United States General Accounting Office

GAO

Report to the Chairman, Committee on Finance, U.S. Senate

September 1996

EARNED INCOME CREDIT

IRS' 1995 Controls Stopped Some Noncompliance, But Not Without Problems

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United States General Accounting Office
Washington, D.C. 20548

General Government Division

B-261635

September 18, 1996

The Honorable William V. Roth, Jr.
Chairman, Committee on Finance
United States Senate

Dear Mr. Chairman:

This report responds to your request for information on Earned Income Credit (EIC) noncompliance.[1] Specifically, our objective was to provide information on and our analysis of the results of the Internal Revenue Service's (IRS) efforts to reduce noncompliance in calendar year 1995. This report updates preliminary data included in other products we provided to you during the course of this assignment.[2]

Results in Brief

IRS took several steps to prevent and detect EIC noncompliance in 1995. IRS' data indicate that those steps stopped some noncompliance. However, there were also some problems.

IRS uses up-front controls (filters) in its Electronic Filing System to identify electronic submissions with problems, such as invalid or duplicate Social Security numbers (SSN).[3] If a problem is identified, the submission is rejected, and the problem has to be corrected before IRS will accept the electronic return. IRS added some new filters for 1995. Those new filters, plus the ones already in place, identified about 1.3 million SSN problems on electronic submissions from persons who were claiming the EIC in 1995, compared with about 600,000 problems in 1994.

In 1995, for paper returns, IRS placed an increased emphasis on transcribing and validating SSNs. IRS identified about 3.3 million paper returns (most claiming refunds) with missing or invalid SSNs for

[1]Throughout this report we use the term "noncompliance" to include erroneous EIC claims caused by taxpayer mistakes, negligence, or fraud. Determining whether an EIC claim is fraudulent requires knowing the taxpayer's intent, which is difficult to prove.

[2]Tax Administration: Earned Income Credit—Data on Noncompliance and Illegal Alien Recipients (GAO/GGD-95-27, Oct. 25, 1994); Earned Income Credit: Targeting to the Working Poor (GAO/GGD-95-122BR, Mar. 31, 1995); Earned Income Credit: Targeting to the Working Poor (GAO/T-GGD-95-136, Apr. 4, 1995); and Earned Income Credit: Noncompliance and Potential Eligibility Revisions (GAO/T-GGD-95-179, June 8, 1995).

[3]As used in this report, an invalid SSN is one that does not match Social Security Administration records.

EIC-qualifying children[4] and/or dependents. In about 1 million of those cases, IRS delayed refunds or otherwise held up the processing of the returns while staff in IRS' Examination function contacted taxpayers, asking them to prove their eligibility. As of June 30, 1996, those contacts had resulted in over $800 million in either reduced refunds or additional tax assessments.

Even though IRS' efforts in 1995 produced some favorable results, IRS also encountered several problems in implementing those efforts. For example, IRS' procedures generated a workload that far exceeded IRS' capabilities. Although 3.3 million paper returns were identified with missing or invalid SSNs, IRS had sufficient resources to follow up on only about 1 million. And, according to IRS' Internal Audit Division, IRS' procedures for deciding which of the cases warranted follow-up did not ensure selection of the most productive cases and resulted in an inefficient use of resources. IRS was also unable to follow through on plans to check for duplicate use of SSNs. In that regard, IRS delayed refunds on about 4 million EIC returns that did not have an SSN problem, primarily to give it more time to determine whether other returns were filed using the same SSNs. However, IRS eventually released almost all of those refunds, after holding them for several weeks, without checking for duplicate SSNs. IRS took steps to prevent the recurrence of these problems in 1996. It revised its procedures for selecting cases to review in an attempt to identify more productive cases and to limit the number of delayed refunds.

IRS' efforts and the publicity surrounding them may have also had a sizable deterrent effect, at least in the short term. According to IRS data, for example, over 2 million fewer EIC claims were filed in 1995 than IRS had expected.

Although IRS' data provided some evidence of the results of its efforts in 1995, the data were not sufficient to allow an overall assessment of the impact of IRS' initiatives on EIC noncompliance. For example, (1) IRS has not yet released the results of an EIC compliance study it did in 1995 and (2) data on the results of the Examination function's SSN verification efforts were not reported in a way that isolated tax year 1994 cases from prior years' cases or distinguished between EIC cases and cases involving dependents.

[4]A qualifying child (1) is an EIC claimant's son, daughter, adopted child, grandchild, stepchild, or foster child; (2) is under age 19, or under age 24 and a full-time student, or any age and permanently and totally disabled; and (3) lives in the claimant's home in the United States for more than half of the year (or all of the year if a foster child).

Background

The EIC is a refundable tax credit available to low-income working taxpayers. Congress established the EIC in 1975 to offset the impact of Social Security taxes on low-income families and to encourage low-income individuals with families to seek employment rather than welfare. EIC coverage and benefit amounts have expanded significantly since 1975. For example, provisions in the Omnibus Budget Reconciliation Act of 1993 (1) raised the maximum credit for families with two or more EIC-qualifying children to $2,528 for tax year 1994 and (2) made certain taxpayers without qualifying children eligible for the credit starting in tax year 1994. For tax year 1994, about 18.9 million taxpayers received about $20.8 billion in EIC benefits. Almost all of those benefits ($20.1 billion) went to families with EIC-qualifying children. Other families who qualify for the EIC may not be claiming it. In that regard, researchers have estimated that between 75 and 86 percent of all eligible families actually claimed the EIC in 1990.[5]

EIC Noncompliance

IRS data show high noncompliance rates associated with EIC claims. Some noncompliance involves mathematical errors and other obvious mistakes made by taxpayers or their representatives in preparing the returns. Staff in IRS' 10 service centers are to review each paper return when it is received to make sure it is accurate and complete (e.g., includes required supporting schedules) and, for returns claiming the EIC, contains basic eligibility information, such as the age of qualifying children.[6] Information is then entered into computers. The computers check for math and qualifying errors, some of which could affect EIC eligibility or the size of the EIC claim.

EIC claims have for years been the source of many errors identified during processing. In 1995, for example, IRS identified 1.6 million EIC-related errors involving about 8 percent of all returns with EIC claims. Of the 1.6 million errors, about 600,000 involved situations where the taxpayer claimed the EIC but was found not to qualify and about 1 million involved cases where the taxpayer erred in computing the EIC.

Other noncompliance involves mistakes that can be detected only through an audit of the return. In the past, IRS measured this kind of noncompliance through its Taxpayer Compliance Measurement Program

[5]Yin et al., Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program, American Tax Policy Institute, Feb. 1994.

[6]These types of errors are avoided on electronic returns through filters that check such things as mathematical correctness before the submission is accepted.

(TCMP).[7] The last TCMP, involving audits of tax year 1988 returns, found that about 42 percent of EIC recipients were not entitled to some or all of the credit that they claimed—representing about 34 percent of the EIC dollars paid that year. However, these TCMP results may not represent current compliance levels because the EIC has changed substantially since 1988. For example, changes enacted in 1990 included a major redesign and simplification of the EIC eligibility rules that had accounted for many of the errors found in the 1988 TCMP.

More recently, IRS sampled EIC returns filed electronically during a 2-week period in January 1994. Although the results can be generalized only to returns filed in that 2-week period, IRS' analysis of this limited EIC data showed that 39 percent of the returns involved overstated EIC claims that represented 26 percent of the dollars claimed. IRS conducted a broader, more statistically reliable study of EIC returns filed electronically and on paper in 1995. As of August 26, 1996, IRS had not released the results of that study.

The most serious form of noncompliance involves deliberate attempts to defraud the government through, for example, phony refund claims. The Questionable Refund Program, established in the 1970s, is IRS' primary effort to identify fraudulent refund claims, including those involving the EIC. An IRS computer program analyzes all returns to identify those that are potentially fraudulent. Then, fraud detection teams in the 10 service centers perform more in-depth reviews and, if a return is considered fraudulent, attempt to stop any refund before it is issued. The number of returns identified by IRS as containing fraudulent refund claims and the total dollar amount of stopped refunds have increased significantly since 1990. From January 1 through December 31, 1995, the fraud detection teams had identified about 62,000 fraudulent returns and stopped about $83 million in refunds. About 72 percent of the returns had EIC claims. We do not know whether that large percentage reflects (1) the level of EIC-related fraud compared with other types of fraud, (2) IRS' emphasis on EIC-related fraud, or (3) the comparative ease of identifying EIC-related fraud versus other types of fraud.

