

Keeping it in Context: Earned Income Tax Credit Compliance and Treatment of the Working Poor

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I. INTRODUCTION

Reflections on the financial interactions of low-income Americans with government often focus on transfer programs—cash assistance, Food Stamps, Medicaid—that are collectively referred to as welfare. These programs help those in need, but they do so with a watchful eye. Program design reinforces that government must be vigilant to ensure that its generosity is not exploited.¹ In contrast, thoughts about monetary transactions between government and higher-income Americans focus on the tax system. Paying taxes is an obligation, but minimizing what must be paid is fully legitimate.² Program design recognizes that necessity of enforcement, but the system relies heavily on trust.³

In reality, lower-income Americans interact with government more through the tax system than through welfare offices.⁴ However, a sizeable

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¹ E.g., public attitudes about government assistance programs vary based on descriptions of recipient circumstances, evincing concerns about distinguishing the “deserving” from the “undeserving” (as well as perceptions of the relative efficacy of different programs). See MARY CLARE LENNON ET AL., NAT’L CTR. FOR CHILDREN IN POVERTY, PUBLIC ATTITUDES TOWARD LOW-INCOME FAMILIES AND CHILDREN: CIRCUMSTANCES DICTATE PUBLIC VIEWS OF GOVERNMENT ASSISTANCE, (2003), <http://www.nccp.org/media/pat03a-text.pdf>.

² This is due in part to an underlying belief that by not paying a tax one is saving his own money. Lawrence Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867, 1902 (2005). See also Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 U. KAN. L. REV. 1145, 1160, 1167-77, 1181 (2003) (“Tax cheating and public benefits cheating have very different public images.”).

³ “IRS’ systems were designed and, for the most part, are operated with the overriding objective of enabling anyone who wants to pay their taxes to do it.” *Internal Revenue Service’s 1995 Earned Income Tax Credit Compliance Study before the H. Comm. On Ways and Means*, 105th Cong. 71-72 (1997) (statement of Lynda D. Willis, Director, Tax Policy and Administrative Issues, General Government Division, U.S. General Accounting Office).

⁴ In 2002, there were 56.5 million tax returns filed showing incomes under \$25,000 (representing in some cases households with more than one person). Internal Revenue Service, *2003 Data Book*, 17-19, Table 10 (2003), <http://www.irs.gov/pub/irs-soi/03databk.pdf>. In addition, non-filing workers incurred payroll tax obligations. There were 19.1 million Food Stamps recipients, 5.2 million Temporary Assistance for Needy Families recipients, and 42.8 million Medicaid recipients, STAFF OF HOUSE COMM. ON WAYS & MEANS, 108TH CONGRESS, *2004 GREEN BOOK*, 15-24, 7-31, 15-44 (Comm. Print 2004) (Fiscal Year 2002 data except 2000 for Medicaid), with many of the recipients participating in more than one of those programs. *Id.* at 15-3.

number of taxpayers also receive transfer assistance administered through the tax system, most notably the federal Earned Income Tax Credit, or EITC.⁵ While these mixed roles invite both paternalism and trust, the appropriate balance is unclear.⁶

This article contextualizes tax compliance among the working poor with a particular focus on the EITC. Part II looks at error associated with the EITC and how that compares to what is known about tax compliance on the whole. Part III reviews how the EITC has affected tax law enforcement directed at the working poor and how it differs from enforcement generally. Part IV differentiates types of non-compliance, focusing again on the EITC. Part V advocates alternatives to addressing tax compliance among the working poor that promote equal respect for low-income filers.

II. MAGNITUDE OF NON-COMPLIANCE

Quantifying the extent of non-compliance is difficult, because empirical data on the subject is scarce. Until recently, the last comprehensive study of taxpayer compliance was the Internal Revenue Service (IRS) Taxpayer Compliance Measurement Program (TCMP) for Tax Year 1988.⁷ The IRS replaced the TCMP with the National Research Program, and results from its comprehensive study of Tax Year 2001 will be available in the near future.⁸ Nonetheless, the available data regarding non-compliance among low-income filers comes from investigations specifically targeted at errors with the EITC.⁹

⁵ Among returns filed during Fiscal Year 2005, 21.6 million claimed the EITC. INTERNAL REVENUE SERVICE, 2005 DATA BOOK 9, <http://www.irs.gov/pub/irs-soi/05databk.pdf> (Table 5).

⁶ See Zelenak, *supra* note 2, at 1874, 1900-03.

⁷ Janet Holtzblatt & Janet McCubbin, *Issues Affecting Low-Income Filers*, in THE CRISIS IN TAX ADMINISTRATION 148, 162 (Henry J. Aaron & Joel Slemrod eds., 2004). See generally Robert E. Brown & Mark J. Mazur, *The National Research Program: Measuring Taxpayer Compliance Comprehensively*, 51 U. KAN. L. REV. 1255, 1261-1263 (2003) (summarizing the history of the TCMP and its demise).

⁸ See Brown & Mazur, *supra* note 7, at 1264-69. See also, e.g., Charles Bennett, Preliminary Results of the National Research Program's Reporting Compliance Study of Tax Year 2001 Individual Returns, Internal Revenue Service (2005), <http://www.irs.gov/pub/irs-soi/05bennett.pdf>; News Release IR-2006-28, Internal Revenue Service, IRS Updates Tax Gap Estimates (Feb. 14, 2006), <http://www.irs.gov/newsroom/article/0,,id=154496,00.html> [hereinafter Tax Gap Estimates] (on file with author).

⁹ Holtzblatt & McCubbin, *supra* note 7, at 149. See Brown & Mazur, *supra* note 7, at 1256.

A. Earned Income Tax Credit Error Rate

The TCMP found problems with EITC compliance during the 1980s,¹⁰ and subsequent, less comprehensive reviews also found significant error.¹¹ Critics of the Credit's rapid expansion focused on error rate statistics.¹²

The IRS conducted in-depth EITC compliance studies for Tax Years 1997 and 1999.¹³ The latter determined that 27 to 32 percent of the EITC dollars paid for Tax Year 1999 should not have been paid.¹⁴ This represented \$8.4 billion to \$9.9 billion in improper payments.¹⁵ Among the EITC claimants studied, 44 to 47 percent claimed the correct amount while 46 to 50 percent claimed too much.¹⁶

However, though the IRS EITC studies are a relatively complete examination of compliance, they should not be viewed as definitive. The methodology used likely exaggerates the true level of improper payments.¹⁷ The lag time between the tax year studied and the

¹⁰ The TCMP for Tax Years 1982, 1985, and 1988 found that 29%, 37%, and 34%, respectively, of the total EITC claimed should not have been claimed. See George K. Yin et al., *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11:2 AM. J. OF TAX POL'Y 225, 296 (1994).

¹¹ E.g. *Earned Income Credit: Noncompliance and Potential Eligibility Revisions before the S. Fin. Comm.*, 104 Cong. 35-36 (1995) (statement of Lynda D. Willis, Director, Tax Policy and Administrative Issues, General Government Division, U.S. General Accounting Office) (citing an IRS study finding that 26% of total EITC claims from a sample period in January 1994 should not have been paid) (hereinafter *EIC Hearing*). A more complete subsequent IRS review of Tax Year 1994 also found that 26% of the total EITC claimed should not have been claimed. Janet McCubbin, *Noncompliance with the Earned Income Tax Credit: The Determinants of the Misreporting of Children*, in *MAKING WORK PAY: THE EARNED INCOME TAX CREDIT AND ITS IMPACT ON AMERICA'S FAMILIES* 237, 239 (Bruce D. Meyer & Douglas Holtz-Eakin eds., 2001) (also noting that the rate of improper payments, reflecting IRS enforcement activities, was 24%).

¹² E.g. "In a political culture where the cynical expectation is that all programs are permeated by some degree of waste, fraud and abuse, the EITC, with its current 30-45 percent (\$5-6 billion) fraud rate, is in a league by itself." Lisa Schiffren, *America's Best-Kept Welfare Secret*, AM. SPECTATOR, Apr. 1995, at 27. See also Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit, 1969-99*, 53 NAT'L TAX J. 983, 1004-06 (2000).

¹³ INTERNAL REVENUE SERVICE, COMPLIANCE ESTIMATES FOR EARNED INCOME TAX CREDIT CLAIMED ON 1997 RETURNS (2000); INTERNAL REVENUE SERVICE, COMPLIANCE ESTIMATES FOR EARNED INCOME TAX CREDIT CLAIMED ON 1999 RETURNS (2002) [hereinafter 1999 COMPLIANCE STUDY]. In each study, there were audits of a random sample of tax returns on which the EITC was claimed, and these were augmented by information compiled from EITC claims disallowed during return processing and returns subjected to EITC-related enforcement programs. 1999 COMPLIANCE STUDY, *supra* at 5.

¹⁴ 1999 COMPLIANCE STUDY, at 12. The study reported lower-bound and upper-bound estimates; the higher figure uses the assumption that all of the sampled taxpayers who did not appear for their audit had overclaimed the credit, and the lower figure assumes that compliance among this group was the same as for those who did appear for audits. *Id.* at 10.

¹⁵ *Id.* at 10. A higher percentage of the total EITC claimed—31% to 36%—was found by the IRS to have been claimed in error. The difference between the percentage of improper claims and improper payments represents the effect of enforcement efforts. See *id.* at 12.

¹⁶ *Id.* at 11.

