for which that information is needed.

- If IRS decides not to develop a standard form, revise Form 886-R to clearly remind taxpayers that records for parts of 2 school years are needed to document a living arrangement for the tax year.
- Take appropriate steps to ensure that the new EIC decision support tool does not continue the inappropriate linkage of financial support to decisions on EIC eligibility.

In conjunction with the establishment of the EIC decision support tool, which is intended to improve consistency among EIC examinations, provide examiners with the training needed to better ensure consistent and accurate decisions. As part of the training, emphasize to examiners the difference between the eligibility requirements for an EIC-qualifying child and a dependent.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from IRS. We obtained written comments in an April 10, 2002, letter from the commissioner of Internal Revenue (see app. V).

The commissioner cited several steps being taken with respect to the EIC, including the development of the decision support tool and convening of the IRS/Treasury task force, referred to earlier, and the redesign of EIC taxpayer notices. The commissioner said that the IRS/Treasury task force would consider the findings discussed in this report in evaluating "legislative and administrative solutions to [EIC] recertification problems."

With respect to our recommendation that IRS revise Form 8862, the commissioner said that the Wage and Investment Division will study the use of Form 8862 in EIC recertifications and the examination of related issues. Based on the results of that study and our findings, IRS "will evaluate possible revisions to the form that will make communications clearer, reduce taxpayer burden, and aid the recertification and examination processes." IRS anticipates completion of this study by June 2003. Such a study, with the objectives cited by the commissioner, would be responsive to our recommendation.

Regarding our recommendation that IRS revise Form 886-R and similar forms, the commissioner said that IRS plans to have revised forms that incorporate feedback from taxpayers and tax practitioners by the 2003 filing season. We agree wholeheartedly with the plan to obtain feedback from taxpayers and practitioners and look forward to seeing the results of these efforts. However, the commissioner's response did not clearly indicate that the intended revisions to the forms would reflect the specific

changes we recommended. We encourage the commissioner to ensure that the recommended changes are made.

In response to our two recommendations relating to child care provided by a taxpayer's relative, the commissioner said the following:

- "A child-care provider's statement by itself may not be sufficient to verify eligibility. In that instance, the taxpayer will need to provide additional collaborating evidence to support his or her [EIC] claim. We will show examples of this evidence on Form 886-R."
- IRS will enhance examiner awareness of IRS's official position on this issue and the consistency of its application through the decision support tool, in examiner training and the Internal Revenue Manual, and during quality reviews.

The actions referred to by the commissioner would be responsive to our recommendations.

With respect to our two recommendations about helping ensure that taxpayers obtain documentation for the proper time period, the commissioner said that IRS was revising Form 886-R to clearly remind taxpayers that records for parts of 2 school years are needed to document a living arrangement for the tax year. That would be responsive to our recommendation.

Finally, the commissioner said that the new EIC decision support tool has been revised to incorporate our recommendation that IRS take appropriate steps to ensure that the new tool does not continue the inappropriate linkage of financial support to decisions on EIC eligibility. The new tool is to be rolled out nationwide in May 2002.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution of it until 30 days from the date of this report. We will then send copies to the Chairmen and Ranking Minority Members of the Senate Committee on Finance and the House Committee on Ways and Means; the Ranking Minority Member of this Subcommittee; the secretary of the Treasury; the commissioner of Internal Revenue; the director, Office of Management and Budget; and other interested parties. We will also make copies available to others on request.

This report was prepared under the direction of David J. Attianese, Assistant Director. Other major contributors to this report are acknowledged in appendix VI. If you have any questions, contact Mr. Attianese or me on (202) 512-9110.

Sincerely yours,

Michael Brostek
Director, Tax Issues

Appendix I: Evolution of the Earned Income Credit Recertification Program

The Congress established the earned income credit (EIC) in 1975 to offset the impact of Social Security taxes paid by low-income workers and to encourage low-income persons to choose work over welfare. A significant number of taxpayers are affected by EIC. In 2001, 18.7 million taxpayers claimed a total of $31 billion in EIC.

Since 1995, we have identified EIC noncompliance as one of the high-risk areas within IRS.[1] EIC noncompliance has resulted in billions of dollars in EIC claims that IRS paid, but should not have. In its most recent EIC compliance study, IRS determined that of an estimated $31.3 billion in EIC claims for tax year 1999, between $9.7 billion and $11.1 billion was overclaimed. After deducting the estimated amount of those overclaims that it recovered during the processing of returns and through enforcement programs, IRS determined that between $8.5 billion and $9.9 billion in tax year 1999 EIC claims was paid out that should not have been.