IRS Efforts to Address EIC Noncompliance in 1995

Over the past few years, more attention has been placed on determining whether the EIC is being paid to ineligible taxpayers. In 1995, IRS expanded its efforts to identify and stop incorrect refunds. Much of what IRS did

[7]TCMP involves audits of a random sample of tax returns in which every line of every return is to be examined.

involved verifying SSNs, with an emphasis on returns claiming the EIC. IRS was looking for SSNs that did not match the Social Security Administration's records or that had been used on another return filed that year, and returns that were missing one or more required SSNs. IRS warned taxpayers that their refunds could be delayed if they submitted a return with a missing or incorrect SSN. On the cover of the instructions accompanying Form 1040, for example, IRS warned taxpayers to check their SSNs and explained that "incorrect or missing SSNs for you, your spouse, or dependents may delay your refund." IRS also issued several public service announcements to alert taxpayers to the need for correct SSNs.

Another important step IRS took in preparing for the 1995 filing season was to eliminate the direct deposit indicator. In conjunction with the electronic filing program, the private sector offers what is commonly referred to as a refund anticipation loan (RAL). These loans enable taxpayers, for a fee, to get their money more quickly than if they were to wait for IRS to issue their refunds. A taxpayer repays the loan by arranging to have the refund deposited directly to an account specified for repayment of the loan. Although RALs are contracts between the financial institution and the borrower, IRS facilitated the process in the past by providing the direct deposit indicator to the electronic return transmitter after the return was received, acknowledging that the taxpayer's direct deposit request would be honored. IRS would not honor a request if the taxpayer had a debt, such as unpaid child support or unpaid federal taxes, that would be offset against the taxpayer's refund. Because the opportunity to get money quickly through RALs was seen as encouraging electronic filing fraud and because a large number of EIC fraud schemes identified by IRS in the past involved RALs, IRS did not provide the direct deposit indicator in 1995.

Objective, Scope, and Methodology

Our objective was to provide information on and our analysis of IRS' efforts to reduce EIC noncompliance in 1995.

To achieve our objective, we

- reviewed studies on EIC noncompliance,
- reviewed IRS' initiatives and procedures for preventing and detecting EIC noncompliance,
- analyzed IRS data on the results of its efforts to reduce EIC noncompliance,
- interviewed IRS National Office officials responsible for various EIC compliance initiatives, and

- interviewed Cincinnati and Fresno Service Center officials responsible for EIC-related studies or investigations.

IRS took several steps in 1995 to address a growing problem with refund fraud in general. In March 1996, we reported on those efforts.[8] Unlike that report, this report focuses, to the extent possible, on IRS' efforts and results as they relate specifically to EIC noncompliance. As discussed later, our attempt to focus specifically on EIC-related results was limited by the nature of IRS' data.

We relied on data provided in IRS' reports and did not verify the data. We did our work from January 1995 through June 1996 in accordance with generally accepted government auditing standards.

You also asked us to determine the extent of EIC noncompliance. Although this letter contains some data on noncompliance, a critical piece of information needed to respond to that portion of your request—the results of IRS' study of EIC returns filed in 1995—was unavailable at the time we prepared this report. That study was designed to provide current and projectable data on the extent of EIC noncompliance. IRS said that it would provide a report on the results of this study after completing its analysis of the data. After we receive the report, we will analyze the results and issue a separate product.

We requested comments on a draft of this report from the Commissioner of Internal Revenue or her designee. On July 30, 1996, we met with the Assistant Commissioner for Criminal Investigations and other IRS officials, who provided us with oral comments. Those comments were generally reiterated and expanded upon in an August 12, 1996, letter from the Acting Chief Compliance Officer. IRS' comments are summarized and evaluated beginning on page 12 and the Acting Chief's letter is reprinted in the appendix.

[8] Tax Administration: IRS Efforts to Control Fraud in 1995 (GAO/GGD-96-96R, Mar. 25, 1996).

IRS' Efforts to Reduce EIC Noncompliance in 1995: Some Positive Results, Some Problems

IRS took several steps in 1995 to combat a growing problem with refund fraud in general and, more specifically, EIC noncompliance. Most significantly, IRS (1) expanded the up-front controls in its Electronic Filing System, (2) placed increased emphasis on its efforts to verify SSNs on paper returns, and (3) held up the refunds on millions of EIC returns with valid SSNs to allow IRS time to check for duplicate SSN usage.[9] IRS' efforts had some positive results (e.g., over $800 million in reduced refunds and additional tax assessments) but also had some problems (e.g., an inability to follow through on plans to check for duplicate SSNs) that limited their effectiveness. IRS' efforts and the publicity surrounding them also may have had a sizable deterrent effect. For example, they may have contributed to the receipt of many fewer EIC claims in 1995 than IRS had expected.

Some Noncompliance Avoided by Up-Front Controls in Electronic Filing System

For the past several years, IRS has included up-front controls (filters) in its Electronic Filing System to identify submissions that had data problems, such as missing or invalid SSNs or an SSN that had already been used on another return filed for the same tax year. If a problem was identified, IRS refused to accept the electronic submission until the problem was corrected. In 1994, IRS' electronic filters identified about 1 million SSN problems, about 600,000 of which involved the EIC.[10] In 1995, IRS added more electronic filters to prevent multiple use of an SSN on a return or EIC schedule and identified 4.1 million SSN problems, of which about 1.3 million involved the EIC.[11] Those EIC-related problems included instances where the SSN, name, and date of birth for an EIC-qualifying child did not match Social Security Administration records and instances where the SSN had been previously used on another return claiming an EIC-qualifying child.

There is no way of knowing how many of those problems involved intentional noncompliance, as opposed to honest mistakes or IRS database problems. Also, IRS does not routinely track electronic filing rejections and thus does not know whether the problems were eventually resolved or whether the rejected returns were ever resubmitted (either electronically or on paper). However, evidence suggests that some taxpayers whose

[9]These changes were made possible because IRS transcribed more SSNs from tax returns in 1995, thus allowing for more computer matching.

[10]Because an electronic submission can be rejected for more than one reason, the number of problems identified does not equal the number of submissions rejected.

[11]Of the 700,000 additional EIC-related problems identified by the electronic filters in 1995 compared with 1994, about 150,000 were due to the 1 new EIC-related filter IRS added in 1995.

electronic submissions were rejected because of an SSN problem were able to avoid the problem by filing on paper. IRS reviewed 395 electronic submissions that were rejected because of duplicate SSNs and found that in 113 cases (29 percent) the taxpayers subsequently filed on paper, using the same problem SSNs, and received their refunds. The results of this test, which involved cases from two of the five IRS service centers that receive electronic returns, are not projectable to all electronic filers.

IRS Identified Significant Noncompliance on Paper Returns but Also Encountered Problems

IRS also set up controls to better identify noncompliance on paper returns. Starting in 1994, IRS identified certain returns that had missing or invalid SSNs for EIC-qualifying children and delayed refunds to give Examination staff in IRS' 10 service centers enough time to validate EIC eligibility. Those validation efforts in 1994 showed that about 300,000 of the EIC claimants were ineligible for some portion of the credit.

IRS expanded its SSN validation efforts in 1995 to include dependents with a problem SSN and identified 3.3 million paper returns with 1 or more missing or invalid SSNs for EIC-qualifying children and/or dependents.[12] About 3 million of those returns involved requests for refunds. Examination had enough resources to review only about 1 million of the questionable returns. In those 1 million cases, IRS sent notices to taxpayers telling them (1) that a problem had been identified with their returns; (2) what they had to do to resolve the problem; and (3) that their refund, if they had claimed one, was being delayed while IRS checked for noncompliance. For the other 2.3 million returns, all of which involved refunds, IRS delayed the refunds but did not refer the returns to Examination for follow-up. The taxpayers were told that their refunds were being delayed but were not told that IRS had identified a problem on their returns. IRS subsequently released the refunds after holding them for several weeks.