¹⁷ The exclusive reliance on the outcome of EITC audits that are frequently incorrect and improperly deny the credit overstated the 1999 study overclaim rate. NATIONAL TAXPAYER

promulgation of findings causes interim statutory and administrative steps to address error to go unrecognized.¹⁸ The lack of differentiation among types of error makes it impossible to identify the extent of fraud in the program as opposed to technical or inadvertent error.¹⁹

ADVOCATE, INTERNAL REVENUE SERVICE, THE NATIONAL TAXPAYER ADVOCATE'S FISCAL YEAR 2004 OBJECTIVES REPORT TO CONGRESS 20-21 (2003) [hereinafter FY 2004 OBJECTIVES]. A review of the 1997 EITC compliance study also cited this as a significant methodological weakness. Memorandum from Pamela J. Gardiner, Deputy Inspector General for Audit, Department of the Treasury, *There Are Significant Weaknesses in the Internal Revenue Service's Efforts to Measure Earned Income Credit Compliance*, at 3-6, Ref. No. 2002-40-021 (2001), <http://treas.gov/tigta/audit/reports/2002reports/200240021fr.pdf> [hereinafter *TIGTA (2001)*]. "The truth is that we simply do not know how many taxpayers identified as noncompliant were in fact EITC-eligible." Leslie Book, *EITC Noncompliance: What We Don't Know Can Hurt Them*, TAX NOTES 1821, 1826 (June 23, 2003). The studies themselves recognize the sensitivity of the error measures to the underlying audit dynamics. See *supra* note 13. The EITC studies overestimate non-compliance by not offsetting a claim found to be in error by the amount that could have been legitimately claimed for the same qualifying child by another filer. See 1999 COMPLIANCE STUDY, *supra* note 13, at 14; ROBERT GREENSTEIN, CENTER ON BUDGET AND POLICY PRIORITIES, WHAT IS THE MAGNITUDE OF EITC OVERPAYMENTS, at 2-3, (July 23, 2003); see also McCubbin, *supra* note 11, at 238-239 (the reliance on audits of EITC filers ignores amounts that could have been claimed by those who did not claim any EITC at all). Methodological and procedural refinements may themselves increase the amount of error found. See 1999 COMPLIANCE STUDY, *supra* note 13, at 16. Inconsistent test methodologies between studies make problematic cross-study comparisons of changes in error rates. See Memorandum from Gordon C. Milbourn, III, Treasury Inspector General for Tax Administration, Department of the Treasury, *Opportunities Exist to Improve the Administration of the Earned Income Tax Credit*, at 3, Ref. No. 2003-40-139 (2003).

¹⁸ The 1999 study acknowledges the likely effect of such changes on error rates. 1999 COMPLIANCE STUDY, *supra* note 13, at 21-22. Changes cited in the study include creation of the Federal Case Registry of child support orders and the empowerment of the IRS to math error authority to deny claims made by persons identified through the Registry as non-custodial parents, new tie-breaker rules applicable when a child for EITC purposes is the qualifying child of more than one taxpayer, more objective definitions of qualifying foster children, and conformance of the EITC-applicable definitions of earned income and adjusted gross income to those otherwise used. *Id.*; see GREENSTEIN, *supra* note 17, at 3-5; but cf. Janet Spragens & Nancy Abramowitz, *Low-Income Taxpayers and the Modernized IRS: A View from the Trenches*, TAX NOTES 1407, 1410 (June 13, 2005) (use of the Federal Case Registry can deny legitimate claims, as living and custody circumstances can change frequently). See also McCubbin, *supra* note 11, at 239 (citing IRS and Treasury estimates of the reductions in prior studies' error rates from application of subsequent enforcement procedures); Jeffrey B. Liebman, *Who Are the Ineligible Earned Income Tax Credit Recipients?*, in MAKING WORK PAY, *supra* note 11, at 274, 275-280 (discussing the dynamics of expansions of the EITC, simplifications of rules, and enhanced enforcement mechanisms on rates of non-compliance). Nonetheless, the IRS Commissioner testified in March 2006 that the erroneous payment percentage for Tax Year 2005 was in the range of 23% to 28%. *Reporting Improper Payments: A Report Card on Agencies' Progress Before the Subcomm. on Fed. Fin. Mgmt., Govtmnt. Info. & Int'l Security, S. Homeland Security & Govtmnt. Affairs. Comm.*, at 5 (March 9, 2006) (written testimony of Mark Everson, IRS Commissioner), http://hsgac.senate.gov/_files/030906Everson.pdf.

¹⁹ See Leslie Book, *Preventing the Hybrid From Backfiring: Delivery of Benefits to the Working Poor Through the Tax System*, 2006 WIS. L. REV. 1113, 1113; General Accounting Office, *Earned Income Credit: Opportunities to Make Recertification Program Less Confusing and More Consistent*, GAO-02-449, at 5 n.6; McCubbin, *supra* note 11, at 238. See also Leonard E. Burman, Comment, in THE CRISIS IN TAX ADMINISTRATION, *supra* note 7, at 188, 190-91 (suggesting possible features of an econometric model for distinguishing taxpayer confusion from intentional non-compliance.). Distinguishing between overpayments and fraud is an issue with traditional transfer programs as well. See, e.g., DOROTHY ROSENBAUM, CENTER ON BUDGET AND POLICY PRIORITIES, FOOD STAMP ERROR RATES HOLD AT RECORD LOW LEVELS IN 2005, at 4 (2006) (asserting that relatively few overpayment errors represent dishonesty or fraud).

B. Earned Income Tax Credit Compliance: Transfer Program Context

Even if IRS studies exaggerate the actual error rate, the EITC has a much higher incidence of improper payments than other transfer programs.²⁰ This should not be surprising. As a tax credit, the EITC resides in the tax system's environment of largely voluntary compliance by offering self-declared eligibility.²¹

The ease of claiming the EITC is undoubtedly a factor in the Credit's much higher estimated participation rate compared to traditional transfer programs.²² Non-participation by eligible persons can be viewed as an underpayment of benefits.²³ An overall assessment of comparative program accuracy needs to account for under-provision of benefits, through actual underpayments and constructive underpayments (non-participation), and over-provision through overpayments of whatever origin.²⁴ Using this measure for the EITC and Food Stamps, the two programs arguably operate with roughly equal overall accuracy.²⁵

Self-declared eligibility—as opposed to the pre-certification required with traditional transfer programs²⁶—enables the EITC to operate with low administrative costs of not more than one percent of total benefits paid.²⁷ The Food Stamp program has much higher administrative costs of between 20 and 25 percent of total benefits paid.²⁸ Self-declared eligibility is also at the root of the EITC error rate problem.²⁹ However, if overall program cost is viewed as the combined cost of overpayments and direct

²⁰ Congressional testimony in 1995 compared EITC non-compliance to calculations for 1992 for Food Stamps (8.2% overpayment rate) and Aid to Families with Dependent Children (5.3% overpayment rate). *EIC Hearing*, *supra* note 11, at 36. The Food Stamp overpayment rate has since fallen to a record low level of 4.5% for fiscal years 2004 and 2005. Rosenbaum, *supra* note 19, at 1. *But cf.* Marsha Blumental et al., *Participation and Compliance with the Earned Income Tax Credit*, 58 NAT'L TAX J. 189, 206-07 (2005) (controlling for differences in the claiming populations and the estimation methodologies would probably result in a less pronounced gap in the comparative overclaim rates).

²¹ See Zelenak, *supra* note 2, at 1869, 1876.

²² *Id.* at 1915; Holtzblatt & McCubbin, *supra* note 7, at 176. See also David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L. J. 955, 1004-05 (2004).

²³ See Zelenak, *supra* note 2, at 1888.

²⁴ Weisbach & Nussim, *supra* note 22, at 1005.

²⁵ See *id.*

²⁶ This distinction and terminology are borrowed from Zelenak, *supra* note 2, at 1876-78, 1881.

²⁷ Holtzblatt & McCubbin, *supra* note 7, at 161.

²⁸ Zelenak, *supra* note 2, at 1881. In the fiscal year 1998, Food Stamps had administrative costs equal to 19% of total program costs (administration plus program benefits). Janet Holtzblatt, *Choosing Between Refundable Tax Credits and Spending Programs*, in 93 PROC. ANN. CONF. ON TAX'N 116, 121 (2001).

²⁹ Book, *supra* note 19, at 1106 ("The EITC's error rate is high, in large part because the IRS has no extensive bureaucracy to predetermine eligibility, and instead has largely relied on a small number of correspondence-based eligibility audits following the filing of a tax return to determine whether a claimant is eligible.").

administrative expenses as a percentage of total costs (adding in benefits paid), the EITC and Food Stamps are, again, roughly equal.³⁰

C. Earned Income Tax Credit Compliance: Tax System Context

The relative size of different sources of tax law non-compliance is illustrated in estimates of the “tax gap”: the difference between what is actually collected (or paid out) and what would have been with full compliance.³¹ The estimated tax gap for Tax Year 2001 was \$345 billion.³² Only a small portion of this gap—eight percent—represented taxes due from non-filers.³³ Over half involved individual filers’ business income and self-employment taxes.³⁴ Taxes not collected due to underreported wages, salaries, and tips were a relatively small problem (3% of the total tax gap) compared to taxes not collected because of underreported self-employment income (20 percent).³⁵

The tax gap category encompassing EITC errors—overstated credits—accounted for a mere five percent of the overall tax gap.³⁶ The proportion of this amount (\$17.3 billion) attributable to the EITC versus all other tax credits is not specified. If the overpayment findings from the Tax Year 1999 error rate study³⁷ were applied to the 2001 tax gap figures, eliminating EITC non-compliance would, at best, remedy approximately one-fortieth of the overall tax gap.³⁸ Addressing EITC compliance is

³⁰ Zelenak, *supra* note 2, at 1905-06 (citing Janet Holtzblatt that each program spends about twenty-five cents of every dollar on either administrative costs or erroneous payments). Weisbach & Nussim find a preference to spend on administration instead of on transfers to individuals unjustifiable. Weisbach & Nussim, *supra* note 22, at 1011-12. *Cf.* Liebman, *supra* note 18, at 292 (the relative cost-effectiveness of low administrative costs and high error rates to high administrative costs and lower error rates heavily depends on the valuation of those dollars transferred to ineligible taxpayers).

³¹ See Tax Gap Estimates, *supra* note 9. Estimating the tax gap is a key objective of the IRS National Research Program. *Id.*

³² *Id.* This translates into a non-compliance rate of 16.3% for the overall federal tax system. See Tax Gap Estimates, *supra* note 9. See also Tax Gap Figures (2006), http://www.irs.gov/pub/irs-news/tax_gap_figures.pdf (cited in Tax Gap Estimates, *supra* note 9) (chart titled Tax Year 2001 Federal Tax Gap).

