

August 2007

ADVANCE EARNED INCOME TAX CREDIT

Low Use and Small Dollars Paid Impede IRS's Efforts to Reduce High Noncompliance



Highlights of [GAO-07-1110](#), a report to the Chairman and Vice Chairman of the Joint Committee on Taxation

ADVANCE EARNED INCOME TAX CREDIT

Low Use and Small Dollars Paid Impede IRS's Efforts to Reduce High Noncompliance

Why GAO Did This Study

The Advance Earned Income Tax Credit (AEITC) allows individuals to receive a portion of the Earned Income Tax Credit (EITC) in their paychecks, instead of receiving all of it when filing their year-end tax return. Limited research has been conducted on the AEITC since GAO last examined it in the early 1990s.

GAO was asked to determine (1) how many individuals received the AEITC compared with the EITC in tax years 2002 through 2004, what actions, if any, have been taken to increase use, and the potential for increases in use in the future; (2) the extent of noncompliance, if any, associated with the AEITC; and (3) how well the Internal Revenue Service's (IRS) procedures address the areas of noncompliance. To address these questions, GAO analyzed Forms W-2 and tax return data and interviewed IRS and Social Security Administration (SSA) officials.

What GAO Recommends

GAO recommends that the Acting Commissioner of Internal Revenue analyze options to reduce AEITC noncompliance such as implementing a "soft notice" test. If these options are deemed ineffective, and no other options are viable, the Treasury Secretary should provide an opinion to the Congress as to whether the AEITC should be retained. IRS agreed with our recommendation and outlined the actions IRS plans to take.

www.gao.gov/cgi-bin/getrpt?GAO-07-1110.

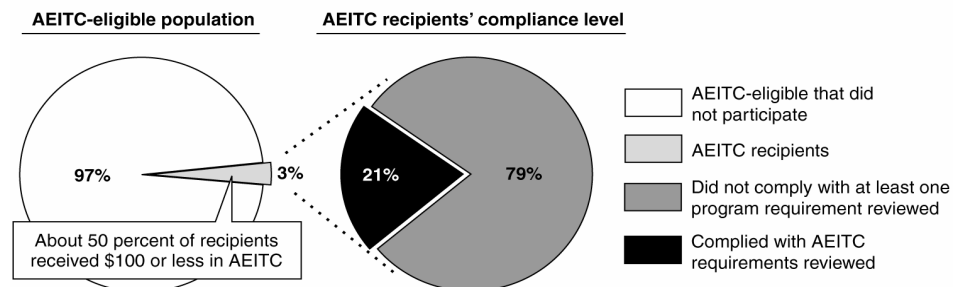
To view the full product, including the scope and methodology, click on the link above. For more information, contact Michael Brostek at (202) 512-9110 or brostekm@gao.gov

What GAO Found

AEITC use was low—only about 3 percent of EITC recipients potentially eligible for the advance received it in tax years 2002 through 2004, or about 514,000 of the 17 million potentially eligible individuals each year. About half of all recipients received \$100 or less in AEITC and 75 percent received \$500 or less for the year, with a total benefit paid of about \$146 million each year. Several efforts have been aimed at increasing use over the last approximately 15 years, such as sending notices to individuals informing them that they were potentially eligible for the AEITC and making changes to IRS forms. Despite these efforts, use did not substantially increase and, for several reasons, it may be difficult to increase it in the future. For example, IRS officials, other experts, and prior GAO work suggests that individuals often do not elect the AEITC because they prefer receiving the entire EITC as a lump sum after filing their tax return.

As many as 80 percent of AEITC recipients did not comply with at least one of the program requirements GAO reviewed, and some were noncompliant with more than one during the 3 years we reviewed. In tax years 2002 through 2004, about 20 percent, or more than 100,000 AEITC recipients, may not have been eligible for the AEITC because they had an invalid Social Security number (SSN). These individuals received a total of \$37 million to \$39 million each year. Almost 40 percent (about 200,000 recipients) did not file the required tax return; these individuals received \$42 million to \$50 million each year. Of the about 60 percent (more than 300,000) AEITC recipients who did file a return, about two-thirds misreported the amount received.

AEITC Use, Dollars, and Compliance in Tax Years 2002-2004



IRS's procedures have limited effectiveness in addressing AEITC noncompliance. For example, Automated Underreporter (AUR) staff worked on only a fraction of AEITC cases because of resource constraints and criteria limiting case selection. IRS could address AEITC noncompliance by sending "soft notices" to recipients, requiring employers to verify employee SSNs before providing the AEITC, or creating a Forms W-5, "EITC Advance Payment Certificate," database. Each of these options have advantages, however, they also have potential disadvantages that could limit their effectiveness.

Contents

Letter		1
	Results in Brief	3
	Background	6
	AEITC Use Low and May Be Difficult to Increase	9
	High Noncompliance Exists with AEITC Requirements	15
	IRS's AEITC Compliance Procedures Have Limited Effectiveness and Options to Better Address Noncompliance Have Advantages and Disadvantages	21
	Conclusions	44
	Recommendations for Executive Action	45
	Agency Comments	46
Appendix I	IRS's Implementation of Recommendations from GAO's 1992 Report on the Advance Earned Income Tax Credit	47
Appendix II	Scope and Methodology	49
Appendix III	Demographic Characteristics of Advance Earned Income Tax Credit Recipients and Their Employers	56
Appendix IV	Administrative and Legislative Changes to the Advance Earned Income Tax Credit Since 1990	76
Appendix V	Additional Analyses of Advance Earned Income Tax Credit Noncompliance	78
Appendix VI	Comments from the Internal Revenue Service	92

Tables

Table 1: EITC Requirements for 2006 That All AEITC Recipients Must Also Expect to Meet	8
Table 2: Percentage of AEITC Recipients Receiving an Amount of AEITC, Tax Years 2002 through 2004	11
Table 3: Frequency of Individuals Electing the EITC and AEITC, Tax Years 2002 through 2004	14
Table 4: AEITC Recipients and Recipients with Invalid SSN on Form W-2, Individuals and Dollars, Tax Years 2002 through 2004	17
Table 5: AEITC Recipients and Recipients Who Did Not File a Tax Return, Individuals and Dollars, Tax Years 2002 through 2004	18
Table 6: AEITC Recipients, Recipients Who Did Not File a Federal Tax Return, and Recipients Who Did Not File a Tax Return and Had an Invalid SSN on the Form W-2, Individuals and Dollars, Tax Years 2002 through 2004	19
Table 7: AEITC Matches and Mismatches between Form(s) W-2 and Filed Tax Returns, Tax Years 2002 through 2004	20
Table 8: IRS Implementation of Recommendations from GAO's 1992 Report on the Advance Earned Income Tax Credit	47
Table 9: Number of Forms W-2, Number of Individuals, and the Dollars for Each Subpopulation, Tax Years 2002 through 2004	51
Table 10: Number of Forms W-2 Received by Subpopulation, Tax Years 2002 through 2004	58
Table 11: AGI for AEITC and EITC Recipients, Number, Average, and Sum, for Tax Year 2002	62
Table 12: AGI for AEITC and EITC Recipients, Number, Average, and Sum, for Tax Year 2003	63
Table 13: AGI for AEITC and EITC Recipients, Number, Average, and Sum, for Tax Year 2004	63
Table 14: Wages Reported for AEITC and EITC Recipients, Number, Wage Amount, and Average Dollars Received for Tax Years 2002 through 2004	65
Table 15: Filing Status of AEITC and EITC Recipients, Number and Percentage, Tax Years 2002 through 2004	66

Table 16: Age of AEITC and EITC Recipients, Tax Years 2002 through 2004	68
Table 17: Gender of AEITC and EITC Recipients, Number and Percentage, Tax Years 2002 through 2004	70
Table 18: Number of Qualifying Children for AEITC and EITC Recipients, Number and Percentage, Tax Years 2002 through 2004	72
Table 19: Filing Method of AEITC and EITC Recipients, Number and Percentage, Tax Years 2002 through 2004	72
Table 20: Employer Size, Number of Employers, Number of Forms W-2 Employers Issued to AEITC Recipients and Total Dollars Reported on Forms W-2, Tax Years 2002 through 2004	75
Table 21: Administrative Changes to the AEITC since 1990	76
Table 22: Number of Individuals and AEITC Dollars Received by AEITC Recipients and Individuals Who Elected the AEITC Consecutively Using an Invalid SSN and an Invalid SSN and Not Filing, Tax Years 2002 through 2004	79
Table 23: Number of AEITC Consecutive Recipients with Matches and Mismatches between Forms W-2 and Filed Tax Returns, Tax Years 2002 through 2004	80
Table 24: Amount of AEITC Received Per Invalid Form W-2, Number and Percentage, Tax Years 2002 through 2004	81
Table 25: Number of Individuals Receiving a Form(s) W-2, Total Number of Form(s) W-2 Reporting AEITC, Total Associated and Average Dollars Received Relative to Number of Form(s) W-2 Reporting AEITC for AEITC Recipients with an Invalid SSN on the Form(s) W-2, Tax Year 2002	82
Table 26: Number of Individuals Receiving a Form(s) W-2, Total Number of Form(s) W-2 Reporting AEITC, Total Associated and Average Dollars Received, Relative to Number of Form(s) W-2 Reporting AEITC for AEITC Recipients with an Invalid SSN on the Form(s) W-2, Tax Year 2003	83
Table 27: Number of Individuals Receiving a Form(s) W-2, Total Number of Form(s) W-2 Reporting AEITC, Total Associated and Average Dollars Received, Relative to Number of Form(s) W-2 Reporting AEITC for AEITC Recipients with an Invalid SSN on the Form(s) W-2, Tax Year 2004	84

Figures

Figure 1: AEITC Process for Employees and Employers	7
Figure 2: Number of EITC Recipients, EITC Recipients Potentially Eligible for the AEITC, AEITC Recipients, and Total Dollars They Received, Tax Years 2002 through 2004	10
Figure 3: Percentage of AEITC Recipients Compliant and Noncompliant with at Least One AEITC Requirement, Tax Years 2002 through 2004	15
Figure 4: Submission Processing Procedures for Paper and Electronic Tax Returns Reporting AEITC	22
Figure 5: AUR Program Procedures to Resolve Discrepancies between AEITC Amounts on Forms W-2 and Tax Returns	26
Figure 6: Average Amount of AEITC Received by Consecutive and AEITC Recipients, Tax Years 2002 through 2004	61
Figure 7: Geographic Location of AEITC Recipients in the Valid Subpopulation, Tax Years 2002 through 2004	74
Figure 8: Geographic Location of AEITC Recipients in the Invalid Name Subpopulation, Tax Years 2002 through 2004	87
Figure 9: Geographic Location of AEITC Recipients in the Invalid Number Subpopulation, Tax Years 2002 through 2004	89
Figure 10: Number of Forms W-2 Received with Amounts above the Yearly AEITC Maximum, Tax Years 2002 through 2004	90
Figure 11: AEITC Dollars Reported on Form W-2s above the Yearly AEITC Maximum, Tax Years 2002-2004	91

Abbreviations

AEITC	Advance Earned Income Tax Credit
AGI	Adjusted Gross Income
AUR	Automated Underreporter
DM-1	Data Master File
EITC	Earned Income Tax Credit
ERS	Error Resolution System
IRS	Internal Revenue Service
OBRA '93	Omnibus Budget Reconciliation Act of 1993
SSA	Social Security Administration
SSN	Social Security number
SSNVS	Social Security Number Verification System
TIN	Taxpayer Identification Number

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



United States Government Accountability Office
Washington, DC 20548

August 10, 2007

The Honorable Charles B. Rangel
Chairman
The Honorable Max Baucus
Vice Chairman
Joint Committee on Taxation

Beginning in 1979, eligible taxpayers could elect to receive the Earned Income Tax Credit (EITC), a refundable credit available to low income workers, as an advance payment—an option currently found in only one other federal tax credit.¹ Individuals who elect this option receive a portion of the EITC from their employer throughout the year with their regular pay, instead of receiving only a lump sum refund or tax credit when filing their year end federal income tax returns.² The Advance Earned Income Tax Credit (AEITC) provides employees an immediate benefit from the credit, which may help them meet their daily expenses by increasing their take-home pay.

Little has been known about the individuals who receive the AEITC, the employers who pay it, and compliance with its requirements. Neither the Internal Revenue Service (IRS) nor the employer is required to confirm the eligibility of those who elect the AEITC before they receive it. Thus, the extent of compliance problems related to the AEITC may depend on factors such as how knowledgeable individuals applying for the AEITC are about eligibility requirements and how well the IRS addresses various kinds of noncompliance that the agency may identify only after AEITC payments have been made.

Limited research has been conducted on the AEITC since we last examined it in the early 1990s. In 1992, we reported that the percentage of individuals receiving the EITC in 1989 who also received the AEITC was

¹ The other credit with an advance option is the Health Coverage Tax Credit, which pays 65 percent of qualified health plan premiums for eligible trade-affected workers and certain Pension Benefit Guaranty Corporation benefit recipients.

² In tax year 2004, about 22 million individuals received about \$40 billion in EITC payments from the IRS. Any portion of the EITC that an individual did not obtain as an advance can be obtained when he or she files a tax return, assuming qualifications are maintained.

low and that many eligible workers were not aware of it.³ We estimated that almost half of those who received the AEITC in 1989 and filed a tax return did not report receiving it and that 45 percent of people whom IRS records show may have received the AEITC never filed a tax return, meaning that IRS would have no way of determining their eligibility. We made six recommendations to the Commissioner of Internal Revenue designed to increase awareness of the AEITC among eligible individuals and improve compliance among those who receive it. Appendix I discusses IRS's implementation of the recommendations from our 1992 AEITC report.

To provide current information on the AEITC, the Committee asked us to answer the following questions: (1) How many individuals received the AEITC compared with the EITC and how much did they receive in tax years 2002 through 2004? What actions, if any, have been taken to increase use since 1992 and what is the potential for significant increases in the future? (2) What is the extent of noncompliance, if any, associated with the AEITC? (3) How well do IRS's procedures address any areas of noncompliance? In addition, the Committee asked us to provide basic demographic characteristics of AEITC recipients and their employers and to identify legislative and administrative changes made since our 1992 report, some of which were discussed by IRS in its response to that report's recommendations. The information is presented in appendixes I and III through V.

To answer these questions, we obtained a data file from IRS containing all Form W-2 "Wage and Tax Statements" that reported AEITC in tax years 1999 through 2004. We performed data reliability tests on this file to determine whether the data were sufficiently reliable for our intended purposes and determined that they were. This process involved, among other things, checking the validity of the Social Security number (SSN) on the Form W-2, determining whether the AEITC amount was above the yearly maximum limit, and creating subpopulations in which to conduct our analyses. Using the Form W-2 data and data from other sources, such as IRS's Individual Return Transaction File that contains tax return information, we compiled relevant demographic characteristics data and compared AEITC data with EITC data when possible. We also reviewed administrative and legislative changes as well as relevant reports and

³ GAO, *Earned Income Tax Credit: Advance Option Is Not Widely Known or Understood by the Public*, GAO/GGD-92-26 (Washington, D.C.: Feb. 19, 1992).

considered these along with our data analyses. To examine actions intended to increase use and determine the potential for increases in future AEITC use, we reviewed various reports and literature and interviewed IRS officials and individuals we determined to be experts. We also used the Form W-2 and other data to identify areas of noncompliance by comparing the data to the AEITC requirements. In addition, we examined IRS's procedures for processing individual income tax returns with AEITC and interviewed IRS officials to determine how IRS addressed noncompliance. Finally, we explored possible remedies for the noncompliance we identified through literature searches and interviews with various Department of the Treasury, IRS, and Social Security Administration (SSA) officials. It was not within the scope of our work to fully evaluate the potential cost and benefits of these options for reducing noncompliance. We conducted our work in accordance with generally accepted government auditing standards from December 2005 through July 2007. Appendix II provides more detail on the scope and methodology we used to conduct our work.

Results in Brief

AEITC use and the amount paid out by employers was low in tax years 2002 through 2004—only about 3 percent of the EITC recipients potentially eligible for the advance received it and about half of the recipients received \$100 or less per year. In total, approximately 514,000 individuals received about \$146 million of AEITC in each of the 3 years. Several federal efforts, including two legislative and several administrative changes, have been aimed at increasing AEITC use in the last approximately 15 years. For example, the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), directed IRS to send notices to taxpayers during 2 tax years informing them that they were potentially eligible for the advance. Similarly, IRS made changes to its forms and increased speaker seminars to inform the public about the AEITC. Despite these efforts, use has not substantially increased and, for several reasons, it may be difficult to significantly increase it in the future. For example, IRS officials, other experts, and our prior work suggest that individuals often do not elect the AEITC because they prefer receiving the entire EITC as a lump sum when filing their tax return. An IRS-funded study revealed that low use is also attributed to concerns that prospective recipients would receive more in advance than they would ultimately be entitled to, thus owing the difference when filing their tax return.

As many as 80 percent of recipients did not comply with at least one AEITC requirement, while some individuals were noncompliant with more than one requirement. Approximately 20 percent (more than 100,000) of all

AEITC recipients each year may not have been eligible for the advance because they did not have a valid SSN, that is, a SSN that has been assigned by the SSA or a SSN/name combination that could be matched to SSA records. These individuals received \$37 million to \$39 million in each tax year from 2002 through 2004. Almost 40 percent (about 200,000 recipients) did not file the required tax return; they received between \$42 million and \$50 million of AEITC for each of these years. When individuals do not file a return, IRS cannot readily identify whether they were eligible for AEITC and whether they owed IRS any of the amounts they received. Conversely, by not filing a tax return, some individuals did not receive additional EITC monies that they could only receive had they filed. Of the 60 percent of AEITC recipients who did file a return, about 300,000 individuals in each of the 3 years, two-thirds misreported the amount they received—the majority did not report receiving any AEITC. As a result, these AEITC recipients who claimed the EITC when filing their return collectively received an excess amount of EITC of about \$64 million for the 3 years.

Although IRS has processing and enforcement procedures in place to monitor the AEITC, the agency has limited effectiveness in addressing AEITC noncompliance, in large part because it targets most of its enforcement efforts at more widely used programs that involve larger amounts of money. For example, Automated Underreporter (AUR) staff worked only a fraction of the AEITC underreporting cases because resource constraints and criteria limited case selection. Moreover, AUR and other IRS enforcement programs use revenue collection potential as a primary criterion in identifying cases on which to work, and AEITC cases generally have low revenue potential. Although all AEITC nonfiler cases are eligible to be worked on by various enforcement programs, IRS officials said they work on only a limited number for similar reasons.

One means to improve AEITC compliance might be to send “soft notices.” Recent IRS tests have shown that the agency has successfully reduced subsequent noncompliance in situations that involve relatively small amounts of money by sending soft notices that ask taxpayers to voluntarily fix their misreporting by filing an amended return or not repeating the action in the next year. However, high annual turnover in the AEITC population could undermine this approach. Another means to improve AEITC compliance would be to partially verify individuals’ eligibility before they receive the advance by verifying their SSNs. IRS operates the Taxpayer Identification Number (TIN) Matching service and SSA maintains the Social Security Number Verification System (SSNVS), both of which are open to registered public users for the purpose of

determining the validity of an SSN. Both have unique advantages and disadvantages that would come into play if employers were required to use them to verify the SSNs of individuals seeking AEITC. SSA emphasized that verifying eligibility for the AEITC is most appropriate for IRS because it is a tax administration issue and therefore outside the scope of SSA's mission. Separately, IRS could verify individuals' SSNs and take other enforcement steps if it had a database of AEITC applicants. However, IRS cannot create such a database because it does not require employers to send copies of the Form W-5, "Earned Income Credit Advance Payment Certificate," to them when an employee requests receipt of the AEITC. Despite some benefits, IRS officials questioned the effectiveness of such a requirement due to (1) the low anticipated return on investment of AEITC compared with other areas with noncompliance problems and (2) their experience with the prior Questionable W-4 program, which required employers to submit information to IRS on taxpayers claiming more than 10 withholding allowances or exemptions, that showed employers did not adhere to similar requirements imposed by the agency.

We recommend that the Acting Commissioner of Internal Revenue analyze whether it could cost effectively and significantly reduce AEITC noncompliance by sending soft notices to potentially noncompliant AEITC recipients, requiring employers to verify the SSN of employees seeking the AEITC, or requiring employers to submit Forms W-5 to IRS to create an AEITC database. To better identify the costs and implementation issues as well as the likelihood for these or other options to reduce AEITC noncompliance, where practical, the Acting Commissioner of Internal Revenue should test these options to make a more fully informed judgment about whether any would be worthwhile. If the Acting Commissioner of Internal Revenue determines that none of these options would be cost effective and that no other remedies are viable, then the Treasury Secretary should inform the Congress of this and provide Treasury's opinion about whether the AEITC should be retained.

In providing written comments on a draft of this report (see app. VI), the Acting Commissioner of Internal Revenue agreed with our recommendation and outlined the actions IRS would take to address that recommendation, including conducting further analyses and possible testing of proposed options for reducing AEITC noncompliance. He also stated that IRS will conduct its cost-benefit analyses in conjunction with a congressional requirement to study the impact of expanding eligibility of

the AEITC to all EITC recipients.⁴ We also provided a draft of this report to the Department of the Treasury and SSA and incorporated technical comments where appropriate. SSA emphasized that verifying eligibility for the AEITC is most appropriate for IRS because it is a tax administration issue and outside the scope of SSA's mission.

Background

The EITC was enacted in 1975 and was originally intended to offset the burden of Social Security taxes and provide a work incentive for low-income taxpayers.⁵ It is a refundable federal income tax credit, meaning that qualifying working taxpayers may receive a refund greater than the amount of income tax they paid for the year. For tax year 2006, the maximum amount of EITC a taxpayer could receive was \$4,536.

Beginning in 1979, individuals could elect to receive the EITC in advance payments from their employer during the year along with their regular pay.⁶ One purpose of the advance payment is to provide employees with an immediate reward for their work effort rather than forcing them to postpone receiving the credit until they file their tax returns. To get the credit, at any time during the year, an employee would complete the Form W-5 and provide it to his or her employer.⁷

Upon receiving a completed Form W-5, the employer calculates the amount of the AEITC payment to include with the employee's pay by considering (1) the employee's wages, (2) whether the employee is married or single, and (3) if married, whether the employee's spouse has a Form W-5 in effect with an employer. The AEITC payment to the employee is considered to be equivalent to the employer making a payment to IRS for employee income tax withholding and employee and employer Social Security and Medicare tax. When employers file their quarterly tax returns, they show the total payments made to employees on the AEITC payment line on Form 941, "Employer's Quarterly Federal Tax Return."

⁴ U.S. Troop Readiness, Veteran's Care, Katrina Recovery, and Iraq Accountability Appropriations Act of 2007, Pub. L. No. 110-28.

⁵ 26 U.S.C. Sec. 32.

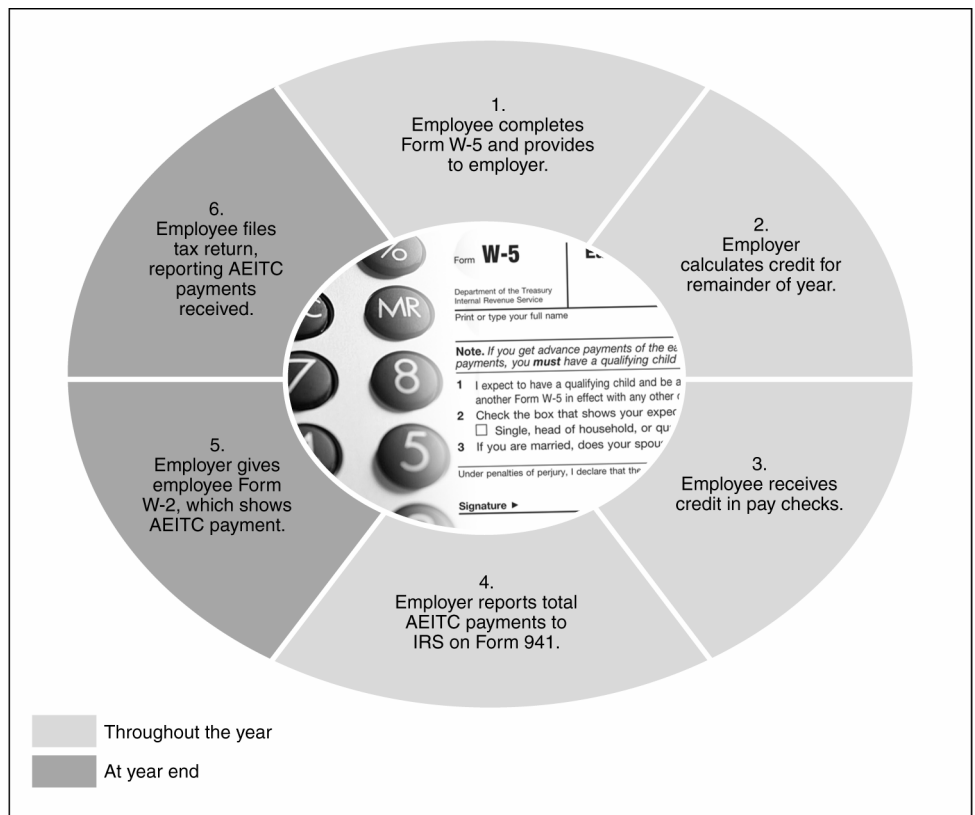
⁶ Pub. L. No.103-66 (1993). The Omnibus Budget Reconciliation Act of 1993 limited the amount of advance payments that eligible individuals can receive to 60 percent of the EITC available with one qualifying child.