Information on the results of Examination's review of the 1 million cases was not readily available from IRS. Although IRS routinely reports on the disposition of such reviews, the data are not reported in a way that aligns results with specific tax years. Instead, results are reported on the basis of the fiscal year a case is closed. Thus, data reported for fiscal year 1995 represented the results of all cases closed in 1995, no matter what the tax

[12] IRS does not know the number of paper returns filed in 1995 with missing or invalid SSNs for EIC-qualifying children and dependents because (1) IRS only identified returns that met certain minimum dollar criteria and (2) computer problems caused some returns not to be selected for SSN verification when they should have been. The computer problems occurred primarily because IRS did not have enough time to design and test program changes.

year. While that kind of reporting has value, it was not useful for assessing the results of IRS' expanded SSN-verification procedures in 1995 because the results of that year's cases were commingled with the results of prior years' cases.

To determine the results of IRS' fiscal year 1995 efforts, we requested a special breakdown of Examination's case closure data that aligned results by tax year. We analyzed the data and provided a copy to IRS' Office of Refund Fraud.[13] We concluded, and officials of the Office of Refund Fraud agreed, that tax year results are helpful in assessing program initiatives. According to IRS officials, these data could be provided on a regular basis at minimal cost.

Our analysis of the special breakdown of Examination's case closure data showed that 986,000 of the 1 million tax year 1994 cases had been closed as of June 30, 1996. Of the closed cases, 500,000 (51 percent) were closed with no change to the reported tax liability or refund because the taxpayers were able to prove that they were entitled to claim the dependent or the EIC. The other 486,000 cases were closed with changes (either in reduced refunds or additional taxes assessed) amounting to about $808 million. Even with our special breakdown, we do not know how much of this money related to EIC claims because IRS' data did not distinguish between cases involving dependents and those involving EIC-qualifying children.

According to data reported in IRS' Data Book for fiscal years 1993 and 1994 (the most recent reported data), the 51-percent no-change rate for cases with missing or invalid SSNs for EIC-qualifying children or dependents was more than double the 24 percent no-change rate for all service center audits done in fiscal year 1994. The high no-change rate can be attributed to IRS procedures that, according to IRS' Internal Audit Division, did not adequately ensure selection of the most productive cases and thus resulted in an inefficient use of Examination resources and an undue burden on thousands of taxpayers. IRS changed its procedures for 1996 in an attempt to target its resources on the most egregious cases and minimize the burden on taxpayers.

[13]The Office of Refund Fraud was established on October 1, 1994, to monitor IRS' programs to stop refund fraud and noncompliance and suggest needed changes.

IRS Did Not Follow Through on Plans to Check for Duplicate SSN Use

Because IRS studies have shown a high risk of noncompliance with returns claiming the EIC, IRS decided to delay about 4 million EIC refunds in 1995 even though IRS had identified no missing or invalid SSNs on those returns.[14] The 4 million returns included returns filed electronically and on paper with EIC claims above a certain dollar amount. IRS stated that one of its goals in doing so was to allow additional time to identify any returns that might be filed later using one or more of the same SSNs as the delayed returns, with the expectation that Examination staff would research the duplicate SSN usage and stop inappropriate refunds. IRS was not able to realize this potential because it did not have enough resources to research many questionable cases. After holding the refunds for several weeks, IRS released almost all of them without checking for duplicate SSNs. For the 1996 filing season, IRS revised its procedures so as not to delay refunds on returns with valid SSNs.

An April 1996 report by IRS' Internal Audit Division provided some indication of the level of noncompliance associated with the duplicate use of SSNs on EIC claims. In that report, Internal Audit estimated that the number of duplicate SSN occurrences[15] on returns filed in 1995 ranged from 233,000 to 449,000 and that the revenue impact ranged from $283 million to $545 million.

IRS' Efforts May Have Had a Deterrent Effect

IRS' efforts to better control EIC noncompliance in 1995 and the publicity surrounding them may have had a significant deterrent effect.

The number of EIC claims filed by persons with qualifying children had increased steadily over the past 10 years. For 1995, IRS' Research Division had estimated that the number of such claims would increase by about 2.2 million. IRS data showed, instead, that persons with qualifying children made about 100,000 fewer EIC claims in 1995 than in 1994. In that regard, the Congressional Budget Office, in its August 1995 Economic and Budget Outlook update, decreased anticipated EIC outlays by $2 billion to $3 billion a year. In doing so, it stated that EIC spending "has been lower than expected this year, possibly as a result of a recent crackdown by the Internal Revenue Service on fraudulent claims."