³³ See Tax Gap Figures, *supra* note 32 (chart titled Tax Year 2001 Federal Tax Gap) (author’s calculations).

³⁴ See *id.*

³⁵ See *id.* (charts titled Tax Year 2001 Federal Tax Gap & Individual Income Tax Underreporting Gap Estimates, Tax Year 2001) (author’s calculations that the \$10 billion tax gap in underreported wages, salaries, and tips divided by the \$345 billion gross tax gap is 3%; the \$68 billion tax gap in nonfarm proprietor income divided by the \$345 billion gross tax gap is 20%).

³⁶ See *id.* (author’s calculations that the \$17 billion tax gap in overreported credits divided by the \$345 billion gross tax gap is 5%).

³⁷ See *supra* notes 14-17 and accompanying text; *but see* notes 18-20 and accompanying text (overpayment statistics are likely overstated).

³⁸ See Tax Gap Figures, *supra* note 32 (charts titled Tax Year 2001 Federal Tax Gap & Individual Income Tax Underreporting Gap Estimates, Tax Year 2001) (author’s calculations). Another compliance measure is the net misreporting percentage; that is, the amount inaccurately reported as a percentage of the total that should have been reported. Tax Gap Estimates, *supra* note 9. The net misreporting percentage for wages, salaries, and tips was only 1%, but it was 57% for sole proprietor

important, but its importance should not overshadow general compliance problems in the tax system.³⁹

III. COMPARATIVE ENFORCEMENT

Although the tax system relies largely on voluntary compliance, the IRS maintains an extensive enforcement infrastructure to identify and correct non-compliance. Tools range from computer matching of information, to third-party reporting, to audits and criminal investigations.⁴⁰ In addition to its direct effect on compliance, the existence of this enforcement regime may serve as a deterrent that reinforces the viability of the voluntary approach.⁴¹

income and 72% for farm income. Tax Gap Figures, *supra* note 32 (chart titled Individual Income Tax Underreporting Gap Estimates, Tax Year 2001). The net misreporting percentage for all tax credits was 26%. *Id.* As with the tax gap, the EITC's share is not known.

³⁹ The relative importance given to EITC non-compliance is, in part, a result of the relative availability of data:

Without comparable data on taxpayers who do not claim the EITC, it is impossible to fully understand the extent to which EITC overclaims are the result of the EITC itself and the extent to which they are part of a more general compliance problem. The absence of broader compliance data also makes it difficult to evaluate the importance of the EITC compliance problem relative to other tax compliance problems....

McCubbin, *supra* note 11, at 264. See Burman, *supra* note 19, at 189. See also Holtzblatt & McCubbin, *supra* note 7, at 163 n.28 (noting that the National Research Program represents a strong consensus regarding the importance of comprehensive compliance data); *but see* Zelenak, *supra* note 2, at 1889:

There seems to be almost no interest, however, in the underclaiming of nonrefundable tax benefits. Perhaps this is because inaccuracy in the delivery of legislated benefits is considered an important issue only if it involves a drain on the Treasury or nonreceipt by the poor of desperately needed benefits, and the underclaiming of nonrefundable tax benefits implicates neither concern.

⁴⁰ Income tax withholding by employers may be seen as the most comprehensive compliance tool. See General Accounting Office, *Taxpayer Compliance: Analyzing the Nature of the Income Tax Gap*, GAO/T-GGD-97-35, at 3 (January 9, 1997) (statement of Lynda D. Willis before the Nat'l Comm'n on Restructuring the I.R.S.) (tax withholding is "the most systematic method for making income visible to [the] IRS"). "Withholding essentially puts third parties in charge of paying the taxpayer's taxes to the IRS and eases the psychological burden that would be associated with writing a check for the full year's taxes to send in with the tax return." Leandra Lederman, *Tax Compliance and the Reformed IRS*, 51 U. KAN. L. REV. 971, 974-75 (2003) (citation omitted). Nonetheless, even with tax withholding, backed up by third-party reporting and enforcement actions, the extent of tax compliance (for almost everyone) remains a voluntary choice. Alan H. Plumley & C. Eugene Steurele, *Ultimate Objectives for the IRS: Balancing Revenue and Service*, in *THE CRISIS IN TAX ADMINISTRATION*, *supra* note 7, at 311, 317 n.4.

⁴¹ But "[P]atterns of evasion cannot be explained by any simple concept of deterrence." Robert Mason & Lyle D. Calvin, *A Study of Admitted Income Tax Evasion*, 13 LAW & SOC'Y REV. 73, 87 (1978) (survey of 800 Oregon adults finding that nearly 1 in 4 admitted practicing tax evasion). There is nonetheless a logical disconnect between the extent of tax law enforcement and the level of tax compliance. "The penalty for ordinary tax convictions is small; the probability of detection is trivial; so the expected sanction is small. Yet large numbers of Americans pay their taxes." Eric A. Posner, *Law and Social Norms: The Case of Tax Compliance*, 86 VA. L. REV. 1781, 1782 (2000).

A likely factor is overestimation of the probability of audit, *see id.* at 1808, as detection risk is an important factor in compliance, Steven Klepper & Daniel Nagin, *The Anatomy of Tax Evasion*, 5 J.L. ECON. & ORG. 1, 2, 22-23 (1989). See also Joel Slemrod et al., *Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Experiment in Minnesota*, 79 J. PUB. ECON. 455, 482

As described in this section, the attention given to quantifying EITC-related error has extended to enforcement. Accordingly, the working poor have been among the most-examined tax filers and have also seen the development and application of new enforcement tools.

A. Audits

In fiscal year 2005, 43 percent of IRS audits of individual income tax returns were associated with an EITC claim.⁴² This figure was lower than the prior year, when EITC returns comprised 48 percent of all individual income tax returns audited.⁴³ However, a higher percentage of EITC returns were audited in 2005 (2.4 percent)⁴⁴ than in 2004 (2.2 percent).⁴⁵ For several years, Congress gave the IRS a specific appropriation to audit EITC returns.⁴⁶

The audit rate for individuals with high incomes (\$100,000 and higher) has increased in recent years, but it remains much lower than it was ten years ago.⁴⁷ Even with the recent increase, EITC claimants have a significantly greater chance of being audited than high-income households.

(2001) (heightened threat of audit increases reporting, at least among low- and middle-income taxpayers). “I believe many honest taxpayers overestimate both the likelihood of IRS detection and the magnitude of the penalty if detected (for example, some EITC-claiming taxpayers who were audited and I believe mistakenly claimed ineligible children as qualifying children have asked my students if their actions could lead to imprisonment).” Book, *supra* note 2, at 1149 n.16.

A comprehensive model that satisfactorily explains tax compliance is elusive. *See generally id.* at 1183-91; James Andreoni et al., *Tax Compliance*, 36 J. ECON. LIT. 818 (1998); Frank Cowell, *Carrots and Sticks in Enforcement*, in *THE CRISIS IN TAX ADMINISTRATION*, *supra* note 7, at 230; Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OHIO ST. L.J. 1453, 1463-99 (2003).

⁴² *See* DATA BOOK 2005, *supra* note 5, at Tables 5 & 10 (author’s calculations).

⁴³ *See* INTERNAL REVENUE SERVICE, DATA BOOK 2004, Tables 5 & 10 (2005), <http://www.irs.gov/pub/irs-soi/04databk.pdf> (author’s calculations). The IRS data books for fiscal years prior to 2004 do not include the statistic for the number of returns examined with an EITC claim.

⁴⁴ *See* DATA BOOK 2005, *supra* note 5, at Tables 5 & 10 (author’s calculations).

⁴⁵ *See* DATA BOOK 2004, *supra* note 43, at Tables 5 & 10 (author’s calculations).

⁴⁶ The Balanced Budget Act of 1997, Sec. 5702, set aside \$716 million over five years for EITC enforcement initiatives. Balanced Budget Act of 1997, Pub. L. No. 105-33, 5702, 111 Stat. 251, 648 (1997). *See also* INTERNAL REVENUE SERVICE, EARNED INCOME TAX CREDIT (EITC) PROGRAM EFFECTIVENESS AND PROGRAM MANAGEMENT FY 2002 – FY 2003 (August 8, 2003), http://www.irs.gov/pub/irs-utl/eitc_effectiveness.pdf [hereinafter EITC PROGRAM EFFECTIVENESS]. Book, *supra* note 2, at 1164-65, notes how reform and restructuring of the IRS in the late 1990’s also created institutional incentives to devote more resources to EITC enforcement. *See also id.* at 1158 (disproportionate attention to EITC during period of steep decline in overall IRS enforcement).

⁴⁷ *See* INTERNAL REVENUE SERVICE, FISCAL YEAR 2006 ENFORCEMENT AND SERVICE RESULTS 4 (November 20, 2006), http://www.irs.gov/pub/newsroom/11-06_enforcement_stats.pdf [hereinafter FY 2006 ENFORCEMENT RESULTS]. The preliminary results for fiscal year 2006 indicate that 1.67% of high-income returns were audited. *Id.* This is more than twice the rate for fiscal year 2001 (0.79%) but well below the 2.74% rate in fiscal year 1997. *Id.* *Cf.* TRANSACTIONAL RECORDS ACCESS CLEARINGHOUSE (TRAC), PERCENT OF HIGH INCOME INDIVIDUAL RETURNS AUDITED (2005), <http://www.trac.syr.edu/tracirs/highlights/current/highincomeIndividual.html> (finding audit rates of 5.28% in fiscal year 1992, 2.27% in 1997, 0.69% in 2001, and 1.39% in 2004 for high-income individuals whose primary source of income was from salaries and investments).