The Taxpayer Relief Act of 1997 reflects the Congress' concern about the level of EIC noncompliance. Among other things, the 1997 act amended the Internal Revenue Code to provide that taxpayers who are denied EIC during an IRS audit are ineligible to receive the EIC in subsequent years unless they provide documentation to demonstrate their eligibility. IRS developed a recertification program designed to deal with this new requirement. Taxpayers were first required to recertify, based on a 1997 audit, when submitting their 1998 tax returns.

Taxpayer Outreach and Correspondence and Examiner Training Have Improved

Tax year 1998 returns filed in 1999 were the first returns to which affected EIC claimants would have to attach a Form 8862 for recertification. In preparation for that event, IRS provided little information to taxpayers on what to expect when they sought recertification. IRS issued recertification guidelines to service center examiners at the beginning of the 1999 filing season but, according to examiners we interviewed, gave no formal training on recertification to examination staff. As described in appendix II, we and TIGTA found that service centers did not consistently follow the recertification guidelines, and a number of forms and letters IRS used for recertification contained inconsistent or irrelevant information.

[1]Initially, this high-risk area was referred to as "IRS Tax Filing Fraud." In January 2001, we narrowed the focus of the high-risk area and renamed it "Noncompliance With EIC."

IRS's outreach and correspondence to taxpayers and its training of examiners have improved since then. For example, IRS began to distribute basic information on the recertification program through its web site on the Internet, Publication 596 (Earned Income Credit) was revised to include a section on what taxpayers need to do if they have been disallowed the EIC as a result of audit, some changes were made to improve the quality of IRS correspondence, and more guidance was provided to examiners.

Slow Start—1999, First Year of Recertification Requirement

In 1998, IRS disallowed, through audits, the EIC claims on about 312,000 taxpayers. According to IRS's Recertification Guidelines, these taxpayers were to be sent Letter 3094 notifying them that:

"The law now requires when we deny EIC [as a result of deficiency procedures], we must also deny it for any succeeding years unless you provide information showing you are entitled to the credit.

You must, therefore, complete and attach Form 8862, Information to Claim Earned Income Credit After Disallowance, to the next return on which you claim EIC. While we determine if you are entitled to the credit, we will delay any refund due. If you claim EIC on your return without attaching a completed Form 8862, we will disallow the credit.

You can get Form 8862 at most locations where tax forms are available. You will also be able to submit Form 8862 electronically when you file federal tax return…"

None of the 1999 IRS publications, forms, and instructions regarding the EIC provided any information on the recertification process or requirements other than the need to file Form 8862.[2] Even IRS's publication of the need to file Form 8862 was not completely effective. An internal IRS study found that of the 312,000 required-to-recertify taxpayers, 38 percent (118,989) claimed the EIC again for tax year 1998. However, nearly 46 percent of these taxpayers (54,194 of the 118,989) did not attach the Form 8862 with their returns and thus were automatically denied the EIC.

[2]We reviewed the following IRS information: Form 8862 and the accompanying instructions, Publication 17 (Your Federal Income Tax), Publication 596 (Earned Income Credit), Form 1040 and the accompanying instructions, and a transcript of pre-recorded EIC information available on IRS's TeleTax system.

Within IRS, there was also confusion over the recertification process. At the beginning of the 1999 filing season, IRS issued recertification guidelines for Service Center examiners, but examiners we interviewed said that there was no formal training for examiners on recertification. With some exceptions pertaining to which EIC children an examiner should seek verification and how the recertification indicator should be handled after a taxpayer has been recertified, the recertification process essentially follows IRS's normal process for conducting examinations via correspondence.

During our review of the 1999 filing season, we found that (1) form letters that IRS sent to taxpayers seeking recertification contained inconsistent and irrelevant information; (2) form letters that IRS sent to taxpayers asked for information beyond that specified in the recertification guidelines; and (3) service centers were not consistently following the recertification process.[3]

A more detailed review by TIGTA disclosed, among other things, that (1) the indicator used to identify taxpayers who must recertify was not always removed accurately; (2) some suspended refunds were not released timely; (3) recertification audits were not always processed in a timely manner; (4) not all recertification determinations were accurate; and (5) IRS correspondence was unclear.[4] TIGTA attributed these problems, in part, to (1) the IRS correspondence used did not clearly explain how the program worked or what was required for the taxpayer to be recertified and (2) IRS did not ensure that employees received, understood, and implemented recertification procedures. (See app. II for TIGTA's findings and IRS's corrective actions.)

Improvements During the 2000 and 2001 Filing Seasons

Outreach to taxpayers for filing seasons 2000 and 2001 improved compared with 1999. For example, in 2000, IRS revised Publication 596 (Earned Income Credit) by expanding the section on EIC recertification. The publication provided examples of who would be required to file Form 8862 and alerted taxpayers that they may have to provide additional documentation before being recertified. In 2001, IRS included questions on EIC recertification in the "Frequently Asked Questions" section of its Web

[3]GAO/GGD-00-37.

