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Creating Access to Tax Benefits: How Pro Bono Tax Professionals Can Help Low-Income Taxpayers Claim the Earned Income Tax Credit

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CREATING ACCESS TO TAX BENEFITS: HOW PRO BONO TAX PROFESSIONALS CAN HELP LOW-INCOME TAXPAYERS CLAIM THE EARNED INCOME TAX CREDIT

Kate Leifeld

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CREATING ACCESS TO TAX BENEFITS: HOW PRO BONO TAX PROFESSIONALS CAN HELP LOW-INCOME TAXPAYERS CLAIM THE EARNED INCOME TAX CREDIT

*Kate Leifeld**

I. INTRODUCTION

The Earned Income Tax Credit (EITC) is meant to help low-income, working taxpayers and their families by providing a refundable tax credit. In healthy economic times, the EITC is relied upon to pull low-income taxpayers and their children out of poverty.¹ However, we are facing the toughest economic climate in decades. In September 2009, unemployment was reported to be at 9.7 percent.² While the economic outlook has begun to show signs of improvement, the unemployment rate for February 2010 remained at 9.7 percent.³ Even when improvement starts, the turnaround will not be overnight.

In this economic climate, the EITC becomes even more important. High levels of unemployment mean that many more families will struggle to make ends meet. Families that were already surviving on the margin will now face additional pressure just to survive. However, taxpayers who claim the EITC are subject to a high level of IRS examination because of perceived EITC fraud. In fact, EITC audits now comprise roughly 36 percent of all individual taxpayer audits.⁴

If not successful in the audit process, the taxpayer may be denied part or all of this valuable credit. A study that appeared in the 2007 National Taxpayer Advocate Report to Congress (2007 NTA study)⁵ revealed that when taxpayers have professional representation during an EITC audit, they are almost twice as likely to be found eligible for the EITC as unrepresented taxpayers.⁶ This study

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1. See CTR. ON BUDGET & POLICY PRIORITIES, POLICY BASICS: THE EARNED INCOME TAX CREDIT (2009), available at <http://www.cbpp.org/cms/index.cfm?fa=view&id=2505> (last visited Mar. 20, 2010).

2. Jack Healy, *Fed Survey Finds Signs of a Slow, Fragile Recovery*, N.Y. TIMES, Sept. 10, 2009, at B11, available at <http://www.nytimes.com/2009/09/10/business/economy/10econ.html> (last visited Mar. 20, 2010).

3. Peter S. Goodman & Javier C. Hernandez, *Jobless Rate Holds Steady, Raising Hopes of Recovery*, N.Y. TIMES, Mar. 6, 2010, at A1, available at <http://www.nytimes.com/2010/03/06/business/economy/06jobs.html> (last visited Mar. 20, 2010).

4. INTERNAL REVENUE SERV., DATA BOOK 2008 tbl. 9a & n.4 (2008), available at <http://www.irs.gov/pub/irs-soi/08-databk.pdf> (last visited Mar. 20, 2010).

5. The Taxpayer Advocate Service, headed by the National Taxpayer Advocate (NTA), is an independent organization within the IRS whose employees assist taxpayers who are experiencing economic harm, who are seeking help in resolving tax problems that have not been resolved through normal channels, or who believe that an IRS system or procedure is not working as it should. For more information, go to <http://www.irs.gov/advocate>.

6. I TAXPAYER ADVOCATE SERV., INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE: 2007 ANNUAL REPORT TO CONGRESS 225-26 (2007), available at http://www.irs.gov/pub/irs_utl/arc_2007_vol_1_cover_msps.pdf (last visited Mar. 20, 2010) [hereinafter 2007 ANNUAL REPORT VOL. 1].

demonstrates that fraud is not the sole cause of EITC noncompliance. It also shows that representation can make a positive impact for low-income taxpayers. This Article will highlight the valuable services that pro bono tax professionals can offer low-income families, which are especially important during these tough economic times.

The Article begins with an overview of the EITC. The Article then explores some of the common characteristics of the low-income taxpayer community which can foster noncompliance. Given the high level of EITC audits performed by the IRS, the Article then briefly describes the exam process as well as recertification. The discussion then turns to what happens when the characteristics of low-income taxpayers are applied to the audit process. In doing so, special attention is given to the findings of the 2007 NTA study. This discussion points out pitfalls for low-income taxpayers where pro bono professionals can offer the most assistance. The Article concludes by encouraging all tax professionals to consider offering volunteer assistance to low-income taxpayers during these tough times.

II. THE EARNED INCOME TAX CREDIT

A. The Benefits

The EITC is a refundable credit available to low-income, working taxpayers. The credit can reduce the amount of tax due, or, if there is no tax debt, the taxpayer can receive a refund. The EITC creates an additional incentive to work in that the amount of credit increases with the amount of earnings.⁷

The amount of benefits for which a taxpayer is eligible also depends on his filing status and the number of children claimed. In tax year 2009, the most that a taxpayer could receive in EITC benefits was \$5,657.⁸ The greatest amount is available to taxpayers with three or more children. With one child, the taxpayer could qualify for up to \$3,043.⁹ A taxpayer with no children could qualify for up to \$457.¹⁰

This is a sizeable amount of tax-free money that can go far in helping low-income families secure safe housing; contribute to major purchases like cars, education, and heating oil; and provide a safety net in tough times. In 2009, the EITC was responsible for boosting an estimated 6.6 million taxpayers above the poverty line.¹¹ Since its inception in 1975, the amount of EITC benefits claimed by taxpayers has increased from \$4.5 billion (in 2005 dollars) to \$41 billion in 2005.¹²

7. At a certain amount of earnings, the credit is maxed and the amount of benefit plateaus until a point where more earnings mean less credit. Eventually, a taxpayer will earn too much to qualify for the credit. CTR. ON BUDGET & POLICY PRIORITIES, *supra* note 1.

