



Treasury Inspector General for Tax Administration Office of Audit

ACTIONS CAN BE TAKEN TO IMPROVE THE IDENTIFICATION OF TAX RETURN PREPARERS WHO SUBMIT IMPROPER EARNED INCOME TAX CREDIT CLAIMS

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Highlights

Highlights of Report Number: 2010-40-116 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

The Earned Income Tax Credit (EITC) was created in 1975 to offset the impact of Social Security taxes for individuals who work but have low incomes. The amount of EITC claimed has increased steadily. The American Reinvestment and Recovery Act of 2009 increased the Credit for families with three or more EITC qualifying children, further increasing the amount of benefits that will be claimed in Tax Year 2009.

WHY TIGTA DID THE AUDIT

This audit was initiated because tax return preparers play a significant role in EITC noncompliance. The Internal Revenue Service (IRS) estimates between \$11 billion and \$14 billion in erroneous EITC claims are paid annually. For Tax Year 2008, individuals claimed \$49.2 billion in EITC; 66 percent of the tax returns were prepared by tax return preparers. The objective of this review was to determine whether the EITC Paid Preparer Strategy effectively identifies and addresses tax return preparer EITC noncompliance.

WHAT TIGTA FOUND

The IRS has taken steps to strengthen the EITC Preparer Strategy for Fiscal Year 2010. Our review of the IRS's methodology determined that actions can be taken to further improve the effectiveness of identifying high-risk EITC tax return preparers.

Risk factors used in Fiscal Year 2010 did not include identification of tax return preparers who were identified as high risk in the prior year but had not received a Due Diligence Visit (DDV) because they were included in a control group.

In addition, the IRS did not exclusively use the probability score it developed when identifying and selecting preparers for a DDV. As a result, the IRS

incorrectly selected 378 tax preparers and missed 655 preparers. TIGTA estimates the shift in tax return preparers within the DDV treatment category could result in the IRS paying \$25 million less in erroneous Tax Year 2010 EITC claims. Finally, the quality of the DDVs limited the success of IRS efforts to reduce tax return preparer noncompliance.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Wage and Investment Division:

- Include a risk factor in its computation of the probability score for tax return preparers who were identified in a previous year as a high-risk tax return preparer and were included in the control group.
- Select high-risk tax return preparers for a DDV based on the preparer's probability score and volume of EITC tax returns prepared.

The Commissioner, Small Business/Self-Employed Division, should ensure the DDVs are properly performed, with adequate case documentation in support of the assessment/nonassessment of penalties.

In their response to the report, IRS officials agreed to implement actions to improve the probability scoring and the quality of the DDVs. However, IRS management did not agree with our recommendation to revise the selection of high-risk tax return preparers for a DDV. Management indicated the current process provides the flexibility needed to maximize the use of resources and allows for consideration of additional factors when needed.

The EITC is the second highest Federal program with respect to the amount of improper payments. The IRS reports annual improper EITC payments totaling between \$11 to \$14 billion dollars. As such, TIGTA is concerned that the IRS did not agree to implement our recommendation that could result in further reducing erroneous EITC payments. Our analysis shows the IRS's process does not result in the most efficient and effective use of limited DDV resources. Our analysis of the volume of EITC tax returns prepared and the IRS probability score identified more high-risk tax return preparers for a DDV than the IRS identified.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2010reports/201040116fr.pdf>.

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