[4]TIGTA, Reference No. 2001-40-030.

site and further expanded the chapter on EIC recertification in Publication 596.

The 2001 improvement in outreach was especially critical because the Ticket to Work and Work Incentives Improvement Act of 1999 (P.L. 106-170) had tightened the definition of an eligible foster child for EIC purposes. IRS publicized this change on its Web site, in Publications 596 and 553 (Highlights of 2000 Tax Changes), and on Schedule EIC.

Recertification training for examiners also improved compared with 1999. EIC training videos that were sent to IRS's processing centers for the 2001 filing season included materials on recertification. IRS also incorporated the recertification guidelines into the Internal Revenue Manual section dealing with correspondence examinations in an effort to improve program consistency. Forms and letters were revised and examiners were instructed, via IRS's internal Taxpayer Service Electronic Bulletin Board, to correct improper handling of recertification cases.

Appendix II: Recent GAO and TIGTA Recommendations Relating to EIC Recertification and IRS Corrective Actions

Since July 1999, we[1] and the Treasury Inspector General for Tax Administration (TIGTA)[2] have reported several concerns about the EIC Recertification Program and have made several recommendations. In response to those recommendations, IRS implemented several corrective actions. The recommendations and corrective actions are described in tables 2 and 3.

[1]U.S. General Accounting Office, *IRS Correspondence to Taxpayers on Earned Income Credit Recertification*, GAO/GGD-99-112R (Washington, D.C.: July 30,1999.) and GAO/GGD-00-37.

[2]*Improvements Are Needed in the Earned Income Credit Recertification Program*, TIGTA, Reference No. 2001-40-030, Dec. 29, 2000.

Table 2: Prior GAO Report Findings on IRS's Recertification Process and IRS's Corrective Actions

GAO findings	GAO recommendations	IRS corrective actions
Irrelevant information in IRS Letter 3094 could confuse taxpayers.	Revise Letter 3094 by either (1) making the paragraph relating to reckless or intentional disregard of law and fraud an optional paragraph to be used only when it is relevant; (2) restricting letter 3094 to cases that do not involve reckless or intentional disregard of the law or fraud; or (3) rewording the paragraph to make it clear that it does not apply to the specific audit finding covered by the letter but is being provided to alert taxpayers to the potential consequences if they continue their noncompliant behavior.	IRS revised Letter 3094 by eliminating the 2-year penalty warning for those taxpayers who were not found reckless. This revised letter also included a statement that "Even though you attach Form 8862, we may request additional documentation to substantiate your EIC claim." A new letter, 3094A, was designed for those taxpayers who were found recklessly disregarding the EIC rules. Letter 3094A tells taxpayers that (1) they were found to have recklessly or intentionally disregarded the EIC rules and would be subjected to the 2-year penalty and (2) when and how they can claim the EIC in the future.
IRS Letters 3177 and 3183 contain inconsistent information.	Revise Letter 3177 and/or letter 3183 so that consistent refund issuance time frames are cited in both letters.	Revised Letters 3177 and 3183 for fiscal year 2000 so that consistent refund issuance time frames are cited in both letters.
IRS Letter 3184 and Form 886-H are inconsistent with IRS's operating procedures.	Make the documentation requirements in Letter 3184 and Form 886-H more consistent with the requirements in IRS's internal recertification guidelines.	Letter 3184 was discontinued, and Form 886-R, which IRS now uses in recertification cases instead of Form 886-H, was revised in November 1999.
IRS examiners did not rely on the information on Form 8862 to recertify taxpayers claiming EIC based on a qualifying child. Form 8862 may mislead taxpayers to believe the information they provide on the form would be sufficient for recertification.	If IRS does not rely on Form 8862 for recertification purposes, discontinue its use. If IRS continues using Form 8862 for recertification purposes, redesign the form to include reference to the documentation listed on Form 886H and any other documentation that IRS thinks is necessary for recertification so that taxpayers who are required to recertify know as early as possible what documentation is required for recertification.	IRS said that it relies on Form 8862 to "identify the type of action to be taken for taxpayers required to recertify." IRS also noted that redesigning Form 8862 to include references to documentation that might be needed for recertification may be counterproductive to IRS's efforts to reduce taxpayer burden. We revisited the need for and design of Form 8862 as part of this review of the Recertification Program and have a recommendation in this report that supersedes our prior recommendation.
Despite the issuance of national guidance on the recertification process, procedures were not being followed consistently.	Ensure that all service centers implement the recertification procedures according to national guidelines to avoid possible disparate treatment of taxpayers.	According to IRS (1) the guidelines were incorporated into the Internal Revenue Manual, (2) adherence to procedures in the manual is mandatory, and (3) special reviews were to be done during fiscal year 2000 to assess conformance to the procedures.