8. Internal Revenue Serv., EITC Income Limits, Maximum Credit Amounts and Tax Law Updates (Dec. 18, 2009), *available at* <http://www.irs.gov/individuals/article/0,,id=150513,00.html> (last visited Mar. 20, 2010).

9. *Id.*

10. *Id.*

11. CTR. ON BUDGET & POLICY PRIORITIES, *supra* note 1.

12. INTERNAL REVENUE SERV., DEP'T OF THE TREASURY, IRS EARNED INCOME TAX CREDIT (EITC) INITIATIVES: REPORT ON QUALIFYING CHILD RESIDENCY CERTIFICATION, FILING STATUS, AND

B. How It Works

The EITC has characteristics of both a welfare benefit and a tax credit. It has been described as “a welfare program that happens to be administered through the tax system.”¹³ Unlike other forms of welfare benefits, where recipients have to apply and qualify with a government agency, taxpayers claim the EITC by voluntarily filing a tax return. Unless the IRS has previously determined that they are ineligible for the EITC, it is up to the taxpayers to determine whether they are eligible. However, if the IRS determines that an EITC claim is incorrect, taxpayers must be able to substantiate their claim before they can qualify to use it again.

A taxpayer is eligible to claim the EITC if all of the following requirements are met: (1) the taxpayer has earned income;¹⁴ (2) the taxpayer is a United States citizen or resident alien; (3) the taxpayer (and anyone the taxpayer includes on his or her return) has a social security number; and (4) the taxpayer has limited investment income (less than \$2,200 in 2009).¹⁵

Furthermore, married taxpayers must file a joint return in order to qualify.¹⁶ If a taxpayer wants to claim a child, the child must be a “qualifying child,” as defined by Internal Revenue Code (IRC) Section 152(c). Primarily, the child must meet age, relationship and residency requirements. This means the child must be related to the taxpayer,¹⁷ and the child must live with the taxpayer for more than six months of the year.¹⁸ Furthermore, the child must be under age nineteen (twenty-four if the child is a full-time student and any age if the child is disabled).¹⁹

Additional rules were introduced for tax year 2009. Now, the qualifying child must be younger than the taxpayer.²⁰ If both parents can claim a qualifying child but do not, the child can be claimed by another taxpayer only if that taxpayer’s adjusted gross income is higher than that of both of the parents.²¹ Lastly, the qualifying child must not have filed a joint return other than to claim a refund.²²

For taxpayers who do not have children, there are separate tests. The taxpayer must live in the United States for more than half of the year, must be at least twenty-five but not older than sixty-five, and not claimed as a dependent of

AUTOMATED UNDERREPORTER TESTS 6 (2008), available at http://www.irs.gov/pub/irs_utl/final_eitc_initiatives_report_final_121708.pdf (last visited Mar. 20, 2010).

13. Lawrence Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867, 1869 (2005).

14. Earned income is defined as “wages, salaries, tips and other employee compensation . . . plus the amount of the taxpayer’s net earnings from self-employment for the taxable year.” I.R.C. § 32(c)(2) (2009). Earned income therefore does not include child support, unemployment, or social security benefits.

15. See I.R.C. § 32 (2009).

16. I.R.C. § 32(d) (2009).

17. The person being claimed may be “a child of the taxpayer or a descendant of such a child, or . . . a brother, sister, stepbrother, or stepsister of the taxpayer or a descendant of any such relative.” I.R.C. § 152 (c)(2) (2009).

18. I.R.C. § 152(c)(1)(B) (2009).

19. I.R.C. § 152(c)(3) (2009).

20. I.R.C. § 152(c)(3)(A) (2009).

21. I.R.C. § 152(c)(4)(C) (2009).

22. I.R.C. § 152(c)(1)(E) (2009).

another.²³

Once eligibility is determined, there are still additional rules for the operation of the EITC. In some situations, more than one person has a legitimate right to claim a child for the EITC. For example, if a husband and wife are divorced in August, assuming the other criteria are met, both of them would have spent more than half of the year with their child and could therefore both claim the child. The IRS has developed “tie-breaker” rules to mediate these situations.²⁴ Unlike the dependency exemption, which can be claimed by the non-custodial parent when the custodial parent signs Form 8332, the EITC must remain with the custodial parent.

C. The Problems

The EITC rules are notoriously confusing for taxpayers. The IRS has made an effort to educate taxpayers who are eligible for the EITC. For example, a section of the IRS website is dedicated to providing taxpayers with EITC information.²⁵ The IRS also has published educational material, namely Publication 596, and it sponsors partnerships with community organizations to spotlight the EITC, such as EITC Awareness Day. The most recent EITC Awareness Day, held on January 29, 2010, was responsible for “24 satellite media interviews with television stations . . . a conference call with 24 print reporters and 10 interviews with radio networks reaching more than 1,000 radio stations.”²⁶

Unfortunately, the pool of taxpayers who claim the EITC is constantly changing. So, despite IRS efforts to educate, the message is always new for some taxpayers. One study shows that one-third of taxpayers claiming the EITC are “intermittent” or claiming the credit for the first time.²⁷ This Article questions whether the process of substantiating an EITC claim may be a contributing factor to the amount of turnover in claimants.

The lack of understanding prevents some taxpayers from claiming the credit. As mentioned above, the EITC is a refundable credit. If the EITC exceeds the amount of tax liability or there is no tax liability, the taxpayer can receive a refund. Some taxpayers who do not have a tax liability mistakenly think that they do not qualify.

Arguably, a more important problem with the EITC is the large amount of refunds issued to taxpayers who do not have a valid EITC claim. From the point of view of the IRS, noncompliance includes not just fraudulent claims, but also cases where taxpayers were audited and either did not participate in the audit process or did not supply sufficient information to substantiate their claims. EITC

23. I.R.C. § 32(c)(1)(A)(ii) (2009).

24. I.R.C. § 152(c)(4) (2009).

25. See *supra* note 8.

26. Press Release, Internal Revenue Serv., EITC Awareness Day 2010—A Time for Celebration, Information and Assistance, *available at* <http://www.eitc.irs.gov/ptoolkit/awarenessday/> (last visited Mar. 20, 2010).

