REFUNDABLE TAX CREDITS

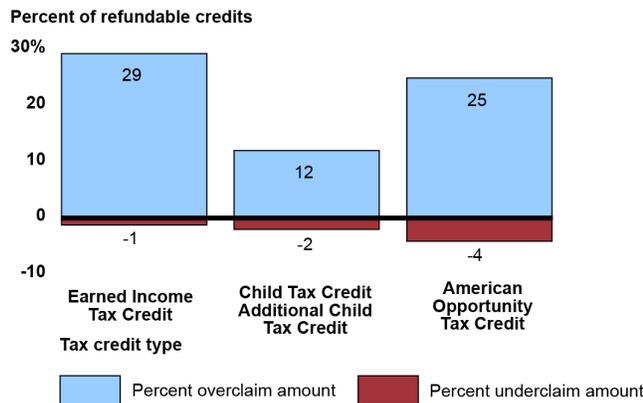## Comprehensive Compliance Strategy and Expanded Use of Data Could Strengthen IRS's Efforts to Address Noncompliance

Why GAO Did This Study

Refundable tax credits are policy tools available to encourage certain behavior, such as entering the workforce or attending college. GAO was asked to review the design and administration of three large RTCs (the EITC, AOTC, and ACTC). The ACTC is sometimes combined with its nonrefundable counterpart, the Child Tax Credit. For this report GAO described RTC claimants and how IRS administers the RTCs. GAO also assessed the extent to which IRS addresses RTC noncompliance and reviewed proposed changes to the RTCs.

GAO reviewed and analyzed IRS data, forms and instructions for claiming the credits, and planning and performance documents. GAO also interviewed IRS officials, tax preparers, and other subject-matter experts.

What GAO Recommends

GAO recommends 1) IRS develop a comprehensive compliance strategy that includes all RTCs, 2) use available data to identify potential sources of noncompliance, 3) ensure reliability of collections data and use them to inform allocation decisions, and 4) assess usefulness of third-party data to detect AOTC noncompliance. IRS agreed with three of GAO's recommendations, but raised concerns about cost of studying collections data for post-refund enforcement activities. GAO recognizes that gathering collections data has costs. However, a significant amount of enforcement activity is occurring in the post-refund environment and use of these data could better inform resource allocation decisions and improve the overall efficiency of enforcement efforts.

View GAO-16-475. For more information, contact James R. McTigue, Jr. at (202) 512-9110 or mctiguej@gao.gov.

What GAO Found

The Earned Income Tax Credit (EITC), the Additional Child Tax Credit (ACTC), and the American Opportunity Tax Credit (AOTC) provide tax benefits to millions of taxpayers—many of whom are low-income—who are working, raising children, or pursuing higher education. These credits are refundable in that, in addition to offsetting tax liability, any excess credit over the tax liability is refunded to the taxpayer. In 2013, the most recent year available, taxpayers claimed $68.1 billion of the EITC, $55.1 billion of the CTC/ACTC, and $17.8 billion of the AOTC.

Eligibility rules for refundable tax credits (RTCs) contribute to compliance burden for taxpayers and administrative costs for the Internal Revenue Service (IRS). These rules are often complex because they must address complicated family relationships and residency arrangements to determine who is a qualifying child. Compliance with the rules is also difficult for IRS to verify due to the lack of available third party data. The relatively high overclaim error rates for these credits (as shown below) are a result, in part, of this complexity. The average dollar amounts overclaimed per year for 2009 to 2011, the most recent years available, are $18.1 billion for the EITC, $6.4 billion for the CTC/ACTC, and $5.0 billion for the AOTC.

Overclaims and Underclaims as a Percent of Total Credit Amount
Percent of refundable credits

Source: GAO analysis of IRS National Research Program (NRP) data 2009-2011. | GAO-16-475

IRS uses audits and automated filters to detect errors before a refund is sent, and it uses education campaigns and other methods to address RTC noncompliance. IRS is working on a strategy to address EITC noncompliance but this strategy does not include the other RTCs. Without a comprehensive compliance strategy that includes all RTCs, IRS may be limited in its ability to assess and improve resource allocations. A lack of reliable collections data also hampers IRS's ability to assess allocation decisions. IRS is also missing opportunities to use available data to identify potential noncompliance. For example, tracking the number of returns erroneously claiming the ACTC and AOTC and evaluating the usefulness of certain third party data on educational institutions could help IRS identify common errors and detect noncompliance.

Proposals to change the design of RTCs--such as changing eligibility rules--will involve trade-offs in effectiveness, efficiency, equity, and simplicity.

_____ **United States Government Accountability Office**