Source: GAO/GGD-99-112R and GAO/GGD-00-37.

Table 3: TIGTA Recertification Report Findings and IRS's Corrective Actions

TIGTA findings	TIGTA recommendations	IRS's corrective actions
IRS did not always remove the recertification indicators accurately. IRS allowed the EIC but did not remove the recertification indicator for an estimated 11,400 taxpayers nationwide. Additionally, IRS erroneously removed the recertification indicator for an estimated 4,100 taxpayers nationwide. IRS should remove the recertification indicators from those accounts where taxpayers have proven their EIC eligibility and should improve its quality review process to help ensure employees remove indicators when appropriate.	(1) IRS should ensure that the recertificiaton indicators on taxpayers' accounts are accurate. Accordingly, it should remove indicators from taxpayers' accounts if they have proven their EIC eligibility.	In January 2000, IRS formalized EIC recertification procedures by including them in the Internal Revenue Manual that is available to all EIC examiners.
	(2) IRS should improve its quality review process to help ensure employees remove indicators when appropriate.	IRS disagreed with the need to revise the quality review process since closed recertification cases accounted for only 1.4 percent of all EIC cases. However, IRS said it would revise its procedures and training to ensure employees remove indicators when appropriate. IRS agreed to reconsider its quality review procedures if future reviews indicate problems.
	(3) IRS should clarify its procedures to specifically instruct employees as to what information and actions are needed to prove taxpayers are qualified to receive the income-only EIC. These procedures should also be clarified to ensure that taxpayers are not considered recertified when they file Forms 8862 but do not claim or receive an EIC.	IRS revised its procedures to specifically instruct employees as to what information and actions are needed to prove taxpayers are qualified to receive the income-only EIC. IRS also revised Letter 3094 to explain to taxpayers how to claim income-only EIC.
Some suspended refunds were not released timely. In a sample of 200 accounts with actions to suspend any refunds, TIGTA identified that IRS did not release refunds timely for 86 (43%) accounts.	(4) IRS should identify and resolve recertification accounts with incorrectly suspended refunds.	IRS performed a one-time extract to identify recertification accounts with suspended refunds and issued instructions to examination personnel for working these cases. Also, according to IRS, it has been generating, since January 2001, a monthly extract of nonreversed refunds, which is forwarded to each Examination Branch for action and resolution.
	(5) IRS should modify computer programs to ensure that the weekly listings used to determine whether to release suspended refunds or to conduct an audit include all applicable taxpayer accounts with suspended refunds.	IRS said it (1) corrected the programming by automating transaction codes on pick-up cases, which should ensure that weekly listings contain all accounts with suspended refunds and (2) issued instructions to Examination personnel to work the list within 5 business days and included the instructions in the Internal Revenue Manual.
Recertification audits were not always completed timely. TIGTA reviewed 104 EIC recertification audits and identified 59 (57%) that had not been timely processed. The delays ranged from 2 weeks to 29 weeks and averaged 8 weeks.	(6) IRS should ensure that inventory reports are effectively used to monitor and identify processing delays and provide timely feedback to offices where delays occur.	The monthly extract in Corrective Action #4 above should assist examiners in identifying and resolving processing delays. IRS's National Office was to perform monthly oversight to ensure feedback is provided to offices where delays occur. Other IRS monitoring tools included (1) status workload reports that were to be generated every 2 weeks in each processing center and (2) monthly inventory oversight by headquarters and field office analysts.
	(7) IRS should use the correct project codes to identify recertification audits.	IRS corrected the programming on pick-up cases by automating relevant transaction codes and the project code, which will ensure all cases contain the correct code.