27. TREASURY INSPECTOR GEN. FOR TAX ADMIN., REF. NO. 2009-40-024, THE EARNED INCOME TAX CREDIT PROGRAM HAS MADE ADVANCES; HOWEVER, ALTERNATIVES TO TRADITIONAL COMPLIANCE METHODS ARE NEEDED TO STOP BILLIONS OF DOLLARS IN ERRONEOUS PAYMENTS 2 (2008), *available at* <http://www.treas.gov/tigta/auditreports/2009reports/200940024fr.pdf> (last visited Mar. 20, 2010) [hereinafter TIGTA 1].

noncompliance was estimated to cost the IRS between \$9.6 and \$11.4 billion in 2005 (which represents between 23 and 28 percent of all EITC claims).²⁸

D. Low-Income Taxpayers and EITC Noncompliance

The 2007 NTA study was a two-prong study conducted to identify what barriers low-income taxpayers face during the EITC audit process and the impact of representation during such an audit. This portion of the Article is concerned primarily with barriers faced by low-income taxpayers and how those barriers can be mitigated by pro bono representation.

To determine the impact of representation during an EITC audit, the NTA compared the results of the 2004 EITC audits for unrepresented taxpayers to those of represented taxpayers (of the 400,000 EITC audits that year, only 1.8 percent had representation during the original audit).²⁹ The 2007 NTA study found that taxpayers who had representation fared better in the EITC audit process than their unrepresented counterparts.³⁰ In particular, the study found that 41.5 percent of represented taxpayers had no change in the amount of EITC that they received after the audit, compared to 23.1 percent of unrepresented taxpayers.³¹ Taxpayers with representation on average actually kept \$623 more EITC than the taxpayers without representation.³²

What causes the high level of EITC noncompliance? If it were fraud alone, then one would not expect to see a higher success rate with representation. Instead, if we want to understand EITC noncompliance, we need to consider some common issues that are shared by low-income taxpayers by virtue of their lack of resources. The NTA briefly addressed this concept in the 2007, stating that “EI[T]C filers have several attributes that may hinder their ability to respond effectively to an audit.”³³ More emphasis on the attributes, or issues, that impact low-income taxpayers puts the barriers identified by the NTA, discussed below, in a better context and makes a strong argument for pro bono participation.

Leslie Book previously discussed common issues affecting low-income taxpayers.³⁴ In particular, Book outlined issues that can affect a low-income taxpayer’s compliance with tax laws. I believe these factors can also explain why low-income taxpayers fare better when they have the assistance of representation.

First, maintaining safe housing is a major obstacle for many low-income

28. *Id.* at 1. EITC noncompliance is part of the larger problem of a national tax gap. For instance, the GAO found that business owners failed to pay the IRS \$54 billion in payroll taxes over a ten-year period. Memorandum from J. Russell George, Inspector Gen. to Sec’y Paulson, Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2009, (Oct. 15, 2008), available at http://www.treas.gov/tigta/management/management_fy2009.htm (last visited Mar. 20, 2010).

29. 2007 ANNUAL REPORT VOL. 1, *supra* note 6, at 225.

30. 2 TAXPAYER ADVOCATE SERV., INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE: 2007 ANNUAL REPORT TO CONGRESS 94 (2007) [hereinafter 2007 ANNUAL REPORT VOL. 2].

31. *Id.* at 108.

32. *Id.* at 112.

33. *Id.* at 99. These attributes include being less likely to speak English, having less education, and being at a low income level.

34. See Leslie Book, *The IRS’s EITC Compliance Regime: Taxpayers Caught in the Net*, 81 OR. L. REV. 351, 375 (2002).

taxpayers. Book points out that even a brief amount of time spent homeless or in temporary housing can lead to a rejected EITC claim.³⁵ Considering that the initial audit notice is sent to the last known address, frequent moves can prove fatal to even starting the audit process. Furthermore, frequent relocations also make it difficult and expensive to track the records necessary to substantiate EITC claims.³⁶

Perhaps more importantly, a crisis in housing often will trump all other problems that a low-income taxpayer may be facing. How can taxpayers worry about substantiating an EITC claim when they need to find safe housing for themselves and their families? This type of crisis situation is not limited to housing concerns. Low-income taxpayers often find themselves barraged with various crises that are exacerbated by their limited resources: struggles with health care, childcare, heating costs, accessing transportation, and more. At any time, one of these problems may need the taxpayer's immediate attention and will likely put something like an EITC audit, which takes many months to resolve, on the backburner.

Second, Book also points to low literacy rates among low-income taxpayers as another obstacle that they face in completing an EITC audit.³⁷ This prevents many taxpayers from fully understanding their rights and responsibilities if they do not have access to a tax professional. For instance, in Publication 596, the purpose of which is to educate taxpayers about the EITC rules, the IRS addresses what taxpayers should do if their EITC claims previously have been denied or reduced. This publication is not mentioned in order to argue that educational materials for taxpayers are inadequate. Rather, it is included to show that rules for claiming the EITC are complex and even the most basic explanation may not be sufficient. To illustrate the point, the following is from IRS Publication 596:

If your EI[T]C for any year after 1996 was denied or reduced for any reason other than a math or clerical error, you must attach a completed Form 8862 to your next return to claim the EI[T]C. You must also qualify to claim the EI[T]C by meeting all the rules described in this publication.

However, do not file Form 8862 if either (1) or (2) below is true.

1. After your EI[T]C was reduced or disallowed in the earlier year:
 - a. You filed Form 8862 in a later year and your EI[T]C for that later year was allowed, and
 - b. Your EI[T]C has not been reduced or disallowed again for any reason other than a math or clerical error.
2. You are taking the EI[T]C without a qualifying child for 2009 and the only reason your EI[T]C was reduced or disallowed in the earlier year was because the IRS determined that a child listed on Schedule EI[T]C was not your qualifying child.