In fiscal year 2004, an EITC household was 1.76 times more likely to be audited.⁴⁸ The audit rate disparity declined somewhat in 2005 but remained significant.⁴⁹

Most EITC reviews are correspondence audits⁵⁰ rather than field (face-to-face) audits,⁵¹ meaning they are conducted by mail. Although correspondence audits are less intrusive, the lack of direct contact may cause them to be more disruptive in the context of the EITC. There are high non-response and late response rates to the envelopes delivered from the IRS.⁵² Challenging circumstances specific to the working poor can make an effective response problematic because they complicate both receipt and comprehension of correspondence and documentation of eligibility.⁵³ Accordingly, the audit determination by the IRS may be based on incomplete information.⁵⁴

⁴⁸ See FY 2006 ENFORCEMENT RESULTS, *supra* note 47, at 4 (author's calculations).

⁴⁹ See *id.* Specifically, the percentage of high-income returns audited grew faster from 2004 to 2005 than the percentage of EITC returns (1.25% to 1.57%, versus 2.2% to 2.4%). Therefore, in 2005, the EITC households were 1.53 times as likely to be audited as the high-income households. See *id.*

⁵⁰ See NATIONAL TAXPAYER ADVOCATE, I.R.S., PUB'N NO. 2104B (REV. 12-2004), 2004 ANNUAL REPORT TO CONGRESS, 2 EARNED INCOME TAX CREDIT (EITC) AUDIT RECONSIDERATION STUDY 8, 12 (2004), <http://www.irs.gov/pub/irs-utl/nta2004arcvol2interactive.pdf> [hereinafter NATIONAL TAXPAYER ADVOCATE REPORT 2004].

⁵¹ "A correspondence examination (audit) is handled through written correspondence (rather than a face-to-face meeting), normally can be conducted in a few hours, is limited in scope to a few issues and does not include a review of detailed account records." *Id.* at 12 n.10. The correspondence process is a more centralized, corporate approach that offers little direct contact between taxpayers and the IRS. Leslie Book, *The IRS's Compliance Regime: Taxpayers Caught in the Net*, 81 OR. L. REV. 351, 385-90, 407 (2002). Correspondence audits have been less frequently used with higher-income taxpayers, although there has been an increase in recent years. See FY 2006 ENFORCEMENT RESULTS, *supra* note 47, at 4. In federal Fiscal Year 1998, 24% of audits of returns with incomes \$100,000 and higher were conducted by mail, and this increased to 62% in Fiscal Year 2005 and 56% in Fiscal Year 2006. See *id.* (author's calculations). In the context of higher-income taxpayers and the methods they can use to avoid taxes, the greater use of correspondence audits may undercut the effectiveness of the increase in enforcement efforts among that population. See TRANSACTIONAL RECORDS ACCESS CLEARINGHOUSE (TRAC), NATIONAL PROFILE AND ENFORCEMENT TRENDS OVER TIME, (2005), <http://trac.syr.edu/tracirs/latest/127/>.

⁵² Data from the EITC Program Office in 2003 indicated that more than 30% of taxpayers undergoing EITC correspondence audits over the previous three years had either not received the IRS notices or had failed to respond to them. FY 2004 OBJECTIVES, *supra* note 17, at 23. In a sample of cases in which the taxpayer sought reconsideration of an adverse EITC audit determination, the primary cause of the determination in 42% of them was either no taxpayer response or a late response. NATIONAL TAXPAYER ADVOCATE REPORT 2004, *supra* note 50, at 21. The failure to augment letters with sufficient telephone contact is a significant communication barrier. See *id.* at 35-37, 43. "Correspondence examinations are particularly ill-suited for obtaining information from low-income taxpayers. It was my experience, in representing low-income taxpayers, that I would have to make seven or eight contacts and follow-up calls before the taxpayer provided me with sufficient information to assist him or her." Nina Olson, Comment, *in* THE CRISIS IN TAX ADMINISTRATION, *supra* note 7, at 193, 195.

⁵³ Specific barriers include transiency and homelessness, illiteracy, limited English proficiency, fear of government (especially among immigrants), and distrust and disuse of financial institutions. Book, *supra* note 51, at 390-405.

⁵⁴ National Taxpayer Advocate Report 2004, *supra* note 51, at 13. Since EITC eligibility requirements are tied to a taxpayer's living arrangements and familial relationships, auditors need to inquire about a taxpayer's personal life to determine eligibility. TIGTA (2001), *supra* note 18, at 2.

A taxpayer receiving an IRS determination of an incorrect EITC claim can seek reconsideration.⁵⁵ Most people who receive an adverse determination do not take this step,⁵⁶ but those who do often obtain a favorable outcome.⁵⁷ The original audit results may reflect the ability to negotiate the initial review process more than indicating eligibility for the EITC.⁵⁸

B. Sanctions

The IRS has authority to impose civil penalties equal to 20 percent of the amount of an underpayment for actions found to be negligent,⁵⁹ and 75 percent for instances of fraud.⁶⁰ However, these penalties are rarely applied to EITC non-compliance.⁶¹

Criminal prosecutions related to the EITC appear to be rare,⁶² but IRS investigative powers have adversely affected credit claims through the Questionable Refund Program (QRP).⁶³ The IRS can stop all processing of tax returns flagged through the QRP, including the issuance of a refund without notification to the taxpayer.⁶⁴ In a sample of 2004 and 2005 cases examined by the National Taxpayer Advocate, 74 percent of frozen

⁵⁵ NATIONAL TAXPAYER ADVOCATE REPORT 2004, *supra* note 50, at 13. Book details the post-audit enforcement and review process in his article. Book, *supra* note 51, at 375-81. The average time elapsed from processing the original EITC claim to closing the audit reconsideration was 2.7 years. NATIONAL TAXPAYER ADVOCATE REPORT 2004, *supra* note 50, at 22.

⁵⁶ This is based on a rough calculation from available data from Fiscal Year 2000 (325,654 EITC-related correspondence audits, BOOK, *supra* note 51, at 374, and Fiscal Year 2002 (66,893 EITC audit reconsideration cases, NATIONAL TAXPAYER ADVOCATE REPORT 2004, *supra* note 50, at 13, 13 n.14, for a reconsideration rate of 20.5%.

⁵⁷ In a sample of EITC audit reconsiderations from Fiscal Year 2002, 43% of those taxpayers were entitled to virtually all of the EITC they had originally claimed. NATIONAL TAXPAYER ADVOCATE REPORT 2004, *supra* note 50, at i, 9, 27-29. In more than half of the EITC correspondence examinations closed by the Taxpayer Advocate Service, the IRS agreed to a change in the examination result. FY 2004 OBJECTIVES, *supra* note 17, at 21 n.22. A prior study of EITC correspondence audits found that eligibility determination standards varied among IRS service centers. General Accounting Office, *IRS Audits: Weaknesses in Selecting and Conducting Correspondence Audits*, GAO/GGD-99-48, at 28-29 (1999), <http://www.gao.gov/archive/1999/gg99048.pdf>. This may be seen as an example of bureaucratic disenfranchisement (an effective difference in eligibility due to frontline administrative actions). Book, *supra* note 51, at 405-09.

⁵⁸ NATIONAL TAXPAYER ADVOCATE REPORT 2004, *supra* note 50, at i.

⁵⁹ I.R.C. § 6662(a) (2002).

⁶⁰ I.R.C. § 6663(a) (2002).

⁶¹ Book, *supra* note 2, at 1167-77, 1181 (2003). "The accuracy-related penalties were not designed to apply to taxpayers who may in fact not have tax liabilities, but who were merely using the tax system to generate refunds." *Id.* at 1182.

⁶² See Zelenak, *supra* note 2, at 1891-92. This is largely because criminal investigations of taxpayers are rare. See Book, *supra* note 2, at 1180 n.127. Criminal prosecutions attributable to the EITC appear to be roughly proportionate. Zelenak, *supra* note 2, at 1892.

⁶³ Criminal prosecutions related to the EITC originated through the QRP. See Zelenak, *supra* note 2, at 1891; EITC PROGRAM EFFECTIVENESS, *supra* note 46, at 13.

⁶⁴ NATIONAL TAXPAYER ADVOCATE, 2005 ANNUAL REPORT TO CONGRESS, VOLUME 2: CRIMINAL INVESTIGATION REFUND FREEZE STUDY 5-6 (2005).

refunds involved the EITC.⁶⁵ In most cases, the claims were later found to be legitimate,⁶⁶ and the lower-income households needlessly suffered financial hardship.⁶⁷ The investigation led to the IRS's modifying its procedures for the QRP to reduce its inappropriate application.⁶⁸

Another IRS enforcement tool used aggressively with respect to the EITC is "math error authority." This procedure allows the IRS to make a summary assessment of taxes owed if there is a mathematical or clerical error.⁶⁹ In its efforts to control EITC-related error, Congress has empowered the IRS to use the summary processes of math error authority for errors that can be identified through data matching.⁷⁰ Expanded math error authority has certainly reduced improper EITC payments, but it has also increased the number of legitimate claims that are challenged and delayed.⁷¹

⁶⁵ *Id.* at 10.

⁶⁶ Nearly 75% of taxpayers who claimed the EITC were allowed the credit after IRS processing. *Id.* at 12.

⁶⁷ The frozen refund amount equaled 25% or more of adjusted gross income for half of all taxpayers. *Id.* The median wait for the refunds to be processed and paid was almost 9 months. *Id.* at 15.

⁶⁸ Key changes announced by the IRS were refining the accuracy of filters to reduce the number of refund freezes, notifying taxpayers whose refunds are frozen, and expediting reviews to speed release of refunds. Press Release, Internal Revenue Service, New Steps Taken to Improve Questionable Refund Program, IR-2006-24 (Feb. 6, 2006), <http://www.irs.gov/newsroom/article/0,,id=154285,00.html>.

⁶⁹ EITC PROGRAM EFFECTIVENESS, *supra* note 46, at 7. The procedure permits more efficient return processing. "Math error authority allows the IRS to avoid providing the taxpayer with a statutory notice of deficiency for math errors. In general, these are errors that must be corrected for the IRS to process the return. These include obvious errors such as omissions of data needed to substantiate items on the tax return, as well as mathematical errors." V. Joseph Hotz et al., Institute for Research on Poverty, *Can Administrative Data on Child Support Be Used to Improve the EITC? Evidence from Wisconsin*, Discussion Paper no. 1310-05, at 2 n.5 (Oct. 2005), <http://www.irp.wisc.edu/publications/eps/pdfs/dp131005.pdf>. The IRS must explain the error to the taxpayer, and the taxpayer can choose to challenge the IRS action and require use of normal enforcement procedures. See EITC PROGRAM EFFECTIVENESS, *supra* note 46, at 7. See also Spragens & Abramowitz, *supra* note 18, at 1410 (use of math error authority limits exercise of taxpayer rights); NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE, FY 2002 ANNUAL REPORT TO CONGRESS 26-27 (2002), http://www.irs.gov/pub/irs-utl/nta_2002_annual_rpt.pdf. (possible loss of access to administrative appeal and judicial review of particular concern).

⁷⁰ This includes missing or invalid Social Security Numbers (including for EITC qualifying children) and EITC qualifying child dates of birth. EITC PROGRAM EFFECTIVENESS, *supra* note 46, at 7. "Math error authority now also applies to EITC claims made with respect to children for whom the taxpayer is identified as a non-custodial parent through the Federal Case Registry of child support orders. Hotz, *supra* note 61, at 2.

⁷¹ In Fiscal Year 2002, the IRS issued math error notices for approximately 1.1 million returns representing \$729 million in EITC claims. EITC PROGRAM EFFECTIVENESS, *supra* note 46, at 7. Almost half of this amount derived from the expanded authority. See *id.* at 9. "In some instances, taxpayers subsequently provided the IRS with information that resolved the math error condition." *Id.* at 8. In fact, 39% of the EITC amount challenged using all math error authority was subsequently paid, and over half (53%) of the amount challenged under the expanded authority was eventually paid. See *id.* at 9 (author's calculations). The data matching processes used as the basis for some summary denials inevitably generate false positives that can lead to denials (or at least delays) of legitimate claims. See Hotz, *supra* note 61, at 19.

There are also IRS sanctions specific to the EITC. If an EITC claim is found to be improper due to negligence, the IRS can disallow any subsequent EITC claims for two years.⁷² In cases of fraud, the disallowance penalty is ten years.⁷³ The IRS has used these penalties sparingly.⁷⁴ Even if a ban is not in effect, a taxpayer who has had an EITC reduction or disallowance through an audit determination must take the additional step of filing Form 8862 to make a subsequent EITC claim.⁷⁵

C. Third-Party Reporting and Certifications

The Form W-2 annual wage statement provided by employers is a well-known example of third-party reporting. This tool operates both directly as an investigative measure (through document matching) and indirectly as a deterrent of third-party reporting.⁷⁶

The effectiveness of third-party reporting may be seen in the tax gap measures. There is relatively little misreporting of wages (which are reported via the W-2).⁷⁷ Another example is unemployment compensation income, which is reported to the IRS via Form 1099-G⁷⁸ and has a net misreporting percentage of 11 percent.⁷⁹

Conversely, over half of unreported income comes from self-employment.⁸⁰ There is a third-party reporting requirement that attempts to track payments to the self-employed,⁸¹ however, there is relatively little reporting associated with business expenses that can be claimed to lower

⁷² I.R.C. § 32(k)(1)(B)(ii) (2002).

⁷³ I.R.C. § 32(k)(1)(B)(i) (2002).

⁷⁴ During Fiscal Year 2003, the IRS applied the two-year ban to approximately 8,600 taxpayers, and there were two-year bans in effect for a total of approximately 18,000 taxpayers as of July 2003. Treasury Inspector General for Tax Administration, Department of the Treasury, *Application of the Earned Income Credit Two-Year Ban Could Be More Consistent, Accurate, and Clear to Taxpayers*, Ref. No. 2005-40-015, at 1 (2004). The bans imposed in 2003 represented less than 0.1% of all EITC claims. Zelenak, *supra* note 2, at 1896. There does not appear to be comparable data with respect to the ten-year ban. See Book, *supra* note 2, at 1183 n.137. One problem with imposing the ban is the inability of the IRS to make the state of mind determination required to find fraud or reckless action. Zelenak, *supra* note 2, at 1895-96.

⁷⁵ See IRS Form 8862 and general instructions, at <http://www.irs.gov/pub/irs-pdf/f8862.pdf>. See also GENERAL ACCOUNTING OFFICE, EARNED INCOME CREDIT: OPPORTUNITIES TO MAKE RECERTIFICATION PROGRAM LESS CONFUSING AND MORE CONSISTENT, GAO-02-449 8-23 (2002).

⁷⁶ See *supra* note 43. But cf. NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE, 2005 ANNUAL REPORT TO CONGRESS, at 58 (2005) (“The IRS’s over-reliance on information reporting may reinforce the belief held by some cash economy participants that only income subject to information reporting is subject to tax.”).

⁷⁷ The Net Misreporting Percentage for wages, salaries, and tips is 1%. Tax Gap Figures, *supra* note 32, at 2. Of course, the withholding and payment to the IRS of taxes on wages, salaries, and tips plays a role. See *supra* note 42.

⁷⁸ See Instructions for Form 1099-G, at <http://www.irs.gov/pub/irs-pdf/i1099g.pdf>.

⁷⁹ Tax Gap Figures, *supra* note 32, at 1.

⁸⁰ *Supra* note 35 and accompanying text. This is also true in the context of EITC non-compliance. See Holtzblatt & McCubbin, *supra* note 7, at 167.

⁸¹ See Instructions for Form 1099-MISC, at <http://www.irs.gov/pub/irs-pdf/i1099misc.pdf>.

net income.⁸² Self-employed persons operating on a cash basis present a particular problem, as they report only 11 to 19 percent of their income.⁸³ In the context of the EITC, cash basis income presents a potential over-reporting problem.⁸⁴

The IRS has experimented with third-party reporting specific to the EITC. Because failure to meet the qualifying child residency and relationship tests figure prominently in the EITC error rate, the IRS proposed a broad pre-certification process in 2003 to establish those elements of eligibility.⁸⁵ After encountering opposition,⁸⁶ the IRS instead tested a certification of residency requirement for a random sample of 25,000 EITC claimants for whom the IRS could not establish child residency from available data.⁸⁷ The study offered various certification methods.⁸⁸ It found that there were fewer EITC claims made among the

⁸² Payments to contractors, landlords, and others may need to be reported, *see id.* but there is no independent reporting of other business expenses.

⁸³ *See The 350 Billion Question: How to Solve the Tax Gap*, Hearing Before the S. Comm. on Finance, 108th Cong. 8 (2005) (statement of J. Russell George, Treasury Inspector General for Tax Administration), http://www.ustreas.gov/tigta/congress/congress_04142005.pdf; GENERAL ACCOUNTING OFFICE, *supra* note 19, at 4-5.

⁸⁴ The cash-basis economy presents a different potential opportunity for EITC claimants. Because filers with very low incomes receive a larger credit as they report more income, there is some incentive among this group for overstating income from sources not providing third-party reporting. This issue was raised during the period of EITC expansion. *See, e.g.*, Yin et al, *supra* note 10, at 259 (also voicing concern about superfluous work, such as neighbors taking care of each other's homes); C. Eugene Steuerle, *The Future of the Earned Income Tax Credit*, TAX NOTES 1819, 1820 (June 26, 1995) (citing the inherent problem in monitoring this "superterranean economy"). However, this has not been found to be a significant problem. Holtzblatt & McCubbin, *supra* note 7, at 168; MCCUBBIN, *supra* note 11, at 242-43; *see also* V. JOSEPH HOTZ & JOHN KARL SCHOLZ, MEANS-TESTED TRANSFER PROGRAMS IN THE UNITED STATES 141 (Robert Moffitt, ed. 2003) (noting the sophistication required to manipulate self-employment income accurately for EITC purposes); *but see also* EMMANUEL SAEZ, *DO TAXPAYERS BUNCH AT KINK POINTS?*, NATIONAL BUREAU OF ECONOMIC RESEARCH Working Paper No. W7366, at 17-18 (2002), <http://www.elsa.berkeley.edu/~saez/bunch.pdf>. (some evidence that the self-employed are able to manipulate their earnings, including through tax avoidance mechanisms, to receive the maximum credit). On the other hand, the same structural element of the EITC provides an incentive for legitimizing off-the-books income by providing a return greater than the cost of payroll and other taxes.

⁸⁵ Zelenak, *supra* note 2, at 1869-72 (Descriptions of the IRS pre-certification proposal, its shortcomings, and its evolution into the Qualifying Child Study); Spragens & Abramowitz, *supra* note 1/, at 1412-14; ROBERT GREENSTEIN, CENTER ON BUDGET AND POLICY PRIORITIES, THE NEW PROCEDURES FOR THE EARNED INCOME TAX CREDIT (2003). "The Internal Revenue Service is planning to ask more than four million of the working poor who now claim a special tax credit to provide the most exhaustive proof of eligibility ever demanded of any class of taxpayers." Mary Williams Walsh, *I.R.S. Tightening Rules for Low-Income Tax Credit*, N.Y. TIMES, Apr. 25, 2003, at A1.

⁸⁶ Zelenak, *supra* note 2, at 1870-71.

⁸⁷ INTERNAL REVENUE SERVICE, IRS EARNED INCOME TAX CREDIT (EITC) INITIATIVE: FINAL REPORT TO CONGRESS, OCTOBER 2005, at 4 (2005) [hereinafter EITC INITIATIVE]. "The results are intended to help the IRS evaluate whether to implement a certification requirement more broadly and to provide insight into how the requirement might be administered." *Id.*

⁸⁸ Taxpayers in the study could provide proof of qualifying residency in the form of records, a letter on official letterhead, or a signed affidavit from identified third parties, including child care providers, clergy, employers, health care providers, landlords, or school officials. EITC INITIATIVE, *supra* note 87, at 7.

study group, and there was a drop in the number of filers claiming two or more children.⁸⁹ This could have been the result of valid deterrence, or it could represent legitimate claims not made due to fear or difficulties associated with the additional requirement.⁹⁰

In 2005, the IRS undertook a follow-up certification test to determine the impact of using third parties as intermediaries for assisting EITC claimants required to prove eligibility.⁹¹ This included a geographically-concentrated component in Hartford, Connecticut⁹² that encountered widespread local resistance.⁹³ Taxpayers who participated in the Hartford experiment reported that the pre-certification requirement was awkward and burdensome.⁹⁴ The IRS is not publicly pursuing further pre-certification initiatives at this time.⁹⁵

IV. UNDERSTANDING NON-COMPLIANCE

Non-compliance with tax law takes many forms and arises from varying motivations.⁹⁶ Inadvertent error in applying the qualification rules for a tax provision is quite unlike intentional fraud, and there are several shadings in between. The involvement of third parties in the preparation of tax returns provides additional opportunities for a range of non-compliant actions. Efforts to improve tax law compliance—in particular, reducing the EITC error rate—must be cognizant of this variation.

⁸⁹ *Id.* at 13-14.

⁹⁰ *See id.* at ii; Zelenak, *supra* note 2, at 1872; Spragens & Abramowitz, *supra* note 18, at 1414.

⁹¹ NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE, THE NATIONAL TAXPAYER ADVOCATE'S FISCAL YEAR 2006 OBJECTIVES REPORT TO CONGRESS 32 (2005) [hereinafter FY 2006 OBJECTIVES].

⁹² *Id.*

⁹³ *See, e.g.*, Zelenak, *supra* note 2, at 1872-73; Spragens & Abramowitz, *supra* note 18, at 1414.

⁹⁴ Focus groups, interviews, and surveys with taxpayers, free return preparation programs, third-party affidavit providers, and other community stakeholders found that the certification process added considerably to return preparation time and delayed receipt of the EITC by several weeks. ANNE ST. GEORGE ET AL., IMPLEMENTATION STUDY OF THE QUALIFYING CHILD RESIDENCY CERTIFICATION REQUIREMENT IN HARTFORD, CT 4-5, 14-17, 31-34 (2006). Affidavit providers reported confusion about both purpose and process, and they were uncertain whether the documentation they provided was definitive for the residency text. *Id.* at 38-39. *See also* GENERAL ACCOUNTING OFFICE, *supra* note 75, at 3, 14-20 (documentation difficulties in the context of recertification). "Although our review was directed at the EITC 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." *Id.* at 25. General concerns about the pre-certification approach from the practitioner perspective are at Spragens & Abramowitz, *supra* note 18, at 1414-16.

⁹⁵ The IRS EITC initiative involving pre-certification included two other studies: the Filing Status Study (requiring documentation of marital status) and the Automated Underreporter Study (identifying returns with a greater likelihood of under-reporting income using EITC income criteria). EITC INITIATIVE, *supra* note 87, at iii-iv. As with the study of qualifying child residency certification, these studies found that the experimental procedures resulted in a reduction in EITC payments but could not estimate how many improper payments were stopped. *Id.*

⁹⁶ *See generally* Book, *supra* note 2, at 1167-77 (applying an eight-part typology of taxpayer non-compliance developed by sociologists Robert Kidder and Craig McEwen to low-income taxpayers specifically).

A. Complexity and Accidental Error

Tax code provisions tend to presume a “typical family” that does not resemble how many people live.⁹⁷ This can be especially true among lower-income households. Even the most well-intentioned taxpayer can make mistakes in negotiating the mismatch between real life and tax rules.⁹⁸

In the EITC compliance study of Tax Year 1999, nearly 60 percent of the amount improperly claimed involved misapplication of the qualifying child and filing status rules.⁹⁹ The breakdown of these errors between intentional and accidental is unknown.¹⁰⁰ The rules are quite complex, so inadvertent error could easily occur.¹⁰¹

An example comes from a scenario used in a field review of the quality of free tax preparer sites.¹⁰² The filer’s son lived with him for five and a half months during 2003 and with the son’s grandparents for the remainder of the year, with the filer paying for the son’s living expenses. Correct application of the EITC rules required, in part, a determination of whether the son was temporarily or permanently living with the grandparents.¹⁰³ In a real-life family, the permanency of the living arrangement may not have been known or could have been understood differently by each party, and auditors reviewing the situation could reasonably disagree.¹⁰⁴

⁹⁷ See Mark Schwanhausser, *Atypical Families Could Get Walloped*, MERCURY NEWS, Feb. 5, 2006, at B1.

⁹⁸ See Robert Greenstein, *Welfare Reform’s Hidden Ally*, AM. PROSPECT, July 15, 2002, at A35; Holtzblatt & McCubbin, *supra* note 7, at 149-56. See also, e.g., Book, *supra* note 51, at 393-95 (discussing the impact of transiency); Jennifer L. Romich & Thomas S. Weisner, *How Families View and Use the Earned Income Tax Credit: Advance Payment Versus Lump-Sum Delivery*, in MAKING WORK PAY, *supra* note 11, 366, 379 (“In extended families in which multiple adults share child-raising responsibilities, different people may file returns identifying different children as dependents.”).

⁹⁹ See 1999 COMPLIANCE STUDY, *supra* note 13, at 13.

¹⁰⁰ See, e.g., Holtzblatt & McCubbin, *supra* note 7, at 169; GENERAL ACCOUNTING OFFICE, *supra* note 75, at 5 n.6; HOTZ & SCHOLZ, *supra* note 84, at 153-54. Some researchers have tried to identify the extent of intentional error by testing whether there is a correlation between the size of the credit and non-compliance, meaning that the errors are not random and therefore perhaps intentional. Holtzblatt & McCubbin, *supra* note 7, at 169-70.

¹⁰¹ Holtzblatt & McCubbin, *supra* note 7, at 150-56; HOTZ & SCHOLZ, *supra* note 84, at 153-54. See also Book, *supra* note 2, at 1171-72 (complexity may result in unknowing non-compliance.) “Noncompliance is not necessarily deliberate, but can stem from a wide range of causes, including lack of knowledge, confusion, poor recordkeeping, differing legal interpretations, unexpected personal emergencies and temporary cash flow problems.” INTERNAL REVENUE SERVICE, PUBL’N NO. 3349, MODERNIZING AMERICA’S TAX AGENCY 7 (2000).

¹⁰² TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, DEPARTMENT OF THE TREASURY, REF. NO. 2004-40-154, IMPROVEMENTS ARE NEEDED TO ENSURE TAX RETURNS ARE PREPARED CORRECTLY AT INTERNAL REVENUE SERVICE VOLUNTEER INCOME TAX ASSISTANCE SITES 6 (2004). Using this and similarly complex scenarios in anonymous visits to 44 Volunteer Income Tax Assistance sites offering free return preparation to low-income filers, the study reported that no return was correctly prepared. *Id.* at 5.

¹⁰³ *Id.* at 6.

¹⁰⁴ In a study of the EITC recertification process, see *supra* note 75 and accompanying text, 21 IRS examiners at 4 processing centers were presented with 5 scenarios involving different sets of

Until Tax Year 2005, there were different qualification rules for the dependent exemption, head-of-household filing status, the EITC, the Child Tax Credit, and the Child and Dependent Care Credit.¹⁰⁵ Proper use of head-of-household status could have depended on how much of a household's food expenses were for food consumed at home.¹⁰⁶ Although there is now an ostensibly uniform definition of a "qualifying child,"¹⁰⁷ significant differences remain.¹⁰⁸ Having several qualification tests can increase error; filers who find that they satisfy some requirements are more likely to infer that they meet them all even when they are not in fact eligible.¹⁰⁹

B. Intentional Error

Willful misapplication of tax code rules can arise in different ways.¹¹⁰ A basic form of intentional error is failing to report all income.¹¹¹ In the EITC context, this can increase the amount of a claim by falsely establishing eligibility or by changing where one's income falls in the credit's phase-out range.¹¹² A filer can bend the EITC qualifying child rules by claiming a child meeting some but not all of the qualification tests (such as relationship or residency).¹¹³ Nonetheless, despite the

supporting documents. In no case did all examiners agree; in some cases, the examiners' decisions varied significantly. GENERAL ACCOUNTING OFFICE, *supra* note 55, at 21. See also Francine J. Lipman, *The Working Poor Are Paying for Government Benefits: Fixing the Hole in the Anti-Poverty Purse*, 2003 WIS. L. REV. 461, 464 (2003) (citing report that experienced certified public accountants found EITC returns challenging).

¹⁰⁵ See, e.g., Holtzblatt & McCubbin, *supra* note 7, at 155-56. These complexities affect not only low-income taxpayers but all who claim, for instance, the dependency exemption. See GENERAL ACCOUNTING OFFICE, *supra* note 75, at 5 n.7.

¹⁰⁶ See Holtzblatt & McCubbin, *supra* note 7, at 156.

¹⁰⁷ INTERNAL REVENUE SERVICE, FS-2005-7, A "QUALIFYING CHILD" (2005), <http://www.irs.gov/newsroom/article/0,,id=133298,00.html>. The new rules may work against many non-nuclear families. See Schwanhausser, *supra* note 97.

¹⁰⁸ "Families claiming tax benefits for their children face a bewildering and often conflicting array of tax programs and eligibility rules." ADAM CARASSO ET AL., THE URBAN INSTITUTE, A UNIFORM CHILDREN'S TAX CREDIT 1 (2005), <http://www.urban.org/url.cfm?ID=1000790>.

¹⁰⁹ Marsha Blumenthal et al., *Participation and Compliance with the Earned Income Tax Credit*, 53 NAT'L TAX J. 189, 204-05 (2005).

¹¹⁰ See generally Book, *supra* note 2, at 1172-77 (exploration of different types of intentional non-compliance); NATIONAL TAXPAYER ADVOCATE, *supra* note 64, at 27 (brief overview of range of taxpayer fraud).