TIGTA findings	TIGTA recommendations	IRS's corrective actions
TIGTA found that not all recertification determinations were accurate. TIGTA identified 40 returns where IRS allowed child-related EIC totaling about $82,000 without sufficient documentation provided by taxpayers. These 40 returns included 22 returns from a sample of 69 returns that had been audited and 18 returns from a sample of 37 returns that had not been audited.	(8) IRS should establish minimum standards for auditors determining the extent of source documents required to allow child-related EIC and children claimed as exemptions.	IRS said that (1) it revised the Internal Revenue Manual to include guidelines for EIC examiners, (2) training packages for the applicable tax law allowing deductions and credits are available to the EIC examiners, (3) performance reviews are done to ensure that the Manual and tax laws are followed, and (4) a national training tape was provided to all centers to ensure consistency in training.
	(9) IRS should emphasize the procedures to send Recertification Program claims to the Examination function.	IRS said it would update the Internal Revenue Manual to emphasize procedures for the Recertification Program for Customer Account Service employees.
Correspondence to taxpayers about the recertification process was not always clear or was not sent.	(10) IRS should revise letters sent to taxpayers in the Recertification Program to ensure letter accuracy and to better explain the program and should revise computer programming to ensure only appropriate letters are generated.	IRS revised Letter 3094 to inform taxpayers that additional documentation may be required to substantiate their claims for EITC when they file Form 8862 following disallowance. In addition, IRS designed a letter, CP 75A, specifically for the Recertification Program, which tells taxpayers that their refund will be delayed. IRS also implemented a program change to suppress the CP 75A when the taxpayer has a balance due on the original filing.
	(11) IRS should notify potentially qualified taxpayers subject to recertification that they might be entitled to income-only EIC. Any corrective action should take into consideration the rules for taxpayers previously denied the EIC due to reckless or intentional disregard for the law or fraud.	IRS revised Letter 3094 to tell taxpayers that they may qualify for income-only EIC even though child-related EIC was denied.
Recertification Program procedures and the recertification indicators are not based on the reasons the EIC is denied. Taxpayers who receive income-only EIC when child-related EIC had been previously denied should not be considered recertified.	(12) To increase revenue protection, IRS should consider changing the Recertification Program regarding when taxpayers are recertified. If this recommendation is adopted, IRS should make a business decision as to what actions are necessary for taxpayers to receive income-only EIC after child-related EIC has been denied. Any changes should take into consideration the rules for taxpayers previously denied the EIC due to reckless or intentional disregard for the law or fraud.	IRS issued Final Rules on Eligibility for Earned Income Credit Following Denial, which state that IRS will explore whether, and to what extent, its system is capable of undertaking a change to have taxpayers establish eligibility the next time they claim the credit with one or more qualifying children rather than the next time they claim the credit.

Source: TIGTA, Reference No. 2001-40-030.

Appendix III: Sampling Methodology and Results

To help identify any problems taxpayers may have in understanding and complying with the EIC recertification process and determine how consistently IRS examiners assess evidentiary support, we conducted a telephone survey of IRS examiners doing recertification audits. We obtained from IRS a list of all examiners who were working on EIC recertification cases as of April 2001. From that list of 323 examiners, we selected a simple random sample of 105 examiners. We found that 12 of those 105 examiners were not doing recertification audits at the time of our survey and 3 others were unavailable for us to interview during our survey timeframe.[1] Therefore, our survey results represent the views of about 277, or about 97 percent, of the estimated 286 examiners doing recertification audits at the time of our survey.[2]

The estimates we made from our telephone survey and their 95-percent confidence intervals are provided in table 4.

[1]The 12 included 3 examiners on extended leave, 7 examiners no longer doing recertification audits, and 2 examiner who reported never having done any recertification audits.

[2]The confidence interval for our estimate of 277 is from 254 to 294. The confidence interval for our estimate of 97 percent is from 92 to 99 percent. The confidence interval for our estimate of 286 is from 265 to 301. All confidence intervals are at the 95-percent level of confidence.

Table 4: GAO Estimates from Its Survey of Examiners Doing Recertification Audits

Amounts in percent

		95-percent confidence interval	
Of about 277 examiners doing recertification audits at the time of our review, the percentage that	**Estimate**	**Lower estimate**	**Upper estimate**
Did not find Form 8862 useful.	86	78	91
Believed that Form 8862 had some value.	13	8	21
Believed that Form 8862 misleads taxpayers into thinking that IRS's final decision on their eligibility will be based on information in the form.	16	10	24
Said that when a taxpayer failed to be recertified, most or all of the time the taxpayer's inability to substantiate that a child lived with the taxpayer led to the failure.	80	72	87
Would not accept a notarized statement as evidence.	62	53	71
Would not accept a notarized letter from a relative, such as a grandparent.	79	70	86
Examined the filing status and dependent exemptions on a taxpayer's return in addition to the EIC.	97	91	99
Also audited other items such as child tax, child care, and education credits.	57	47	66
Said that at least some of the taxpayers who failed to be recertified failed because they couldn't provide documentation of the eligible child's financial support.	53	44	63

Note: Confidence intervals were computed using the hypergeometric distribution. In doing these computations, we used a population size of 323 and a sample size of 90. Had we known exactly how many of the 323 examiners were doing recertification audits at the time of our survey, the confidence intervals we computed would have been somewhat narrower.

Source: GAO's survey of IRS examiners.

Appendix IV: IRS Forms 8862 and 886-R

Form **8862** (Rev. November 2000)
Department of the Treasury
Internal Revenue Service

Information To Claim Earned Income Credit After Disallowance

▶ Attach to your tax return. ▶ See separate instructions.

OMB No. 1545-1619

Attachment Sequence No. **43A**

Name(s) shown on return

Your social security number

Before you begin: See your tax return instructions for the year for which you are filing this form to make sure you can take the earned income credit (EIC) **and** to find out who is a qualifying child.

Part I All Filers

1 Enter the year for which you are filing this form (for example, 1999, 2000, etc.) . . . . . ▶

2 Were you, or your spouse if filing a joint return, a qualifying child of another person during the year entered on line 1? . . . . . ☐ Yes ☐ No

Next, if you do not have a qualifying child, go to Part II. If you do have a qualifying child, go to Part III.

Part II Filers Without a Qualifying Child

Caution. See your tax return instructions for the year entered on line 1 to be sure you can take the EIC.

3a Enter the dates during the year shown on line 1 that your home was in the United States ▶

b If married filing a joint return, enter the dates during the year shown on line 1 that your spouse's home was in the United States ▶

Part III Filers With a Qualifying Child or Children	**Child 1**	**Child 2**
Caution. If you have two qualifying children, complete lines 4–8 for one child **before** going to the next column. Be sure you list your children here in the same order as you did on **Schedule EIC.**		
4 Is the child your son, daughter, adopted child, grandchild, or stepchild? . . . . . **Next,** if you checked "Yes" for this child, go to line 5a. If you checked "No," go to line 6a.	☐ Yes ☐ No	☐ Yes ☐ No
5a Did the child live with you in the United States for more than half of the year entered on line 1?	☐ Yes ☐ No	☐ Yes ☐ No
b Enter the address(es) where you and the child lived during the year entered on line 1.		
c If the child attended school or day care, enter the name(s) of the school(s) or care provider(s) . . . . . **Next,** go to line 7a on the back for this child.		
6a Are you related to the child **or** was the child placed with you by an authorized placement agency? . . . . . **Next,** if you checked "No" on line 6a for this child, go to line 6c. If you checked "Yes," continue.	☐ Yes ☐ No	☐ Yes ☐ No
b Enter the child's relationship to you **or** the name of the placement agency. Enter both items if the child is related and was also placed with you by an agency.		
c Did you care for the child as if he or she were your own child during the entire year entered on line 1?	☐ Yes ☐ No	☐ Yes ☐ No

For Paperwork Reduction Act Notice, see page 2 of the separate instructions. Cat. No. 25145E Form **8862** (Rev. 11-2000)

Part III Filers With a Qualifying Child or Children *(Continued)*	Child 1	Child 2
d Did the child live with you in the United States for the entire year entered on line 1?	☐ Yes ☐ No	☐ Yes ☐ No
e Enter the address(es) where you and the child lived during the year entered on line 1.		
f If the child attended school or day care, enter the name(s) of the school(s) or care provider(s)		
7a Did the child live with any other person for more than half of the year entered on line 1 (see instructions before answering)?	☐ Yes ☐ No	☐ Yes ☐ No
Next, if you checked "No" on line 7a for this child, go to line 8a. If you checked "Yes," continue.		
b Was this person the child's parent or grandparent?	☐ Yes ☐ No	☐ Yes ☐ No
Next, if you checked "Yes" on line 7b for this child, go to line 7f. If you checked "No," continue.		
c Did this person live with the child for the entire year entered on line 1 **and** care for the child as if the child were his or her own?	☐ Yes ☐ No	☐ Yes ☐ No
Next, if you checked "No" on line 7c for this child, go to line 8a. If you checked "Yes," continue.		
d Was this person related to the child **or** was the child placed with this person by an authorized placement agency?	☐ Yes ☐ No	☐ Yes ☐ No
Next, if you checked "No" on line 7d for this child, go to line 7f. If you checked "Yes," continue.		
e Enter the child's relationship to this person or the name of the placement agency. Enter both items if the child was related and was also placed with this person by an agency		
f Enter this person's name and social security number (see instructions)		
g Is your **modified AGI** (adjusted gross income) for the year entered on line 1 **higher** than the modified AGI of every person listed on line 7f?	☐ Yes ☐ No	☐ Yes ☐ No
8a Was the child under age 19 at the end of the year entered on line 1?	☐ Yes ☐ No	☐ Yes ☐ No
Next, if you checked "Yes" on line 8a for this child, **do not** fill in lines 8b–8e for this child. If you checked "No," continue.		
b Was the child under age 24 at the end of the year entered on line 1 and a student?	☐ Yes ☐ No	☐ Yes ☐ No
Next, if you checked "No" on line 8b for this child, go to line 8d. If you checked "Yes," continue.		
c If you checked "Yes" on line 8b, enter the name of the school(s), or the state, county, or local government agency if an on-farm training course, the child attended. Do not enter if shown on line 5c or 6f		
d If you checked "No" on line 8b, was the child permanently and totally disabled?	☐ Yes ☐ No	☐ Yes ☐ No
e If you checked "Yes" on line 8d, enter the name of the child's health care provider or social worker		

Form **886-R**
(Rev. Nov. 1999)
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Department of the Treasury – Internal Revenue Service

SUPPORTING DOCUMENTS

NAME OF TAXPAYER: «TP_NAME»
TAX IDENTIFICATION NUMBER: «SSN»
TAX YEAR(S) : «TAX_YEAR»

Please provide appropriate information and documents for the specific tax year(s) shown above, and return this sheet with your documents in the envelope provided. Please include documents for **each** dependent and for **each** qualifying child listed below. Incomplete documents or documents submitted for the wrong tax year will **not** be considered. Do not submit more than one copy of any document.