Also, do not file Form 8862 or take the EI[T]C for:

- 2 years after there was a final determination that your EI[T]C claim was due to reckless or intentional disregard of the EI[T]C rules, or

35. *Id.* at 395.

36. *See id.*

37. *Id.* at 396-397.

- 10 years after there was a final determination that your EI[T]C claim was due to fraud.³⁸

For a trained tax professional this excerpt makes sense. However, for the typical taxpayer this passage likely creates confusion. The taxpayer has to understand the meaning of legal terms of art such as “math and clerical error,” “qualifying child,” and “final determination.” One would expect that the passage becomes even more confusing if the taxpayer has a low literacy level.

Third, language barriers pose an obstacle for taxpayers who do not speak English as a first language.³⁹ The IRS invested resources into making services available to such taxpayers by offering publications in languages other than English and by making taxpayer hotlines available in Spanish. However, in Maine, there is a large population of Somali taxpayers. These taxpayers are not able to contact the IRS easily and often do not understand what the IRS attempts to convey in the notices.

Fourth, a fear of government in general and the IRS in particular can be an obstacle of low-income taxpayers.⁴⁰ Taxpayers may be asked to provide the IRS with personal information including birth and marriage certificates, school records, medical records, and bank records. Many taxpayers are anxious about the idea of providing such information. Fear of sharing information with the IRS is not completely unfounded, especially for the immigrant population, given events such as the recent raid of a tax preparer office in Greeley, Colorado.⁴¹ Publicity surrounding the rise of identity theft has also made taxpayers wary to share personal information.

Some taxpayers fear receiving mail from the IRS. Once they find that the IRS has begun the audit they may assume that their claim is incorrect. As Book notes, “Many taxpayers are unsure what would happen if they tried to validate eligibility, and do not want to get in trouble by compounding what they believe might have been an initial error on their part, even if in fact they were right in the first instance.”⁴² For those who cannot consult a tax professional, this fear may be enough to prevent them from entering the audit process.

Fifth, low-income taxpayers may underutilize or be wary of banks.⁴³ Direct deposit and other tools associated with wages are often not utilized. In fact, many low-income taxpayers simply cash their check and spend their money. If proving their financial situation is part of their EITC audit, many low-income taxpayers struggle figuring out how to work with the IRS.

38. INTERNAL REVENUE SERV., DEP’T OF THE TREASURY, CAT. NO. 15173A, EARNED INCOME CREDIT (EIC): ARE YOU ELIGIBLE? 28 (2009), available at <http://www.irs.gov/pub/irs-pdf/p596.pdf> (last visited Mar. 21, 2010).

39. Book, *supra* note 34, at 403-05.

40. *Id.* at 401-02.

41. See Dan Frosch, *Paying Taxes, and Fearing Deportation*, N.Y. TIMES, Feb. 2, 2009, at A9, available at <http://www.nytimes.com/2009/02/02/us/02greeley.html> (last visited Mar. 21, 2010).

42. Book, *supra* note 34, at 402.

43. *Id.* at 402-03. See also FED. DEPOSIT INS. CORP., FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 11 (2009), available at http://www.fdic.gov/householdsurvey/full_report.pdf (last visited Mar. 21, 2010) (showing that households earning less than \$30,000 per year constitute 71 percent of the “unbanked” households in the United States).

Sixth, mental health issues are more prevalent in the low-income community. According to the Center for Disease Control and Prevention, adults living in poverty are five times more likely to report a “serious psychological distress” compared to adults that have an income at least twice the poverty level.⁴⁴ The presence of a mental illness can impact a taxpayer’s experience with the IRS in many ways. For instance, a taxpayer with high levels of anxiety or depression may struggle to open their mail, let alone contact the IRS. Managing a mental health issue may also take precedence over a tax problem, may prevent taxpayers from fully understanding the problem, or prevent taxpayers from fully advocating for themselves.

III. OPTIONS AND TOOLS FOR THE IRS

A. Pre-Audit Options

Before initiating an audit, the IRS has several options that it can use to freeze a questionable claim before a refund is issued. First, the IRS utilizes electronic filing filters.⁴⁵ As noted above, taxpayers and anyone they claim on their tax returns must have Social Security numbers. The filters can detect if there is an error with a Social Security number. For example, if the Social Security number was included on an earlier return by another taxpayer or the Social Security number is invalid, the return is flagged at this point and rejected.

Second, “math and clerical” errors can be flagged without initiating the formal audit process.⁴⁶ Such an error includes the situation where a Social Security number is incorrectly reported.⁴⁷ It can also be applied if the taxpayer fails to: (1) include a valid social security number for the primary taxpayer; (2) include a valid social security number for the secondary taxpayer; (3) include a valid social security number for each EITC qualifying child; (4) pay self-employment tax on self-employment income; (5) correctly compute adjusted gross income; (6) correctly consider investment income in the EITC computation; (7) meet the age requirement when there is no qualifying child; or (8) claim a qualifying child meeting the age criteria for EITC.⁴⁸

The IRS can also utilize the Dependent Database. This database is comprised of “a collection of information databases that include birth certificate information and court documents.”⁴⁹ Two aspects of the database include the Social Security Administration’s KIDLINK and the Department of Health and Human Services’s Federal Case Registry. KIDLINK connects children to their parents by matching Social Security numbers. The Federal Case Registry includes family law documents provided by the individual states.⁵⁰

44. NAT’L CTR. FOR HEALTH STATISTICS, CTRS. FOR DISEASE CONTROL & PREVENTION, U.S. DEP’T OF HEALTH & HUMAN SERVS., HEALTH, UNITED STATES, 2007 10 (2007), available at [www.cdc.gov/nchs/data/07.pdf](http://www.cdc.gov/nchs/data/hus/07.pdf) (last visited Mar. 21, 2010).