⁷ The Form W-5, completed by the employee, expires at the end of each calendar year. Therefore, employees must resubmit the form each year if they want to receive the AEITC.

This amount is then subtracted from the total amount of tax the employer owes.

At the end of the calendar year, the employer indicates the total AEITC payments the employee received on the employee's Form W-2. Employees are then required to report this amount either on their Form 1040 or Form 1040A tax return. Assuming the employee qualified for the EITC, the AEITC amount received should be reported on the tax return as other taxes, which, in effect, subtracts the amount received from the total amount of any EITC. If the employee did not qualify for the EITC, he or she is still required to file a tax return, regardless of income level, and the AEITC amount paid is added to any taxes owed. Figure 1 illustrates this process and notes the major forms involved.

Figure 1: AEITC Process for Employees and Employers



Source: GAO analysis of IRS data; IRS and PhotoDisc (images).

An individual must meet certain requirements to qualify for the AEITC. Specifically, an individual must expect to (1) be able to claim the EITC for the current year (EITC requirements for 2006 are shown in table 1), (2) have at least one qualifying child, and (3) have earned income and adjusted gross income below a certain amount for that year. There are additional requirements that an individual may only have one Form W-5 in effect at a time and that he or she informs their employer if their spouse also has a Form W-5 in effect.⁸ AEITC recipients can receive up to 60 percent of the EITC benefits for one qualifying child. The maximum AEITC amount for 2006 was \$1,648.

Table 1: EITC Requirements for 2006 That All AEITC Recipients Must Also Expect to Meet

First, an individual must meet all the rules in this column.		Second, an individual must meet all the rules in one of these columns, whichever applies.		Third, an individual must meet the rules in this column.
Rules for everyone		Rules if have a qualifying child	Rules if do not have a qualifying child	Figuring and claiming the EITC
1. Adjusted gross income (AGI) must be less than:	2. Must have a valid Social Security number.	8. Child must meet the relationship, age, and residency tests.	11. Must be at least age 25 but under age 65.	15. Earned income must be less than:
• \$36,348 (\$38,348 for married filing jointly) if more than one qualifying child.	3. Filing status cannot be "Married filing separately."	9. Qualifying child cannot be used by more than one person to claim the EIC.	12. Cannot be the dependent of another person.	• \$36,348 (\$38,348 for married filing jointly) if more than one qualifying child
• \$32,001 (\$34,001 for married filing jointly) if one qualifying child, or	4. Must be a U.S. citizen or resident alien all year.	10. Cannot be a qualifying child of another person.	13. Cannot be a qualifying child of another person.	• \$32,001 (\$34,001 for married filing jointly) if one qualifying child, or
• \$12,120 (\$14,120 for married filing jointly) if no qualifying child.	5. Cannot file Form 2555 or Form 2555-EZ (relating to foreign earned income).		14. Must have lived in the United States more than half of the year.	• \$12,120 (\$14,120 for married filing jointly) if no qualifying child.
	6. Investment income must be \$2,800 or less.			
	7. Must have earned income.			

Source: Excerpt of IRS Publication 596, Earned Income Credit.

⁸ When both spouses have a Form W-5 in effect, the amount each person can receive is reduced to below 60 percent of the EITC maximum.

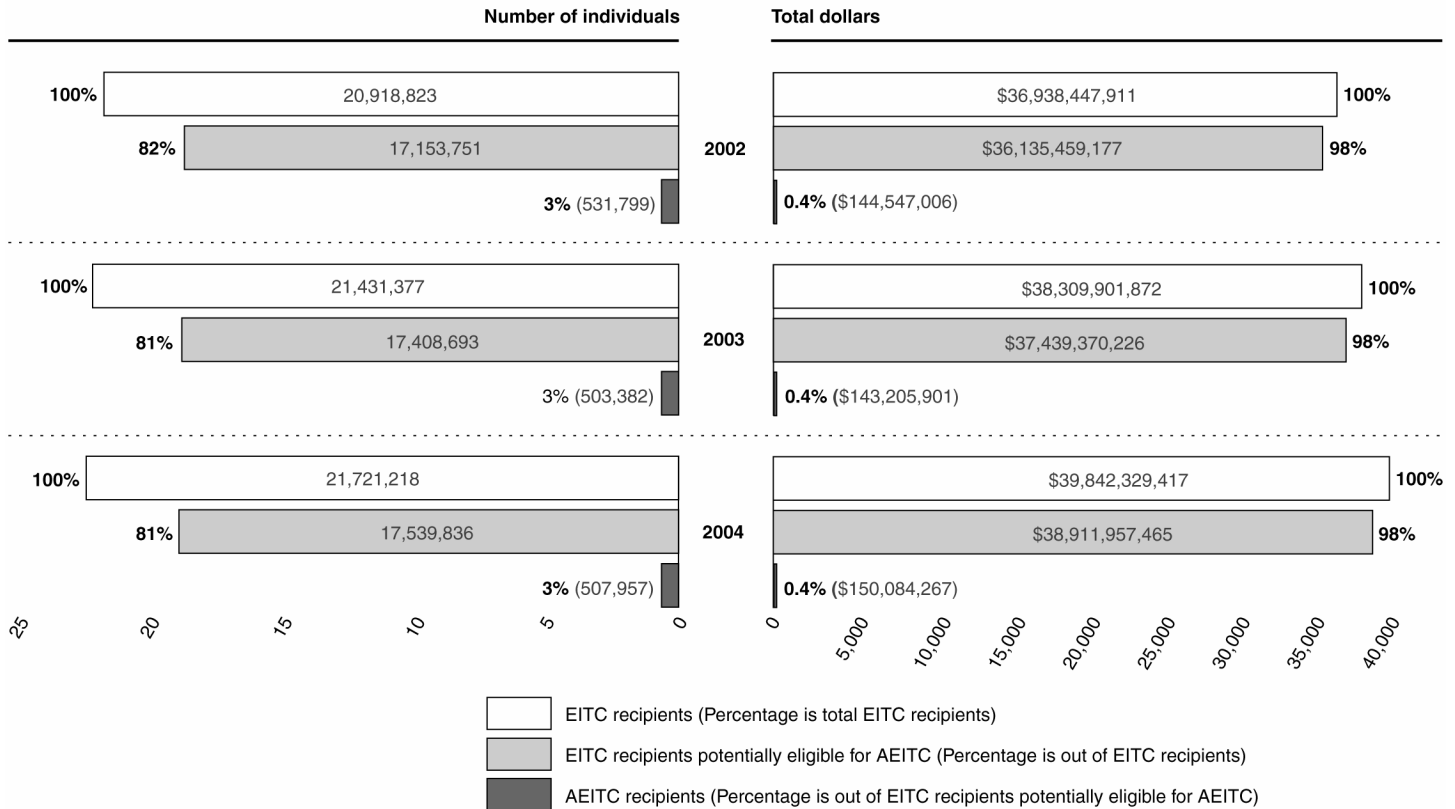
A change in an individual's personal circumstances after submitting the Form W-5 could affect their eligibility for both the EITC and the AEITC. For example, an individual who received the AEITC, separated from his or her spouse during the year, and used the married filing separately filing status would not be eligible for the AEITC (or EITC). In such cases, when the individual files their tax return and reports the AEITC amount received, the amount would be added to any taxes due or subtracted from any refund.

AEITC Use Low and May Be Difficult to Increase

About 3 percent of the EITC recipients potentially eligible for the advance, about 514,000 individuals on average, elected it in each year, tax years 2002 through 2004, according to data employers reported on the Form W-2. As shown in figure 2, about 21 million taxpayers received the EITC each year and of these recipients, about 17 million were eligible for the AEITC.⁹

⁹ Individuals who receive the EITC without a qualifying child are not eligible for the AEITC.

Figure 2: Number of EITC Recipients, EITC Recipients Potentially Eligible for the AEITC, AEITC Recipients, and Total Dollars They Received, Tax Years 2002 through 2004



Sources: GAO analysis of IRS data.

Note: This figure includes the valid, invalid name, and invalid number subpopulations. (see app. II).

In total, AEITC recipients received an average of about \$146 million in AEITC for each tax year from 2002 through 2004. Yet, those who elected it often received relatively few dollars from their employers. As table 2 indicates, about half of all individuals who got AEITC received \$100 or less each year and about 75 percent received \$500 or less. Even at \$100 per year, this equates to about \$8 a month, or \$4 every 2 weeks, and even at \$500 per year, this equates to about \$42 a month or \$19 every 2 weeks. The amounts most individuals received were significantly less than the yearly maximum, and were consistent for the 3 years we reviewed.

Table 2: Percentage of AEITC Recipients Receiving an Amount of AEITC, Tax Years 2002 through 2004

Amount of AEITC received	Percentage of AEITC recipients		
	2002	2003	2004
\$1—\$100	50	50	48
\$101—\$250	17	17	17
\$251—\$500	13	13	13
\$501—\$750	7	7	8
\$751—\$1,000	5	5	5
\$1,001—yearly maximum	7	8	8

Source: GAO analysis of IRS data.

Note: The AEITC yearly maximum was \$1,503, \$1,528, and \$1,563 for tax years 2002, 2003, and 2004, respectively. This table includes the valid, invalid name, and invalid number subpopulations.

The number of individuals who have elected the AEITC has remained low for many years. For example, between 1990 and 1997, AEITC use never exceeded 2 percent of qualifying EITC recipients. IRS calculated use based on tax returns showing receipt of the AEITC divided by the EITC population that reported at least one qualifying child. Using this same methodology, use for tax years 2002 through 2004 was relatively the same at an average of 0.8 percent. Our figures for 2002 through 2004 are higher than these prior AEITC figures because our figures are based upon the Forms W-2 that reported AEITC (see fig. 2). Historically, AEITC use has been based upon the number of individual federal tax returns that reported an amount on the AEITC line. The historic method excludes individuals who did not file a federal tax return and individuals who filed a federal tax return but did not report the AEITC.

Additional demographic data about individuals who elected the AEITC are included in appendix III. These additional data represent new analysis that has not been previously available, including each recipient's filing method, age, and gender, and each employer's size.

AEITC Use Has Not Increased Significantly Despite Several Targeted Efforts

Use of the AEITC has remained low for many years despite several targeted efforts to increase it. There have been several federal efforts targeted to increase AEITC use over the last approximately 15 years, including both legislative and administrative changes. (A full description of these changes is included in app. IV.) One significant piece of legislation was OBRA '93, which involved the AEITC in two ways: it (1) reduced the maximum amount of EITC an individual could receive in advance and (2)

required IRS to conduct outreach directly to potentially eligible AEITC recipients. First, OBRA '93 reduced the AEITC maximum from 100 percent to 60 percent of the maximum credit available to a taxpayer with one qualifying child. This change was made to improve compliance and lessen concerns that recipients would owe the difference when filing their federal tax return, which was thought to discourage AEITC use.

Second, OBRA '93 directed IRS to send notices to taxpayers who were likely to be eligible for the AEITC for 2 years and directed the Secretary of the Treasury to study the effect of the notice program on AEITC use. Only some information is available about the first notice mailing, which occurred in 1994.¹⁰ For the first notice mailing, IRS mailed Publication 1235, "Advance Earned Income Tax Credit Brochure," and the Form W-5 to about 13.5 million taxpayers who were potential AEITC candidates during tax year 1993 informing them about the AEITC. AEITC use increased about 1 percent following this effort; however, because other outreach efforts were ongoing during this time, IRS could not conclude that the increase was attributable to the notice or any other effort specifically.

In 1997, IRS mailed the notice to about 6 million taxpayers who claimed the EITC in tax year 1996, but did not report receiving AEITC on their federal tax return. With this second mailing, IRS created two groups, a test group of about 60,000 taxpayers that received the notice and a control group of about 60,000 taxpayers with similar characteristics who did not. Results from the IRS report indicated that about 1.27 percent (771 taxpayers) of the tax returns in the test group reported the AEITC compared to 0.51 percent (309 taxpayers) of returns in the control group. The summary report concluded that further efforts to increase AEITC use substantially are unlikely to succeed.¹¹ Further, the study recommended that notification of EITC recipients about the advance not be repeated.

Some of IRS's administrative changes include outreach to specific groups and changes to publications. For example, after our 1992 report, the White House, the Treasury Department, and IRS conducted extensive EITC and AEITC outreach efforts, including a 1993 announcement of the AEITC by President Clinton. Other outreach efforts included IRS contacts with

¹⁰For the first notice mailing, specific information on how the population was selected, for example, is not known.

¹¹IRS, National Research Office, *Advance Earned Income Tax Credit 1994 and 1997 Notice Study, A Report to Congress* (Washington, D.C.: August 1999).

charitable, social welfare, and minority groups to encourage awareness of the EITC and AEITC among their memberships. IRS also contacted a number of employer organizations to encourage them to publicize the AEITC with their memberships. IRS also made changes to its forms, developed print and video products, and increased speaker seminars to inform the public about the AEITC. For example, IRS developed publicity materials, such as grocery bag and milk carton art, brochures, and posters; provided information in the Small Business Taxpayer Education Program guide; and increased outreach speaker seminar efforts.¹²

Presently, IRS continues to conduct outreach about the AEITC as part of its EITC outreach efforts. IRS focuses its outreach to large employer organizations or to specific large employers, which then promote the AEITC to employers or employees.

Future AEITC Growth Is Unlikely

Increasing AEITC use in the future is unlikely for several reasons, but perhaps primarily because of potential recipients' preferences and high AEITC turnover. Interviews with IRS officials, other experts, and our prior AEITC work suggest that those eligible for the AEITC prefer receiving the EITC in a lump sum after they file their federal tax return instead of receiving relatively small portions spread throughout the year.¹³ Another reason is that, despite the reduction in the yearly AEITC maximum to 60 percent of the maximum credit available to a taxpayer with one qualifying child, results from an IRS-funded study using focus groups of EITC participants and interviews we conducted with experts indicated that potential recipients continue to have concerns that they would receive more AEITC than they were ultimately entitled to and that they would owe the difference when filing their federal tax return.

In addition, AEITC growth is adversely affected by individuals who elect the AEITC and fail to elect it again, i.e., turnover. As table 3 indicates, more than half of the individuals who elected the AEITC did so for the first

¹²The Small Business Taxpayer Education Program provides help to those who are starting or already have a small business and need information in such areas as taxes, recordkeeping, accounting practices, and completing federal business and employment tax returns. Much of the assistance is free.

¹³We identified other studies with limited populations that also found taxpayers preferred receiving a lump sum instead of smaller periodic AEITC payments; for example, Jennifer Romich and Thomas Weisner, "How Families View and Use the EITC: Advance Payment vs. Lump Sum Delivery," *National Tax Journal* (December 2000).

time since 1999 in either tax year 2002, 2003, or 2004. With the overall AEITC use remaining relatively constant over the 3 years, this indicates the large number of yearly first-time recipients was almost equally offset by existing recipients forgoing the AEITC in a following year.¹⁴ The percentage of AEITC first-time recipients is much higher than the percentage of first-time EITC recipients, which is slightly less than one-third. Also, of the individuals who elected the AEITC for the first time in 2002 or 2003, about 28 percent elected it again in the following year, 2003 or 2004, respectively, while the remainder did not elect it again in the subsequent year. Conversely, only about 98,000 (9 percent) individuals elected the AEITC consecutively in all 3 years, 2002 through 2004.

Table 3: Frequency of Individuals Electing the EITC and AEITC, Tax Years 2002 through 2004

	Tax year 2002	Tax year 2003	Tax year 2004
EITC recipients	20,918,823	21,431,377	21,721,218
First-time EITC recipients (percentage) ^{a, b}	6,077,104 (29%)	5,313,089 (25%)	4,842,922 (22%)
AEITC recipients	531,799	503,382	507,957
First-time AEITC recipients (percentage) ^{a, c}	271,600 (51%)	259,579 (52%)	259,282 (51%)
First-time AEITC recipients who did not elect the advance in the subsequent year (percentage) ^d	198,096 (73%)	187,871 (72%)	N/A
First-time AEITC recipients who elected the advance in the subsequent year (percentage) ^d	73,504 (27%)	71,708 (28%)	N/A
Number of individuals who consecutively received the AEITC (percentage) ^e		97,998 (9%)	

Source: GAO analysis of IRS data.

Note: N/A means not applicable. Tax year 2004 data are not applicable because we did not look at any subsequent years. All AEITC figures include the valid, invalid name, and invalid number subpopulations.

^aFirst-time EITC recipients are based upon how often a primary or secondary taxpayer filed a federal tax return receiving EITC for the first year since 1999. First-time AEITC recipients are based upon the first year an individual (defined by unique SSN) received AEITC since 1999. IRS officials agreed this approach is a reasonable method to compare AEITC and EITC first-time use.

¹⁴ One reason an AEITC recipient may not elect the advance in a subsequent year is because he or she no longer meets the eligibility requirements.

^bPercentage is out of EITC recipients.

^cPercentage is out of AEITC recipients.

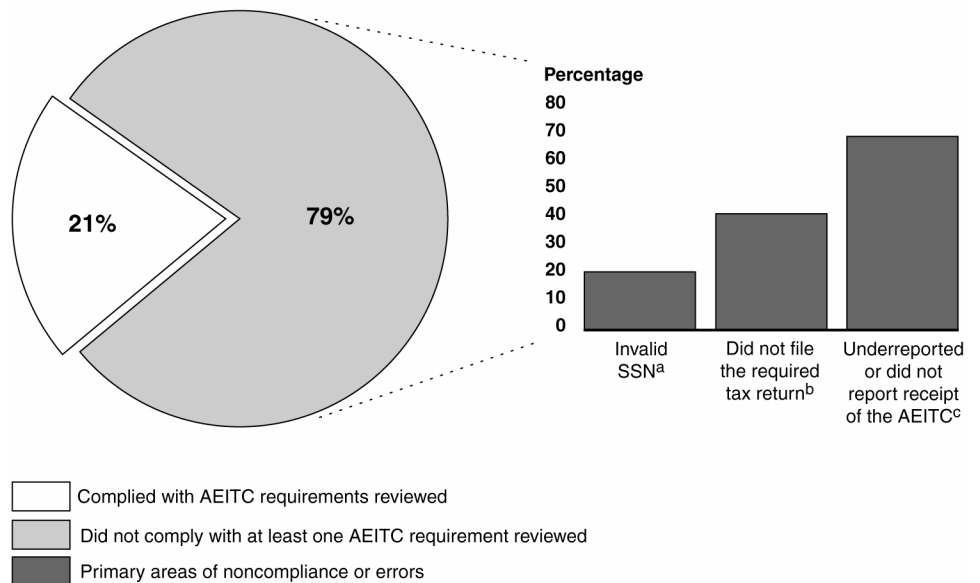
^dPercentage is out of first-time AEITC recipients.

^eNumber of individuals who consecutively received the AEITC are individuals who received the advance each year in tax years 2002 through 2004. Percentage is of individuals who received the AEITC each year in tax years 2002 through 2004 out of all recipients who received it at least once during these same years (1,133,908 individuals). The percentage who received it twice during these years is 19 percent (213,234) and once is 73 percent (822,676). Percentages may not add due to rounding.

High Noncompliance Exists with AEITC Requirements

Overall, as many as 80 percent of all AEITC recipients did not comply with or made errors involving one of the three AEITC requirements that we reviewed, and they received about \$282 million when the 3 years, 2002 through 2004, are aggregated. Some taxpayers were noncompliant with more than one requirement. Those requirements are having a valid SSN, filing a federal tax return, and reporting the proper amount of AEITC received on the tax return (see fig. 3).

Figure 3: Percentage of AEITC Recipients Compliant and Noncompliant with at Least One AEITC Requirement, Tax Years 2002 through 2004



Source: GAO analysis of IRS data.

Note: The pie chart includes the valid, invalid name, and invalid number subpopulations.

^aThis includes the invalid name and invalid number subpopulations.

^bThis includes the valid, invalid name, and invalid number subpopulations.

^cThis is of individuals who filed a federal tax return in the valid, invalid name, and invalid number subpopulations.

Specifically, in tax year 2002, we found that individuals were noncompliant with at least one of three requirements we reviewed 79 percent of the time and they received about \$93 million of AEITC. For tax year 2003 and 2004, individuals were noncompliant with at least one requirement 78 percent (about \$91 million) and 79 percent (about \$98 million) of the time, respectively.

Some of the noncompliance we identified could have resulted from IRS or employer clerical errors or improper reporting by the taxpayer. Therefore, some of the errors may be correctable or were corrected by filing an amended return. IRS cannot readily identify the number of amended returns specifically associated with the AEITC because such returns combine several credits onto one line. The explanation attached to the amended return would provide details on the change and any analysis of the explanation would be a manual process.

About 20 Percent of AEITC Recipients Had an Invalid SSN

AEITC recipients are required to provide their employer with a valid SSN for the Form W-2.¹⁵ As table 4 illustrates, about 20 percent (more than 100,000) of AEITC recipients each year may not have been eligible for the advance because they did not have a valid SSN on their Form W-2. Collectively, these individuals received between \$37 million and \$39 million in AEITC each year. The data are consistent over the 3 years reviewed.¹⁶

¹⁵ AEITC recipients must expect to be able to claim the EITC, which requires that taxpayers and their spouses, if filing a joint return, have valid SSNs issued by SSA to all U.S. citizens or individuals eligible to work.

¹⁶If any portion of the invalid SSNs is attributable to aliens not currently authorized to work in the United States, the number of invalid SSNs could be affected if the Congress changes policies regarding such aliens. See Treasury Inspector General for Tax Administration, *The Internal Revenue Service's Individual Taxpayer Identification Number Creates Significant Challenges for Tax Administration*, 2004-30-023 (January 2004), for more information about aliens' use of invalid SSNs.

Table 4: AEITC Recipients and Recipients with Invalid SSN on Form W-2, Individuals and Dollars, Tax Years 2002 through 2004

	Tax year 2002		Tax year 2003		Tax year 2004	
	Individuals	Dollars	Individuals	Dollars	Individuals	Dollars
AEITC recipients	531,799	\$145 million	503,382	\$143 million	507,957	\$150 million
AEITC recipients with an invalid SSN on Form W-2 (percentage) ^a	113,025 (21%)	\$37 million (26%)	104,856 (21%)	\$37 million (26%)	109,622 (22%)	\$39 million (26%)

Source: GAO analysis of IRS data.

^aPercentage is out of AEITC recipients. This analysis includes the invalid name and invalid number subpopulations.

For purposes of this report, invalid SSNs include instances where the SSN did not match SSA’s records (i.e., the number was never assigned by SSA) and the SSN/name combinations reported on the Form W-2 did not match SSA records.¹⁷ Some of these individuals were likely eligible for the AEITC. For example, a name/SSN mismatch could include instances when a woman who receives the AEITC marries and changes her name with her employer but not with SSA. This could result in the employer issuing a Form W-2 in the new name, but IRS and SSA only identifying her by the former name.¹⁸

Individuals who file a federal tax return are required to include a valid SSN on their return.¹⁹ An individual who provides an invalid SSN on the tax return is not compliant in meeting AEITC requirements and may also violate the Social Security Act.²⁰ Such an individual is also required to provide a valid SSN to their employer for income tax withholding purposes and for purposes of certifying eligibility for the AEITC and could be subject to a penalty for failure to do so.²¹ Further, if the individual does not file a valid SSN, IRS is unable to assess the recipient’s federal tax liability

¹⁷There could be some instances where the SSN reported on the Form W-2 does not match the SSN the taxpayer used on the tax return. Even still, IRS uses the SSN on the Form W-2 and other third party forms for document matching to identify noncompliance such as wage underreporting.

¹⁸ Of the more than 100,000 AEITC recipients with an invalid SSN, most involved a SSN that did not match the individual’s name on the Form W-2.

¹⁹ IRC § 6109(a)(1).

²⁰ 42 U.S.C. § 408.

²¹ IRC §6723.

and SSA cannot credit the recipient for money withheld for Social Security purposes.²² Also, because taxpayers often do not report receipt of the advance on their tax return, IRS cannot determine whether the taxpayer owes money or deserves a refund.