Dependent/Qualifying Child

1) «DEP1»	4) «DEP4»
2) «DEP2»	5) «DEP4»
3) «DEP3»	6) «DEP6»

PART 1 EARNED INCOME CREDIT

Copy of –

- **Social Security card** for you (and your spouse, if filing a joint return).
  Birth Certificate and Social Security card for each child.
  Postal Form 1093, if your address on the tax return was a post office box.

Information needed-

- **Name, address**, and **Social Security number** of each child's mother and father (if other than you and your spouse).
- **List of persons** who lived with each child during the tax year. Include **name, relationship. Social Security number,** and the **number of months** each person lived with the child.
- **Dates** each child lived with you during the year.

Documents to verify that the child lived with you-

- Examples of acceptable documents are:
- School records or transcripts or an administrative statement from a school official on school letterhead containing the **child's name, address,** and **dates of attendance for the entire tax year**, and the **name and address of the child's parent or guardian**, or
- A statement on company letterhead or a notarized statement from a child care provider containing the **child's name, address**, and **dates of care for the entire tax year, the name and address of the child's parent or guardian,** and **the name and taxpayer identification number of the child care provider,** or
- Medical records or an administrative statement from a health care provider containing the **child's name, address,** and **dates of medical care** during the tax year, and the **name and address of the child's parent or guardian.**

Form 886-R (Rev. Nov 1999)

Form 886-R
(Rev. Nov. 1999)
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Department of the Treasury – Internal Revenue Service
SUPPORTING DOCUMENTS

NAME OF TAXPAYER: «TP_NAME»
TAX IDENTIFICATION NUMBER: «SSN»
TAX YEAR(S) : «TAX_YEAR»

PART 2 EXEMPTION FOR DEPENDENTS

Copy of –
- **Birth Certificate**, or
- **Green card** (if not a U.S. citizen)

Information needed-
- **Statement of relationship of person to you.**

Documents needed-
- **If the person was a student over age 18 and under age 24 on December 31,** school records or transcripts containing the person's name, address, and dates of attendance for the tax year.
- **If you received any government benefits,** a statement from the government agency verifying the amounts and types of benefits received by you for you and/or your dependents during the tax year. **If the person was over age 18 on December 31 and permanently and totally disabled,** an official letter or document indicating that the person is disabled.

Custodial parents and guardians, please submit-
- Copy of your lease or rental agreement or your last mortgage statement for the tax year.
- Copies of utility bills (water, electric, telephone, cable, etc.) for the tax year.
- Copies of canceled checks or receipts for rent or mortgage payments and household expenses paid during the year.

Non-custodial parents and guardians, please submit-
- Copies of canceled checks verifying support payments or a statement of account from your child support agency.

Divorced and legally separated parents , please submit-
- Copy of your divorce decree or separation agreement. Include all pages and all revisions.
- Copy of any other written agreement showing which parent has custody.
- Copy of Form 8332, *Release of Claim for Dependent*, signed by the other parent.

PART 3 HEAD OF HOUSEHOLD

Please refer to the enclosed *Helpful Information on General Requirements* for an explanation of the conditions that qualify you for Head of Household filing status, and send the appropriate documents from the list above. However, if the same document can be used to support your claim for the earned income credit or a dependency exemption, do not send more than one copy of that document.

Form 886-R (Rev. Nov 1999)

Appendix V: Comments from the Internal Revenue Service

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER

April 10, 2002

Mr. Michael Brostek
Director, Tax Issues
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Brostek:

I appreciate your recognition of our efforts to reduce taxpayer burden since we implemented the Earned Income Tax Credit (EITC) recertification program. These improvements include expanded outreach to stakeholders, revised taxpayer correspondence, and improved examiner training.

The IRS is continuing efforts to improve the EITC audit process. These include an inventory management tool and a decision support tool that we will deploy in May. These tools will help examiners and managers make consistent determinations on EITC eligibility. We are also redesigning EITC taxpayer notices used by Examination. The notice redesign process will include feedback from impacted stakeholders including the Taxpayer Advocate, practitioners, and Low Income Taxpayer Clinics.