45. TIGTA 1, *supra* note 27, at 9.

46. INTERNAL REVENUE SERV., INTERNAL REVENUE MANUAL § 21.5.4.1.

47. I.R.C. § 6213(g)(2)(F) (2009).

48. INTERNAL REVENUE SERV., *supra* note 46, § 21.6.3.4.2.7.13.

49. TIGTA 1, *supra* note 27, at 9.

50. *Id.*

Last, the IRS has the ability to match documents that are reported to them from third parties.⁵¹ For instance, employers report the information from the W-2s that they issue for employees. If a taxpayer fails to report income from a W-2 that otherwise would make them ineligible for the EITC, the IRS will deny the EITC claim.

It should be noted that even though these options are considered minor compared to an actual audit, they can still prevent a taxpayer from receiving the EITC when they have a legitimate claim. For instance, the IRS may not implement an actual audit if a taxpayer incorrectly reports his child's Social Security number, but the taxpayer still has to understand that there is a problem and how to correct the mistake.

B. Audit Tools

A small fraction of returns are chosen at random to be audited.⁵² More likely, a taxpayer will be audited because he or she falls into a group that is recognized as a "special project" for the IRS or that is subject to automatic audits.⁵³ For example, IRS Notice 79A is sent to clients who are barred from claiming the EITC for two years due to reckless or intentional disregard for EITC rules. This notice informs taxpayers that they can claim the EITC after two years but that they need to attach Form 8862 and that the IRS "will likely ask you for documents to support your EI[T]C claim" after the return is received.⁵⁴

The Electronic Fraud Detection System (EFDS)⁵⁵ is one tool that the IRS utilizes to identify potentially fraudulent returns for audit. However, it is not always completely accurate in determining which returns get flagged. The NTA conducted a study involving taxpayers who contacted them during 2005 because their refunds were frozen for being potentially fraudulent.⁵⁶ The study found that 80 percent of the taxpayers received all or part of their refund at the end of the audit.⁵⁷

The IRS primarily conducts its EITC audits via correspondence.⁵⁸ In other

51. *Id.* at 10.

52. Sarah B. Lawsky, *Fairly Random: On Compensating Audited Taxpayers*, 41 CONN. L. REV. 161, 166 (2008).

53. *Id.* at 164-65.

54. Internal Revenue Serv., CP 79A Sample Contents (2009), <http://www.irs.gov/individuals/article/0,,id=161603,00.html> (last visited Mar. 21, 2010).

55. For information about this program, see, INTERNAL REVENUE SERV., CRIMINAL INVESTIGATION (CI) ELECTRONIC FRAUD DETECTION SYSTEM (EFDS) PRIVACY IMPACT ASSESSMENT (2006), <http://www.irs.gov/pub/irs-pia/efds-pia.pdf> (last visited Mar. 21, 2010).

56. TAXPAYER ADVOCATE SERV., INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE REPORT TO CONGRESS: FISCAL YEAR 2010 OBJECTIVES xx (2009), *available at* http://www.irs.gov/pub/irs_utl/fy2010_objectivesreport.pdf (last visited Mar. 21, 2010) [hereinafter 2010 OBJECTIVES].

57. *Id.*

58. In fiscal year 2007, 83 percent of the audits performed on individual taxpayers were correspondence audits. 1 TAXPAYER ADVOCATE SERV., INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE: 2008 ANNUAL REPORT TO CONGRESS 244 (2008), *available at* http://www.irs.gov/pub/irs_utl/08_tas_arc_intro_toc_msp.pdf (last visited Mar. 21, 2010) [hereinafter 2008 ANNUAL REPORT].

words, “a taxpayer is expected to establish the correctness of positions taken solely by exchanging documents and correspondence with an IRS examiner.”⁵⁹ The IRS can also utilize field examinations (conducted where the taxpayers maintains their books and records) and office audits (conducted at local IRS offices).⁶⁰

The IRS initiates correspondence audits by sending initial contact letters to taxpayers, informing them that there is a proposed assessment on their accounts and for what reason they are being audited. For EITC audits, a form is enclosed to explain what documents are necessary to substantiate the claim.

If taxpayers do not respond to the initial notice or do not provide sufficient documentation to substantiate their claims, the IRS issues a second notice. The second notice comes with a thirty-day deadline.⁶¹ If a taxpayer does not respond to the second notice or still does not provide sufficient documentation, the IRS issues the statutory notice of deficiency, which provides the taxpayer with the ability to petition the Tax Court. If the taxpayer does not file a petition in Tax Court, then the debt is assessed.

It is important to note that the notice is sent to the taxpayer’s last known address.⁶² It is also important to note that the system is automated. If a taxpayer does not respond to the notices then the case could be opened and closed without any work by an IRS employee.⁶³ Assuming that a taxpayer has been able to enter the audit process, IRS employees are instructed to use “[j]udgment . . . based on the facts and circumstances in each case to make a substantially correct determination.”⁶⁴

If the taxpayer does not respond to the audit notice, or does not provide the correct information, the IRS will assess a tax (in the amount of EITC received) plus interest and penalties if a refund was issued. Interest accrues until the debt is paid or the debt expires. This assessment can exacerbate tough economic times. For instance, an unpaid assessment leaves the taxpayer vulnerable to levies on their income after the credit has been spent.

Handling an EITC audit improperly can mean more than just missing out on one year’s credit. If the IRS determines that the taxpayer made a fraudulent claim, the IRS can bar that taxpayer from claiming the EITC for ten years.⁶⁵ If the IRS determines that the taxpayer’s claim was the result of “reckless or intentional disregard of rules and regulations,” the taxpayer can be barred from claiming the

59. Book, *supra* note 34, at 375.

60. Treas. Reg. § 301.7605-1(c) (as amended in 1993).

61. This dual notice system is an improvement from past procedure, where the IRS issued a single letter that both denied the EITC claimed in the tax return and requested substantiating documents. This led to confusion on the part of taxpayers. 1 TAXPAYER ADVOCATE SERV., INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE: 2005 ANNUAL REPORT TO CONGRESS 98 (2005), available at http://www.irs.gov/pub/irs_utl/section_1.pdf (last visited Mar. 21, 2010) [hereinafter 2005 ANNUAL REPORT].