Almost 40 Percent of AEITC Recipients Did Not File the Required Federal Tax Return

All AEITC recipients are required to file a federal tax return, regardless of the amount of their income, which is generally the primary basis for determining whether a return is required to be filed. Table 5 shows that between 36 and 40 percent, about 200,000 AEITC recipients, did not file a required federal tax return each year. Collectively, these individuals received between \$42 million and \$50 million of AEITC benefits.²³

Table 5: AEITC Recipients and Recipients Who Did Not File a Tax Return, Individuals and Dollars, Tax Years 2002 through 2004

	Tax year 2002		Tax year 2003		Tax year 2004	
	Individuals	Dollars	Individuals	Dollars	Individuals	Dollars
AEITC recipients	531,799	\$145 million	503,382	\$143 million	507,957	\$150 million
AEITC recipients who did not file a federal tax return (percentage) ^a	192,857 (36%)	\$42 million (29%)	186,423 (37%)	\$44 million (31%)	200,706 (40%)	\$50 million (33%)

Source: GAO analysis of IRS data.

^aPercentage is of AEITC recipients. This analysis includes the valid, invalid name, and invalid number subpopulations.

About 56,000 to 60,000 of the about 200,000 individuals who did not file the required tax return (about 30 percent) had an invalid SSN on the Form W-2 each year, as shown in table 6. Having a valid SSN is another AEITC requirement, discussed previously, which means these individuals were noncompliant or made an error with at least two AEITC requirements.

²² IRS can file a substitute return for people who do not voluntarily file. IRS assesses a tax liability and notifies the taxpayer of any tax due based on the substitute tax return, which is created from available Form W-2 and other information.

²³ There could be instances where our methodology did not detect a filed tax return; for example, when a taxpayer's SSN on the Form W-2 might have been incorrect. See our scope and methodology (app. II).

Table 6: AEITC Recipients, Recipients Who Did Not File a Federal Tax Return, and Recipients Who Did Not File a Tax Return and Had an Invalid SSN on the Form W-2, Individuals and Dollars, Tax Years 2002 through 2004

	Tax year 2002		Tax year 2003		Tax year 2004	
	Individuals	Dollars	Individuals	Dollars	Individuals	Dollars
AEITC recipients	531,799	\$145 million	503,382	\$143 million	507,957	\$150 million
AEITC recipients who did not file a federal tax return (percentage) ^a	192,857 (36%)	\$42 million (29%)	186,423 (37%)	\$44 million (31%)	200,706 (40%)	\$50 million (33%)
AEITC recipients who did not file a federal tax return and had an invalid SSN on Form W-2 (percentage) ^b	59,607 (31%)	\$20 million (48%)	55,601 (30%)	\$20 million (45%)	58,370 (29%)	\$21 million (42%)

Source: GAO analysis of IRS data.

^aPercentage is of AEITC recipients. This analysis includes the valid, invalid name, and invalid number subpopulations.

^bPercentage is of AEITC recipients who did not file a federal tax return. An unknown portion of these recipients may have corrected the SSN error and subsequently filed a tax return. This analysis includes the invalid name and invalid number subpopulations.

There are several reasons why a significant number of AEITC recipients might not have filed a federal tax return. For example, depending on their filing status, age, and type of income they receive, recipients may not have had a filing responsibility other than for the AEITC and they may not have remembered or understood they must file a return. In addition, AEITC recipients may not have filed because they were not initially eligible or they became ineligible for the AEITC because of a change in their personal circumstances, and filing would require them to pay back the AEITC they received.

When individuals are required to file a federal tax return and do not, IRS cannot readily identify whether the individual was eligible for the advance or whether they owed IRS any of the amounts they received. Conversely, by not filing a federal tax return, some individuals did not receive additional EITC monies that they could only receive had they filed.

About Two-Thirds of AEITC Recipients Who Filed a Federal Tax Return Misreported the Amount of AEITC They Received

All AEITC recipients are required to report on their federal tax return the amount of AEITC they received according to the Form(s) W-2. Reporting this amount allows the IRS to determine whether the taxpayer received too much AEITC, and owes money back to the IRS, or whether the taxpayer is entitled to additional amounts of the EITC.

Of the approximately 60 percent (about 300,000) AEITC recipients who filed a federal tax return, two-thirds misreported the amount they received

in tax year 2002 through 2004, as shown in table 7. Misreported means that the total amount of AEITC reported on the Form W-2 does not match the AEITC amount reported on the federal tax return. Approximately one-third of the federal tax returns correctly matched to the Form(s) W-2 AEITC amount. Of those that misreported, the vast majority did not report receiving any AEITC.

Table 7: AEITC Matches and Mismatches between Form(s) W-2 and Filed Tax Returns, Tax Years 2002 through 2004

	Tax year 2002		Tax year 2003		Tax year 2004	
	Number	Dollars	Number	Dollars	Number	Dollars
Number of individuals who filed federal tax returns ^a	342,841	\$108,189,196	320,588	\$101,078,453	309,724	\$102,512,732
Number of returns that matched the Form(s) W-2 AEITC amount (percentage) ^b	112,421 (33%)	\$51,457,254 (48%)	111,266 (35%)	\$52,246,111 (52%)	106,980 (35%)	\$52,338,650 (51%)
Number of mismatches between Form(s) W-2 and filed federal tax return (percentage) ^b	230,420 (67%)	\$56,731,942 (52%)	209,322 (65%)	\$48,832,342 (48%)	202,744 (65%)	\$50,174,082 (49%)
Number of mismatches due to nonreporting of AEITC (percentage) ^c	222,691 (97%)	\$53,343,102 (94%)	202,152 (97%)	\$45,487,033 (93%)	195,571 (96%)	\$46,806,223 (93%)
Number of mismatches due to underreporting of AEITC (percentage) ^c	4,996 (2%)	\$2,349,197 (4%)	4,779 (2%)	\$2,389,854 (5%)	4,881 (2%)	\$2,337,603 (5%)
Number of mismatches due to overreporting AEITC (percentage) ^c	2,733 (1%)	\$1,039,643 (2%)	2,391 (1%)	\$955,455 (2%)	2,292 (1%)	\$1,030,256 (2%)

Source: GAO analysis of IRS data.

Note: Percentages may not add due to rounding. This table includes individuals who filed a tax return in the valid and invalid name subpopulations.

^aThe total number of filed federal tax returns is greater than the total number of AEITC recipients who filed a return because there were some dependents who received AEITC and were listed on more than one federal tax return. The total number of AEITC recipients who filed a federal tax return can be calculated using table 5 by subtracting the number of AEITC recipients who did not file a federal tax return from the number of AEITC recipients.

^bWe considered a match to be anything plus or minus a dollar on the Form W-2 in order to allow for taxpayer rounding. We tested the sensitivity of this result by using a difference between the AEITC reported on the Form W-2 and the tax return of up to \$100 and the results were similar. Percentage is of number of individuals who filed federal tax returns.

^cPercentage is of number of mismatches between Form(s) W-2 and filed federal tax returns.

Taxpayers may not report the amount of AEITC they received because they either forget or do not know they are required to do so. Underreporting can occur when there is a computation error involving multiple Forms W-2, a taxpayer disagrees with the amount reported on the

Forms W-2, or there is willful noncompliance. IRS officials in the AUR program pursue some AEITC cases where taxpayers either underreport or do not report receipt of the AEITC. These procedures are discussed in detail in a following section.

Due to the high number of mismatches, many of the AEITC recipients who also claimed the EITC likely received excess benefits. For example, of the 222,691 taxpayers who did not report receipt of the AEITC on their tax return in tax year 2002, almost half went on to claim the EITC. We determined that those taxpayers received nearly \$22 million in excess AEITC benefits. For the 3 years, 2002 through 2004, taxpayers received a total of about \$64 million in excess AEITC benefits.

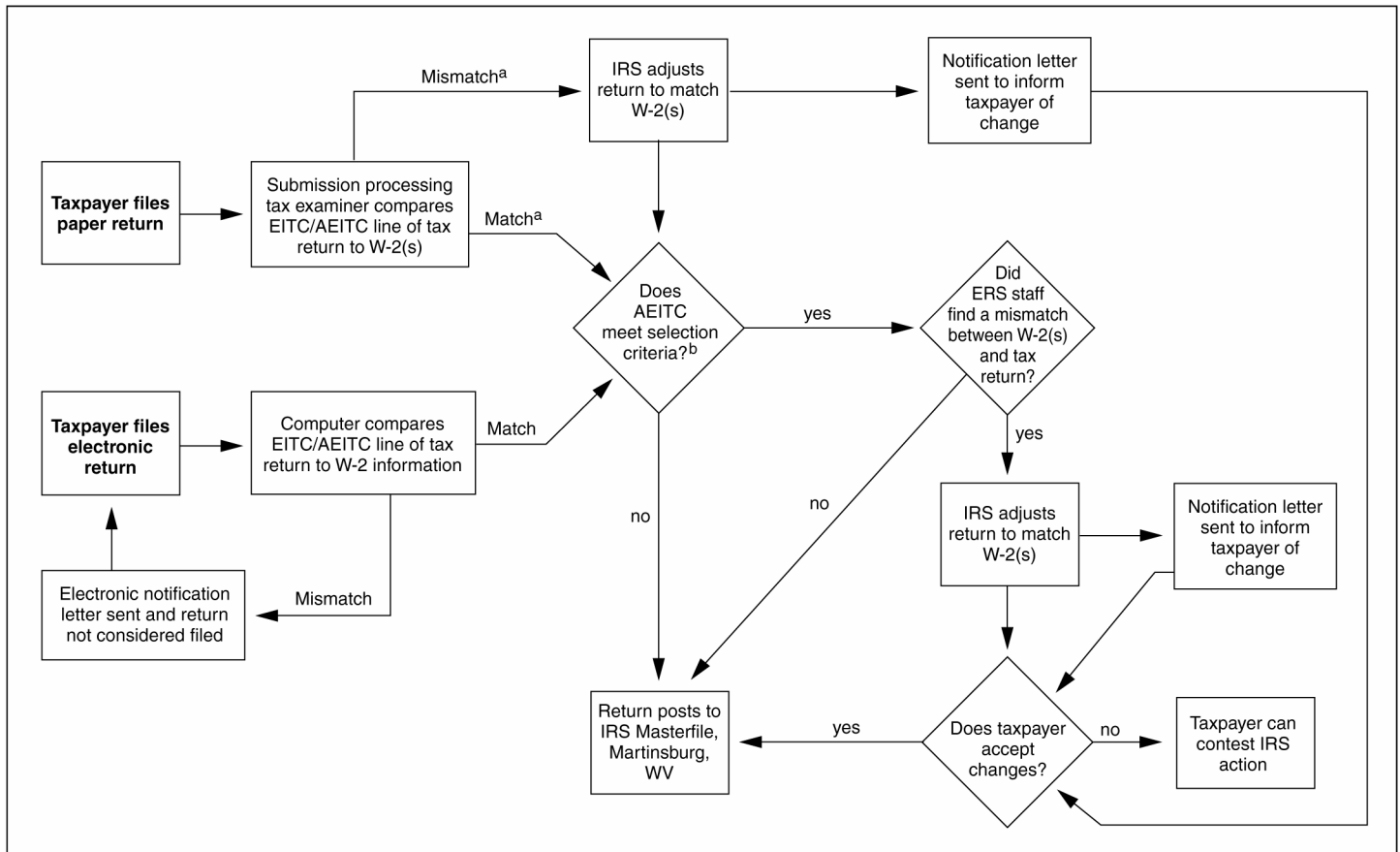
AEITC Recipients Were Noncompliant with Other Program Requirements

Additional noncompliance or errors existed with other program requirements, such as receiving excess AEITC. Details and demographic information on the noncompliant individuals are in appendix V.

IRS's AEITC Compliance Procedures Have Limited Effectiveness and Options to Better Address Noncompliance Have Advantages and Disadvantages

IRS's Submission Processing is responsible for receiving, processing, and archiving the nation's federal tax returns, payments, and information returns. In the context of AEITC, Submission Processing attempts to catch mismatches between both paper and electronic tax returns and Forms W-2 (see fig. 4).

Figure 4: Submission Processing Procedures for Paper and Electronic Tax Returns Reporting AEITC



Source: GAO analysis of IRS procedures.

^aAfter some initial checks, such as comparing the EITC/AEITC line of a tax return to the Form W-2(s), all paper returns go to Submission Processing staff, who enter select data from the Form 1040 into an electronic database.

^bEffective January 2, 2007, at our suggestion, Submission Processing changed its selection criteria to include filing status.

Between 32 percent and 22 percent of tax returns reporting an AEITC amount were filed on paper between tax years 2002 and 2004, respectively. If a paper tax return has an entry on either the AEITC or EITC lines on the Form 1040, Submission Processing tax examiners are required to ensure that the AEITC amount reported on the return matches the amount in box

9 of the Form(s) W-2, which records the amount of AEITC paid by the employer to the employee.²⁴

If the amounts on the AEITC line of the tax return and Form W-2(s) match, the tax examiner takes no further action. If the amounts differ (e.g., the tax return reports a lesser amount than is reflected on the Form(s) W-2) the examiner is required to adjust the entry on the return to equal the total AEITC amount from the Form(s) W-2. All paper returns then go to staff who enter data from the Form 1040 into an electronic database.

After an examiner makes an adjustment, IRS sends a letter to the taxpayer explaining that an adjustment was made and it was based on the mismatch between the tax return and the Form(s) W-2. IRS sent 282 and 220 such letters in tax years 2003 and 2004, respectively.²⁵ Submission Processing's role is to ensure that the return amount is consistent with the Form W-2, not to determine which of the differing numbers accurately reflects the amount of AEITC actually paid to the employee. If the taxpayer disagrees with the adjustment, e.g., believes that the amount on the Form(s) W-2 is incorrect, the taxpayer can dispute it.

Between 68 percent and 78 percent of returns reporting an AEITC amount were filed electronically between tax years 2002 and 2004. Submission Processing runs a computer check to find any mismatches between the amounts on the electronic tax returns and the electronic Form(s) W-2. When mismatches are found, Submission Processing rejects the return and sends it to the taxpayer or preparer to correct and retransmit to IRS.

In most tax preparation software, once a user enters an amount from the Form(s) W-2, the amount is automatically transferred to the appropriate line of the tax return. Thus, if the user errs in entering the proper amount from the Form W-2, the software would enter this erroneous number on the tax return. As a result, Submission Processing rarely identifies AEITC tax return/Form(s) W-2 mismatches because the original Form(s) W-2 from the employer(s) is rarely included in electronic filings.²⁶ IRS rejected

²⁴ Because AEITC is an advance payment of the EITC, filers who claim the EITC are required to reduce the EITC by any AEITC received. By examining the Form(s) W-2 of EITC claimants for AEITC payments, the IRS attempts to ensure that excess amounts of EITC are not claimed.

²⁵ Submission Processing did not have tax year 2002 data available.

²⁶ The electronic Form (s)W-2, which is an iteration of a user's entries into the tax preparation software, is generally included in the electronic filing submission.

172 electronically filed returns reporting AEITC in tax year 2004 and 147 in tax year 2003. Adding these mismatches to the paper return mismatches, Submission Processing found 392 mismatches in tax year 2004 and 429 in tax year 2003.

Next, Submission Processing sends the return through its Error Resolution System (ERS) when the AEITC amount on the Form 1040 meets certain selection criteria.²⁷ If ERS finds that AEITC exceeds this amount, a tax examiner matches the Form 1040 AEITC amount to the Form W-2(s). If they match, no action is taken, and the return is posted in IRS's Masterfile, the agency's central repository for taxpayer information. If there is a mismatch, IRS adjusts the return to match the Form(s) W-2, and IRS sends a letter to the taxpayer describing the error and the ERS correction. Taxpayers who disagree with the change can dispute it. The ERS process thus serves as a back-up check in case the earlier physical or electronic processes missed these AEITC mismatches. ERS examined 3,380 tax returns with AEITC in tax year 2004. IRS was not able to tell us how many of these returns involved mismatches.

Prior ERS selection criteria would not have identified some returns for individuals when the Form(s) W-2 had AEITC amounts that were above the legal maximums, but below the ERS selection criteria. While interviewing Submission Processing officials, we suggested that the criteria be modified and associated with filing status. IRS made such changes to the criteria, effective January 2, 2007.

IRS's Procedures to Verify SSNs Have Limited Effectiveness for AEITC Recipients Due to Taxpayer Noncompliance in Reporting and Filing

Submission Processing's procedures have limited effectiveness in verifying that AEITC recipients have a valid SSN because, as previously noted, many individuals do not file the required tax return and, for those who do, most do not report receipt of the advance.

For both paper and electronically filed returns, Submission Processing checks IRS's Data Master (DM-1) file, which is a database that includes, among other things, all validly issued SSNs and the individual's name associated with each SSN. Submission Processing rejects electronically filed tax returns with an invalid SSN on the Form 1040, including those

²⁷ ERS is the system for examining and correcting electronic and paper individual income tax returns rejected due to taxpayer and processing errors. ERS treats paper and electronic returns in the same way.

from taxpayers who received the AEITC, and sends back the tax return to the taxpayer for correction before processing. For returns filed on paper with an invalid SSN on the Form 1040, Submission Processing processes the return, but disallows certain credits and exemptions, such as the EITC. If the taxpayer's SSN is invalid and the AEITC is claimed on a paper return, Submission Processing processes any AEITC reported. Since the AEITC is reported as tax, it will either offset all or part of any refund due or, if no refund is due, require the taxpayer to pay back the full AEITC amount.

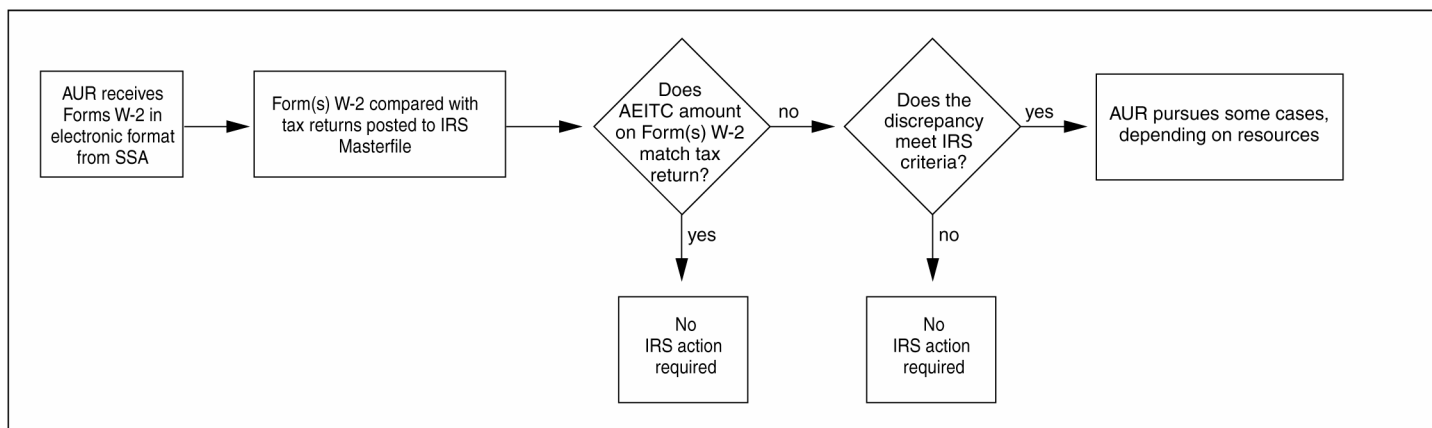
Thus, of the approximately 514,000 individuals who received the AEITC each year between tax years 2002 through 2004, Submission Processing's procedures would apply to about 118,000 taxpayers—those who filed and reported receipt of the advance. For nonfilers, Submission Processing cannot verify SSNs because there are no tax returns—the basis of its examination. While Submission Processing performs a SSN verification for those who file and do not report receipt of the AEITC, it is not effective for the advance since the advance is not reported on the return.

Many Taxpayers Underreported AEITC and IRS Worked on a Limited Number of These Cases, Some of Which Submission Processing Did Not Find

After a return has been processed, the next point when IRS might identify and correct AEITC noncompliance is when it matches tax returns to other documents it receives. Overall, each year AUR identifies about 14 million discrepancies between taxpayer income and deduction information submitted by third parties and amounts reported on individual income tax returns. AUR has the resources to only work on a fraction of these cases each year and uses criteria, such as revenue collection potential, for case selection.

For AEITC, AUR compares the amount of AEITC that employers report on a taxpayer's Form W-2 to the amount reported on an individual's tax return (see fig. 5). AUR receives this information in separate databases from SSA and undertakes these comparisons in August and December of each year—well after Submission Processing has completed its review of the returns and associated Forms W-2.

Figure 5: AUR Program Procedures to Resolve Discrepancies between AEITC Amounts on Forms W-2 and Tax Returns



Source: GAO analysis of IRS data.

Generally, AUR does not take action when the AEITC amounts match the amounts reported on the return or when the discrepancy does not meet IRS case selection criteria. For example, for tax year 2003, our data show that there were about 209,000 tax returns where the AEITC amount did not match the amount on taxpayers' Forms W-2, primarily because the returns failed to report any AEITC or underreported the amount. AUR identified about 25,000 of those cases in tax year 2003 as potential cases on which to work.

In tax year 2003, Submission Processing identified 429 instances where the amount of AEITC reported on the tax return was less than the amount on the Forms W-2, which was much fewer than the about 25,000 mismatches detected by AUR that year. The mismatches involving individuals who filed paper returns and reported receiving the AEITC should have been caught by Submission Processing because its examiners are supposed to match the amount reported on the return with the Form(s) W-2. However, Submission Processing examiners review huge volumes of returns and it can be a challenge to identify the relatively few with AEITC.

Because AUR does not break down its AEITC cases by filers who underreport and filers who fail to report any AEITC amount or by filers of paper versus electronic returns, it is not possible to determine exactly how many AUR cases should have been caught by Submission Processing. AUR officials told us that it would be difficult for them to routinely break out this information in this way because this would require new computer

programming and the budget for new programming requests was reduced for fiscal year 2007.

In accordance with return processing procedures, if Submission Processing identifies an underreporter, it reduces the size of the refund that will be sent to the taxpayer. Thus, using Submission Processing, rather than AUR, better protects revenue because the erroneous EITC amounts are never paid to the taxpayer. If AUR works on the case, it assesses the tax owed, but further IRS action is required to collect the actual overpayment—through a future refund offset or a current effort to collect the refund paid erroneously.

Although catching AEITC underreporting in Submission Processing would better protect revenue than do AUR processes, the benefits to improving Submission Processing to catch AEITC errors may already be small and could get smaller. This is because the number of EITC returns filed electronically is more than 68 percent and has been growing and, as previously noted, Submission Processing identifies few mismatches for returns that are filed electronically because the electronic Form W-2 is an iteration of the user's entries. In its July 2006 report, the Treasury Inspector General for Tax Administration recommended that IRS reemphasize the use of the current AEITC review procedures for paper returns, but agreed with IRS that it could not implement additional procedures for electronic returns because IRS is unable to fully verify the accuracy of the Form(s) W-2 during electronic processing of returns.

AUR worked on about twice as many AEITC cases in tax year 2003 as in the previous year. The total amount of tax assessed in these cases in tax year 2003 was more than three times the amount in the previous year, and the amount assessed per case increased about 71 percent, from \$555 to \$947, which is near the average AUR assessment of about \$1,000.²⁸ These trends were either holding steady or improving for the 84 percent of tax year 2004 cases for which we had data when we completed our review. The number of cases in which the taxpayer fully agreed with the assessment rose from about 29 percent in tax year 2002 to about 41 percent in tax year 2003. The number of cases in which IRS withdrew the assessment, generally after the taxpayer provided documentation that it

²⁸ AUR categorizes a case as an AEITC case if AEITC is the primary issue, responsible for at least 80 percent of the increased tax liability. Thus, the total amount assessed in each AEITC case may include other underreported amounts. The total amount assessed is not necessarily the total amount that IRS collects from the taxpayer.

was erroneous, dropped from about 15 percent in tax year 2002 to about 4 percent in tax year 2003.

IRS Works on a Limited Number of AEITC Nonfiler Cases

As previously noted, from tax years 2002 through 2004, about 40 percent of the individuals who had a Form W-2 reporting that they received AEITC did not file a tax return as required by law.

All nonfiler cases, including AEITC nonfiler and other lower dollar nonfiler cases, are eligible to be worked on by IRS's Wage and Investment and Small Business/Self Employed divisions. IRS's policy dictates that some lower dollar cases and even some cases in which nonfilers are due a refund may be worked on to ensure that all kinds of cases have the possibility of being worked on. Still, a key criterion that IRS uses to determine cases on which to work is potential revenue or the anticipated net balance due. The higher this amount, the more likely the case will be worked on. IRS does not track the total number of nonfiler cases worked on or the kinds of income or credits taken by the nonfilers whose cases were worked on. Because IRS selects cases based on these criteria, IRS officials said they worked on few AEITC nonfiler cases.