[14] Because IRS' primary concern on these returns centered on the validity of the EIC claim, it delayed only that part of the refund attributable to the EIC.

[15] "Occurrences" are the number of times an SSN was used more than once. For example, if the same SSN was used on three returns filed in 1995, the number of occurrences would be two. Similarly, if the same SSN was used for two different children on the same return, the number of occurrences would be one.

According to the Director of IRS' Office of Refund Fraud, another indication of the deterrent effect of IRS' efforts in 1995 was the drop in identified fraud by IRS' fraud detection teams. In calendar year 1995, the detection teams identified $132 million in fraudulent refunds on 62,309 returns compared with $161 million on 77,781 returns in 1994. Likewise, about 73 percent of the fraudulent returns identified in 1995 involved EIC claims, down from 91 percent in 1994. Although the numbers went down, there is no way of knowing, from available data, whether the decrease reflects a decline in the incidence of fraud or just a decrease in the amount of fraud identified by IRS. For example, elimination of the direct deposit indicator, which the Director said was one of the most effective actions taken by IRS for 1995, may have contributed to a decrease in fraud. But such a direct cause and effect relationship is difficult, if not impossible, to prove.

Conclusions

EIC noncompliance has been an ongoing concern of Congress and IRS. To meet the challenge, IRS expanded its controls in 1995 to better prevent taxpayers from receiving EIC benefits to which they were not entitled. A successful compliance program requires that IRS effectively balance taxpayer burden against the program's revenue protection benefits. In implementing its fiscal year 1995 controls, however, IRS delayed significantly more EIC refunds than it was able to review and did not select the most productive cases to review. While we agree that IRS needs to delay EIC refunds in order to follow up with taxpayers on questionable claims, we believe that IRS would have achieved better results if it had better targeted its efforts to those cases most in need of review. For the 1996 filing season, IRS decided to delay only those cases that it had the time and resources to review and revised its procedures in an attempt to select the most egregious cases to review.

Although IRS data indicated that its controls for 1995 identified and prevented some noncompliance, including that associated with the EIC, IRS did not compile data in such a manner as to allow for a meaningful analysis of those controls. The results of IRS' SSN validation efforts on paper returns were reported in a way that (1) did not distinguish between dependent claims and EIC claims and (2) commingled the results of IRS' efforts in 1995 with the results of efforts in prior years. The ultimate impact of the up-front filters in the Electronic Filing System is unknown because IRS does not track the resolution of problems identified by the filters. If IRS does not have adequate data to assess its efforts, it is less likely to make informed decisions about continuing, expanding, or revising those efforts.

Some of the data discussed in this report, such as the disaggregation of Examination results by tax year, would seem inexpensive to compile. Other data, such as the tracking of electronic rejections, might be more costly. Only IRS knows what such efforts would cost and whether compilation of the data is feasible given the cost and the level of effort IRS expects to devote to EIC noncompliance in the future.

Recommendation to the Commissioner of Internal Revenue

We recommend that IRS consider cost-effective ways to compile the kind of data needed to better assess the effectiveness and direction of its efforts to combat EIC noncompliance. In doing so, IRS should consider (1) routinely reporting data, by tax year, on the results of Examination efforts to validate eligibility for benefits; (2) tracking what happens to returns rejected by the Electronic Filing System; and (3) distinguishing the results relating to EIC-qualifying children from the results relating to dependents.

Agency Comments and Our Evaluation

We requested comments on a draft of this report from the Commissioner of Internal Revenue or her designee. On July 30, 1996, we met with the Assistant Commissioner for Criminal Investigations and other IRS officials, who provided us with oral comments. Those comments were generally reiterated and expanded upon in an August 12, 1996, letter from the Acting Chief Compliance Officer (see app.).

In response to our suggestion that IRS consider reporting Examination's results by tax year, IRS agreed that such information is important in assessing program effectiveness and said that it is available when needed by querying an automated management information system. Our report acknowledges that such information exists. However, it is important not only to have the information available but also to use it. As we pointed out earlier, IRS was not using tax-year specific data to assess program results until we specifically asked for it. To clarify our intent, as discussed with IRS officials at our July 30 meeting, we reworded our recommendation to say that IRS should consider routinely "reporting" data by tax year.