62. If mail is returned as undeliverable, IRS employees have access to tools that allow them to search for a new address. However, if no new address is found, notices will continue to be sent to the old address. 2008 ANNUAL REPORT, *supra* note 58, at 250.

63. 2005 ANNUAL REPORT, *supra* note 61, at 100.

64. INTERNAL REVENUE SERV., *supra* note 46, § 4.19.14.5.

65. See I.R.C. § 32(k)(1)(B)(i) (2009).

EITC for two years.⁶⁶

C. Recertification Tools

Once a taxpayer's EITC claim is denied, the taxpayer cannot claim the EITC again until they "recertify" by submitting Form 8862 with their subsequent tax return.⁶⁷ In such cases, the IRS marks the taxpayer's account with an "indicator" after the taxpayer's initial failure to substantiate, which prevents any future EITC claim until proper substantiation is offered.⁶⁸ Also, if the taxpayer fills out the Form 8862 incorrectly or if "any item of information of Form 8862 is incorrect or inconsistent with any item on the return," the EITC claim will be denied.⁶⁹ It is clear that taxpayers who initially made a mistake may continue to make the same mistake until they understand the EITC rules. They will not get a second chance until they understand the problem.

The Treasury Inspector General for Tax Administration (TIGTA) found that in a study of 174 taxpayers who were required to recertify in 2005, 67 percent of them changed their filing "pattern" in 2006, and TIGTA thereby found recertification to be an effective tool in preventing fraud.⁷⁰ This finding meant that two-thirds of the taxpayers either did not claim the EITC the following year or complied with the request for substantiating documents. Thirty-three percent continued to claim it even though they were deemed ineligible.⁷¹ It is important to find out why a portion of the 67 percent of taxpayers who decided to stop claiming the EITC did so and why 33 percent continued to claim it incorrectly.

It makes sense that the IRS would strive to create a balance between encouraging valid claims and deterring fraudulent claims. Audits and recertification can be useful tools for this. However, if the IRS adopts procedures that the typical low-income taxpayer cannot comply with, or is intimidated by, the IRS will deny otherwise eligible taxpayers from a valuable tax credit in the name of reducing fraud.

IV. BARRIERS IDENTIFIED IN THE 2007 NTA STUDY

How do the characteristics of low-income taxpayers affect their participation in the EITC audit process? As noted above, the 2007 NTA study consisted of two parts: (1) identifying barriers to low-income taxpayers and (2) measuring the impact of representation. The remainder of this Article is concerned with how pro bono representation can overcome the barriers faced by low-income taxpayers.

The results for this part of the 2007 NTA study were gleaned from "targeted

66. I.R.C. § 32(k)(1)(B)(ii) (2009).

67. Treas. Reg. § 1.32-3(c) (as amended in 2001).

68. TREASURY INSPECTOR GEN. FOR TAX ADMIN, REF. NO. 2008-40-131, WHILE PROGRESS HAS BEEN MADE, LIMITS ON THE NUMBER OF EXAMINATIONS REDUCE THE EFFECTIVENESS OF THE EARNED INCOME CREDIT RECERTIFICATION PROGRAM 2 (2008), available at <http://www.treas.gov/tigta/auditreports/2008reports/200840131fr.pdf> (last visited Mar. 21, 2010) [hereinafter TIGTA 2].

69. Treas. Reg. § 1.32-3(c) (as amended in 2001).

70. TIGTA 2, *supra* note 68, at 5.

71. *Id.*

interviews” with Low Income Taxpayer Clinic⁷² attorneys, comments from tax preparers at Taxpayer Advocate focus groups, and a survey of taxpayers audited in 2004.⁷³

An explanation for high levels of noncompliance becomes clearer when one considers the unique situation that many low-income taxpayers find themselves in and the barriers identified by the NTA. Based on the results, the NTA broke down the barriers into three categories: communication, documentation, and process.⁷⁴

A. Communication

The NTA found communication barriers as occurring “at the point of initial audit notification and throughout the audit as the IRS attempts to contact the taxpayer for information to verify the EI[T]C claim.”⁷⁵ As mentioned above, the IRS primarily relies on correspondence exams to resolve disputed EITC claims. In a population where mobility is high and literacy is low, one would not expect a correspondence exam to be very productive. For instance, in 2004, 5.8 percent of the EITC correspondence exams were closed because they were undeliverable.⁷⁶ This means that almost 6 percent of taxpayers picked for an EITC audit did not receive notice of the audit but were denied benefits anyway.

Once a notice reaches the taxpayer the situation does not become any better. The 2007 NTA study found that a little over 25 percent of taxpayers who received the initial letter from the IRS regarding their EITC audit did not understand that they were being audited.⁷⁷ Approximately 40 percent of taxpayers did not understand what the IRS was questioning.⁷⁸

Understanding that they are being audited and being able to figure out the subject of the audit are very basic but necessary steps that must occur before a taxpayer can be successful in navigating the system. Given this early confusion with the audit process, it is not hard to imagine that taxpayers struggle with obtaining sufficient substantiating documentation. Furthermore, it is easy to see how taxpayers would struggle with the recertification process—if they do not fill out Form 8862 or make a mistake on it, their future claims are rejected automatically.

B. Documentation

Documents are at the heart of every EITC audit because taxpayers have to substantiate the claims that they made, whether it be that they earned a certain amount of income or that their child is a qualifying child. The NTA notes that

72. Low Income Taxpayer Clinics (LITCs) represent low-income taxpayers who have controversies with the IRS. While partially funded by the IRS, LITC offices are not affiliated with the IRS. There is at least one LITC office in each state. For more information about the LITC program, see Internal Revenue Serv., Low Income Taxpayer Clinics!, <http://www.irs.gov/advocate/article/0,,id=106991,00.html> (last visited Feb. 13, 2010).

73. 2007 ANNUAL REPORT VOL.2, *supra* note 30, at 94.

74. *Id.*

75. *Id.*

76. 2005 ANNUAL REPORT, *supra* note 61, at 100.

77. 2007 ANNUAL REPORT VOL. 2, *supra* note 30, at 103.

78. *Id.* at 104 tbl.1.

roughly 60 percent of taxpayers had difficulty obtaining documents.⁷⁹ The reasons for this difficulty include taking time off from work, not being able to find papers, and having to pay for the documents.⁸⁰ Taking time off from work may not be a possibility for some workers. Childcare and transportation issues must be factored into the ability to get paperwork, especially in areas where public transportation is not an option. Also, there may be an expense associated with retrieving these documents, both for the actual costs and for a loss of earnings while away from work.

Strict IRS requirements for documentation may also play a role here. Many taxpayers have already attempted to fix the problem on their own with no success before they seek professional assistance. Taxpayers often do not understand what information the IRS needs or why their documentation is insufficient.

C. Process

The last barrier that NTA mentions involves barriers in relation to the audit process itself. The report highlights the fact that the IRS emphasis on correspondence exams is not a way the majority of those interviewed would like to interact with the IRS: 46 percent prefer communication via telephone and 23 percent prefer face-to-face meetings.⁸¹

The reliance on correspondence exams creates problems for taxpayers. The NTA reports that such problems include: “the mishandling of taxpayer correspondence (receipt, control, and response); a lack of one-on-one contact with taxpayers in resolving their inquiries and disputes; and inconsistent, sometimes ignored policies and procedures that cause premature and incorrect assessment of tax, penalties, and interest.”⁸² Approximately 39 percent of the interviewed taxpayers reported that they had to send the same documents multiple times.⁸³ Complicating the situation is the fact that the IRS does not assign one worker to each case. When taxpayers call to follow up with the materials that they previously sent, they often have to explain their story from the beginning to the person who has taken their call. Given the strains on their daily lives, it is easy to see how low-income taxpayers can fall out of the EITC audit process if they cannot receive a timely resolution.

V: THE EITC QUALIFYING CHILD RESIDENCY CERTIFICATION STUDY

The 2007 NTA study is not the only time that low-income taxpayer participation in EITC audits has been addressed. In 2003, the commissioner of the IRS initiated a plan to improve “service, fairness, and compliance” of the EITC.⁸⁴ One goal of this initiative was to increase compliance while still encouraging use of the EITC. To meet this goal, the IRS conducted three studies: the EITC Qualifying Child Residency Certification Study (CRC study), the EITC Filing Status Study,

79. *Id.* at 106.

80. *Id.*

81. *Id.* at 107.

82. 2008 ANNUAL REPORT, *supra* note 58, at 243.

83. 2007 ANNUAL REPORT VOL. 1, *supra* note 6, at 107.

84. INTERNAL REVENUE SERV., *supra* note 12, at 6.

and the Automated Underreporter Study. The CRC study is of particular importance to this Article.

The CRC study had three main purposes: to educate taxpayers to make the right decision regarding their EITC eligibility, to deter those who would otherwise make fraudulent claims, and to allow the IRS to identify erroneous claims.⁸⁵ For purposes of this Article, the CRC study gives a good glimpse into the interaction between low-income taxpayers and the IRS generally. In particular, it mirrors what the audit and recertification processes are like for taxpayers. The CRC study shows that certification can be an effective tool in deterring EITC claims. However, it does not clearly show how much of this deterrence is attributable to fraudulent claims and how much is attributable to taxpayers who, for whatever reason, could not navigate the IRS system effectively.

In 2003, the first year of this study, the IRS focused on all qualifying child claims that the IRS could not confirm through its available data.⁸⁶ In the second year, the IRS focused on EITC claims in a particular community.⁸⁷ And, in the third year, the IRS picked the study participants by using a “revised algorithm.”⁸⁸

For all three years, the IRS required each test group of taxpayers to certify their eligibility for the EITC prior to claiming the credit. To do so, the IRS sent “certification packages” to taxpayers prior to the filing season to ensure that taxpayers had enough time to respond with the necessary documentation.⁸⁹ If the taxpayers did not provide the necessary information, the claim was denied and the standard deficiency procedures were used by the IRS.⁹⁰

Included with the certification packets were questions related to the burden on taxpayers created by the certification process. This part of the CRC study concluded that “[w]hile the certification requirement did not appear to increase monetary burden, taxpayers experienced an observable time burden to comply with the certification requirement.”⁹¹ In the 2003 test group, over 20 percent of respondents reported that they took time off from work to comply with the certification requirements.⁹² For many low-income taxpayers, time off from work translates into a financial burden. In fact, having to take time off from work may prevent a low-income taxpayer from substantiating their claim if, for instance, it means they have to juggle childcare and transportation issues.

In terms of the barriers identified by the 2007 NTA study, the CRC study noted that the IRS could not reach *one-third* of the taxpayers in the 2004 follow-up study either by phone or mail.⁹³ If taxpayers do not learn about the problems, they cannot respond. Most importantly, the CRC study concluded that the certification process may have created a potential deterrence:

IRS intended [certification] to help taxpayers make the correct decision about

85. *See id.* at 11.

86. *Id.* at 8.

87. *Id.*

88. *Id.*

89. *Id.* at 10-11.

90. *See* INTERNAL REVENUE SERV., *supra* note 12, at 11.

91. *Id.* at 17.

92. *Id.* at 18, fig. 5.

93. *Id.* at 19.

claiming the EITC at the time of filing. However, an unintentional consequence of the certification program could be to deter eligible taxpayers from claiming the credit. This deterrence could happen for several reasons. A taxpayer may feel that the certification process is too complicated or burdensome and therefore decide not to claim the EITC. Alternatively, the information may confuse taxpayers who then conclude that they are ineligible for the EITC when, in fact, they are actually eligible.⁹⁴

The 2007 NTA study demonstrates that there are definable barriers for low-income taxpayers who want to participate in the EITC audit process. While the CRC study does not focus on barriers, its results do show that the certification process, similar to the EITC audit and recertification process in many ways, has the potential to act as a deterrent for legitimate EITC claims.

For taxpayers who do comply with the initial audit notice, a breakdown in the audit process can create delays in the resolution of the case.⁹⁵ Any delays in the process prevent the taxpayers from having the benefits of the EITC when they need it.⁹⁶ The NTA has determined that the average wait time for a taxpayer going through an audit is more than eight and a half months.⁹⁷ Problems within the process can also create additional expenses for both the taxpayer and the IRS, including petitions to the Tax Court.⁹⁸

VI: HOW PRO BONO PROFESSIONALS CAN HELP

The exam process, and particularly the correspondence exam process, often does not meet the needs of the typical taxpayer.⁹⁹ When low-income taxpayers enter the audit process, they likely bring with them certain characteristics that will intensify the problems inherent with the correspondence exam process, as shown with the 2007 NTA study. As it is now structured, the correspondence exam process will have a hard time addressing these problems. In the meantime, pro bono tax professionals can offer assistance with this process to mitigate the barriers. The ways in which assistance can be achieved is discussed below.

A. Knowledge

The EITC rules confuse taxpayers. Pro bono professionals can connect with low-income taxpayers on a one-on-one level to answer their questions and analyze the merit of their cases. This kind of service is important, especially when one considers that of the taxpayers who turned to the IRS for assistance, only about half of the taxpayers found the IRS to be helpful.¹⁰⁰

On a related note, pro bono professionals can also utilize their experience on

94. *Id.* at 20.

95. In 2005, the IRS issued 2.9 million “interim letters,” which inform taxpayers that the IRS response will be delayed beyond the expected thirty days. 2008 ANNUAL REPORT, *supra* note 58, at 249.

96. As of 2004, only the portion of the refund attributable to the EITC can be frozen. 2005 ANNUAL REPORT, *supra* note 61, at 98.

97. 2010 OBJECTIVES, *supra* note 56, at xx.

98. 2008 ANNUAL REPORT, *supra* note 58, at 236.

99. *Id.* at 227.

100. 2007 ANNUAL REPORT VOL. 2, *supra* note 30, at 108.

behalf of the taxpayer. This can mean a great deal to low-income taxpayers. For instance, giving clients a roadmap of what to expect often diffuses much of their anxiety. If they know that an EITC audit can take several months, it allows them to relax a bit. Also, many taxpayers become resigned to the fact that they have a debt with the IRS if their EITC claim is denied. Most do not know that there is an option for relief available by requesting an audit reconsideration.¹⁰¹

Lastly, a tax professional's familiarity with the IRS can assist taxpayers. For instance, many taxpayers send original documents to the IRS and are then confused and disappointed when the IRS misplaces the documents and makes a second request. Tax professionals, through their experience with the IRS, will be able to avoid such pitfalls.

B. Advocacy

Along with knowledge comes the ability to advocate. Some low-income taxpayers do not have the tools or training to advocate for themselves. Tax professionals know what arguments to make and how to make them. Depending on their backgrounds, tax professionals may routinely advocate for taxpayers and can do it with relative ease. One would expect that effective advocacy would also reduce the amount of time that it takes to complete an EITC audit. Effective advocacy would reduce the amount of time that it takes to complete an EITC audit.

C. Stability

As mentioned above, there is a high amount of mobility among low-income taxpayers. This means that notices are not received or lost, that records are difficult to track and obtain, or that once an audit is started the taxpayer cannot always continue to work on it. By being a contact person for the taxpayer, the pro bono professional's stability often means the taxpayer can complete the audit process.

D. Patience

Many low-income taxpayers are frustrated with the EITC audit process. They are frustrated because they do not understand why the IRS is asking for information, that they have to send information multiple times, or that their refund has been frozen indefinitely. They cannot dedicate more time and resources to complying with the audit process. This frustration leads to negative interactions with the IRS or taxpayers dropping their cases altogether. Pro bono representatives can diffuse this frustration and resolve the case.

VII. CONCLUSION

*"The IRS believes we cannot audit our way to EITC compliance as we are continuing to study and test new and innovative solutions to the error problem."*¹⁰²

The quote above was made by Richard Byrd, Jr., Commissioner for the Wage and

101. For information on audit reconsideration, see INTERNAL REVENUE SERV., *supra* note 46, §§ 4.13.1.2-4.

102. TIGTA 1, *supra* note 27, at 31.

Investment Division. He further reports that the IRS continues to work on the EITC compliance problem by improving selection criteria for non-compliant returns, sending “soft notices” in situations where a child is claimed by more than one taxpayer, and focusing on improving the work of tax preparers.¹⁰³ However, for the near future, it appears that EITC audits will play a big role in determining who can claim and receive this credit. Given the barriers discussed above, it is clear that pro bono representation can provide critical assistance during the current economic climate, when the EITC has become even more important.

The IRS has undoubtedly put a great deal of energy into providing the EITC with a spotlight by making educational publications available, holding EITC Awareness Days, and offering explanatory notices. However, it takes more than education to resolve some of the issues highlighted in this Article. Tax professionals, who navigate the tax code daily, have the ability to work with low-income taxpayers in a way that the IRS cannot. Pro bono professionals can ensure that low-income taxpayers are getting the EITC that they deserve, and not a determination based on their inability to work with the system.¹⁰⁴

103. *See id.*

104. This Article has highlighted one area where low-income taxpayers can benefit from the pro bono services of tax professionals. The EITC can provide much-needed funds when a taxpayer is struggling to make ends meet. However, there are numerous tax matters where a low-income taxpayer can benefit from the assistance of a pro bono professional, such as innocent and injured spouse requests, audit reconsiderations, and setting up installment agreements when repayment is necessary. Low Income Taxpayer Clinics welcome the assistance of professionals on a pro bono basis. For information about the clinic in each state, visit <http://www.irs.gov/advocate/content/0,,id=-151026,00.html> (last visited Apr. 25, 2010).