Beyond AEITC nonfiler cases potentially being worked on by Wage and Investment and the Small Business/Self Employed divisions, these cases are also eligible to be worked on by other IRS programs. For example, the automated collection system involves calls from IRS staff to taxpayers asking them to file a return or explain why they believe filing is not required.²⁹ IRS's automated substitute for return program involves collection staff preparing a tax return on behalf of a nonfiler based on third-party and other information that IRS has available. Once a return has been created, IRS can act to collect any taxes due.

During 2005 through 2006, IRS conducted a test to determine whether receipt of AEITC should be a criterion to determine nonfiler cases on which to work. The test involved working on cases from tax years 2000 through 2003 for 433 taxpayers drawn from a sample of taxpayers who did not file a return in tax year 2002, but did receive the AEITC that year, and

²⁹ The automated collection system primarily focuses on collecting taxes from taxpayers who are delinquent in paying assessed taxes.

whose income was between \$35,000 and \$50,000 for that year.³⁰ The cases were worked on in the same way that IRS works on other nonfiler cases.

In interviews with IRS officials about the AEITC nonfiler test, we found that the agency's test plan lacked documentation and detail, such as test justification, likely costs and benefits, and implementation details. It also lacked a rationale for some important decisions underlying the test and some changes implemented after the test began were also not well documented. In our report on three tests conducted by IRS in 2004 to address leading sources of EITC errors, we noted that the lack of such documentation hindered monitoring and oversight and did not foster a common understanding of the tests among management and staff.³¹ One of our recommendations was that the rationale for key decisions on such tests be documented, and the Commissioner of Internal Revenue agreed with that recommendation.

Because IRS had not completed its evaluation of the test as of June 2007, the agency has not decided whether AEITC should be a criterion to determine nonfiler cases on which to work. Regardless of the agency's decision, however, it is unlikely to significantly reduce the number of AEITC nonfilers because any increase in cases worked on would likely represent only a small number of such nonfilers, relative to both the total number of AEITC nonfilers and all nonfiler cases worked on by IRS.

Collection Handles Few AEITC Cases

All AEITC cases are eligible to be worked on in IRS's collection program; however, it generally does not work on cases involving AEITC because the amounts involved are below selection criteria that determine which cases to pursue.

Collection does not keep track of the specific types of income and credits claimed by the individuals whose cases they handle. Still, collection officials stated that they worked on few, if any, cases involving the AEITC. Instead, these cases go into "deferral status," which means any refund the

³⁰ IRS officials said they decided to work on the cases for all 4 years, even if they did not involve the taxpayer receiving the AEITC in some of those years so as to bring taxpayers in these cases into full compliance.

³¹ GAO, *Earned Income Tax Credit: Implementation of Three New Tests Proceeded Smoothly, but Tests and Evaluation Plans Were Not Fully Documented*, [GAO-05-92](#) (Washington, D.C.: Dec. 30, 2004).

taxpayer is due will be reduced until the balance due has been paid off. Like other taxpayers with an outstanding tax liability, these taxpayers would also get a notice stating how much they owe.

Collection had an effort under way to work on cases under its selection criteria by setting up automatic monthly installment arrangements and notifying taxpayers that they were expected to begin paying what they owed. Officials said that too many taxpayers ignored the arrangements, and as a result, the program was determined to be cost prohibitive. The program was therefore discontinued.

IRS Audits and Criminal Investigation Identified a Small Number of AEITC Cases

IRS annually audits about 500,000 of the more than 21 million tax returns that claim the EITC. With only about 3 percent of EITC recipients potentially eligible for the advance receiving it, only a small number of the audited returns are likely to involve the AEITC.³² When IRS audits tax returns claiming the EITC, an examiner is required to determine if the taxpayer was eligible for it, whether the taxpayer took the AEITC and, if so, whether the taxpayer reported the correct amount. If the examiner determines that the taxpayer was not eligible for the EITC, then the AEITC is disallowed.

In addition, Criminal Investigation, which investigates potential criminal violations of the tax code and related financial crimes, has identified six cases associated with the AEITC since 2001. Five of the six cases involved refund fraud based on individuals creating fake businesses in order to obtain the AEITC. The other case involved a business owner attempting to evade employment tax by falsely signing up employees for the AEITC, but not including the credit in their paychecks.

Soft Notices Have Increased Compliance in Situations Similar to AEITC, but Turnover and Difficulty Locating Recipients May Limit Effectiveness for AEITC

Because IRS's enforcement resources cannot fully cover all areas of noncompliance, including AEITC noncompliance, the agency has tried to cost effectively increase voluntary compliance in some areas that involve relatively small amounts of money by mailing taxpayers soft notices. Soft notices are letters that ask taxpayers to comply with a certain requirement in the future or, if the notice informs them that they are not entitled to a benefit that they received, to file an amended return.

³² IRS does not track the number of AEITC cases that are audited.

While IRS officials said there have not been any soft notices specifically targeting AEITC noncompliance, we reviewed the results of three tests that involved taxpayers who were not filing accurately—many of whom would not otherwise be subject to an enforcement action. Additionally, IRS has modified one soft notice test that includes cost estimates. Each of the completed soft notice efforts show some benefits in improving compliance, however, they may be less effective for AEITC recipients.

The First Soft Notice Test: The first soft notice—called the “Duplicate TINs” test—involved different taxpayers claiming the same, or a duplicate, TIN for a dependent or qualifying child in order to obtain an exemption, the EITC, or child tax credit benefits. In tax year 2002, IRS identified a total of about 2.4 million taxpayers who used a duplicate TIN. IRS sent soft notices to about 820,000 taxpayers.

In November 2005, IRS reported that after receiving the soft notice, 11.4 percent of the population amended their tax year 2002 returns.³³ Other results focused on taxpayers who received the notice for tax year 2002 and whether they repeated the use of a duplicate TIN on their tax years 2003 and 2004 tax returns. The results were as follows:

- 84.9 percent did not repeat their behavior in either of the ensuing years;
- 7.7 percent repeated the behavior in 2003, but not again in 2004;
- 4.0 percent did not repeat the behavior in 2003, but did so in 2004; and
- 3.4 percent repeated the behavior for both ensuing years.

Although IRS did not report the costs associated with this test, it did estimate the revenue that would have been lost without the soft notices. IRS reported that it protected a total of \$218.3 million using the Duplicate TINs test. Due to limitations in the research design, such as not using a control group, IRS reported that it was uncertain whether these results were solely influenced by the receipt of a soft notice or if other factors may have contributed to the change in taxpayer behavior and subsequent revenue protected. IRS no longer considers this a test and continues to send out soft notices for Duplicate TINs issued each year.

³³ IRS, Wage and Investment Research Group, *Soft Notice for Duplicate TINs for Tax Years 2002, 2003, and 2004*, 6-05-12-2-030E (Nov. 29, 2005).

The Second Soft Notice Test: The second soft notice test—called the “AUR Soft Notice” test—involved filers who underreported small amounts of certain categories of income, such as wages, unemployment insurance, or sales of securities. In December and January 2004 and 2005, respectively, IRS sent 500 soft notices to randomly selected taxpayers who underreported income on their tax year 2003 returns. IRS also randomly selected a control group of 500 taxpayers who underreported small amounts, but did not send notices to this group.

An outside consultant that IRS hired to determine the effectiveness of the test reported in October 2005 that (1) soft notices appeared to have a beneficial result in reducing repeat behavior and (2) IRS resources were not overburdened by the notices.³⁴ Their conclusion was based on several results. First, after receiving the soft notice, 71 out of the 500 taxpayers (14.2 percent) filed an amended return. Second, only 33 taxpayers (6.6 percent) who received the notice repeated the underreporting the following year. In contrast, 174 taxpayers in the control group (34.8 percent) repeated their underreporting. Third, the consultants did not consider IRS resources to be burdened because only 45 of 500 taxpayers (9 percent) called IRS with questions. Similarly, the study found there was limited undeliverable mail—only for 3 taxpayers (0.6 percent). An additional test was conducted for fiscal year 2006 and had similar positive results. IRS is in the process of determining whether it will send out soft notices for AUR in the future.

The Third Soft Notice Test: The third soft notice test—called the “Dependent Database” test—involved cases selected for three EITC related issues, including qualifying child, filing status, and Schedule C, “Profit or Loss from Business,” errors. IRS found that 2.4 million taxpayers appeared to have had errors on their tax returns. In November 2005, IRS selected about 12,500 taxpayers to determine the impact of soft notices on taxpayers’ behavior when filing their tax year 2005 return. About another 12,500 taxpayers were selected as a control group not to receive the notice.

In its October 2006 report, IRS found that, although there was a difference between the test group of taxpayers who received the soft notice and the control group that did not, the direct relationship between receiving a soft

³⁴ Booz Allen Hamilton, *AUR Soft Notice Test Results* (Oct. 6, 2005).

notice and taxpayers' subsequent filing behavior was weak.³⁵ Specifically, the report cited that 88 percent of the test group and 86 percent of the control group changed their subsequent tax year filing behavior, including not breaking the same rule, amending the prior year return, or not filing a 2005 return. Specific noteworthy results were:

- 84 percent of the test group and 83 percent of the control group filed a return in the subsequent year;
- 46 percent of the test group and 44 percent of the control group broke no rules at all;
- 26 percent of the test group and 25 percent of the control group broke a different rule;
- 12 percent of the test group and 14 percent of the control group repeated their behavior the next year by breaking the same rule; and
- 1 percent of the test group and 0.4 percent of the control group amended their prior-year return.

Also in October 2006, IRS modified the Dependent Database test in both the Wage and Investment and Small Business/Self Employed divisions to target notices to another population, i.e., noncustodian person(s) claiming a child. IRS prepared a preliminary cost analysis for this soft notice test based on a sample of 300,000 taxpayers. It estimated the total costs of sending out 300,000 soft notices to be about \$533,000, which included \$449,000 for the labor to process amended returns and answer telephone calls and \$84,000 for mailing. Additional information, including the results of this test, was not available as of mid-June 2007.

Although IRS did not develop criteria for these soft notice tests about what would constitute a success, such as a self-correction percentage, an IRS official knowledgeable about the tests said the agency considers the three completed tests a success, despite the few shortcomings. The first and second tests were considered successes because they led to noteworthy changes in taxpayer behavior. The third test was considered a success because, although taxpayer behavior did not change significantly, officials considered it a cost-effective way to have an enforcement presence among these taxpayers. Officials thought that a soft notice test could be beneficial for reducing AEITC noncompliance as well,

³⁵ IRS, Wage and Investment Research Group, *Dependent Database Soft Notice Report for Tax Year 2005*, 6-06-12-2-0280E (Oct. 31, 2006).

particularly since the amount of money involved with AEITC is low and the noncompliance might not otherwise be addressed by IRS.

Although soft notices may have some potential to address certain AEITC noncompliance, characteristics of the AEITC population might make such notices less effective or more costly than for the test populations for two reasons. First, AEITC turnover is high. In each tax year 2002 through 2004, more than half of the individuals were first time recipients. Moreover, about 73 percent of first-time AEITC recipients in tax years 2002 and 2003 did not elect the AEITC the following year and, thus, would not repeat noncompliance related to the AEITC.³⁶ Second, almost 40 percent of AEITC recipients do not file a tax return, which means that IRS may not have a current address for those taxpayers. If IRS were to send soft notices to AEITC nonfilers using the last known address, a significant number of individuals may no longer reside there. This means IRS might not be able to locate them or it might spend additional resources trying.

Federal On-Line SSN Verification Services Could Be Used to Determine AEITC Eligibility, but IRS and SSA Have Raised Concerns

More than 100,000 AEITC recipients had invalid SSNs and reported receiving millions of dollars in total benefits for each tax year 2002 through 2004 without any substantial check of their eligibility. Because of the low-dollar amounts involved per taxpayer, IRS worked on only a small number of these cases. IRS does not have an up-front control or procedure in place to require employers to verify that an employee seeking the AEITC has a valid SSN, which could address this noncompliance. Two federal on-line services have the potential to be used to implement such controls. Although the services could be used for this purpose, IRS and SSA officials raised several concerns about implementing such a requirement.

The TIN Matching service and SSNVS are federal on-line services that some private organizations may use voluntarily to verify whether federal

³⁶ There are different ways to calculate turnover. We considered it to be first time use within a 6-year period. To provide additional information, we also compared the number of first-time AEITC recipients who did not elect the advance in tax year 2003 with the total number of first-time AEITC recipients in tax year 2002. We made the same comparisons for the following year.

records show that the name and SSN provided by an individual match.³⁷ TIN Matching is a pre-return filing service offered by IRS that allows those payers whose income is subject to backup withholding, who submit any of six Form 1099 information returns (e.g., financial institutions), to match the TIN of the 1099 payee against IRS records.³⁸ It is one of several e-service products offered by IRS. The goal of TIN Matching is to improve the accuracy of Form 1099 data and reduce subsequent inappropriate penalties and error notices. SSNVS is a service offered by SSA that allows registered users (i.e., employers or, in certain instances, their third-party representatives) to verify the names and SSNs of employees against SSA records.³⁹ The AEITC is outside the scope of SSA's responsibilities, and SSNVS is a voluntary service that is currently used only to increase the accuracy of wage reporting on Forms W-2.

IRS and SSA officials identified a number of challenges that the agencies and employers may face if the TIN Matching service or SSNVS were used to verify AEITC eligibility.

Accuracy: Both the TIN Matching service and SSNVS are based on SSA records and have high rates of accuracy in terms of determining whether submitted names and SSNs match. Still, IRS and SSA officials had concerns about whether these rates were high enough for purposes of verifying AEITC eligibility. IRS officials told us that the TIN Matching service is about 98 percent accurate. A December 2006 report by the SSA Office of Inspector General sampled more than 2,000 determinations by SSA's Numident file—the database upon which SSNVS is based—and

³⁷ The Department of Homeland Security operates a voluntary program known as Employment Eligibility Verification, formerly known as Basic Pilot, through which participating employers enter employee information, such as name and SSN, into the Web site to verify newly hired employees' work authorization status. The program then attempts to match that information against SSA and, if necessary, Department of Homeland Security databases. We did not examine Employment Eligibility Verification as part of this report because we have identified several weaknesses in the program's implementation that could adversely impact increased use. See GAO, *Immigration Enforcement: Weaknesses Hinder Employment Verification and Worksite Enforcement Efforts*, [GAO-06-895T](#) (Washington, D.C.: June 19, 2006).

³⁸ Financial institutions and other businesses that make certain payments must file a Form 1099 with IRS. Generally, these payments are not subject to withholding unless certain conditions exist, one of which is an invalid taxpayer identification number.

³⁹ For the purposes of this report, SSN validity with regard to SSNVS includes instances where a name matches its SSN as verified by SSA records.

found a name and SSN match accuracy rate of more than 99 percent.⁴⁰ Still, SSA officials said that if SSA records were used to verify AEITC eligibility, they might want to subject an employee's name and SSN to more "routines"—procedures such as correcting for transposed numbers that SSA uses to increase the likelihood of a match—than is currently done by SSNVS. IRS officials told us that when the agency was informally considering a proposal to charge a fee for using the TIN Matching service, several IRS officials knowledgeable about the database opposed the idea because they did not believe it was accurate enough that users should have to pay for it.

Accuracy concerns, however, do not preclude IRS or SSA from using SSA records to make an initial determination about whether individuals who may claim credits or benefits have demonstrated that they are entitled to them. For example, as previously noted, IRS rejects electronically filed tax returns with a name/SSN mismatch and returns them to the taxpayer for correction. For paper returns reporting AEITC receipt that have a name/SSN mismatch, IRS processes the returns, but since the AEITC is reported as tax, it will either offset all or part of any refund due or, if no refund is due, require the taxpayer to pay back the full AEITC amount.

Similarly, SSA instructs its claims representatives that if the identity of a claimant for Social Security benefits or Supplemental Security Income benefits remains questionable because the individual has not provided sufficient proof to establish his or her identity, the claim will be denied even if other factors of eligibility are met.⁴¹

Additional employer responsibilities: IRS and SSA officials said a major concern about employers using either service was whether a name/SSN mismatch would create new responsibilities for employers beyond informing the employee and denying the AEITC. IRS officials also expressed concern that requiring employers to use the services for AEITC

⁴⁰ SSA, Office of Inspector General, *Accuracy of the Social Security Administration's Numident File A-08-06-26100* (December 2006). When SSA assigns an SSN to an individual, the agency creates a master record in its Numident file, which contains information about the number holder, including the person's name. Thereafter, the Numident record for each number holder identifies any changes to the original information provided by the number holder, including name changes.

⁴¹ Supplemental Security Income is a federal program administered by SSA designed to provide cash for food, clothing, and shelter to aged, blind, and disabled people who have little or no income.

would discourage them from promoting the AEITC and perhaps encourage them to dissuade employees from seeking it. Under current procedures for using the TIN Matching service and SSNVS, employers are not required to take any action based on the results they receive.

IRS officials expressed concern that a June 2006 regulation proposed by the Department of Homeland Security could expressly list employer receipt of a “no match” letter from SSA as possible evidence that the employer knew or should have known that it was employing an individual not authorized to work in the United States.⁴² Under the proposed regulation, if the employer fails to take reasonable steps to resolve the discrepancy after receiving the letter, the Department of Homeland Security may find that the employer had such knowledge and assess civil monetary penalties against the employer.

The proposed Department of Homeland Security regulation describes “safe harbor” procedures that the employer can follow in response to the letter. Those steps include the employer promptly checking its records for clerical errors and obtaining required documentation by working with the employee, SSA, and the Department of Homeland Security. If the name/SSN mismatch cannot be resolved, the employer would have to choose between terminating the employee or facing the risk that the Department of Homeland Security may find that the employer knew that the employee was not authorized to work and, by continuing to employ the individual, violated the law.

While the proposed Department of Homeland Security regulation covers only no match letters, IRS and SSA officials expressed concern that the regulation could be expanded to include name/SSN mismatches disclosed by the TIN Matching service or SSNVS. Under current law, existing and prospective users who are concerned that matching could be used for purposes beyond improving the accuracy of Form 1099 data or wage reporting can voluntarily cease using, or not start using, the systems. IRS and SSA officials noted, however, that employers would no longer have this choice if they were required to use one of these services to verify an AEITC applicant’s SSN.

⁴² As of June 2007, this proposal was still outstanding. SSA sends “no match” letters to employers who submit more than 10 Forms W-2 to SSA or when more than 0.5 percent of these wage reports consist of a name and SSN combination that do not match SSA records.

In addition, existing Department of Homeland Security guidance for employers on the interaction between antidiscrimination laws and legal requirements for verifying employment eligibility states that employers must treat all employees in the same manner. Employers cannot set different employment eligibility verification standards or require that different documents be presented by different groups of employees. If mandatory verification of AEITC applicants' SSNs created additional employer responsibilities under employment eligibility verification requirements, this result could be inconsistent with efforts to ensure that verification procedures apply to all employees.

SSA's position on SSNVS is that a name/SSN mismatch does not make any statement about an employee's immigration status and should not be a basis for taking any adverse action against the employee. SSA officials also expressed reservations about SSNVS results being used to terminate employees.

Capacity and User Access: IRS and SSA officials said changes to the capacity and user access of the TIN Matching service or SSNVS would either be unnecessary or minor if employers used them to verify SSNs of employees seeking AEITC, although the officials said their agencies might favor creating a new service for this purpose instead. They told us that their systems have the capacity to handle the increased volume of requests that would result from this expanded use. Because both services already are used to verify SSNs, IRS and SSA said any changes to how the services are accessed and used would also probably not be extensive.

Both SSNVS and TIN Matching are Web-only services.⁴³ To use one of the services, the employer designates one or more employees or third-party representatives to register on behalf of the employer. The initial registration for both the TIN Matching service and SSNVS is handled in a similar way and may take as long as 4 weeks:

- Registrants go to the agency's Web site and provide information about themselves and their employers on a form, which they send electronically to the agency.

⁴³ Both IRS and SSA have toll-free telephone numbers listed on their Web sites that those looking for help with the particular service can call to speak with agency staff and get help.

-
- The agency sends the employer of the registrant a unique code. The letter directs the employer to provide that code to the registrant.
 - After receiving the code, the registrant can go back to the agency Web site and input the code to activate use of the service.

TIN Matching registrants who do not use it for 6 months must reregister, primarily to receive a new password and update any of the information provided during the registration. SSNVS requires registrants to change their password once a year to keep it from expiring, which also requires reregistration.

IRS and SSA officials told us that the great majority of users of their respective services generally report that they are not difficult to use for either the registration process or ongoing use. IRS officials said users access TIN Matching voluntarily and that some, particularly from smaller organizations, appear more likely to find it burdensome than users from larger organizations. We found that more than half the employers that provided the AEITC in tax years 2002 through 2004 were small businesses or self-employed and about one-quarter were tax exempt and government entities. In addition, despite IRS's efforts to outreach to large employers, fewer than one-fifth were large and midsize employers (see table 20 in app. III). IRS officials said TIN Matching service users who found the registration process burdensome were generally those who reported to IRS that they were not use to filling out forms on-line and creating and using passwords. The officials also said that some TIN Matching users reported being uncomfortable having to provide personal information to register.

SSA officials said SSNVS is used mostly by larger employers, and a relatively small number of them reported that they found the service burdensome. SSA officials did say, however, that SSA received about 89,000 calls through June 2007 from individuals about registration. And, an SSA official said that small business representatives with whom he has recently spoken expressed frustration with the overall number of tasks that the federal government was already requiring them to perform and, therefore, might be reluctant to verify SSNs.

IRS officials also told us that the TIN Matching service is not programmed to track users, which likely would be useful to IRS for enforcement purposes. Still, IRS officials added, that the service could be modified to track employers that used the services for AEITC purposes and report on

the results. SSNVS tracks its users to determine whether the service is being properly used.

Additional resources: IRS and SSA officials said that if employers were required to begin using their respective services to verify the SSNs of employees seeking the AEITC, the agencies would need additional resources. For example, officials from both agencies cited the need to handle questions from new users, particularly in the first year when all individuals seeking the AEITC would be required to have their names and SSN's matched.⁴⁴

When we told IRS officials that our data showed that about 50,000 employers had at least one AEITC recipient, they said such an increase in the number of registrants could require IRS to increase the number of staff available to answer user questions. But they said they could not estimate how many more staff would be necessary.

IRS officials also said they were trying to make the reregistration process easier because they received a substantial number of calls from users who needed to reregister. This would be important for AEITC-related use of TIN Matching because employers with only one or two employees seeking the AEITC would only need to use the service once or twice a year, making it likely that they would have to reregister.

SSA officials told us that if the agency was considering or was directed to make its SSN records available for the purpose of verifying AEITC eligibility, SSA would have to devote additional resources to conduct a comprehensive assessment to determine the changes necessary to SSNVS to properly achieve this goal, including possibly creating a different service for assessing AEITC eligibility and buying a new database server to handle the increased volume of users. Again, SSA officials could not estimate how many more staff would be necessary.

New federal legislation: Enactment of federal legislation would be needed for employers to begin using the TIN Matching service to verify the

⁴⁴ The higher volume of questions in the first year assumes that employees whose name and SSN matched and who sought the AEITC from the same employer in a subsequent year would not be required to undergo a second match.

SSNs of their employees seeking the AEITC.⁴⁵ In 2000, the Department of the Treasury recommended to the Congress that TIN verification be expanded to include other payers subject to an IRS reporting requirement, such as employers who file Forms W-2.⁴⁶

It is uncertain whether IRS could require employers to use SSNVS to verify the SSNs of employees seeking the AEITC. SSA officials said they would need to determine whether SSA's disclosure of SSN data is compatible with the reason it collected the information and, if so, whether verifying SSNs via SSNVS for purposes of AEITC eligibility is consistent with SSA's legal obligations. Both Treasury and SSA officials said their agencies would strongly prefer enactment of legislation before requiring employer or any verification of SSNs of employees seeking the AEITC.

Employee appeal of mismatch: One difference between using the TIN Matching service or SSNVS would occur when an employee claimed that a name and SSN mismatch was inaccurate. IRS and SSA officials said employees who questioned a SSN mismatch would presumably contact IRS, which would send them to SSA to resolve the issue because the TIN Matching service is based on SSA records. IRS officials said that, in contrast, employees questioning a name and SSN mismatch generated by SSNVS would presumably go directly to SSA.

Agency mission: SSA officials also said that verifying eligibility for the AEITC is most appropriate for IRS because it is a tax administration issue and is therefore outside the scope of SSA's mission. However, it is not unusual for agencies to assist other federal agencies in carrying out their mission. SSA officials also said that, regardless of which service was used, IRS would have full administrative responsibility for overseeing a program for employers to verify AEITC applicants' SSNs.

⁴⁵ Internal Revenue Code Section 6103 prohibits the disclosure of information on tax returns, including SSNs, unless permitted by a specific exception. Because there is no exception for the verification of SSNs by employers, legislation would be needed to use the TIN Matching database for this purpose.

