

Administration of the Earned Income Credit

Announcement 2003-40

I. Purpose

This Announcement describes changes the Internal Revenue Service (IRS) is testing in determining qualifying child eligibility under the earned income credit (EIC) under I.R.C. section 32. This Announcement also solicits public comment on those changes.

II. Background

The EIC plays a vital role in rewarding work and lifting working families out of poverty. Historically, the EIC program has experienced a relatively high participation rate. The IRS received claims totaling over \$32 billion from 19 million claimants for tax year 2002. Studies indicate that between 75 and 86 percent of eligible taxpayers participate in the EIC program. In 2001, the EIC lifted 3.9 million people out of poverty.

Although the EIC program has been successful in reaching and assisting low income working families, the EIC program also suffers from high noncompliance. The most recent compliance study, *Compliance Estimates For Earned Income Tax Credit Claimed on 1999 Returns* (the 1999 study), released in February 2002, estimates that out of the \$31.3 billion of EIC claims made by taxpayers for tax year 1999, between \$8.5 and \$9.9 billion – or between 27.0 and 31.7 percent of total EIC claims – were erroneous unrecovered overclaims. The largest amount of EIC overclaims (for which errors were known) was associated with taxpayers claiming children who were not the taxpayers' qualifying children. The most common qualifying child error was claiming a child who did not live with the taxpayer for over half the taxable year and therefore did not satisfy the residency requirement of the EIC. Another common qualifying child error was claiming a child who did not bear an appropriate relationship to the taxpayer. Most taxpayers who did not meet the relationship requirement also did not meet the residency requirement.

EIC noncompliance is high in part because it is difficult for the IRS to verify whether a child claimed by a taxpayer meets the residency and relationship tests of the EIC prior to paying out a refund. The IRS employs extensive outreach and educational programs to inform taxpayer and tax return preparers of the requirements of the EIC. These programs encourage eligible taxpayers to participate in the EIC program and discourage ineligible taxpayers from making erroneous EIC claims. In addition, the IRS conducts examinations to verify the eligibility of individuals with questionable claims. Despite these and other efforts, the IRS has been unable to significantly reduce the noncompliance rate over the years.

To prevent qualifying child errors, the IRS and Treasury Department plan to implement a certification program under which certain taxpayers will be required to demonstrate that they meet the residency requirement with respect to a child before their EIC claims

are accepted. The taxpayers required to demonstrate residency will be those who, based on IRS research, are more likely to claim children who do not satisfy the residency requirement (such as caregivers other than the child's parents and fathers who do not file joint returns).

Under the certification program, a taxpayer will be encouraged to fill out a form and provide certain documentation that establishes that the taxpayer meets the residency requirement with respect to a child in advance of the filing season. If such taxpayers choose not to pre-certify, they will be required to send in the same forms and documentation with their tax returns. Taxpayers who pre-certify will receive their EIC refunds faster than taxpayers who send information with their tax returns. Taxpayers who do not pre-certify or send in the required information with their tax returns will be given an additional opportunity to certify residency, after which time, they will be denied the EIC with respect to a claimed child, subject to normal appeals rights and the ability to contest the denial in Tax Court.

The goal of the certification program is to evaluate high-risk EITC claims before they are paid, using a process that is less burdensome to taxpayers and less costly to the IRS than an audit. In addition, the certification program will enable eligible, but high-risk, taxpayers to receive their refunds faster than if they were subsequently challenged by the IRS. By helping to ensure that certain high-risk taxpayers receive the right amount of the credit before refunds are paid, the program will also reduce the burden that is imposed when taxpayers must repay erroneous refunds.

The IRS and the Treasury Department want to implement this program in a manner that will continue the goals of the EIC program, will not be overly burdensome for taxpayers (and other parties) and will not adversely affect participation. Accordingly, the IRS will test the certification program with a limited number of taxpayers (approximately 45,000) and will carefully study the results from this group to determine the effect of certification on compliance and participation. In addition, the IRS and Treasury Department are continuing to evaluate the proposed form and instructions, the types of documentation that will be required, and the IRS communication and outreach strategy. As part of this evaluation, the IRS will be conducting focus groups of taxpayers, practitioners and third parties (who are asked to help establish residency) prior to the test of the certification program.

As part of the certification program, the IRS and Treasury Department previously considered requiring certain taxpayers whose relationship with a claimed child could not be systematically checked by the IRS through existing databases (e.g., social security records) to establish a qualifying relationship with the child before their EIC claim is accepted. The certification test will not include a relationship certification requirement, and will be limited to residency certification.

III. Request for Comments

Based on preliminary discussions and initial drafts of the residency certification form, stakeholders have expressed concerns about various aspects of the certification program. The IRS and Treasury Department are committed to continuing this dialogue with stakeholders and are issuing this Announcement to help facilitate comments. Concerns expressed by stakeholders prior to and in response to this Announcement will be carefully considered by the IRS and Treasury Department in developing the certification program.

The IRS has revised Form 8836, which is attached to this announcement and will be posted on the IRS website at <http://www.irs.gov/taxpros/lists/0,,id=97784,00.html>.

While the IRS and Treasury Department welcome all comments and suggestions, the IRS and Treasury Department are particularly interested in comments on the following matters:

1. Under Form 8836, taxpayers will have the option to provide different types of information or documentation to establish residency. Are there other sources or types of information that should be added to the form (as another option) that would still give the IRS reasonable assurances that the taxpayer satisfies the residency requirement? What information or documentation could the IRS request that taxpayers currently possess or could reasonably obtain to verify that the taxpayer resides with a child? What information or documentation currently requested on the forms is difficult or burdensome for the taxpayer or a third party to provide, and why?
2. How can Form 8836 be simplified or clarified? For example, would it be easier for taxpayers to certify one child per form or two children per form? How could the instructions to Form 8836 be simplified or clarified?
3. What can the IRS do to reach out to taxpayers and encourage them to pre-certify, rather than wait until the filing season? What is the message the IRS needs to convey and what are the best means through which to convey that message? Who should be the primary deliverer of particular messages – the IRS or outside stakeholders? Are there other incentives the IRS can provide to taxpayers to encourage them to pre-certify?
4. How can the certification program be used to reach out to taxpayers who are eligible for the EIC, but not currently claiming the credit? Should the messages associated with the certification program be coupled with messages designed to educate taxpayers about their eligibility to claim the EIC and to increase participation? Alternatively, would combining these messages cause confusion, in which case, what separate measures

should the IRS take to reach out to eligible taxpayers who are not claiming the credit?

5. What factors should the IRS take into account in designing the study of the initial group of taxpayers who are asked to certify and in evaluating the results of that study?

Comments about the draft Form 8836 or the certification pilot must be submitted on or before July 14, 2003 in order to be considered for the pilot. Otherwise, comments about the precertification process should be submitted on or before December 31, 2003. Comments about certification taking place during the filing season should be submitted on or before April 15, 2004.

Taxpayers may submit electronic comments on Form 8836 at <http://www.irs.gov/taxpros/lists/0,,id=97784,00.html> and on the pre-certification and certification processes to notice.comments@irsounsel.treas.gov. Alternatively, comments may be sent to: CC:PA:RU (Announcement 2003-40), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (Announcement 2003-40), Courier Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC.