



Treasury Inspector General for Tax Administration Office of Audit

EXISTING COMPLIANCE PROCESSES WILL NOT REDUCE THE BILLIONS OF DOLLARS IN IMPROPER EARNED INCOME TAX CREDIT AND ADDITIONAL CHILD TAX CREDIT PAYMENTS

Issued on September 29, 2014

Highlights

Highlights of Report Number: 2014-40-093 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

The Earned Income Tax Credit (EITC) and Additional Child Tax Credit (ACTC) are refundable credits designed to help low-income individuals reduce their tax burden. The IRS estimated that it paid \$63 billion in refundable EITCs and \$26.6 billion in refundable ACTCs for Tax Year 2012. The IRS also estimated that 24 percent of all EITC payments made in Fiscal Year 2013, or \$14.5 billion, were paid in error.

WHY TIGTA DID THE AUDIT

This audit was initiated because the IRS is required to identify and take actions to address the root causes of improper payments in Federal programs identified as being at high risk for improper payments. The only IRS program identified as a high risk is the EITC. The overall objective of this review was to assess the IRS's efforts to identify and address the root causes of erroneous EITC and ACTC payments.

WHAT TIGTA FOUND

Processes have been developed to identify improper EITC payments and their root causes. However, the IRS has not developed processes to quantify or identify the root causes of improper ACTC payments.

The IRS has continually rated the risk of improper ACTC payments as low. However, TIGTA's assessment of the potential for ACTC improper payments indicates the ACTC improper payment rate is similar to that of the EITC. Using IRS data, TIGTA estimates the potential ACTC improper payment rate for Fiscal Year 2013 is between 25.2 percent and 30.5 percent, with potential ACTC improper payments totaling between \$5.9 billion and \$7.1 billion. In addition, IRS enforcement data show the root causes of improper ACTC payments are similar to those of the EITC.

Significant changes in IRS compliance processes would be necessary to make any significant reduction in improper payments. Expanded authority to make corrections to tax returns when data obtained from the Department of Health and Human Services indicate the taxpayer's refundable credit claims are not valid would help reduce improper payments. TIGTA estimates such authority could have potentially allowed the IRS to prevent more than \$1.7 billion in questionable EITC payments in Tax Year 2012.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS ensure that the results of the ACTC Improper Payment Risk Assessment accurately reflect the high risk associated with ACTC payments, identify the root causes of the improper ACTC payments, and establish a plan to reduce erroneous payments. Furthermore, if correctable error authority is granted, the IRS should contract with the Department of Health and Human Services to obtain the complete National Directory of New Hires database.

In addition, the IRS should work with the Assistant Secretary of the Treasury for Tax Policy to consider a legislative proposal to obtain expanded National Directory of New Hires database authority to systemically verify claims for other income-based refundable credits (e.g., the ACTC).

The IRS agreed with our recommendation to pursue expanded National Directory of New Hire authority. The IRS did not agree with our other recommendations. TIGTA's concerns with the IRS's response to the recommendations are noted in the report.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2014reports/201440093fr.pdf>