⁴⁶ Office of Tax Policy, U.S. Department of the Treasury, *Scope and Use of Taxpayer Confidentiality and Disclosure Provisions* October 2000. Such a provision was included in S. 1321, 109 Cong. Sec. 509 (2006).

IRS Does Not Require Submission of Forms W-5 from Employers for Employees Seeking the AEITC

IRS does not require employers to submit a Form W-5 when an employee requests receipt of the AEITC. Several advantages and disadvantages exist if IRS creates a Form W-5 database to use in monitoring AEITC noncompliance issues.

IRS could require employers to submit a Form W-5 when an employee requests receipt of the AEITC. In turn, IRS could use the Forms W-5 to create a database to monitor the AEITC. The database could be used to ensure that the SSN provided on the Form W-5 is valid and that it matches the individual's name. Doing such a check could have prevented more than 100,000 individuals from receiving as much as between \$37 million and \$39 million each year in AEITC to which they were potentially not entitled because of not meeting the valid SSN requirement. Such a database could also allow IRS to know which individuals received the AEITC and provide the agency with an opportunity to send recipients a notice at the start of the next filing season reminding them to file a federal tax return. A reminder to file notice could likely reduce noncompliance for up to about 200,000 individuals who received between \$42 million and \$50 million each year in AEITC without filing a federal tax return. Similarly, IRS officials could use a W-5 database to verify other AEITC requirements, such as ensuring that each recipient has only one Form W-5 in effect at a time. This check could reduce the probability that individuals would receive more than the yearly AEITC maximum.

While acknowledging that potential advantages exist to developing and maintaining a Form W-5 database, IRS officials said that the disadvantages could outweigh these and any other advantages. Although IRS officials said it was too early in the proposal process to calculate the database's potential costs and subsequent return on investment, they said it very likely would be substantially lower than the return on investment for either existing or anticipated future noncompliance programs. For example, IRS estimates the current return on investment for EITC Examination noncompliance is between \$17 to \$1 and \$19 to \$1. Although these amounts only include labor and do not include overhead such as facilities, equipment, and supplies, officials felt confident that the EITC return on investment would far exceed that for the AEITC. Their opinion was largely based on the few dollars involved with the AEITC, especially compared to other noncompliance programs.

In addition, IRS officials expressed concerns that employers would not submit Forms W-5 to IRS. Officials raised an analogy between this proposal and the prior Questionable W-4 program.⁴⁷ As we reported in 2003, about 75 percent of the large employers with 1,000 or more employees in IRS's Large and Medium-Size Business and Small Business/Self Employed divisions who filed tax returns in tax year 2001 did not send IRS any questionable Forms W-4.⁴⁸ After our report, IRS discontinued the Questionable W-4 program. Additionally, officials noted that requiring employers to submit Forms W-5 may discourage them from participating because if the employer was notified that the SSN on a Form W-5 was invalid or that it did not match the employee's name, employers would likely have a responsibility to discuss the matter with the employee, creating yet another new burden employers would not want to accept. Finally, employers may not participate because if the employee left the employer during the year, the employer would again have to contact IRS so the Form W-5 database could be updated.

Options to Reduce AEITC Noncompliance May Be Cost Effective

Although we do not know how successful the various options we have identified for improving AEITC compliance may be if implemented or what the full cost of implementation would be, IRS may be able to achieve a return on investment somewhat comparable to that for EITC examinations. We found an average of about \$94 million a year in AEITC noncompliance for recipients in tax years 2002 through 2004.⁴⁹ If a compliance effort could reduce AEITC noncompliance by one-quarter, that is, \$24 million per year, IRS could spend about \$1.3 million each year to do so and achieve a \$19 to \$1 return on investment.⁵⁰ Alternatively, IRS estimated that it would cost about \$533,000 to send soft notices to 300,000 taxpayers during the Dependent Database test. If IRS were to test sending soft notices for AEITC and it cost IRS about the same amount to send notices to 300,000 noncompliant AEITC recipients, IRS would only need to

⁴⁷ The Questionable W-4 program required employers to submit information to IRS on taxpayers who claimed more than 10 withholding allowances or exemptions.

⁴⁸ GAO, *IRS's Questionable Form W-4 Program*, [GAO-04-79R](#) (Washington, D.C.: Nov. 6, 2003).

⁴⁹ The number includes AEITC amounts received by nonfilers, filers who misreported the amount received, and individuals with invalid SSNs.

⁵⁰ This estimate is illustrative only and many variables could affect how successful any compliance effort would be and the cost of implementing an effort.

reduce AEITC noncompliance by about 11 percent (about \$10 million) to achieve a \$19 to \$1 return on investment.

Eligible Taxpayers Could Receive Full EITC Benefits If the Advance Option Were Discontinued

If the advance option were discontinued, eligible AEITC recipients could still receive the full benefits of the EITC as a lump sum after filing their tax return. In addition, improper AEITC payments to ineligible or noncompliant individuals would be eliminated. The exact amount of revenue that could be saved is not known. However, in determining an amount, IRS officials said they would consider the following: the amount of AEITC disbursed compared with the amount shown on filed tax returns, the cost of administering the AEITC (e.g., forms and publications, processing, compliance activities), and any amount currently recovered through compliance activities.

Conclusions

The AEITC has never achieved a significant participation rate, the amount recipients received in the period we reviewed was quite low, and noncompliance was high. However, policymakers may judge that the goal of providing funds to low-income workers during the year, as opposed to a lump sum that they could get as part of the EITC when filing their taxes, remains important and should continue to be allowed. If so, IRS needs to pursue potentially cost-effective measures to address AEITC noncompliance.

Each of the three options we identified for improving AEITC compliance—using soft notices, having up-front verification of AEITC applicants' SSNs by employers, or requiring employers to submit copies of the Form(s) W-5 and creating a database to monitor AEITC—appears to have potential to improve compliance, but their full benefits and costs need to be evaluated and, if possible, tested. Soft notices have improved compliance in other tax programs but they could be somewhat less effective in improving AEITC compliance, in part, due to its high turnover rate. The TIN Matching service and SSNVS have the potential to reduce AEITC noncompliance by enabling employers to verify workers' SSNs before providing them the AEITC. Differences exist between the two services, but either could likely be used for AEITC SSN verification. Both services are based on SSA records that are already deemed accurate enough such that SSA and IRS make decisions based on them to disallow certain exemptions and credits until eligibility has been properly demonstrated. Significant concerns exist, however, such as the need for legislation authorizing either the use of TIN Matching or SSNVS for AEITC. This and other issues would need to be further explored as the costs and

benefits of employers verifying employees' SSNs are fully identified. If IRS required employers to submit copies of the Form W-5 when an employee requests the AEITC, IRS could create a database to better monitor and address all three of the noncompliance problems we analyzed. However, imposing additional responsibilities on employers for both the SSN verification option and the Form W-5 database option have the potential to adversely affect the AEITC's already low participation rate if employers avoid providing the AEITC due to increased responsibilities on their part.

Due to the relatively small size of the AEITC overall, combined with the low dollar amounts per taxpayer, IRS officials are concerned that addressing AEITC noncompliance may provide less return on IRS's enforcement efforts than would addressing other noncompliance issues. However, IRS may be able to achieve returns on AEITC enforcement that would not be significantly out of line with returns on other enforcement work. For example, it cost IRS about \$533,000 to send soft notices to 300,000 taxpayers in the Dependent Database test. If IRS were to test sending soft notices for AEITC and it cost IRS about the same amount to send notices to 300,000 noncompliant AEITC recipients, IRS would need to reduce noncompliance by about 11 percent (about \$10 million) to achieve a \$19 to \$1 return on investment.

Recommendations for Executive Action

The Acting Commissioner of Internal Revenue should analyze whether any of the following options could cost effectively and significantly reduce AEITC noncompliance:

- sending potentially noncompliant AEITC recipients soft notices, such as to nonfilers whose Forms W-2 show that they received AEITC and filers who misreported the amount they received or whose SSN and name do not match;
- requiring employers to verify the SSN of employees seeking AEITC; or
- requiring employers to submit Form W-5 to IRS and IRS creating and maintaining a database for these forms.

To better identify the costs and implementation issues as well as the likelihood for these or other options to reduce AEITC noncompliance, where practical, the Acting Commissioner of Internal Revenue should test these options to make a more fully informed judgment about whether any would be worthwhile.

If the Acting Commissioner of Internal Revenue determines that none of these options would be cost effective and no other remedies are viable,

then the Treasury Secretary should inform the Congress of this and provide Treasury's opinion about whether the AEITC should be retained.

Agency Comments

The Acting Commissioner of Internal Revenue provided written comments in a July 18, 2007 letter. He agreed with our recommendation and outlined the actions IRS would take to address that recommendation, including conducting further analyses and possible testing of proposed options for reducing AEITC noncompliance. He also stated that IRS will conduct its cost-benefit analyses in conjunction with a congressional requirement to study the impact of expanding eligibility of the AEITC to all EITC recipients. We also provided a draft of this report to the Department of the Treasury and SSA and incorporated technical comments where appropriate. SSA emphasized that verifying eligibility for the AEITC is most appropriate for IRS because it is a tax administration issue and therefore outside the scope of SSA's mission.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its date. At that time, we will send copies of this report to the Secretary of the Treasury, the Commissioner of the Social Security Administration, the Acting Commissioner of Internal Revenue, appropriate Congressional committees, and other interested parties. This report is available at no charge on GAO's web site at <http://www.gao.gov>.

If you or your staffs have any questions, please contact me at (202) 512-9110 or brostekm@gao.gov.



Michael Brostek
Director, Tax Issues
Strategic Issues Team

Appendix I: IRS's Implementation of Recommendations from GAO's 1992 Report on the Advance Earned Income Tax Credit

After analyzing IRS's responses to our recommendations in our 1992 Advance Earned Income Tax Credit (AEITC) report, we determined that IRS has implemented five of the six recommendations to the Commissioner of Internal Revenue from our 1992 report on the AEITC and partially implemented the remaining one (see table 8).

Table 8: IRS Implementation of Recommendations from GAO's 1992 Report on the Advance Earned Income Tax Credit

Number	Recommendation	Status	IRS implementation
1	Include information on AEITC in employee outreach materials and programs.	Implemented	Developed publicity materials.
2	Notify taxpayers who receive the Earned Income Tax Credit (EITC) about the advance option.	Implemented	Revised Form W-2 and Notice 797 to contain information on how to apply for the AEITC and developed radio and television announcements on the AEITC.
3	Encourage employers to notify employees who have no income tax withheld of the advance option.	Implemented	Added text to the face of the Form W-4 instructions advising employees to consider the AEITC.
4	Clarify instructions on AEITC in "Circular E, Employer's Tax Guide."	Implemented	Clarified employers' responsibilities and liabilities in advancing the EITC in the 1993 "Circular E, Employer's Tax Guide."
5	Send, to individuals who do not file tax returns, a notice explaining their requirements to file.	Partially Implemented	Included information on the AEITC in a reminder to file notice until 1997 and added a separate AEITC box on Form W-2.
6	Explore ways to identify those individuals who receive the credit advance, but do not report it, so as to prevent them from receiving the credit a second time.	Implemented	Added a line on the Form 1040 for taxpayers to report AEITC received and redesigned the Form W-2.

Source: GAO analysis of IRS data.

Our first recommendation was for the Commissioner of Internal Revenue to include information on AEITC in employee outreach materials and programs. IRS implemented this recommendation primarily by developing publicity materials (i.e., grocery bags, milk carton art, brochures, posters) and distributing them to the public.

For the second recommendation, IRS stated that it did not have the approximately \$2 million in funding that the agency said would have been required to notify all taxpayers who receive the EITC, but did not elect the advance option. Instead, IRS took other actions including revising the Form W-2 in 1992 to contain information on how to apply for the AEITC and IRS Notice 797, "Possible Federal Tax Refund Due to the Earned Income Credit," to include information on how to apply for the AEITC.

For our third recommendation, IRS noted that it could encourage employers to make such notifications, but that there are no statutory sanctions on employers who fail to do so. Beginning in 1992, IRS placed text on the face of the Form W-4 instructions advising employees to consider filing a Form W-5 with their employer to obtain the advance through lower withholding.

For our fourth recommendation to clarify instructions on the AEITC in "Circular E, Employer's Tax Guide" IRS did so through the inclusion of new examples explaining to employers how they should make advance payments to employees and how employers can report these amounts.

Our fifth recommendation was for the IRS Commissioner to send individuals who received the AEITC and do not file tax returns a notice explaining the requirement to file. IRS partially implemented this recommendation by including information on advance payment in a reminder to file notice and adding a separate AEITC box on Form W-2. IRS did not track the number of AEITC nonfilers who received the notice. The reminder to file notice was only sent until 1997 and IRS officials were uncertain why that notice was discontinued.

The last recommendation was for exploring ways to identify those individuals who receive the credit in advance but do not report it. IRS pointed out that its systems were not geared to detecting unreported AEITC payments at the time the returns are processed and the best approach to preventing noncompliance by AEITC payment recipients is a proactive one that recognizes the filing of correct returns. IRS implemented this recommendation by providing a separate line on Form 1040 on which to report AEITC payments and redesigning the Form W-2, for tax year 1993, which it believed would increase the accuracy of the AEITC payment information reported on Form W-2. Our work in this report demonstrates a continuing need to explore additional compliance initiatives aimed at those who receive the AEITC, but do not report it on their tax return.

Appendix II: Scope and Methodology

To answer the first and second objectives:

- how many individuals received the Advance Earned Income Tax Credit (AEITC) compared with the Earned Income Tax Credit (EITC) and how much did they receive in tax years 2002 through 2004; what actions, if any, have been taken to increase use since 1992; and what is the potential for significant increases in the future; and
- what is the extent of noncompliance, if any, associated with the AEITC;

we obtained a data file of all Forms W-2, “Wage and Tax Statement,” for tax years 1999-2004 indicating AEITC payments as shown by an amount greater than \$0 in box 9 of the Form W-2 from the Internal Revenue Service (IRS).¹ We used these tax years because they were the most current available at the time we started our review. The Form W-2 identified key information, including the AEITC recipient’s name, address, Social Security number (SSN), and amount of AEITC dollars paid, as well as the employer’s name and address.

To determine the number of individuals who received the AEITC, we used Forms W-2 instead of tax returns, which IRS has historically used to estimate AEITC use. We used this alternate approach because we believe the Forms W-2 provide results that are more accurate and complete.² For example, using Forms W-2 would include in the population of AEITC recipients those who received AEITC, but did not file a return, and those who filed a return, but did not report any AEITC. Using tax returns would not capture these individuals or related noncompliance issues. In addition, using tax returns counts instances where both spouses receive the AEITC and file jointly on one return as opposed to two individuals. IRS’s Research, Analysis, and Statistics and EITC program office officials agreed with our methodology.

We performed data reliability tests on the data file to determine whether the data were sufficiently reliable for our intended purposes. We did this testing, in part, by conducting preliminary analyses, which identified certain data irregularities or anomalies. We identified two noteworthy

¹The AEITC amount on the Form W-2 is what an employer reported paying to an employee. While this is not necessarily evidence that the employee actually received that amount, IRS considers the Form W-2 the official wage and tax statement and makes adjustments to the tax return based on the Form W-2 when discrepancies exist.

²An individual who had more than one Form W-2 reporting AEITC for a particular year was counted as only one individual and the amount of AEITC paid was totaled.

anomalies in the data file: (1) excessive AEITC dollar amounts and (2) invalid AEITC recipient SSNs. First, many Forms W-2 showed that employees received amounts over the allowable limits. A few even showed individuals each receiving about \$1 million in AEITC—amounts clearly above AEITC legal limits and which IRS officials said would be improbable, potentially resulting from transcription errors. Second, we also found some instances where the SSN and/or name on the Form W-2 were invalid, which means that the number was never issued by SSA or that the name and number on the Form W-2 did not match the listed name for that same SSN in official records maintained by IRS. We compared the number and name information on the Form W-2 to the National Account Profile to evaluate the validity of that information and to identify any possible subsequent corrections.³

To address these data anomalies, we separated the Form W-2 file into four subpopulations using the following three criteria: whether (1) the SSN on the Form W-2 was valid, according to Data Master File (DM-1); (2) the SSN and the recipient's name on the Form W-2 matched, according to DM-1; and (3) the amount of AEITC received was in excess of the yearly maximum.⁴ Each of the subpopulations had a unique profile, as follows:⁵

1. **Valid subpopulation:** This group of Forms W-2 represents all individuals (1) that had a valid SSN, meaning that it was a number issued by SSA, (2) whose name matches the SSN, and (3) that had an AEITC amount within the yearly maximum. More than 75 percent of the Forms W-2 on average during tax years 2002 through 2004 were in this subpopulation.
2. **Invalid name subpopulation:** This group of Forms W-2 represents all individuals that had (1) a valid SSN (2) a SSN that did not match the individual's name and (3) the AEITC amount was within the yearly

³ The National Account Profile incorporates the DM-1 from SSA, which is the primary source file for all SSNs. The National Account Profile also includes additional SSN change information available to IRS to show the most current and complete taxpayer information.

⁴ The AEITC maximum limits for tax years 1999-2004 were: \$1,387, \$1,412, \$1,457, \$1,503, \$1,528, \$1,563, respectively. These amounts are limited if two married individuals both elect the AEITC.

⁵ While each subpopulation contains a unique set of Form W-2s, during tax years 2002-2004 there were 856 Form W-2s that appear in both the valid and invalid name subpopulations. This could occur due to variations in how the name is spelled or reported by the employer and/or due to timing differences in reporting and updating name changes to SSA.

maximum. About 17 percent of the Forms W-2 fell in this subpopulation for each of the 3 years we reviewed.

3. **Invalid number subpopulation:** This group of Forms W-2 represents all Forms W-2 that had an invalid SSN and an AEITC amount that was within the yearly maximum. About 7 percent of the Forms W-2 during tax years 2002 through 2004 were in this population.⁶
4. **Dollar limit subpopulation:** This group of Forms W-2 represents all instances where the AEITC amount was above the yearly maximum, regardless of whether the SSN was invalid or if the individual's name matched the SSN. This represented less than 1 percent on average of all Forms W-2 in each of the 3 years we reviewed. Because IRS officials told us these data were likely erroneous, we excluded it from most of our analyses, and IRS officials agreed.

Table 9: Number of Forms W-2, Number of Individuals, and the Dollars for Each Subpopulation, Tax Years 2002 through 2004

	Tax year 2002			Tax year 2003			Tax year 2004		
	Number of Forms W-2	Number of individuals	Dollars	Number of Forms W-2	Number of individuals	Dollars	Number of Forms W-2	Number of individuals	Dollars
Valid subpopulation (percentage)	488,007 (74%)	418,774 (78%)	\$107,230,369 (57%)	463,285 (76%)	398,526 (79%)	\$106,075,016 (70%)	469,234 (76%)	398,335 (78%)	\$111,098,330 (68%)
Invalid name subpopulation (percentage)	114,819 (17%)	80,524 (15%)	\$25,734,033 (14%)	101,646 (17%)	74,234 (15%)	\$25,480,158 (17%)	101,140 (16%)	77,747 (15%)	\$26,819,235 (16%)
Invalid number subpopulation (percentage)	49,432 (8%)	32,501 (6%)	\$11,582,604 (6%)	44,244 (7%)	30,622 (6%)	\$11,650,727 (8%)	43,696 (7%)	31,875 (6%)	\$12,166,702 (7%)
Dollar limit subpopulation (percentage)	6,408 (1%)	6,360 (2%)	\$43,703,747 (23%)	2,692 (less than 1%)	2,677 (1%)	\$7,486,726 (5%)	2,768 (less than 1%)	2,757 (1%)	\$12,917,134 (8%)
Total	658,666	538,159	\$188,250,753	611,867	506,059	\$150,692,627	616,838	510,714	\$163,001,401

Source: GAO analysis of IRS data.

Note: Percentages may not add due to rounding.

⁶ Because the SSN was invalid, it is not possible to determine whether the individual's name matched.

We conducted additional data reliability tests for each of the databases we used to obtain information about the AEITC, including IRS's Individual Returns Transaction File, for return and filing information, which came from the Compliance Data Warehouse; National Account Profile/DM-1, for IRS's SSN and name reference information, which also came from the Compliance Data Warehouse; Automated Underreporter (AUR), for IRS's third-party information return data; and Taxpayer Identification Number (TIN) Matching and SSA's Social Security Number Verification System (SSNVS), for alternative SSN and name reference information used by employers.⁷ After completing our data reliability assessments, we determined the AEITC data to be sufficiently reliable for analysis and our reporting objectives.

We also developed a comprehensive analysis plan that included our researchable issues, planned analysis, data sources, and limitations. We shared our plan with IRS and others and incorporated their feedback. Because IRS's workload precluded them from providing information related to employers/AEITC payers within our time frames, we were able to conduct only limited analyses of employers who paid AEITC.

Using the analysis plan for each subpopulation, we conducted multiple analyses to develop relevant demographic, characteristic, and compliance data. Because each population had different criteria, certain characteristics or compliance data could not be developed or compared across the subpopulations. For example, the only characteristics data that could be developed for the invalid SSN subpopulation came from the Form W-2 (e.g., amount of AEITC, geographic location) because it is the only available source. Similarly, tax return data, such as filing status, was not available for those who did not file a tax return.

All data pertaining to filed tax returns came either from returns that reported receipt of the AEITC on the appropriate line or from a "constructed tax return," which IRS officials created using the SSN on the Form W-2 and matching it to an SSN in the primary, secondary, or dependent position on a filed return. The location of the SSN in one of these positions is relevant due to the way IRS manages its data files. There could be instances when a tax return was filed but it was not detected using our methodology. For example, a taxpayer's SSN on the Form W-2

⁷ The Compliance Data Warehouse houses excerpts of data from various IRS systems for easy retrieval.

might have been incorrect and the taxpayer reported the correct number on the tax return (Form 1040).

To report on data pertaining to the EITC, we relied on published EITC data provided by IRS research and program office officials, including the EITC database, the EITC Database Year to Year Comparison Report, and EITC Fact Sheet.⁸ When possible, our analysis compares individuals who received the AEITC with individuals who received the EITC. IRS defines EITC recipients by the number of federal tax returns that received EITC. In addition, EITC data are based upon the primary TIN of all taxpayers who received an amount of EITC. We determined the number of individuals who receive the AEITC based on the number of Forms W-2 reporting AEITC per unique SSN. IRS officials agreed that even though these populations are not identical, it is reasonable to make a comparison between them.

We frequently consulted with IRS officials on the data and our analyses; they generally agreed with both the approach and the accuracy of the results. For the analyses that IRS conducted, we agreed with both the approach and the accuracy of the results.

In addition, we reviewed legislative and IRS administrative changes to the AEITC since 1992 and discussed them with IRS and other officials, including Department of the Treasury officials. We reviewed reports on IRS's implementation of some of our prior recommendations pertaining to the EITC and discussed them with IRS officials, including the National EITC Director. We also coordinated this work with the Treasury Inspector General for Tax Administration.

Finally, we also identified and interviewed 11 individuals we determined to be experts to provide us a fuller understanding on the potential for significant increases or improvement to AEITC use and noncompliance and included academics, researchers, practitioners, and individuals representing the areas of tax policy, low-income individual issues, and

⁸ The EITC Database is an extraction of EITC data from IRS's Individual Returns Transaction File. The database is located on the Compliance Data Warehouse. These data met our reliability standards.

compliance issues.⁹ We chose these individuals based on our knowledge of their areas of expertise and our research that indicated they were knowledgeable about the EITC.

To address the third objective, how well do IRS's procedures address any areas of noncompliance, we examined portions of IRS's Internal Revenue Manual and interviewed IRS Wage and Investment and Small Business/Self-Employed division officials to determine procedures for processing returns that reported receipt of the AEITC. We examined how IRS's enforcement procedures and operations, including Submission Processing, AUR, Nonfiler, Collection, Examination, Criminal Investigation, and Taxpayer Advocate, address certain kinds of potential noncompliance.

We explored various options to improve AEITC compliance. This involved conducting literature searches and interviews with IRS and SSA officials. We reviewed and discussed the results of soft notice tests with IRS officials, including the National EITC Director, and discussed the applicability of soft notices for addressing AEITC noncompliance. We also reviewed and analyzed documents and reports about IRS, SSA, and Department of Homeland Security databases about whether they could be used by employers to verify the SSN of an employee seeking the AEITC before the employer begins paying it. We also interviewed knowledgeable officials at IRS and SSA about the advantages and disadvantages of such systems when considering the AEITC. Further, we interviewed IRS officials from various offices, such as EITC Program, Modernization and Information Technology Services, and Stakeholders, Partnership, Education and Communication, about the advantages and disadvantages of creating a database for the Forms W-5. It was not within the scope of our work to fully evaluate the potential cost and benefits of these options for reducing noncompliance.

