



General Government Division

B-281530

July 30, 1999

Mr. John M. Dalrymple  
Chief Operations Officer  
Internal Revenue Service

Subject: IRS Correspondence to Taxpayers on Earned Income Credit Recertification

Dear Mr. Dalrymple:

We have been reviewing IRS' performance during the 1999 filing season at the request of the Chairman, Subcommittee on Oversight, House Committee on Ways and Means. As part of that review, we have been inquiring into IRS' procedures for implementing the Earned Income Credit (EIC) recertification requirement. That requirement provides that taxpayers who have all or part of their EIC claim disallowed for any taxable year beginning with tax year 1997 be denied the EIC in future years unless they provide information showing that they are entitled to the credit. The purpose of this letter is to share our observations on certain form letters that IRS has been sending to taxpayers in conjunction with this recertification process. We wanted to share those observations now, rather than wait until we issue our report on the 1999 filing season later this year, to give IRS more time to make any necessary changes to the correspondence before the 2000 filing season.

The observations in this letter are based on our reviews of IRS' EIC-related correspondence and operating procedures and our discussions with cognizant IRS officials. We did our work from February through May 1999 in accordance with generally accepted government auditing standards.

## Results in Brief

Some of the correspondence IRS has been sending taxpayers in conjunction with the EIC recertification process could confuse taxpayers and result in additional burden for taxpayers and IRS. Specifically,

- a letter that IRS uses to tell taxpayers that it has disallowed their EIC claim contains irrelevant information that could cause taxpayers to not file a claim to which they might be entitled or to call IRS seeking clarification,
- two letters that IRS uses to correspond with taxpayers who have submitted information in an attempt to certify their eligibility for the EIC contain inconsistent information on the length of time taxpayers will have to wait to receive their refunds, and

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- a letter and form that IRS uses to tell taxpayers that it needs additional information to verify their EIC eligibility could burden taxpayers by causing them to send IRS much more documentation than called for by IRS' operating procedures.

We are recommending changes to the correspondence that, we believe, will avert potential taxpayer confusion and avoid unnecessary taxpayer burden.

## Background

The Taxpayer Relief Act of 1997 included several provisions directed at reducing noncompliance associated with the EIC. In that regard, the act provided generally that taxpayers who are denied all or part of the EIC through IRS' deficiency procedures<sup>1</sup> are ineligible to claim the EIC in subsequent years unless they provide evidence of their eligibility through a recertification process. The act also provided for additional restrictions in cases in which IRS' denial of an EIC claim was accompanied by a final determination that the taxpayer's erroneous claim was due to either (1) fraud or (2) reckless or intentional disregard of the rules and regulations. In the case of fraud, the law requires that IRS deny future EIC claims submitted by that taxpayer for a period of 10 years. In the case of reckless or intentional disregard of the rules and regulations, IRS is to deny future EIC claims by the taxpayer for a period of 2 years. After the 10- or 2-year period expires, taxpayers must go through the recertification process mentioned earlier if they want to claim an EIC.

### Irrelevant Information in Letter 3094 Could Confuse Taxpayers

IRS sends letter 3094 to taxpayers after IRS has decided that it cannot allow the EICs claimed by the taxpayers because they could not prove that they were entitled to the credit. In the letter, IRS tells the taxpayer that it will continue to deny the EIC for succeeding years unless the taxpayer provides information showing that he or she is entitled to the credit, and it tells the taxpayer what to do to provide that information. IRS' letter then contains the following statement:

"If we determine that an EIC claim is due to reckless or intentional disregard of the law, the law now requires that we deny the credit for two taxable years after the determination. If we determine the claim was due to fraud, the law requires that we deny the credit for ten years after the determination."

A representative of IRS' EIC Project Office told us that the quoted language was included in letter 3094 as a way of alerting taxpayers to the potential implications of filing erroneous EIC claims. Although it is important to adequately publicize such information, we do not believe that letter 3094, which is used to communicate with specific taxpayers about IRS' findings with respect to their specific tax returns, is an appropriate vehicle for such general communication.

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<sup>1</sup> As defined by IRS, deficiency procedures include administrative procedures, other than procedures related to math or clerical errors, that result in an assessment of a deficiency in tax.

Taxpayers receiving letter 3094 might be confused by the quoted language, especially since it is our understanding that the language did not apply to any of the taxpayers who had been sent this letter as of April 13, 1999. As of that date, according to IRS' EIC project office, none of the EIC claims on tax year 1997 returns that were disallowed through IRS' deficiency procedures (more than 270,000 according to cognizant IRS staff) involved a finding of either fraud or reckless or intentional disregard of the law.<sup>2</sup> In effect, then, all of these claims were disallowed because the taxpayers could not prove that they were entitled to the credit, which makes the previously quoted statement irrelevant and potentially confusing.

Taxpayers who receive letter 3094 might believe that the statement in question applies to them and, as a result, could decide either not to file a claim to which they might be entitled or to call IRS for clarification. Removal of the previously quoted statement from letter 3094 when the language is irrelevant could alleviate the potential for confusion and thus reduce the need for taxpayers to contact IRS with questions.

## Letters 3177 and 3183 Contain Inconsistent Information

As discussed earlier, taxpayers whose EIC claims in a particular year have been disallowed are to have any EIC claims in succeeding years disallowed until they provide information showing that they are entitled to the credit. Taxpayers are to provide that information by completing Form 8862, Information to Claim Earned Income Credit After Disallowance, and attaching it to the next tax return they file that claims an EIC. Letters 3177 and 3183 are sent to taxpayers who have filed a Form 8862. Those two letters contain inconsistent information that could confuse taxpayers.

IRS uses letter 3177 to tell taxpayers that it is reviewing their Form 8862. The letter also tells taxpayers that if IRS determines, after completing its review, that no other information is required, it will send the taxpayers their refunds within 30 days. IRS may subsequently send those same taxpayers letter 3183 to tell them that IRS has completed its review of Form 8862 and has determined that the claimed EIC will be allowed. However, contrary to the 30-day time frame mentioned in letter 3177, letter 3183 tells taxpayers that they will receive their refunds within 8 weeks (i.e., 56 days). These inconsistent time frames could confuse taxpayers and be seen by some as IRS' renegeing on a promise.

## Letter 3184 and Form 886 H Are Inconsistent With IRS' Operating Procedures

Letter 3184 is to be sent to taxpayers when IRS has decided, after reviewing Form 8862, that it needs additional information. The letter tells taxpayers to send IRS the information and documents indicated on the enclosed Form 886 H. However, the amount of documentation

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<sup>2</sup> It was too soon to have any data on the results of IRS' deficiency procedures for tax year 1998 returns (i.e., the returns filed in 1999).

that taxpayers are asked to send IRS, as listed on Form 886 H, seems much more burdensome than the documentation required by IRS' operating procedures.

In that regard, IRS' internal recertification guidelines dated January 27, 1999, say that documentation should only be requested for (1) an EIC-qualifying child who was claimed and disallowed for tax year 1997 and is being claimed again for tax year 1998 and (2) an EIC-qualifying child who was not claimed for tax year 1997 but is being claimed for tax year 1998. Form 886 H, on the other hand, tells the taxpayer to submit documentation for each EIC-qualifying child and for each dependent, other than a spouse, listed on the return.<sup>3</sup> The documentation to be submitted includes copies of birth certificates and Social Security cards; documents, such as school records, to verify that the child lived with the taxpayer; and documents, such as canceled checks for household expenses or child support payments, to verify that the taxpayer supported the child.

Thus, for example, if a taxpayer claims two EIC-qualifying children (the maximum number a taxpayer can get credit for) but the eligibility of only one of these children is in question, the taxpayer is required to compile and submit twice as much documentation as IRS really needs, according to its internal guidelines. In addition, taxpayers are being asked to submit documentation not only for their EIC-qualifying children, but also for any other dependent listed on their return, except for their spouse. Depending on the number of such dependents, that requirement could cause taxpayers to incur a significant amount of burden in an effort to compile the necessary documentation.

According to cognizant IRS staff, Form 886 H is worded as it is because otherwise IRS would have to customize either each letter 3184 or each Form 886 H to specify the qualifying child for whom the taxpayer needs to submit information—a step that is not feasible. Although we agree that customizing the letters or forms would not be feasible, there may be other options. One option IRS might consider is deleting the requirement on Form 886 H that the taxpayer send in documentation for each dependent listed on the return. That would limit the requirement to EIC-qualifying children, which would be more consistent with IRS' recertification guidelines.

## Recommendations to IRS' Chief Operations Officer

To avert potential taxpayer confusion and avoid unnecessary taxpayer burden, we recommend that IRS take the following actions:

- Revise letter 3094 by either (1) making the paragraph relating to reckless or intentional disregard of the law and fraud an optional paragraph to be used only when it is relevant; (2) restricting letter 3094 to cases that do not involve reckless or intentional disregard of the law or fraud, thus negating the need to ever use the paragraph in question, and devising a separate form letter for taxpayers whose EIC claims are disallowed for those reasons; or (3)

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<sup>3</sup> Because of differences in the criteria for determining whether a person is a dependent or an EIC-qualifying child, a person can have dependents who are not EIC-qualifying children and vice versa.

rewording the paragraph to make it clear that it does not apply to the specific audit finding covered by the letter but is being provided to alert taxpayers to the potential consequences if they continue their noncompliant behavior.

- Revise letter 3177 and/or letter 3183 so that consistent refund issuance time frames are cited in both letters.
- Make the documentation requirements in letter 3184 and Form 886 H more consistent with the requirements in IRS' internal recertification guidelines.

## Agency Comments and Our Evaluation

IRS' Chief Operations Officer commented on a draft of this report by letter dated July 7, 1999 (see enc.). He agreed with our recommendations and said that the related form and letters would be revised.

With respect to our first recommendation, the Chief Operations Officer noted that the paragraph relating to reckless or intentional disregard of the law and fraud had been included in letter 3094 to "ensure that the taxpayer is aware of all the rules and regulations regarding EIC." Recognizing the potential educational value of this information, we have revised our recommendation to include a third option that IRS might consider in revising letter 3094—rewording the paragraph in question to make it clear that it does not apply to the specific audit finding covered by the letter but is being provided to alert taxpayers to the potential consequences if they continue their noncompliant behavior.

In commenting on our last recommendation, the Chief Operations Officer said that changes to letter 3184 and Form 886 H will require some computer programming modifications, which will not be completed until fiscal year 2001. In the meantime, pen and ink changes will be made to Form 886 H when appropriate. That action would be responsive to our recommendation.

We are sending copies of this report to Representative Bill Archer, Chairman, and Representative Charles B. Rangel, Ranking Minority Member, House Committee on Ways and Means; Representative Amo Houghton, Chairman, and Representative William J. Coyne, Ranking Minority Member, of the Committee's Subcommittee on Oversight; and Senator William V. Roth, Jr., Chairman, and Senator Daniel P. Moynihan, Ranking Minority Member, Senate Committee on Finance. We are also sending copies to the Honorable Lawrence H. Summers, Secretary of the Treasury, and the Honorable Jacob Lew, Director, Office of Management and Budget. Copies will be made available to others on request.

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If you have any questions, please call me or David Attianese at (202) 512-9110. Key contributors to this letter were Doris Hynes, John Lesser, and Susan Mak.

Sincerely yours,

*Cornelia M. Ashby*

Cornelia M. Ashby  
Associate Director, Tax Policy and  
Administration Issues

# Comments From the Internal Revenue Service



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

July 7, 1999

CHIEF OPERATIONS OFFICER

Ms. Comelia M. Ashby  
Associate Director, Tax Policy  
and Administration Issues  
U.S. General Accounting Office  
441 G Street, NW  
Washington, D.C. 20515

Dear Ms. Ashby:

Thank you for the opportunity to review the draft letter report entitled "IRS Correspondence to Taxpayers on EIC Recertification." The report contained three recommendations dealing with the form letters sent by the IRS when working Recertification cases. Since this is the first year of the program, we expect to go through some growing pains. Therefore, we appreciate any comments relating to the Recertification program.

**RECOMMENDATION**

Revise Letter 3094 by either (1) making the paragraph relating to reckless or intentional disregard of the law and fraud an optional paragraph to be used only when it is relevant or (2) restricting Letter 3094 to cases that do not involve reckless or intentional disregard or fraud, thus negating the need to ever use the paragraph in question, and devising a separate form letter for taxpayers whose EIC claims are disallowed for those reasons.

**COMMENTS**

We appreciate your concern that the paragraph relating to reckless and intentional disregard may be confusing to taxpayers. We included that paragraph to ensure that the taxpayer is aware of all the rules and regulations regarding EIC. We will revise the wording of Letter 3094 considering the issues you raised and the appropriateness of the language.

**RECOMMENDATION**

Revise Letters 3177 and/or 3183 so that consistent refund issuance time frames are cited in both letters.

**COMMENTS**

We agree that Letters 3177 and 3184 need to be revised. Both Letters 3177 and 3183 will be automated for fiscal year 2000. The entire wording of the letters is in the process of being revised. Refund issuance time frames will be consistent.

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**RECOMMENDATION**

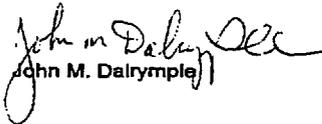
Make the documentation requirements in Letter 3184 and Form 886H more consistent with the requirement in IRS internal Recertification guidelines.

**COMMENTS**

We agree with the recommendation that both letters need to be revised for Recertification cases. Changes to the letters will require some programming modifications. Program changes submitted now will not be completed until fiscal year 2001. In the meantime, we will make pen and ink changes to Form 886H when appropriate.

If you have any questions, please call Floyd Williams, National Director, Legislative Affairs, at (202) 622-3720.

Sincerely,

  
John M. Dalrymple

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