¹¹¹ "For the typical taxpayer, [classic tax cheating] can be accomplished by minimizing his visibility to the tax authorities to reduce the risk of detection." Book, *supra* note 2, at 1172.

¹¹² *Id.* at 1172-73.

¹¹³ *Id.* at 1172. For some low-income taxpayers, the EITC can effectively serve as a "tax planning" opportunity. *Id.* at 1175. This can take different forms; for example:

[O]ne woman relies on her mother to baby-sit her younger daughter every weekend. The grandmother also buys school clothes for the child. In return for this care, the grandmother "gets hers back at the end of the year" by (illegally) filing the child as her dependent and receiving an EITC.

Romich & Weisner, *supra* note 98, at 379. See also Jason DeParle, *On a Once Forlorn Avenue, Tax Prepares Now Flourish*, N. Y. TIMES, Mar. 21, 1999, at A1 (describing EITC claims justified by

implications sometimes drawn from studies of the EITC error rate,¹¹⁴ it does not appear that taxpayers claiming the EITC are more likely to commit fraud than other taxpayers.¹¹⁵

C. Actions of Intermediaries

In Tax Year 2003 (the most recent year for which data are available), 71 percent of all EITC returns were filed through paid preparers.¹¹⁶ This was an increase from 65 percent for Tax Year 2000.¹¹⁷ EITC filers use paid preparers more than middle- and higher-income taxpayers.¹¹⁸ Even though the latter are subject to a wider array of tax code provisions,¹¹⁹ the complexity affecting low-income filers¹²⁰ “may lead these filers to seek added assurance from paid professionals that they are claiming the correct tax benefits.”¹²¹ Filers using paid preparers associate their use with accurate return preparation.¹²²

However, the reliance of EITC filers on paid preparers does not appear to reduce the incidence of improper payments.¹²³ The wide variety of paid

the claimant’s helping out with a child’s expenses); Book, *supra* note 19 (“borrowed” children seen in tax clinic work); Book, *supra* note 2, at 1155 (“...[S]ome EITC noncompliance is garden variety cheating often associated with other benefit programs.”).

¹¹⁴ See *supra* note 14.

¹¹⁵ See NATIONAL TAXPAYER ADVOCATE, *supra* note 64, at 13-14 (looking at Taxpayer Advocate Service cases involving refund freezes). Attempted fraud can adversely affect the program’s intended beneficiaries. For example, free tax return preparation programs with which the author has worked note that a legitimate claimant will sometimes cite a need to file as early as possible to avert a prior filing by someone else (for example, a non-custodial parent) with knowledge of her child’s Social Security Number; although return processing will usually lead to eventual payment of the EITC to the proper claimant, the likely refund freeze and subsequent delay (see *supra* note 68) can create considerable hardship.

¹¹⁶ Alan Berube, THE BROOKINGS INSTITUTION METROPOLITAN POLICY PROGRAM, THE NEW SAFETY NET: HOW THE TAX CODE HELPED LOW-INCOME WORKING FAMILIES DURING THE EARLY 2000’S 9 (2006), http://www.brookings.edu/metro/pubs/eitc/2005209_newsafety.pdf.

¹¹⁷ *Id.*

¹¹⁸ Among taxpayers with adjusted gross incomes above \$35,000, 61% used a paid preparer in Tax Year 2003, and that percentage has remained steady since 2000. *Id.*

¹¹⁹ See *id.* at 8.

¹²⁰ See *supra* notes 97-109, and accompanying text.

¹²¹ Berube, *supra* note 116, at 8. Lower-income filers not claiming the EITC use paid preparers at a significantly lower rate (52% in Tax Year 2003). *Id.* at 9. Looking at the subset of low-income parents, there is significantly greater use of paid preparers among blacks, Hispanics, and those who have not completed high school. Elaine Maag, *Paying The Price? Low-Income Parents and the Use of Paid Tax Preparers*, in THE URB. INST 2005, at 3-4 (New Federalism Series B, No. B-54, 2005). “The American marketplace, rather than Congress, has provided a response to the working poor’s desperate demand for assistance.” Lipman, *supra* note 104, at 465. *Cf.* Book, *supra* note 19 (use of paid preparers closely tied to lump-sum receipt of tax benefits more than complexity per se).

¹²² Over three-quarters of taxpayers who used a paid preparer are very or generally confident that they did not pay more in tax taxes that was legally required. U.S. GEN. ACCOUNTING OFFICE, PAID TAX PREPARERS: MOST TAXPAYERS BELIEVE THEY BENEFIT, BUT SOME ARE POORLY SERVED 3 (2003) (statement of James R. White, Director, tax issues, before the S. Fin. Comm.).

¹²³ Blumenthal et al., *supra* note 109, at 204-05, find that (in Tax Year 1988) practitioners played no deterrent role and may have actually been associated with a higher incidence of improper EITC claims. The EITC overclaim rate for Tax Year 1999 was slightly lower for paid preparer returns.

preparers is certainly a contributing factor.¹²⁴ Preparers may take overly aggressive positions,¹²⁵ rely on poor information provided by taxpayers,¹²⁶ or negligently or intentionally advise improper claims.¹²⁷

Low-income taxpayers are at particular risk for brokered non-compliance¹²⁸ due to institutional incentives.¹²⁹ The large refunds associated with the EITC have led to a higher concentration of paid preparers in low-income communities.¹³⁰ Of particular concern are Refund Anticipation Loans (RALs) offering quick cash to the taxpayer and a sizeable return to the preparer.¹³¹ IRS policies have facilitated the growth

Holtzblatt & McCubbin, *supra* note 7, at 170. That same year, paid preparers were associated with 33% of math errors related to the EITC. NAT'L TAXPAYER ADVOCATE, *supra* note 69, at 69. On the other hand, the widespread use of paid preparers contributes to the EITC's high participation rates. Book, *supra* note 19. See also Brian Erard, *Taxation With Representation: An Analysis of the Role of Tax Practitioners in Tax Compliance*, 52 J. PUBL. ECON. 163, 191-94 (among taxpayers generally, the use of paid preparers—especially the use of certified public accountants and lawyers—is associated with higher levels of non-compliance).

¹²⁴ In Tax Year 1999, the overclaim rate among returns prepared by an attorney, certified public accountant, enrolled agent, or nationally-recognized commercial preparer was 25%; among returns prepared by other types of paid preparers (including self-employed and smaller, local firms), the overclaim rate was 36%. Holtzblatt & McCubbin, *supra* note 7, at 170-71.

¹²⁵ “[C]ompelling evidence exists that [paid preparers] are ‘rule enforcers but ambiguity exploiters.’” Marsha Blumenthal & Charles Christian, in *THE CRISIS IN TAX ADMINISTRATION*, *supra* note 7, at 201, 217. “[T]he game is not between the government and the taxpayer. It is between the government and the taxpayer’s agent, who is an expert at playing the game.” Douglas A. Shackelford, Comment, in *THE CRISIS IN TAX ADMINISTRATION*, *supra* note 7, at 166, 168.

¹²⁶ See U.S. GEN. ACCOUNTING OFFICE, *supra* note 122, at 12.

¹²⁷ Paid preparers may fail to adequately probe and understand taxpayer circumstances, willfully ignore known information, provide questionable advice, or engage in clear-cut fraud. *Id.* at 7-8. Although it does not appear that a large percentage of taxpayers are poorly served by their paid preparers, millions may nonetheless be affected. *Id.* at 6.

¹²⁸ See Book, *supra* note 2, at 1173.

¹²⁹ A dishonest preparer can use improper or overstated EITC claims to generate more revenues and sell additional products and services. Book, *supra* note 19.

¹³⁰ Alan Berube et al, THE BROOKINGS INST. METRO. POLICY PROGRAM, *THE PRICE OF PAYING TAXES: HOW TAX PREPARATION AND REFUND LOAN FEES ERODE THE BENEFITS OF THE EITC* 9-11 (2002). See also Book, *supra* note 19 (ability to monetize EITC-generated refunds immediately and thus pay preparation and related costs contributes to proliferation).

¹³¹ A RAL is a short-term loan based on the taxpayer’s anticipated income tax refund. Commercial tax preparers facilitate or broker the loan (that is issued by a financial institution). The amount received by the taxpayer is net of preparation, filing, and processing fees and finance charges. The financial institution receives the taxpayer’s refund directly from the IRS. The taxpayer is responsible for repaying the loan in full regardless of the amount of refund actually paid. NATIONAL TAXPAYER ADVOCATE, INTERNAL REVENUE SERVICE, 2007 OBJECTIVES REPORT TO CONGRESS: THE ROLE OF THE IRS IN THE REFUND ANTICIPATION LOAN INDUSTRY (VOLUME II) 3 (2006). Over 56% of all RAL borrowers are EITC recipients although EITC recipients make up only 17% of taxpayers (one of every three EITC recipients receives a RAL). CONSUMER FEDERATION OF AMERICA & NATIONAL CONSUMER LAW CENTER, INC., REFUND ANTICIPATION LOANS: UPDATED FACTS & FIGURES 2 (2006) [hereinafter RAL UPDATE]. NATIONAL CONSUMER LAW CENTER, INC. & CONSUMER FEDERATION OF AMERICA, 2005 REFUND ANTICIPATION LOAN REPORT: PICKING TAXPAYERS’ POCKETS, DRAINING TAX RELIEF DOLLARS: REFUND ANTICIPATION LOANS STILL SLICING INTO LOW-INCOME AMERICANS’ HARD-EARNED TAX REFUNDS 8-16 (2005) (detailing RAL provision by tax preparers and lenders); See Berube et al., *supra* note 116 at 7-8 (the role of RALs in growth of commercial tax preparers). A more recent variation is the “pay stub” or “holiday” RAL offered before a taxpayer receives W-2s. NATIONAL CONSUMER LAW CENTER, INC. & CONSUMER FEDERATION OF AMERICA, REPORT ON NEW

of RALs¹³² while disadvantaging low-income taxpayers.¹³³ The linking of return preparation to enable purchases at rent-to-own furniture and appliance stores, car dealers, and other retail outlets further increases the number of potentially non-compliant intermediaries.¹³⁴

V. ALTERNATIVE APPROACH

To summarize, the tendency to see low-income persons as less trustworthy has extended to working poor claimants of the EITC. Findings of high error rates are indeed a concern, but the sense of alarm and special attention given appear to be disproportionate in the context of tax compliance generally.¹³⁵ Although there is undoubtedly some fraudulent activity, the complexity of the EITC and other tax law provisions relevant to low-income households generate inadvertent error as well. The institutional incentives for intermediaries to facilitate error are also a concern. As we address these issues, working poor households claiming the EITC deserve the same respect and presumption of compliance accorded to other taxpayers.¹³⁶ A preferable approach would be to view

ABUSIVE LOAN PRODUCT: CONSUMER ADVOCATES WARN TAXPAYERS AGAINST NEW “PAY STUB” REFUND ANTICIPATION LOANS I (2005).