We also reviewed prior GAO, IRS, Treasury Inspector General for Tax Administration, and other reports on the AEITC and EITC.

⁹We spoke with Leonard Burman, Urban Institute; Leslie Book, Villanova University School of Law; Jonathan Forman, University of Oklahoma College of Law; William Gale, The Brookings Institution; Robert Greenstein, Center on Budget and Policy Priorities; Teresa Hinze, Community Tax Aid, Inc.; Julie Kruse, Center for Economic Progress; Diana Leyden, University of Connecticut School of Law; David Marzahl, Center for Economic Progress; John Karl Scholz, University of Wisconsin Department of Economics; and Eugene Steuerle, Urban Institute.

We conducted our work primarily in Washington, D.C., and Atlanta, Ga., from December 2005 through July 2007 in accordance with generally accepted government auditing standards.

Appendix III: Demographic Characteristics of Advance Earned Income Tax Credit Recipients and Their Employers

We identified basic demographic characteristics of Advance Earned Income Tax Credit (AEITC) recipients and their employers in tax years 2002 through 2004. Specifically, we identified the following 11 characteristics: (1) number of Forms W-2 received; (2) average amount of AEITC received by consecutive recipients; (3) average adjusted gross income (AGI) for AEITC recipients; (4) average wages; (5) filing status; (6) age; (7) gender; (8) number of qualifying children; (9) filing method; (10) geographic location of AEITC recipients; and (11) employer size, number of employees, and number of Forms W-2 with AEITC issued to employees. Each of the characteristics represents an analysis and provides additional objective information about AEITC recipients not previously discussed. Where possible, we compared AEITC recipients to Earned Income Tax Credit (EITC) recipients. Further analyses may provide information to better target IRS enforcement efforts. For example, IRS's information on EITC associated with gender differs from our AEITC results in table 17 on gender.

The characteristics are organized by a declining AEITC population size. For example, table 10, "Number of Forms W-2 Received by Subpopulation, Tax Years 2002 through 2004," includes the valid, the invalid name, and invalid number subpopulations, as described in the scope and methodology (see app. II), while table 15, "Filing Status of AEITC and EITC Recipients, Number and Percentage, Tax Years 2002 through 2004," includes only the valid and invalid name subpopulations. The invalid number subpopulation was not included in the table about filing status because that subpopulation contains only Form W-2 data and not tax return data. Thus, information such as filing status, which comes from the tax return, is not available.

Number of Forms W-2 with AEITC that each individual received: Most individuals who received the AEITC only had one Form W-2 reporting its receipt (see table 10). Having more than one Form W-2 does not necessarily indicate noncompliance because an individual may have more than one job during the year and receive the AEITC from more than one employer. The data did not enable us to analyze whether any of these individuals had more than one Form W-5 in effect at one time. Presently, IRS's administrative procedures do not enable it to identify whether the taxpayer has more than one Form W-5 in effect at one time.

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Table 10: Number of Forms W-2 Received by Subpopulation, Tax Years 2002 through 2004

Number of Forms W-2	Tax year 2002		
	Valid subpopulation	Invalid name subpopulation	Invalid number subpopulation
1	370,350	59,660	22,812
2	35,821	13,275	6,233
3	8,056	4,438	1,954
4	2,671	1,829	874
5	1,040	704	332
6	408	327	142
7	202	138	74
8	109	65	37
9	48	32	10
10	33	18	7
11	16	11	7
12	5	8	3
13	4	7	4
14	2	1	1
15	2	3	1
16	2	0	2
17	2	2	1
18	2	1	0
19	1	1	2
20	0	1	1
21	0	0	0
22	0	0	0
23	0	0	2
25	0	1	0
26	0	0	0
27	0	1	0
28	0	0	1
30	0	0	0
31	0	0	0
33	0	1	0
34	0	0	0
38	0	0	0
643	0	0	0

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Tax year 2003			Tax year 2004		
Valid subpopulation	Invalid name subpopulation	Invalid number subpopulation	Valid subpopulation	Invalid name subpopulation	Invalid number subpopulation
353,284	56,863	22,474	349,544	62,422	24,853
33,440	11,599	5,424	35,518	10,515	4,776
7,645	3,514	1,660	8,568	3,040	1,452
2,417	1,299	600	2,735	1,078	483
907	512	259	1,032	382	187
394	238	94	410	149	57
196	99	41	258	77	27
104	38	22	107	33	13
63	18	17	65	17	8
33	22	6	42	8	4
17	5	4	19	5	5
14	6	5	19	4	1
6	5	5	8	1	2
5	2	3	2	0	0
1	3	1	1	3	1
0	3	1	1	5	0
0	3	1	0	1	0
0	2	0	2	1	0
0	0	0	0	0	1
0	0	1	2	3	1
0	0	0	0	1	0
0	0	0	1	0	1
0	1	0	0	0	0
0	0	0	1	1	0
0	0	1	0	0	1
0	1	0	0	0	0
0	0	1	0	0	0
0	1	0	0	0	0
0	0	1	0	0	0
0	0	0	0	0	0
0	0	0	0	0	0
0	0	0	0	1	0
0	0	0	0	0	1
0	0	1	0	0	0

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Number of Forms W-2	Tax year 2002		
	Valid subpopulation	Invalid name subpopulation	Invalid number subpopulation
935	0	0	1
1088	0	0	0
Totals	418,774	80,524	32,501

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Tax year 2003			Tax year 2004		
Valid subpopulation	Invalid name subpopulation	Invalid number subpopulation	Valid subpopulation	Invalid name subpopulation	Invalid number subpopulation
0	0	0	0	0	0
0	0	0	0	0	1
398,526	74,234	30,622	398,335	77,747	31,875

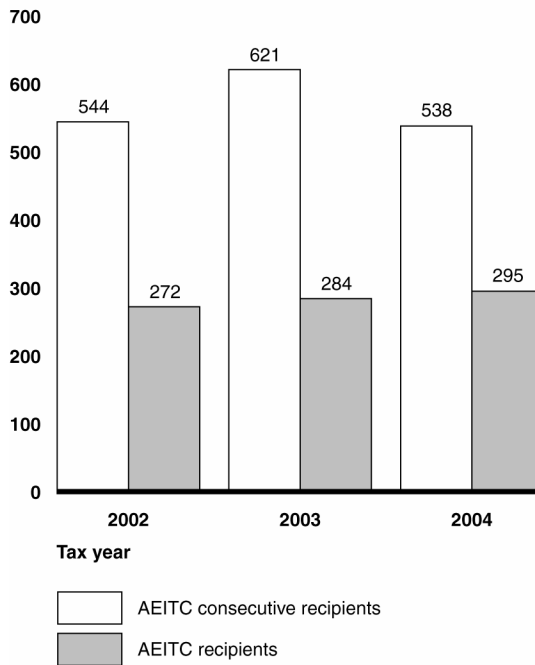
Source: GAO analysis of IRS data.

Note: This table includes the valid, invalid name, and invalid number subpopulations. About 20 percent of the combined invalid name and invalid number subpopulations were noncompliant (see table 4).

Average amount of AEITC received by consecutive recipients:
About 98,000 individuals received the AEITC consecutively during tax years 2002 through 2004. These 98,000 individuals received a higher average amount of AEITC than the entire AEITC population (see fig. 6).

Figure 6: Average Amount of AEITC Received by Consecutive and AEITC Recipients, Tax Years 2002 through 2004

Average amount of AEITC received (in dollars)



Source: GAO analysis of IRS data.

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Note: This figure includes the valid, invalid name, and invalid number subpopulations.

Adjusted gross income (AGI) for AEITC and EITC recipients: The maximum amount of AGI a taxpayer could have in tax years 2002 through 2004 and receive the AEITC and/or EITC was \$34,178, \$34,692 and \$35,458, respectively. As noted in tables 11, 12, and 13, most individuals who received the AEITC and filed a tax return reported an AGI of \$1—\$20,000. Some taxpayers had an AGI above the allowable limits. However, because an individual’s personal circumstance may have changed during the year, for example the individual may have gotten a higher paying job, as long as the same amount of AEITC received as shown on the Form W-2 was reported on the tax return, AGI outside the limit for AEITC recipients is permissible and the taxpayer is considered compliant. By reporting the correct amount on the tax return, the AEITC would increase the tax due or reduce any refund.

Table 11: AGI for AEITC and EITC Recipients, Number, Average, and Sum, for Tax Year 2002

	Tax year 2002								
	AEITC			EITC					
	Valid subpopulation			Invalid name subpopulation					
Adjusted Gross income	Number	Average	Sum	Number	Average	Sum	Number	Average	Sum
Less than or equal to \$0 ^a	2,328	-\$4,602	-\$10,713,330	851	-\$38,560	-\$32,814,646	135,881	-\$40,267	-\$5,471,560,820
\$1 - \$10,000	97,641	\$5,459	\$533,029,760	7,946	\$5,363	\$42,617,768	7,360,626	\$5,905	\$43,461,774,192
\$10,001 - \$20,000	92,795	\$14,768	\$1,370,422,047	9,236	\$14,920	\$137,799,876	7,238,561	\$14,676	\$106,230,907,584
\$20,001 - \$30,000	51,787	\$24,053	\$1,245,652,310	7,867	\$24,847	\$195,471,529	5,395,193	\$24,549	\$132,448,552,653
Greater than \$30,000	38,765	\$56,298	\$2,182,391,376	33,625	\$88,847	\$2,987,478,924	788,562	\$31,806	\$25,081,179,444
Total	283,316	\$18,780	\$5,320,782,163	59,525	\$55,952	\$3,330,553,451	20,918,823	\$14,425	\$301,750,853,053

Source: GAO analysis of IRS data.

^aNegative dollar amounts are possible with an AGI less than or equal to \$0 because these returns likely have eligible deductions (such as alimony payments) that exceed the AGI amount, thus resulting in a negative AGI. This table includes the valid and invalid name subpopulations.

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Table 12: AGI for AEITC and EITC Recipients, Number, Average, and Sum, for Tax Year 2003

Adjusted gross income	Tax year 2003								
	AEITC						EITC		
	Valid subpopulation			Invalid name subpopulation			Number	Average	Sum
Number	Average	Sum	Number	Average	Sum				
Less than or equal to \$0 ^a	1,402	-\$8,980	-\$12,589,922	790	-\$82,807	-\$65,417,790	159,145	-\$37,491	-\$5,966,471,268
\$1 - \$10,000	89,053	\$5,485	\$488,423,673	7,115	\$5,369	\$38,201,515	7,497,336	\$5,895	\$44,194,704,408
\$10,001 - \$20,000	86,420	\$14,768	\$1,276,286,596	8,436	\$14,899	\$125,687,374	7,340,828	\$14,611	\$1,072,555,29,694
\$20,001 - \$30,000	50,197	\$24,168	\$1,213,157,369	7,290	\$24,794	\$180,748,114	5,498,853	\$24,634	\$135,457,333,696
Greater than \$30,000	38,894	\$57,039	\$2,218,488,004	30,991	\$94,505	\$2,928,794,298	935,215	\$31,988	\$29,915,739,209
Total	265,966	\$19,490	\$5,183,765,720	54,622	\$58,731	\$3,208,013,511	21,431,377	\$14,505	\$107,255,529,694

Source: GAO analysis of IRS data.

^aNegative dollar amounts are possible with an AGI less than or equal to \$0 because these returns likely have eligible deductions (such as alimony payments) that exceed the AGI amount, thus resulting in a negative AGI. This table includes the valid and invalid name subpopulations.

Table 13: AGI for AEITC and EITC Recipients, Number, Average, and Sum, for Tax Year 2004

Adjusted gross income	Tax year 2004								
	AEITC						EITC		
	Valid subpopulation			Invalid name subpopulation			Number	Average	Sum
Number	Average	Sum	Number	Average	Sum				
Less than or equal to \$0 ^a	641	-\$22,631	-\$14,506,202	686	-\$61,661	-\$42,299,493	177,820	-\$28,625	-\$5,090,160,585
\$1 - \$10,000	86,180	\$5,578	\$480,670,518	6,988	\$5,391	\$37,671,007	7,497,833	\$5,896	\$44,206,887,726
\$10,001 - \$20,000	83,792	\$14,716	\$1,233,045,113	8,270	\$14,914	\$123,334,680	7,355,688	\$14,562	\$107,113,059,413
\$20,001 - \$30,000	49,165	\$24,204	\$1,189,979,660	7,139	\$24,846	\$177,374,704	5,519,610	\$24,710	\$136,390,977,111

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Tax year 2004										
	AEITC						EITC			
	Valid subpopulation			Invalid name subpopulation						
Adjusted gross income	Number	Average	Sum	Number	Average	Sum	Number	Average	Sum	
Greater than \$30,000	34,225	\$54,623	\$1,869,459,016	32,638	\$101,396	\$3,309,361,834	1,170,267	\$32,204	\$37,687,855,307	
Total	254,003	12,735	\$4,758,648,105	55,721	\$64,705	\$3,605,442,732	21,721,218	\$14,746	\$320,308,618,972	

Source: GAO analysis of IRS data.

*Negative dollar amounts are possible with an AGI less than or equal to \$0 because these returns likely have eligible deductions (such as alimony payments) that exceed the AGI amount, thus resulting in a negative AGI. This table includes the valid and invalid name subpopulations.

Wages for AEITC and EITC recipients: The yearly wage limits for AEITC and EITC recipients were \$34,178 for tax year 2002, \$34,692 for tax year 2003, and \$35,458 for tax year 2004. The average wages for AEITC recipients in the valid subpopulation were about \$18,000, while they were about \$47,000 for the invalid name subpopulation.¹ This compares with about \$13,000 for EITC recipients (see table 14). Some wages are outside the allowable limits. However, because an individual's personal circumstance may have changed during the year, for example, the individual may have gotten a higher paying job, as long as the same amount of AEITC received as shown on the Form W-2 was reported on the tax return, wages outside the limit are permissible and the taxpayer is considered compliant. By reporting the correct amount on the tax return, the AEITC would increase the tax due or reduce any refund.

¹ The large difference in wages between the AEITC valid and invalid name subpopulations could be a result of women who married during the year and changed their name with their employer, but not SSA. These women likely reported combined wages with their spouse.

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Table 14: Wages Reported for AEITC and EITC Recipients, Number, Wage Amount, and Average Dollars Received for Tax Years 2002 through 2004

Tax year	AEITC						EITC		
	Valid subpopulation			Invalid name subpopulation			Number	Wage amount	Average
	Number	Wage amount	Average	Number	Wage amount	Average			
2002	283,316	\$4,926,169,548	\$17,388	59,525	\$2,696,220,392	\$45,296	20,918,823	\$273,167,081,421	\$13,058
2003	265,966	\$4,829,307,231	\$18,158	54,622	\$2,545,765,228	\$46,607	21,431,377	\$280,828,962,882	\$13,104
2004	254,003	\$4,409,967,145	\$17,362	55,721	\$2,759,417,493	\$49,522	21,721,218	\$290,119,218,681	\$13,356

Source: GAO analysis of IRS data.

Notes: This table includes the valid and invalid name subpopulations.

Filing status of AEITC and EITC recipients: As shown in table 15, about half of AEITC recipients in the valid subpopulation and most individuals who received the EITC used the Head of Household filing status. This compares to AEITC recipients in the invalid name subpopulation who most frequently used the Married Filing Jointly filing status. About 2 percent of the tax returns that reported receiving AEITC used the Married Filing Separate filing status, which is not allowed. However, an individual's personal circumstance may have changed during the year, for example the individual may have separated from their spouse. As long as the same amount of AEITC received as shown on the Form W-2 was reported on the tax return, this situation is permissible and the taxpayer is considered compliant. By reporting the correct amount on the tax return, the AEITC would increase the tax due or reduce any refund.

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Table 15: Filing Status of AEITC and EITC Recipients, Number and Percentage, Tax Years 2002 through 2004

	Tax year 2002		
	AEITC		EITC
	Valid subpopulation	Invalid name subpopulation	
Head of household	140,021 (49%)	11,180 (19%)	11,326,654 (54%)
Single	77,347 (27%)	13,457 (23%)	4,495,201 (21%)
Married filing jointly	60,153 (21%)	33,837 (57%)	5,068,608 (24%)
Married filing separate	5,546 (2%)	988 (2%)	3,042 (less than 1%)
Widow(er) with children	180 (less than 1%)	40 (less than 1%)	25,318 (less than 1%)
Married filing separate (with spouse not required to file)	69 (less than 1%)	23 (less than 1%)	N/A
Total	283,316	59,525	20,918,823

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Tax year 2003			Tax year 2004		
AEITC		EITC	AEITC		EITC
Valid subpopulation	Invalid name subpopulation		Valid subpopulation	Invalid name subpopulation	
133,985 (50%)	10,255 (19%)	11,532,582 (54%)	134,964 (53%)	10,551 (19%)	11,659,521 (54%)
68,795 (26%)	12,355 (23%)	4,681,467 (22%)	63,685 (25%)	12,606 (23%)	4,914,789 (23%)
58,133 (22%)	31,043 (57%)	5,190,469 (24%)	51,053 (20%)	31,633 (57%)	5,119,517 (24%)
4,815 (2%)	903 (2%)	0 (0%)	4,052 (2%)	862 (2%)	0 (0%)
187 (less than 1%)	42 (less than 1%)	26,859 (less than 1%)	193 (less than 1%)	52 (less than 1%)	27,391 (less than 1%)
51 (less than 1%)	24 (less than 1%)	N/A	56 (less than 1%)	17 (less than 1%)	N/A
265,966	54,622	21,431,377	254,003	55,721	21,721,218

Source: GAO analysis of IRS data.

Notes: EITC totals are the number of taxpayers who received EITC. N/A means not applicable. This table includes the valid and invalid name subpopulations.

Age of AEITC and EITC recipients: Most individuals who received the AEITC, as well as most EITC recipients, were between the ages of 26 and 64 (see table 16). IRS officials noted that recipients whose age fell into the ‘Over 100’ category are the result of a probable error, such as a transcription error. Alternatively, an AEITC recipient in this category may have used a SSN of a deceased individual.

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Table 16: Age of AEITC and EITC Recipients, Tax Years 2002 through 2004

	Tax year 2002		
	AEITC		EITC
	Valid subpopulation	Invalid name subpopulation	
Age 25 and under	82,810 (20%)	29,010 (36%)	3,259,332 (16%)
Age 26 to 64	333,519 (80%)	31,202 (39%)	17,345,338 (83%)
Age 65 to 100	2,409 (1%)	14,275 (18%)	242,838 (1%)
Over 100	35 (less than 1%)	6,037 (8%)	71,315 (less than 1%)
Total	418,773	80,524	20,918,823

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Tax year 2003			Tax year 2004		
AEITC		EITC	AEITC		EITC
Valid subpopulation	Invalid name subpopulation		Valid subpopulation	Invalid name subpopulation	
78,215 (20%)	26,035 (35%)	3,289,587 (15%)	77,096 (19%)	26,499 (34%)	3,348,578 (15%)
317,997 (80%)	29,300 (40%)	17,613,301 (82%)	318,683 (80%)	31,908 (41%)	17,844,506 (82%)
2,278 (less than 1%)	13,033 (18%)	261,347 (1%)	2,514 (1%)	13,270 (17%)	274,428 (1%)
35 (less than 1%)	5,866 (8%)	267,142 (1%)	42 (less than 1%)	6,070 (8%)	253,706 (1%)
398,525	74,234	21,431,377	398,335	77,747	21,721,218

Source: GAO analysis of IRS data.

Notes: This table includes the valid and invalid name subpopulations. IRS calculated age by subtracting the birth year from the analysis year. Neither IRS nor GAO could identify why the tax years 2002 and 2003 AEITC valid Forms W-2 SSN total is one below the total number of individuals who received a Form W-2 reporting AEITC.

Gender of AEITC and EITC recipients: More males than females received the AEITC during tax years 2002 through 2004. In contrast, more females than males received the EITC during this same period (see table 17).

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Table 17: Gender of AEITC and EITC Recipients, Number and Percentage, Tax Years 2002 through 2004

	Tax year 2002		
	AEITC		EITC
	Valid subpopulation	Invalid name subpopulation	
Female	165,694 (40%)	36,805 (46%)	11,087,655 (53%)
Male	252,922 (60%)	39,908 (50%)	9,822,392 (47%)
Unknown	158 (less than 1%)	3,811 (5%)	8,776 (less than 1%)
Total	418,774 (100%)	80,524 (100%)	20,918,823 (100%)

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Tax year 2003			Tax year 2004		
AEITC		EITC	AEITC		EITC
Valid subpopulation	Invalid name subpopulation		Valid subpopulation	Invalid name subpopulation	
159,681 (40%)	34,019 (46%)	11,277,324 (53%)	165,480 (42%)	35,904 (46%)	11,525,243 (53%)
238,683 (60%)	36,762 (50%)	10,148,364 (47%)	232,690 (58%)	38,472 (49%)	10,190,319 (47%)
162 (less than 1%)	3,453 (5%)	5,689 (less than 1%)	165 (less than 1%)	3,371 (4%)	5,656 (less than 1%)
398,526 (100%)	74,234 (100%)	21,431,377 (100%)	398,335 (100%)	77,747 (100%)	21,721,218 (100%)

Source: GAO analysis of IRS data.

Notes: This table includes the valid and invalid name subpopulations. We reported gender information only for individuals who filed a federal tax return. Percentages may not add due to rounding.

Number of qualifying children for AEITC and EITC recipients:

About half of the individuals who reported receiving the AEITC had two qualifying children. Results were similar for EITC recipients. However, about 8 percent of this population did not report having any qualifying children, which is not allowed (see table 18). However, an individual's personal circumstance may have changed during the year, for example, the individual may have separated from their spouse or divorced. As long as the same amount of AEITC received as shown on the Form W-2 was reported on the tax return, the taxpayer is considered compliant. By reporting the correct amount on the tax return, the AEITC would increase the tax due or reduce any refund. In contrast, most individuals who received the EITC also had two qualifying children. There is no qualifying child requirement to receive the EITC.

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Table 18: Number of Qualifying Children for AEITC and EITC Recipients, Number and Percentage, Tax Years 2002 through 2004

	Tax year 2002		Tax year 2003		Tax year 2004	
	AEITC	EITC	AEITC	EITC	AEITC	EITC
Number of taxpayers with no qualifying children (percentage)	7,946 (8%)	3,765,072 (18%)	7,456 (7%)	4,022,684 (19%)	7,786 (8%)	4,181,382 (19%)
Number of taxpayers with 1 qualifying child (percentage)	43,066 (41%)	8,198,533 (39%)	43,129 (41%)	8,269,050 (39%)	40,379 (40%)	8,354,539 (38%)
Number of taxpayers with 2 qualifying children (percentage)	53,721 (51%)	8,955,218 (43%)	55,558 (52%)	9,139,643 (43%)	52,448 (52%)	9,185,297 (42%)
Total (percentage)	104,733 (100%)	20,918,823 (100%)	106,143 (100%)	21,431,377 (100%)	100,613 (100%)	21,721,218 (100%)

Source: GAO analysis of IRS data.

Note: This table is based on the number of tax returns in the EITC database that had AEITC greater than \$0 and zero, one, or two qualifying children.

Filing method of AEITC and EITC recipients: As noted in table 19, most tax returns that showed receiving an amount of AEITC were filed electronically, as were most tax returns which reported receipt of the EITC. For both AEITC and EITC, about 70 percent of recipients filed electronically for the 3 years we examined.

Table 19: Filing Method of AEITC and EITC Recipients, Number and Percentage, Tax Years 2002 through 2004

	Tax year 2002		Tax year 2003		Tax year 2004	
	AEITC	EITC	AEITC	EITC	AEITC	EITC
Electronic	93,291 (68%)	14,030,564 (67%)	100,085 (72%)	15,322,251 (71%)	98,592 (78%)	16,269,437 (75%)
Paper	44,477 (32%)	6,888,259 (33%)	38,885 (28%)	6,109,126 (29%)	28,228 (22%)	5,451,781 (25%)
Total	137,768 (100%)	20,918,823 (100%)	138,970 (100%)	21,431,377 (100%)	126,820 (100%)	21,721,218 (100%)

Source: GAO analysis of IRS data.

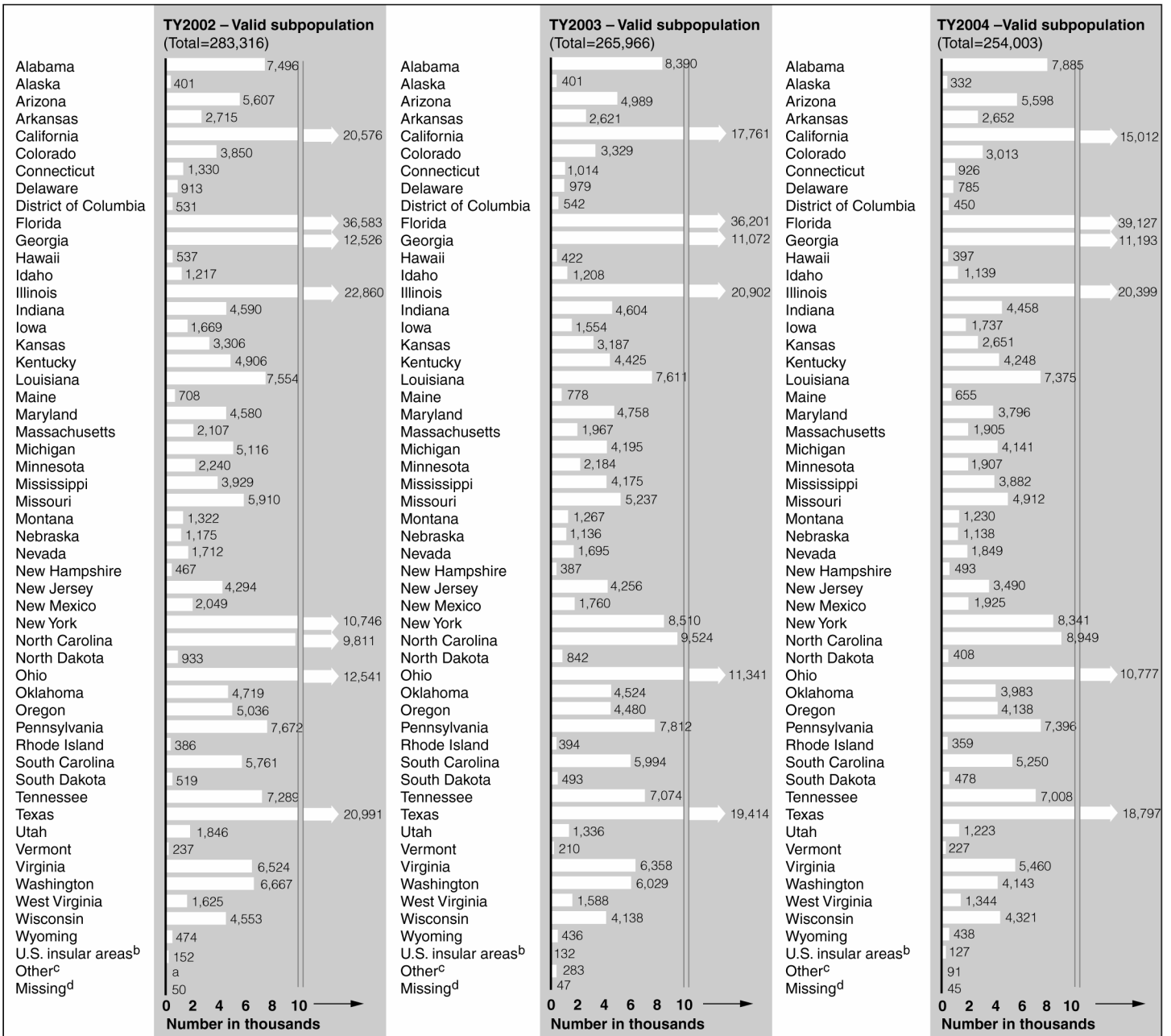
Note: Tax years 2002 and 2003 include 5 and 4 duplicate Taxpayer Identification Numbers (TIN), respectively. The AEITC totals shown above do not equal the total number of individuals who filed a federal tax return for that year. This table only includes the number of tax returns that had an AEITC amount greater than \$0. IRS did not identify the filing method used by individuals who filed a tax return but failed to report receipt of the AEITC. The total number of individuals who filed a federal tax return was 338,942, 316,959, and 307,251, for tax years 2002 through 2004 respectively. The EITC total represents the total number of taxpayers claiming EITC.

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Geographic location of AEITC recipients in the valid subpopulation: Of the individuals in the valid subpopulation, use of the AEITC varied widely across the country. In all 3 tax years, Florida and Illinois had the most AEITC recipients (see fig. 7).

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

Figure 7: Geographic Location of AEITC Recipients in the Valid Subpopulation, Tax Years 2002 through 2004



Source: GAO analysis of IRS data.

Note: AEITC geographic location is based upon information reported on the tax return. This figure includes the valid subpopulation.

^aThese geographic locations had at least 1 but fewer than 10 individuals who received the AEITC.

**Appendix III: Demographic Characteristics of
Advance Earned Income Tax Credit
Recipients and Their Employers**

^bU.S. insular areas include the three major U.S. territories, which are the U.S. Virgin Islands, American Samoa, Guam, and the two Commonwealths, which are the Commonwealth of Puerto Rico and the Commonwealth of Northern Mariana Islands.

^cOther includes Federated States of Micronesia, Marshall Islands, Palau, and Armed Forces mostly located outside the U.S.

^dMissing refers to instances where the geographic location was not available.

Employer size, number of employers, number of forms W-2 employers issued to AEITC recipients and Total AEITC Dollars Reported on Forms W-2: Slightly more than 50,000 employers reported paying at least one employee AEITC in each tax years 2002 through 2004. Most of these employers were classified by IRS as small business/self employed and they issued more than half of all the Forms W-2 with AEITC (see table 20).

Table 20: Employer Size, Number of Employers, Number of Forms W-2 Employers Issued to AEITC Recipients and Total Dollars Reported on Forms W-2, Tax Years 2002 through 2004

Employer size	Tax Year 2002			Tax Year 2003			Tax Year 2004		
	Number of employers	Number of Forms W-2 issued with AEITC	Total AEITC Dollars Reported on Forms W-2	Number of employers	Number of Forms W-2 issued with AEITC	Total AEITC Dollars Reported on Forms W-2	Number of employers	Number of Forms W-2 issued with AEITC	Total AEITC Dollars Reported on Forms W-2
Small business/self employed	30,004 (57%)	368,112 (56%)	\$72,779,073 (50%)	29,562 (57%)	347,942 (57%)	\$73,120,770 (51%)	30,296 (59%)	351,710 (57%)	\$77,689,921 (52%)
Tax exempt and government entities	13,416 (26%)	62,869 (10%)	\$29,103,769 (20%)	12,976 (25%)	57,856 (10%)	\$25,830,428 (18%)	12,609 (24%)	45,301 (7%)	\$24,715,548 (16%)
Large and midsize business	9,058 (17%)	227,029 (35%)	\$42,551,520 (29%)	8,715 (17%)	202,459 (33%)	\$43,615,497 (30%)	8,517 (17%)	219,684 (36%)	\$47,612,524 (32%)
Unknown or unidentifiable	89 (less than 1%)	656 (less than 1%)	\$112,644 (less than 1%)	174 (less than 1%)	3,610 (1%)	\$639,206 (less than 1%)	72 (less than 1%)	143 (less than 1%)	\$66,274 (less than 1%)
Totals	52,567	658,666	\$144,547,006	51,427	611,867	\$143,205,901	51,494	616,838	\$150,084,267

Source: GAO analysis of IRS data.

Note: Employers are defined by unique Employer Identification Numbers (EIN) and the classification of employer size is based on IRS criteria. Number of employers includes the valid, invalid name, and invalid number subpopulations. Number of Forms W-2 issued with AEITC includes all Forms W-2 issued that year reporting an amount of AEITC. Percentages may not add due to rounding.

Appendix IV: Administrative and Legislative Changes to the Advance Earned Income Tax Credit Since 1990

IRS has made several administrative changes to the Advance Earned Income Tax Credit (AEITC) since the beginning of 1990 (see table 21). IRS described these changes in responses to recommendations in our 1992 AEITC report and a 2003 Treasury Inspector General for Tax Administration report.¹

Table 21: Administrative Changes to the AEITC since 1990

Year	Change
1990	Added separate lines to the 1990 Forms 1040 and 1040A for reporting AEITC received.
1991	Revised Form W-4 to advise employees of the availability of the AEITC and to refer them to the Form W-5.
1991-1992	Revised Form W-2 and IRS Notice 797 to contain information on how to apply for the AEITC.
1992	Developed publicity materials and distributed them to the public; provided credit information in the Small Business Taxpayer Education Program; and increased outreach speaker seminar efforts, in cooperation with federal, state, and local officials and private organizations.
1992	Developed print and audiovisual products to inform the public about the AEITC.
1992	Expanded instructions on AEITC in "Circular E, Employer's Tax Guide."
1992	Added examples to "Circular E, Employer's Tax Guide," explaining how to advance the EITC to employees and how to report amounts in advance.
1992	Clarified employer's responsibilities and liabilities in advancing the Earned Income Tax Credit (EITC) in the 1993 "Circular E, Employer's Tax Guide."
1993	Expanded 1993 Form W-2 instructions concerning AEITC. Specifically, revised the Form W-2 to place a bold outline around the AEITC box of the employee's copy.
2003	Updated instructions that require tax examiners to compare the amount of AEITC shown on the tax return to the amount listed as AEITC on the Form W-2 and adjust the amounts when needed.
2004	Created an error condition in return processing when the amount of AEITC reported exceeds the maximum allowed for the year.
2005	Created an error condition in return processing for whenever AEITC is listed on the return without a corresponding entry for the EITC.

Source: GAO analysis.

¹GAO/GGD-92-26 and Treasury Inspector General for Tax Administration, *Taxpayers Were Assessed Additional Tax for Advance Earned Income Credit Payments Not Received*, 2003-40-126 (June 2003).

**Appendix IV: Administrative and Legislative
Changes to the Advance Earned Income Tax
Credit Since 1990**

Notes: Changes made between 1990 and 1993 were a result of GAO's 1992 report and changes between 2003 and 2005 were a result of the Treasury Inspector General for Tax Administration's 2003 report. Some of the changes made between 1990 and 1993 occurred before our report was issued.

There have been two laws enacted since our 1992 report that include specific changes to the AEITC.² First, the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), did the following.

1. Limited the amount of advance payment allowable in a taxable year to 60 percent of the maximum credit available to a taxpayer with one qualifying child.
2. Directed the IRS to notify taxpayers with qualifying children who receive a refund on account of the EITC that the credit may be available on an advance basis. The conference report accompanying OBRA '93 stated that after these notifications had been made for 2 taxable years, the Treasury Secretary was directed to study their effect on utilization of the advance payment mechanism and, based on the results of the study, the Secretary may recommend modifications to the notification program.³

Second, the U.S. Troop Readiness, Veteran's Care, Katrina Recovery, and Iraq Accountability Appropriations Act of 2007, which was enacted in late May 2007, calls for a study of AEITC use.⁴ The study is to be conducted by the Secretary of the Treasury for the Congress and is to include the benefits, costs, risks, and barriers to workers and to businesses (with a special emphasis on small businesses) if the AEITC included all recipients of the EITC (i.e., individuals without qualifying children). It also asks what steps would be necessary to implement such an inclusion.

² We only included laws that made specific changes to the AEITC or its administration that were independent of changes to the EITC. Thus, we did not include laws whose only change to the AEITC occurred because of changes to the broader EITC program, such as changes in EITC benefit amounts or eligibility rules.

³ H.R. Conf. Rep. No. 103-213 (1993).

⁴ Pub. L. No. 110-28.

Appendix V: Additional Analyses of Advance Earned Income Tax Credit Noncompliance

We identified additional areas of noncompliance for AEITC recipients during tax years 2002 through 2004. We also examined demographic characteristics of our noncompliant subpopulations, including the invalid name, invalid number, and dollar limit subpopulations. Our analyses revealed the following: (1) some consecutive AEITC recipients had an invalid SSN, (2) most consecutive AEITC recipients filed a tax return, but did not report the correct AEITC amount on the tax return, (3) AEITC recipients with an invalid SSN received little money, (4) most AEITC recipients with an invalid SSN received one to two Forms W-2, (5) AEITC recipients in the invalid subpopulations lived in various geographic locations, and (6) AEITC was paid in excess of yearly maximum limits. As with the data in Appendix III, further analyses of this data may provide information on noncompliance characteristics potentially useful for IRS enforcement efforts.

Each of the tables provides additional information about AEITC recipients not previously discussed. Where possible, we compared AEITC recipients to EITC recipients. The characteristics are organized by a declining AEITC population size, similar to the organization in appendix III. Most analyses include the invalid name and invalid number subpopulations. The subpopulations are described in the scope and methodology section (see app. II).

Some consecutive AEITC recipients had an invalid SSN: About 98,000 individuals received the AEITC consecutively in each of the 3 years, tax years 2002 through 2004, and received an average of about \$56 million. About a quarter of these individuals had an invalid SSN and received an average of approximately \$16 million in AEITC. Additionally, nearly 15 percent of consecutive users had an invalid SSN and did not file a federal tax return, receiving an average of about \$9 million in AEITC (see table 22).

**Appendix V: Additional Analyses of Advance
Earned Income Tax Credit Noncompliance**

Table 22: Number of Individuals and AEITC Dollars Received by AEITC Recipients and Individuals Who Elected the AEITC Consecutively Using an Invalid SSN and an Invalid SSN and Not Filing, Tax Years 2002 through 2004

	Tax year 2002		Tax year 2003		Tax Year 2004	
	Individuals	Dollars	Individuals	Dollars	Individuals	Dollars
AEITC recipients	531,799	\$144,547,006	503,382	\$143,205,901	507,957	\$150,084,267
AEITC consecutive recipients ^a	97,998 (18%)	\$53,272,152 (37%)	97,998 (19%)	\$60,849,730 (42%)	97,998 (19%)	\$52,698,947 (35%)
AEITC consecutive recipients with invalid SSN (percentage) ^b	23,175 (24%)	\$14,837,041 (28%)	23,175 (24%)	\$17,217,171 (28%)	23,175 (24%)	\$14,798,025 (28%)
AEITC consecutive recipients with invalid SSN and did not file federal tax return (percentage) ^b	13,181 (13%)	\$8,593,857 (16%)	13,153 (13%)	\$9,972,631 (16%)	13,348 (14%)	\$8,722,592 (17%)

Source: GAO analysis of IRS data.

Note: The number of AEITC consecutive recipients represents the total number of individuals who received the AEITC over each of the 3 years. The associated dollars represent the amount those individuals received each year.

^aPercentage is out of AEITC recipients and dollars. This analysis includes the valid, invalid name, and invalid number subpopulations.

^bPercentage is out of AEITC consecutive recipients and dollars. This analysis includes the invalid name and invalid number subpopulations.

Most consecutive AEITC recipients filed a tax return, but did not report the correct AEITC amount on the tax return: About 98,000 individuals received the AEITC consecutively in each of the 3 tax years, 2002 through 2004. More than half of these individuals filed a tax return. Of those who filed, about half reported the same AEITC amount on the tax return as shown on the Form W-2 (i.e., matched). Of the mismatches, the majority did not report receipt of the AEITC (see table 23).

**Appendix V: Additional Analyses of Advance
Earned Income Tax Credit Noncompliance**

Table 23: Number of AEITC Consecutive Recipients with Matches and Mismatches between Forms W-2 and Filed Tax Returns, Tax Years 2002 through 2004

	Tax year 2002		Tax year 2003		Tax year 2004	
	Number	Dollars	Number	Dollars	Number	Dollars
Number of consecutive AEITC recipients who filed federal tax returns	65,864	\$42,750,223	63,189	\$43,205,414	60,257	\$36,916,220
Number of returns that matched the Form(s) W-2 AEITC amount for consecutive recipients (percentage) ^a	29,017 (44%)	\$21,611,779 (51%)	29,606 (47%)	\$24,369,871 (56%)	28,478 (47%)	\$20,706,538 (56%)
Number of mismatches between Form(s) W-2 and filed tax returns for consecutive recipients (percentage) ^a	36,847 (56%)	\$21,138,444 (49%)	33,583 (53%)	\$18,835,543 (44%)	31,779 (53%)	\$16,209,682 (44%)
Number of mismatches due to nonreporting of AEITC for consecutive recipients (percentage) ^b	34,400 (93%)	\$19,751,401 (93%)	31,035 (92%)	\$17,182,551 (91%)	29,675 (93%)	\$14,922,931 (92%)
Number of mismatches due to underreporting of AEITC for consecutive recipients (percentage) ^b	1,567 (4%)	\$956,176 (5%)	1,688 (5%)	\$1,164,494 (6%)	1,352 (4%)	\$843,205 (5%)
Number of mismatches due to overreporting AEITC (percentage) ^b	880 (2%)	\$430,867 (2%)	860 (3%)	\$488,498 (3%)	752 (2%)	\$443,546 (3%)

Source: GAO analysis of IRS data.

Note: Percentages may not add due to rounding. This table includes individuals who filed a tax return in the valid and invalid name subpopulations.

^aWe considered a match to be anything plus or minus a dollar on the Form W-2 in order to allow for taxpayer rounding. We tested the sensitivity of this result by using a difference between the AEITC reported on the Form W-2 and the tax return of up to \$100 and the results were similar. Percentage is of number of consecutive AEITC recipients who filed federal tax returns.

^bPercentage is of number of mismatches due to nonreporting of AEITC for consecutive recipients and number of consecutive AEITC recipients who filed federal tax returns.

AEITC recipients with an invalid Social Security number (SSN) received little money: Most AEITC recipients who had a Form(s) W-2 with an invalid SSN obtained \$100 or less of AEITC (see table 24). These data are consistent with the overall AEITC population, as previously noted, where about half of all recipients received less than \$100 and 80 percent received \$500 or less for the year.

**Appendix V: Additional Analyses of Advance
Earned Income Tax Credit Noncompliance**

Table 24: Amount of AEITC Received Per Invalid Form W-2, Number and Percentage, Tax Years 2002 through 2004

AEITC amount	Tax year 2002	Tax year 2003	Tax year 2004
	Count (percentage)	Count (percentage)	Count (percentage)
\$1- \$100	14,004 (43%)	12,658 (41%)	13,292 (42%)
\$101- \$200	4,075 (13%)	3,818 (12%)	3,817 (12%)
\$201 - \$300	2,651 (8%)	2,471 (8%)	2,605 (8%)
\$301- \$400	2,006 (6%)	1,888 (6%)	1,881 (6%)
\$401 - \$500	1,521 (5%)	1,360 (4%)	1,433 (4%)
\$501- \$600	1,172 (4%)	1,147 (4%)	1,218 (4%)
\$601- \$700	952 (3%)	953 (3%)	929 (3%)
\$701- \$800	848 (3%)	809 (3%)	891 (3%)
\$801- \$900	820 (3%)	727 (2%)	804 (3%)
\$901- \$1,000	705 (2%)	718 (2%)	710 (2%)
\$1,001 - \$1,100	649 (2%)	690 (2%)	691 (2%)
\$1,101 - \$1,200	657 (2%)	634 (2%)	624 (2%)
\$1,201 - \$1,300	634 (2%)	665 (2%)	652 (2%)
\$1,301 - \$1,400	621 (2%)	709 (2%)	731 (2%)
\$1,401 - yearly maximum	577 (2%)	955 (3%)	1,242 (4%)
Above maximum ^a	609 (2%)	420 (1%)	355 (1%)
Total	32,501	30,622	31,875

Source: GAO analysis of IRS data.

Appendix V: Additional Analyses of Advance Earned Income Tax Credit Noncompliance

Note: This table includes the invalid number subpopulation.

^aAbove the maximum is possible because this table presents aggregated Forms W-2 and if an individual received more than one Form W-2, the total received could be above the yearly maximum.

Most AEITC recipients with an invalid SSN received 1 to 2 Forms W-2: Most recipients who had an invalid SSN received 1 to 2 Forms W-2 reporting AEITC. For example, in tax year 2002, 6,223 individuals received two Forms W-2 that reported AEITC. These resulted in a total of 12,466 Forms W-2 equaling \$3,261,327 in AEITC, with an average of \$262 in AEITC per Form W-2 (see tables 25, 26, and 27).

Table 25: Number of Individuals Receiving a Form(s) W-2, Total Number of Form(s) W-2 Reporting AEITC, Total Associated and Average Dollars Received Relative to Number of Form(s) W-2 Reporting AEITC for AEITC Recipients with an Invalid SSN on the Form(s) W-2, Tax Year 2002

A	B	C	D	E
Number of Forms W-2 an individual received reporting AEITC	Number of individuals receiving the number of Forms W-2	Total number of Forms W-2 reporting AEITC ^a	Total associated dollars on Forms W-2	Average dollars per Form W-2 ^b
1	22,812	22,812	\$5,588,671	\$245
2	6,233	12,466	\$3,261,327	\$262
3	1,954	5,862	\$1,290,955	\$220
4	874	3,496	\$689,595	\$197
5	332	1,660	\$287,912	\$173
6	142	852	\$138,384	\$162
7	74	518	\$84,688	\$163
8	37	296	\$46,962	\$159
9	10	90	\$15,429	\$171
10	7	70	\$9,601	\$137
11	7	77	\$12,577	\$163
12	3	36	\$6,073	\$169
13	4	52	\$11,805	\$227
14	1	14	\$6,246	\$446
15	1	15	\$5,156	\$344
16	2	32	\$8,271	\$258
17	1	17	\$3,893	\$229
19	2	38	\$10,695	\$281
20	1	20	\$6,978	\$349

Appendix V: Additional Analyses of Advance Earned Income Tax Credit Noncompliance

A	B	C	D	E
Number of Forms W-2 an individual received reporting AEITC	Number of individuals receiving the number of Forms W-2	Total number of Forms W-2 reporting AEITC^a	Total associated dollars on Forms W-2	Average dollars per Form W-2^b
23	2	46	\$8,101	\$176
28	1	28	\$6,074	\$217
935	1	935	\$83,211	\$89
Total Forms W-2 with invalid SSNs	32,501	49,432	\$11,582,604	\$234

Source: GAO analysis of IRS data.

Note: This table includes the invalid number subpopulation.

^aThis number is derived by multiplying column A by column B.

^bThis amount is derived by dividing column D by column C.

Table 26: Number of Individuals Receiving a Form(s) W-2, Total Number of Form(s) W-2 Reporting AEITC, Total Associated and Average Dollars Received, Relative to Number of Form(s) W-2 Reporting AEITC for AEITC Recipients with an Invalid SSN on the Form(s) W-2, Tax Year 2003

A	B	C	D	E
Number of Forms W-2 an individual received reporting AEITC	Number of individuals receiving the number of Forms W-2	Total number of Forms W-2 reporting AEITC^a	Total associated dollars on Forms W-2	Average dollars per Forms W-2^b
1	22,474	22,474	\$6,787,458	\$302
2	5,424	10,848	\$2,689,186	\$248
3	1,660	4,980	\$1,076,219	\$216
4	600	2,400	\$478,420	\$199
5	259	1,295	\$222,288	\$172
6	94	564	\$107,704	\$191
7	41	287	\$46,869	\$163
8	22	176	\$32,510	\$185
9	17	153	\$30,123	\$197
10	6	60	\$14,293	\$238
11	4	44	\$9,769	\$222
12	5	60	\$14,794	\$247
13	5	65	\$20,860	\$321
14	3	42	\$10,857	\$259

Appendix V: Additional Analyses of Advance Earned Income Tax Credit Noncompliance

A	B	C	D	E
Number of Forms W-2 an individual received reporting AEITC	Number of individuals receiving the number of Forms W-2	Total number of Forms W-2 reporting AEITC^a	Total associated dollars on Forms W-2	Average dollars per Forms W-2^b
15	1	15	\$1,798	\$120
16	1	16	\$4,378	\$274
17	1	17	\$10,284	\$605
19	0	0	\$0	\$0
20	1	20	\$4,468	\$223
22	0	0	\$0	\$0
23	0	0	\$0	\$0
26	1	26	\$8,584	\$330
28	1	28	\$9,513	\$340
31	1	31	\$9,404	\$303
38	0	0	\$0	\$0
643	1	643	\$60,948	\$95
935	0	0	\$0	0
1,088	0	0	\$0	0
Total	30,622	44,244	11,650,727	\$263

Source: GAO analysis of IRS data.

Note: This table includes the invalid number subpopulation.

^aThis number is derived by multiplying column A by column B.

^bThis amount is derived by dividing column D by column C.

