



Treasury Inspector General for Tax Administration Office of Audit

IMPROVEMENTS ARE NEEDED TO ENSURE THE HEALTH COVERAGE TAX CREDIT IS PROPERLY CLAIMED ON TAX RETURNS

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Highlights

Highlights of Report Number: 2009-40-137 to the Internal Revenue Service Commissioner for the Wage and Investment Division.

IMPACT ON TAXPAYERS

The Health Coverage Tax Credit (HCTC) is a provision of the Trade Adjustment Assistance Reform Act of 2002. It was created to cover a substantial portion of the cost of health care for workers who lost their jobs due to foreign trade and receive benefits through Trade Adjustment Assistance programs as well as eligible recipients of pensions that are paid by the Pension Benefit Guaranty Corporation. The Internal Revenue Service (IRS) has implemented a number of processes in an attempt to ensure eligible individuals accurately claim the HCTC. However, improvements are needed to ensure individuals claiming the HCTC on their annual tax return accurately compute the credit. The IRS needs to implement a process to identify inaccurate HCTC claims at the time a tax return is filed to prevent erroneous refunds from being issued.

WHY TIGTA DID THE AUDIT

This audit was initiated to assess the effectiveness of the IRS process to determine whether individuals are eligible to receive the HCTC. The IRS administers the HCTC in partnership with other Federal agencies, States, and the private health care industry. State workforce agencies, through the Department of Labor, and the Pension Benefit Guaranty Corporation are responsible for identifying potentially eligible individuals. The IRS is responsible for ensuring that these individuals meet program requirements. In Tax Year 2007, there were approximately 26,800 participants in the HCTC Program.

WHAT TIGTA FOUND

The monthly HCTC process ensures individuals met the program requirements prior to participation and that the credit was being accurately calculated. This is significant because the majority of individuals claiming the HCTC and the majority of the funds paid (\$80 million of the \$100 million) for Tax Year 2007

were paid as an advance monthly credit.

However, improvements are needed to ensure individuals claiming the HCTC on their Federal tax returns accurately compute the credit. Our review of a valid sample of individuals who claimed the HCTC on their 2006 Federal tax returns identified that 72 percent did not have the required documentation attached.

In addition, IRS processes did not effectively identify and prevent individuals from erroneously claiming the HCTC on their Federal tax return. TIGTA identified 1,260 individuals who appeared to have erroneously claimed \$1.8 million in HCTCs on their Federal tax returns.

WHAT TIGTA RECOMMENDED

TIGTA recommended the Commissioner, Wage and Investment Division, 1) develop a process to ensure taxpayers who claim the HCTC on electronically filed (*e-filed*) tax returns are providing the required documentation in support of their HCTC claim and, if not, the credit should be disallowed as indicated on the Health Coverage Tax Credit (Form 8885), 2) ensure taxpayers claiming the HCTC on paper-filed tax returns attach required documentation and, if not, the IRS should disallow the credit as indicated on the Form 8885, and 3) develop processes to identify erroneous HCTC claims based on criteria used to select taxpayers for examination and reject *e-filed* tax returns or forward paper-filed tax returns to the Error Resolution function at the time the tax return is filed.

In their response to the report, IRS officials agreed with our first two recommendations and agreed with the premise of our third recommendation but proposed an alternative corrective action. The IRS has an *e-file* project underway to improve the HCTC process in the future and will reject the returns if the U.S. Individual Income Tax Transmittal for an IRS *e-file* Return (Form 8453) is not attached. The IRS plans to continue requesting that taxpayers file a Form 8453 with the required documentation attached. Also, the IRS plans to provide reminders to the Error Resolution function regarding the necessity of taxpayers attaching documentation to a return claiming the credit and, if documentation is not attached, the IRS will disallow the credit. For our third recommendation, the IRS plans to identify potentially erroneous claims during processing, program additional error codes, inform taxpayers of their appeal rights, and request that taxpayers provide documentation to prove their claims. TIGTA believes that the IRS' alternative corrective action addresses the intent of our recommendation.

READ THE FULL REPORT

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

<http://www.treas.gov/tigta/auditreports/2009reports/200940137fr.pdf>

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