¹³² The availability of a “direct deposit indicator” or “debt indicator” that informs the RAL originator that a refund will be issued—rather than being intercepted for payment of government debts—has been a major factor in the growth of RALs. NATIONAL CONSUMER LAW CENTER, CORPORATE WELFARE FOR THE RAL INDUSTRY: THE DEBT INDICATOR, IRS SUBSIDY, AND TAX FRAUD 1-5 (2005). *But cf.* FY 2006 OBJECTIVES, *supra* note 91, at 9 (not clear whether the debt indicator facilitates demand for RALs because of its limitations).

¹³³ The debt indicator provided to RAL originators is issued prior to data matching (such as with the database drawn from child support records) that can suspend refund processing and result in a RAL default that leads to debt collection. FY 2006 OBJECTIVES, *supra* note 91, at 10. Even in normal circumstances, a RAL carries a significant cost for limited financial benefit. *See RAL Update, supra* note 131, at 1 (fees of \$29 to \$159 and effective annual interest rates of 40% to over 700%); FY 2006 OBJECTIVES, *supra* note 91, at 5 (“probable that a significant portion of RAL consumers can wait just a few more days for their refunds without incurring a financial burden”). A summary of the reasons why low-income taxpayers use RALs is at Alan Berube & Tracy Kornblatt, THE BROOKINGS INST. METRO. POLICY PROGRAM, *STEP IN THE RIGHT DIRECTION: RECENT DECLINES IN REFUND LOAN USAGE AMONG LOW-INCOME TAXPAYERS* 3-4 (2005). “[E]ven if it is understandable why low-income taxpayers opt for these products, the fact remains that the sale of RALs exploits the precarious financial circumstances and limited information possessed by many of these individuals, and deserves continue scrutiny by policy makers and the public.” *Id.* at 4.

¹³⁴ *See* Dey DelRio & Chris Keeley, *A Primer on Fringe Products Associated with RALs* (2004), <http://www.responsiblelending.org/pdfs/RALs-Primer-1104.pdf>.

¹³⁵ *Cf.* Zelenak, *supra* note 2, at 1887 (“[O]ne cannot claim with confidence that the IRS overspends on EITC enforcement relative to other aspects of income tax enforcement. Nevertheless, all the available evidence—inadequate though it certainly is—suggests that the IRS moderately overemphasizes EITC enforcement at the audit stage.”).

¹³⁶ *See* Book, *supra* note 2, at 1153 (“[I]ncreased compliance efforts must be properly spread across income classes, so that there is neither the reality nor the perception that only the working poor has to deal with the taxman’s compliance regime.”).

EITC non-compliance less as distinctive and more as representative of broader tax compliance concerns.¹³⁷

Simplification of the EITC eligibility rules and greater harmonization with related tax code provisions could reduce accidental errors and lessen the need to rely on sometimes unscrupulous intermediaries.¹³⁸ Yet the tax code is rarely simple. Because some degree of complexity is likely to endure, there needs to be greater focus on the tax preparation aspect.¹³⁹

The disparity in administrative costs between the EITC and more traditional transfer programs¹⁴⁰ stems in part from the shifting of those expenses to the EITC claimant.¹⁴¹ The federal government must recognize responsibility for this shift.¹⁴² Public resources need to be devoted to improved regulation and oversight of return preparers¹⁴³ as well as initiatives that reduce costs for credit beneficiaries.¹⁴⁴ This is undeniably

¹³⁷ This principle can co-exist with a recognition of political exigencies related to long-standing concerns about EITC error:

For those who value tax-based administration of the EITC, it is important to appreciate how historically contingent—and possibly fragile—the existence of the program is in its current form...It may not be wise, then, for EITC proponents to object to every respect in which EITC enforcement may be more rigorous than income tax enforcement generally. Vociferous objections could easily backfire....

Zelenak, *supra* note 2, at 1915-16.

¹³⁸ A unified children's credit incorporating the EITC, the Child Tax Credit, the dependent exemption, and the head-of-household rate schedule is one approach meriting further consideration. See Carasso et al., *supra* note 108. Another option is to split the EITC and related provisions into distinct earnings subsidy and child benefit components. See Adam Carasso & C. Eugene Steurele, Supporting Work and Parenting Among Disadvantaged Young Men: Policy Options and Challenges (unpublished manuscript, presented at Ass'n for Publ. Pol'y Analysis & Mgmt. Fall Research Conference on Nov. 2, 2006).

¹³⁹ Cf. Book, *supra* note 19 (regardless of simplification, highly likely that commercial return preparation will continue to be important for EITC claimants because of positive association between return preparer and lump-sum benefits receipt).

¹⁴⁰ See *supra* notes 28-31 and accompanying text.

¹⁴¹ See Lipman, *supra* note 104, at 464, 466-67, 470-72.

¹⁴² This argument admittedly undercuts the "equal treatment for all taxpayers" approach somewhat, yet it is appropriate due to the unique combined tax and transfer nature of the EITC, and the benefits of one component (improved regulation of return preparers) would accrue to taxpayers beyond the EITC population.

¹⁴³ Existing due diligence requirements (I.R.C. § 6605(g)) are lightly enforced and available penalty provisions rarely used. Book, *supra* note 19. See also NATIONAL TAXPAYER ADVOCATE, *supra* note 64, at 72 (establishing standards and procedures for registering and certifying tax preparers). Investigating and prosecuting preparer misconduct would significantly increase administrative costs. See Book, *supra* note 19. Requiring more meaningful due diligence procedures and perhaps compelling greater due diligence among some types of preparers offer some promise. *Id.* Regulation of RALs is also important. See Lipman, *supra* note 104, at 488-89.

¹⁴⁴ One option is an additional tax credit to reimburse the costs of return preparation and filing. Lipman, *supra* note 104, at 478. This would require careful design, however, to avoid the credit's becoming an additional subsidy to the return preparation industry due to an increase in effective demand. Funding to support the existing volunteer network of community-based free return preparation should also play a role. *Id.* at 493-95. However, scaling limitations (just 1.5% of 2003 EITC returns were prepared by volunteer programs, Berube, *supra* note 116, at 11, suggest that this type of support be equally devoted to increasing community capacity to offer consumer education to the larger number of filers who will continue to use paid preparers. Improved access to free online

difficult, given the currently unrecognized public character of the costs and the perilous federal fiscal condition, but it is an obligation that must be recognized.

Intentional non-compliance among EITC claimants must also be addressed. Fraud and abuse cannot be tolerated.¹⁴⁵ Pre-certification is not the answer, for it inevitably presumes non-compliance in a manner inappropriate to the tax system.¹⁴⁶ More effective and more consistent with general tax administration would be deterrent-oriented enforcement targeted at EITC claims that both recipients and the broader community can easily recognize as improper.¹⁴⁷ A shared understanding of what is legitimate—and a shared belief that those who misstep will be caught—are cornerstones of the voluntary compliance regime, and we should expect that they will work with the EITC as well.

tools for self-preparers is also important. *See generally* Lipman, *supra* note 104, at 480-85, 490-91 (evolution, limitations, and promise of the IRS “Free File” initiative).

¹⁴⁵ “When dealing with intentional or reckless abusive taxpayer behavior, the government must be prepared to punish taxpayers with civil and even criminal penalties.” Book, *supra* note 2, at 1150.

¹⁴⁶ Widely-implemented pre-certification would also likely be very expensive. Book, *supra* note 19. *But see* Book, *supra* note 2, at 1189-93 (potential merit of selective pre-screening for EITC eligibility).

¹⁴⁷ Our concern should be on taxpayers who are neither committed to compliance or to non-compliance but who are susceptible to influence. Lederman, *supra* note 40, at 1500. In tax compliance literature there is disagreement regarding the role of social norms and concepts such as reputational signaling and reciprocity. *See, e.g.*, Posner, *supra* note 41; Dan M. Kahan, *Signaling or Reciprocating? A Response to Eric Posner’s Law and Social Norms*, 36 U. RICH. L. REV. 367 (2002). A concrete issue raised in these discussions is the role and efficacy of publicizing tax evasion and compliance enforcement. Too much publicity can backfire by communicating that non-compliance is widespread, lessening its stigma and/or eroding the perception of a shared inclination to comply. *See* Posner, *supra* note 41, at 1813; Kahan, *supra*, at 380-81. Judiciously publicized enforcement can provide desired influence. Lederman, *supra* note 40 at 1502 (“The overall message should not be that many people cheat, but rather that the IRS is successful at catching the few deliberate cheaters.”). There is no indication that EITC cheating is now widespread or accepted. *See* NATIONAL TAXPAYER ADVOCATE, *supra* note 64, at 13-14; St. George et al., *supra* note 94, at 17 (Hartford filers surveyed about pre-certification expressed an interest in reducing false claims). Using informed screening to select cases for face-to-face audits (which permit an accurate assessment of eligibility and opportunities to preserve taxpayer rights) and then publicizing those found to be bad actors can preserve the existent compliance norm. *See* Lederman, *supra* note 40, at 1509 (“a norm of compliance can gradually erode as enforcement decreases until the norm ‘tips’ to one of noncompliance”).