The Assistant Secretary for Tax Policy and I have convened a high-level IRS/Treasury task force to review the EITC Program. This group will develop recommendations to achieve the congressional objectives of the EITC Program, make it easier for taxpayers to comply with the rules, and allow us to efficiently and effectively administer the rules. The group will also evaluate legislative and administrative solutions to EITC recertification problems and consider your draft report findings. The Assistant Secretary for Tax Policy and I will personally oversee the task force and present its recommendations to Secretary O'Neill.

Our comments on your recommendations follow:

Recommendation 1
Revise Form 8862, Information to Claim Earned Income Credit After Disallowance, to make it a simple request for recertification that IRS can use to trigger the recertification process, and eliminate all of the information that taxpayers are now asked to provide on the form.

Comments
The Director, Reporting Compliance, Wage and Investment (W&I) will study the use of Form 8862 in EITC recertifications and the examination of related issues. Based on the results of this study and your findings, we will evaluate possible revisions to the form that will make communications clearer, reduce taxpayer burden, and aid the recertification and examination processes. We anticipate completion of this study by June 2003.

Recommendation 2
Revise Form 886-H, Explanation of Items, and Form 886-R, Supporting Documents for Recertification (and similar forms used for other EITC audits) to:

- Clarify that taxpayers who are seeking EITC recertification do not have to demonstrate that the EITC qualifying child is a dependent to qualify for EITC.
- Help taxpayers understand what documentation they must provide (such as birth certificates, adoption papers, etc.) to establish their relationship with the EITC qualifying child, especially when the child is not their natural born son or daughter.
- Eliminate the need to have the statement from the child care provider notarized, since a notary public does not verify the content of the statement and most examiners place no validity on the notary stamp.
- Encourage taxpayers to submit more than one type of document to demonstrate that the EITC qualifying children live with them.

Comments
We are revising Forms 886H and R. We are working with our W&I Examination Process Improvement Team and the Dynamic Notices Project Team to revise the forms into different categories based on the relationship between the taxpayer and child (natural, adopted, grandchild, or foster) as claimed by the taxpayer. We will ask for feedback on the revisions at the National Tax Forums held in various cities this summer. Additionally, the Dynamic Notices Project Team is meeting with focus groups of affected taxpayers to obtain their feedback on the revised forms. We plan to have a revised product that will incorporate this feedback by the 2003 filing season.

Recommendation 3
If IRS is not willing to accept a relative's childcare statement as evidence that a child lives with the taxpayer, it should be clear on Form 886-R, on similar forms used for other EITC audits, and in the EITC decision support tool. The IRS should also suggest additional evidence that the taxpayer may provide.

Comments
A childcare provider's statement by itself may not be sufficient to verify eligibility. In that instance, the taxpayer will need to provide additional collaborating evidence to support his or her EITC claim. We will show examples of this evidence on Form 886-R. We plan to have a revised product that will incorporate all changes by January 2003.

Recommendation 4
Whatever IRS' official position on statements from relatives, ensure that examiners are aware of that position and apply it consistently.

Comments
We will enhance awareness and consistency of our position through the EITC decision support tool, in examiner training and the current IRM, and during quality reviews. We plan to have a revised product that will incorporate all changes by January 2003.

Recommendation 5
Develop a standard form that taxpayers can give to the school or healthcare provider that specifies the information needed, and on which examiners can indicate the period of time for which the information is needed.

Comments
We are revising Form 886-R to accomplish the objective of this recommendation.

Recommendation 6
If IRS decides not to develop a standard form, revise Form 886-R to clearly remind taxpayers that records for parts of two school years are needed to document a living arrangement for the tax year.

Comments
We are revising Form 886-R to clearly remind taxpayers that records for parts of two school years are needed to document a living arrangement for the tax year. We plan to have a revised product that will incorporate all changes by January 2003.

Recommendation 7
Take appropriate steps to ensure that the new EITC decision support tool does not continue the inappropriate linkage of financial support to decisions on EITC eligibility.

Comments
The Director, Reporting Compliance, W&I has incorporated your recommendation into the EITC decision support tool. The tool will be rolled out nationwide in May 2002.

If you have any questions, please contact William Zachery, Director, Reporting Compliance, W&I at (404) 338-7643.

Sincerely,

Charles O. Rossotti

Appendix VI: GAO Contacts and Staff Acknowledgments

GAO Contacts

Michael Brostek (202) 512-9110
David Attianese (202) 512-9110

Acknowledgments

In addition to those named above, Karen Bracey, Tara Carter, Art Davis, Ben Douglas, Ann Lee, Susan Mak, Anne Rhodes-Kline, Clarence Tull, and James Ungvarsky made key contributions to this report.

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