Table 27: Number of Individuals Receiving a Form(s) W-2, Total Number of Form(s) W-2 Reporting AEITC, Total Associated and Average Dollars Received, Relative to Number of Form(s) W-2 Reporting AEITC for AEITC Recipients with an Invalid SSN on the Form(s) W-2, Tax Year 2004

A	B	C	D	E
Number of Forms W-2 an individual received reporting AEITC	Number of individuals receiving the number of Forms W-2	Total number of Forms W-2 reporting AEITC^a	Total associated dollars on Forms W-2	Average dollars per Form W-2^b
1	24,853	24,853	\$7,602,238	\$306
2	4,776	9,552	\$2,663,173	\$279
3	1,452	4,356	\$1,022,262	\$235
4	483	1,932	\$385,252	\$199

**Appendix V: Additional Analyses of Advance
Earned Income Tax Credit Noncompliance**

A	B	C	D	E
Number of Forms W-2 an individual received reporting AEITC	Number of individuals receiving the number of Forms W-2	Total number of Forms W-2 reporting AEITC^a	Total associated dollars on Forms W-2	Average dollars per Form W-2^b
5	187	935	\$178,214	\$191
6	57	342	\$72,679	\$213
7	27	189	\$47,036	\$249
8	13	104	\$30,029	\$289
9	8	72	\$15,628	\$217
10	4	40	\$9,060	\$227
11	5	55	\$9,027	\$164
12	1	12	\$3,178	\$265
13	2	26	\$9,049	\$348
14	0	0	\$0	\$0
15	1	15	\$5,077	\$338
16	0	0	\$0	\$0
17	0	0	\$0	\$0
19	1	19	\$5,604	\$295
20	1	20	\$9,567	\$478
22	1	22	\$5,076	\$231
23	0	0	\$0	\$0
26	1	26	\$6,837	\$263
28	0	0	\$0	\$0
31	0	0	\$0	\$0
38	1	38	\$9,575	\$252
643	0	0	\$0	\$0
935	0	0	\$0	\$0
1,088	1	1,088	\$78,141	\$72
Total	31,875	43,696	\$12,166,702	\$278

Source: GAO analysis of IRS data.

Note: This table includes the invalid number subpopulation.

^aThis number is derived by multiplying column A by column B.

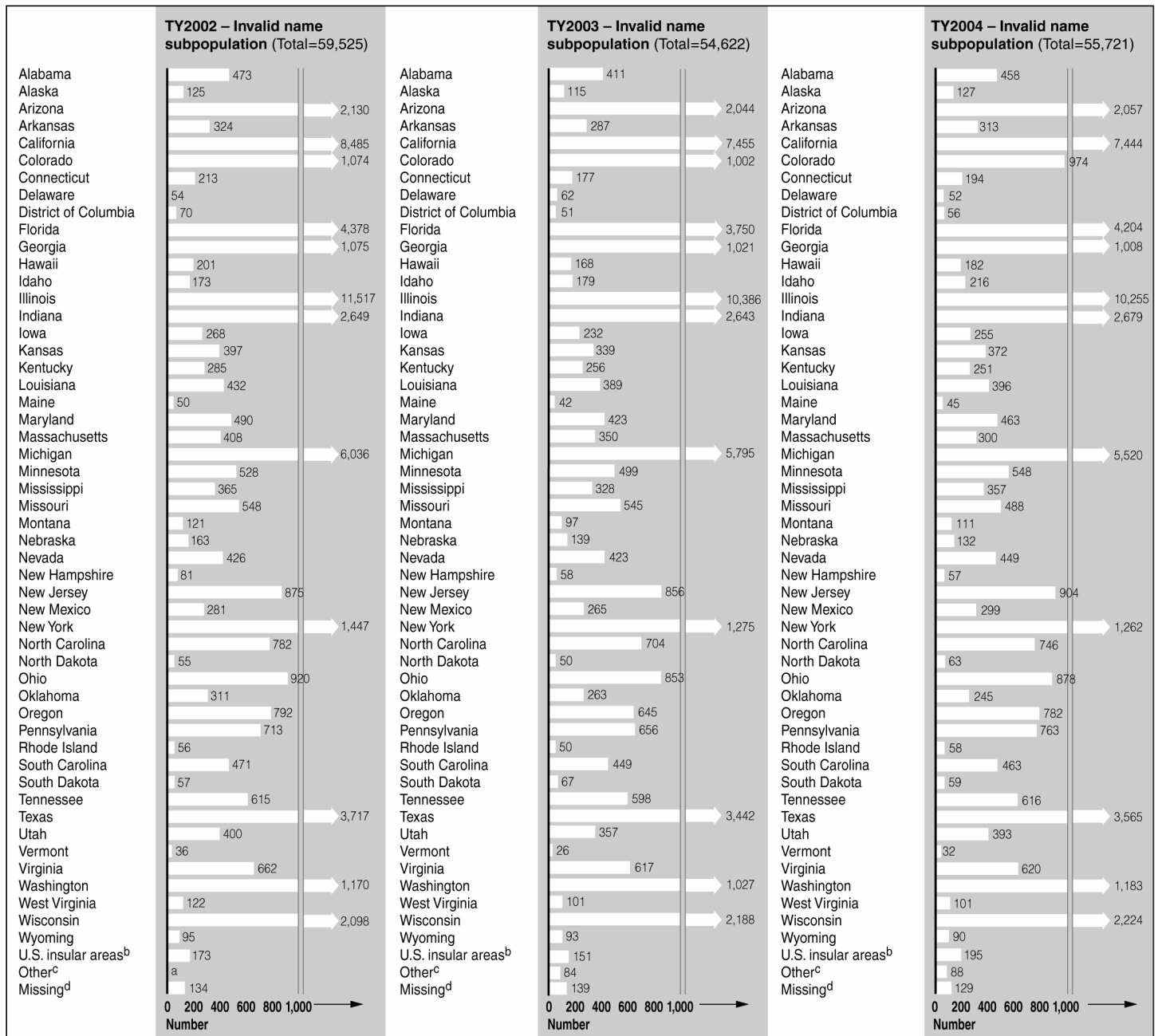
^bThis amount is derived by dividing column D by column C.

AEITC recipients in the invalid subpopulations lived in various geographic locations: Use of the AEITC varied widely across the country for individuals in the invalid number and invalid name subpopulations. For the invalid name subpopulation, in all 3 tax years, California and Illinois

had the most Forms W-2 reporting AEITC and for the invalid number subpopulation, in all 3 tax years, Florida and Illinois had the most (see figs. 8 and 9).

Appendix V: Additional Analyses of Advance Earned Income Tax Credit Noncompliance

Figure 8: Geographic Location of AEITC Recipients in the Invalid Name Subpopulation, Tax Years 2002 through 2004



Source: GAO analysis of IRS data.

Note: AEITC geographic location is based upon information reported on the tax return. This figure includes the invalid name subpopulation.

**Appendix V: Additional Analyses of Advance
Earned Income Tax Credit Noncompliance**

^aThese geographic locations had at least one but fewer than 10 individuals who received the AEITC.

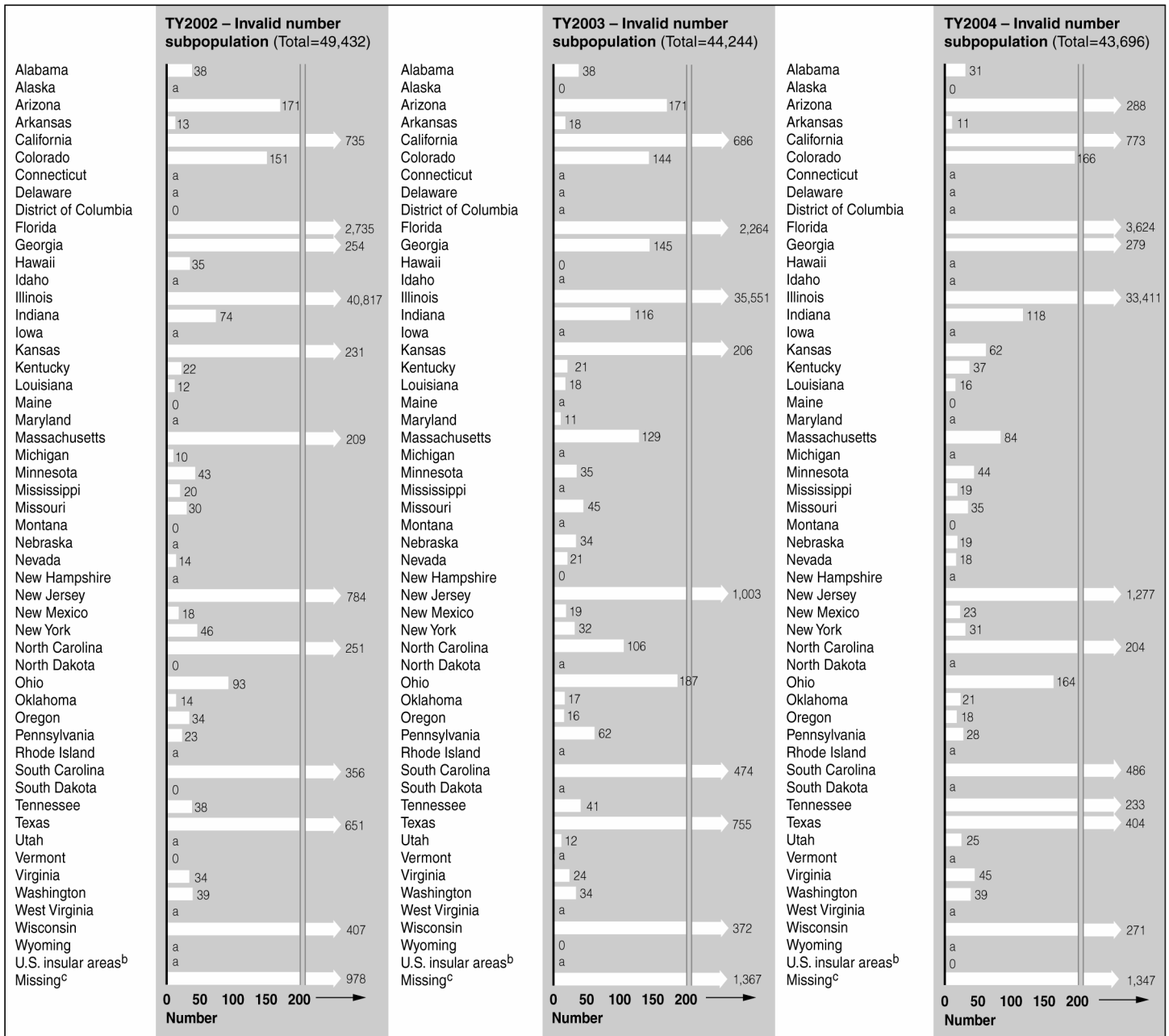
^bU.S. insular areas include the three major U.S. territories, which are the U.S. Virgin Islands, American Samoa, Guam, and the two Commonwealths, which are the Commonwealth of Puerto Rico and the Commonwealth of Northern Mariana Islands.

^cOther includes Federated States of Micronesia, Marshall Islands, Palau, and Armed Forces mostly located outside the U.S.

^dMissing refers to instances where the geographic location was not available.

**Appendix V: Additional Analyses of Advance
Earned Income Tax Credit Noncompliance**

Figure 9: Geographic Location of AEITC Recipients in the Invalid Number Subpopulation, Tax Years 2002 through 2004



Source: GAO analysis of IRS data.

Note: AEITC geographic location is based upon information reported on the tax return. This figure includes the invalid number subpopulation.

Appendix V: Additional Analyses of Advance Earned Income Tax Credit Noncompliance

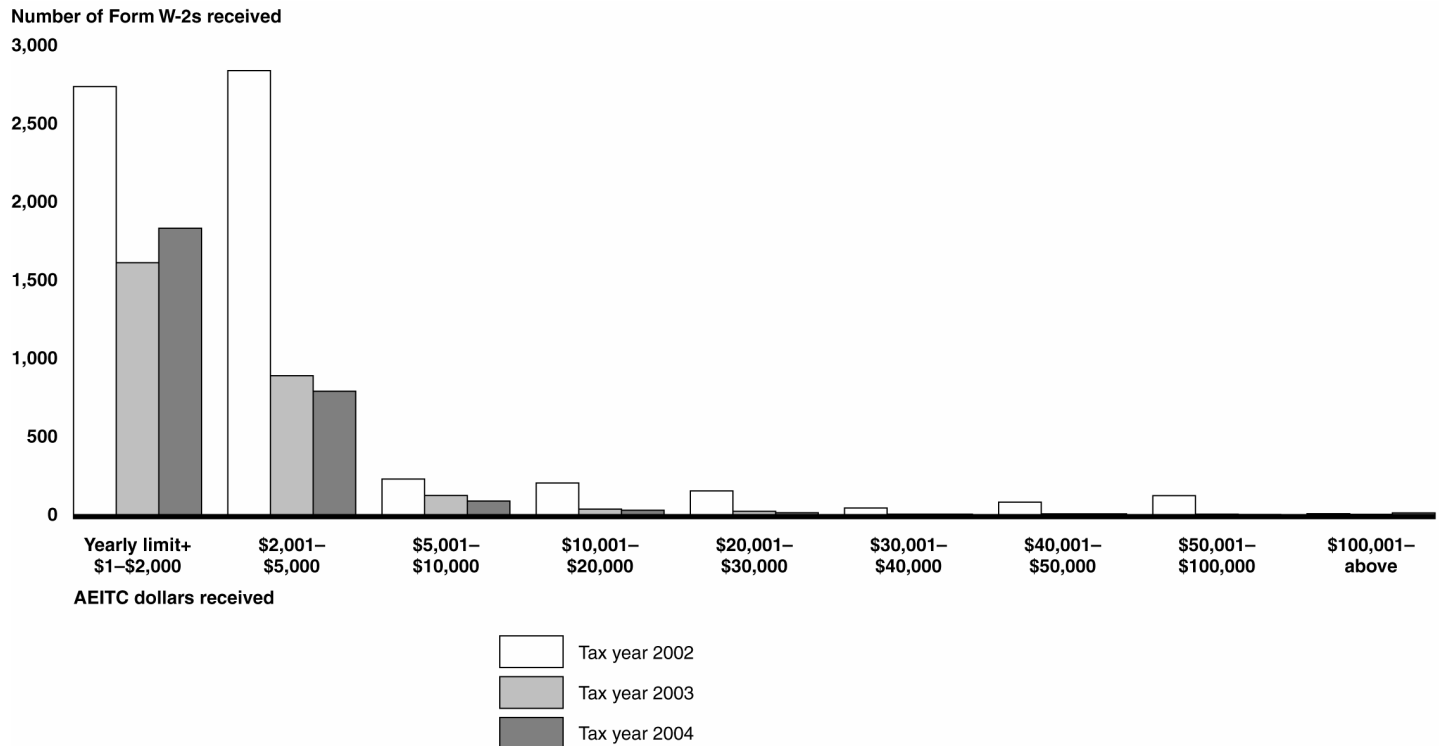
^aThese geographic locations had at least 1 but fewer than 10 individuals who received the AEITC.

^bU.S. insular areas includes the three major U.S. territories, which are the U.S. Virgin Islands, American Samoa, Guam, and the two Commonwealths, which are the Commonwealth of Puerto Rico and the Commonwealth of Northern Mariana Islands.

^cMissing refers to instances where the geographic location was not available.

AEITC was paid in excess of yearly maximum limits: A total of almost 12,000 Forms W-2, reporting about \$64 million, showed AEITC paid above the yearly maximum between tax years 2002 through 2004 (see figs. 10 and 11). Specifically, in tax year 2002 there were 6,408 Forms W-2 above the yearly maximum reporting almost \$44 million; 2,690 in tax year 2003, reporting over \$7 million; and 2,768 in tax year 2004, reporting almost \$13 million. As noted in figure 10, most Forms W-2 above the yearly maximum were between \$1 above the limit and \$5,000. An individual receiving the AEITC was eligible to obtain a maximum yearly amount of \$1,503 in tax year 2002, \$1,528 in tax year 2003, and \$1,563 in tax year 2004.

Figure 10: Number of Forms W-2 Received with Amounts above the Yearly AEITC Maximum, Tax Years 2002 through 2004

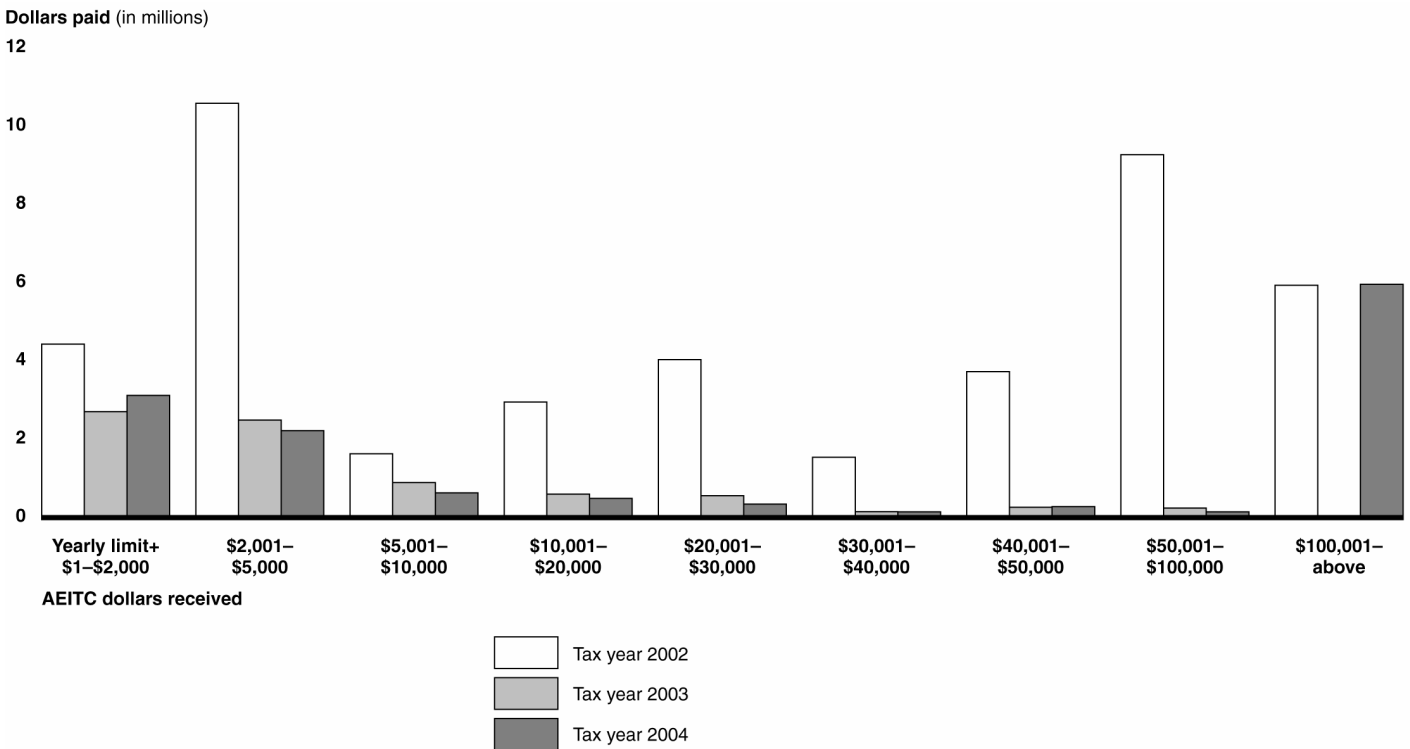


Source: GAO analysis of IRS data.

Appendix V: Additional Analyses of Advance Earned Income Tax Credit Noncompliance

Note: This excludes 2 Forms W-2 in 2003 that when totaled, reported about \$1 billion paid in AEITC. This figure includes the dollar limit subpopulation.

Figure 11: AEITC Dollars Reported on Form W-2s above the Yearly AEITC Maximum, Tax Years 2002-2004



Source: GAO analysis of IRS data.

Note: This excludes 2 Forms W-2 in 2003 that when totaled, reported about \$1 billion paid in AEITC. This figure includes the dollar limit subpopulation.

Appendix VI: Comments from the Internal Revenue Service



COMMISSIONER

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

July 18, 2007

Mr. Michael Brostek
Director, Tax Issues Strategic Issues Team
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Brostek:

I am writing in response to the draft Government Accountability Office (GAO) audit report entitled *Advance Earned Income Tax Credit, Low Use and Dollars Impede Efforts to Reduce Noncompliance* (GAO-07-1110). I reviewed the report and generally agree with its findings and recommendations. The report accurately reflects the difficulty the IRS faces to increase participation in the Advance Earned Income Tax Credit (AEITC) payment option among eligible taxpayers. Your report also appropriately acknowledges the challenges involved in efforts to reduce noncompliance among the small percentage that receive AEITC.

The IRS realizes the importance and potential benefits of AEITC as an immediate reward for work effort and as a help in meeting the day-to-day needs of low income workers. However, both your analysis and our own experience suggest that most taxpayers prefer to receive the earned income tax credit (EITC) as a lump sum rather than in smaller amounts meted out over time. As a result, despite our efforts to promote AEITC and to educate employers and taxpayers on the benefits of this option participation remains low. Currently, 3 percent of the potentially eligible population opt for AEITC, and this percentage has grown only slightly since your 1992 report on the subject (*EIC Advance Payment* (GAO/GGD 92-26)).

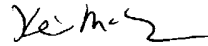
Your report also cites the high degree of noncompliance among the small number of participants receiving AEITC. However, because the participation rate for this program is low and half of all advance payment workers receive \$100 or less in AEITC during the year, noncompliance in this area represents a very small fraction of the overall tax gap. For these reasons, the IRS must carefully weigh its efforts to address AEITC error against opportunities to address other areas of noncompliance.

I appreciate the continued and valuable support from you and your staff on this issue. Detailed comments on your specific recommendation are enclosed. If you have any

2

questions or would like to discuss this response in more detail, please contact
David R. Williams, Director, Electronic Tax Administration and Refundable Credits, at
(202) 622-7990.

Sincerely,



Kevin M. Brown
Acting Commissioner

Enclosure

Enclosure

Recommendation:

The Commissioner of Internal Revenue should analyze whether any of the following options could cost effectively and significantly reduce AEITC noncompliance:

- sending potentially noncompliant AEITC recipients soft notices, such as to nonfilers whose Forms W-2 show that they received AEITC and filers who misreported the amount they received and/or whose SSN and name do not match;
- requiring employers to verify the SSN of employees seeking AEITC; or
- requiring employers to submit Form(s) W-5 to IRS and IRS creating and maintaining a database for these forms.

To better identify the costs and implementation issues as well as the likelihood for these or other options to reduce AEITC noncompliance, where practical, the Commissioner should test these options to make a more fully informed judgment about whether any would be worthwhile.

If the Commissioner determines that none of these options would be cost effective and no other remedies are viable, then the Treasury Secretary should inform the Congress of this and provide Treasury's opinion about whether the AEITC should be retained.

Response:

IRS agrees to conduct further cost/benefits analyses of the three proposed options. We will consider each within the context of the number of taxpayers affected, dollars involved (average per case and in aggregate), and the trade-offs from the return on investment realized by addressing other areas of the tax gap.

Of the three compliance treatments recommended, we believe the soft notice option is the most viable, despite the known limitations cited in your report. The high AEITC turnover and nonfiler rates may make this option less effective and more costly than other successful IRS soft notice tests. While we agree the soft notice option may produce first year compliance improvements, it is unclear that it will significantly reduce overall AEITC noncompliance or substantially increase revenue protected. Important parts of our cost-benefit analysis of this option must also include collection potential, taxpayer burden, and costs associated with provisions for free or low cost alternatives for return preparation assistance.

The option to require employers to verify SSNs of employees seeking AEITC will require legislation and new inter-agency coordination of roles and responsibilities between IRS and the Social Security Administration (SSA). Your report appropriately cites other concerns raised by IRS and SSA, such as data accuracy, additional employer

2

responsibilities and burden, adverse effects on participation, potential for inconsistent treatment of workers due to the disparity between antidiscrimination laws and legal requirements for verifying employment eligibility status, and the need for additional agency resources. The option to require employers to submit Forms W-5 to IRS and for the IRS to create and maintain a database for these forms will generate new employer compliance issues, as well as concerns similar to those for the SSN verification option. Although we will conduct further analyses of these two options, we believe these challenges may preclude any meaningful near-term testing or implementation.

Finally, our cost/benefits analyses of your recommended options will be conducted in tandem with a study of AEITC use required by the U.S. Troop Readiness, Veteran's Care, Katrina Recovery, and Iraq Accountability Appropriations Act of 2007 (PL 110-28) enacted in late May 2007. The study will include the benefits, costs, risks, and barriers to workers and to businesses (with a special emphasis on small businesses) if the AEITC included all recipients of the EITC (i.e., individuals without qualifying children), and the steps necessary for implementation. This report will be reviewed and approved by the Treasury Department and is due to the Congress in November 2007.

Appendix VII: GAO Contacts and Staff Acknowledgments

GAO Contacts

Michael Brostek, (202) 512-9110
Libby Mixon, (404) 679-1900
Joanna Stamatiades, (404) 679-1900

Acknowledgments

In addition to those named above, Blake Ainsworth, Frances Cook, James Cook, Rebecca Gambler, Evan Gilman, George Guttman, Donna Miller, Cheryl Peterson, Michael Rose, Steve Sebastian, Daniel Schwimer, Richard Stana, James Ungvarsky, Michael Volpe, and Paul Wright made key contributions to this report.

GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to www.gao.gov and select "Subscribe to Updates."

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDD: (202) 512-2537
Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Gloria Jarmon, Managing Director, JarmonG@gao.gov (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, D.C. 20548

Public Affairs

Paul Anderson, Managing Director, AndersonP1@gao.gov (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, D.C. 20548