IRS also said that while it seems reasonable to track what happens to returns rejected by the Electronic Filing System, certain legal ramifications have to be explored first. Those ramifications center on the question of whether any files of rejected electronically filed returns that IRS might have to compile for tracking purposes would constitute a system of records under the Freedom of Information Act. The officials said that the legal issues had been referred to IRS' Office of Chief Counsel. We agree that any possible legal issues should be resolved before designing and implementing a system to track rejected returns.

With respect to our suggestion that IRS consider distinguishing the results relating to EIC-qualifying children from the results relating to dependents, IRS said that it wanted to defer any decision while two pieces of legislation, that would have a bearing on how IRS handles missing/invalid SSN conditions in the future, were pending.[16] According to IRS, the new procedures called for in the legislation would not automatically provide the sort of data we envisioned and that complicated systems programming would be required to capture the data systemically. IRS said that until its fiscal year 1997 appropriation is approved, it is unable to determine if resources will be available to make the programming changes. We agree with IRS' position.

We are sending copies of this report to the Ranking Minority Member of the Senate Finance Committee, the Chairman and Ranking Minority Member of the House Committee on Ways and Means, various other congressional committees, the Secretary of the Treasury, the Commissioner of Internal Revenue, the Director of the Office of Management and Budget, and other interested parties. Copies will be made available to others upon request.

[16]The legislation referred to by IRS was signed into law on August 20 and August 22, 1996.

If you have any questions, please contact me on (202) 512-5594. Major contributors to this report were David J. Attianese, Assistant Director, and William H. Bricking, Evaluator-in-Charge.

Sincerely yours,

James R. White
Associate Director, Tax Policy
and Administration Issues

Comments From the Internal Revenue Service

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

F COMPLIANCE OFFICER

August 12, 1996

Mr. James R. White
Associate Director, Tax Policy and Administration Issues
General Accounting Office
Washington, DC 20548

Dear Mr. White:

We appreciate the opportunity to comment on your recent draft report, Earned Income Credit: IRS' 1995 Controls Stopped Some Noncompliance, But Not Without Problems (Job Code 268692). The draft report contains one recommendation at pages 21-22. Our comments address each of the recommendations' three parts.

"We recommend that IRS consider cost-effective ways to compile the kind of data needed to better assess the effectiveness and direction of its efforts to combat EIC noncompliance. In doing so, IRS should consider (1) routinely compiling data, by tax year, on the results of Examination efforts to validate eligibility for benefits; (2) tracking what happens to returns rejected by the Electronic Filing System; and (3) distinguishing the results relating to EIC-qualifying children from the results relating to dependents."

(1) We agree that it is important to compile this information by tax year to assess program effectiveness, and we do. Tax year data is available when needed by querying the Automated Information Management System (AIMS) Closed Case Data Base. By accessing this database, we determined that during the period January through June 1996, an additional 211,597 TY1994 cases were closed with recommended dollars totaling $313,949,297. Enclosed is a table showing data on TY1994 cases during the period January 1995 - June 1996.

(2) Although this recommendation seems reasonable, we are unable to agree or commit to any implementation until we have explored and resolved all of the legal ramifications involved. We are pursuing the legal issues with Chief Counsel and will provide a copy of their written guidance once it is received. (The Jacksonville District Office Research and Analysis site is conducting a study on the use of duplicate SSNs, using historical data. It does not track rejected ELF returns.)

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Mr. James R. White

(3) Earned Income Credit-related provisions in two separate bills approved by Congress will change the way the IRS processes missing/invalid SSN conditions for dependent exemptions and EIC qualifying children. The President has indicated he will sign the bills. Under this legislation, the IRS in most instances will no longer process missing/invalid SSN conditions for dependent exemptions and EIC as unallowables using deficiency procedures. Instead, we anticipate that the majority of these returns will be processed using math error procedures. These new processing procedures will not automatically provide the sort of data envisioned by this recommendation. Very complicated systems programming would be required to capture the data systemically. Until the FY 1997 budget is final, we are unable to determine if resources will be available to do the systems programming changes.

Sincerely,

Ted F. Brown
Acting Chief Compliance Officer

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