



economic perspective

by Gene Steuerle

Research Required for the EITC Precertification Procedure

On June 13, 2003, the IRS requested public comments on a proposed EITC procedure by July 16, 2003. (For a summary of the announcement, see *Tax Notes*, June 23, 2003, p. 1780.) The goal of this new EITC procedure, known as precertification, is to reduce EITC error rates by individuals who are ineligible. Precertification would apply mainly to taxpayers *other* than married couples and single female heads of household. Essentially, these grandparents, aunts, uncles, other relatives or guardians, and single male filers — whose claims of maintaining a household for a child are more suspicious and more likely to be in error — would be required to file a form that gave some evidence that they had met various tests and were eligible to claim the credit. Because a variety of questions have been raised about this procedure, and also because of its embryonic stage of development, the IRS wants to start with a pilot study that involves 45,000 filers.

Many people are beginning to comment on the strengths and weaknesses of the procedure itself. (For special reports on the subject, see *Tax Notes*, June 9, 2003, p. 1525, and June 23, 2003, p. 1821.) Here I wish to concentrate on a subset of issues related less to the procedure itself than to how IRS will perform research over time to improve any precertification procedure. The pilot study should be conducted in a way that would emphasize gathering as much information as possible about EITC errors and ways of reducing them through alternative processes. The IRS should *not* merely produce some simple statistics about *one* procedure that may or may not work.

IRS research has always been given an extraordinarily low status within the organization. No large business organization would conduct activities on one-tenth the scale of the IRS without a multiple of its current effort toward data collection, statistical analysis, and study design. Here I focus solely on the negative impact of that research neglect on figuring out how to administer the EITC.

The IRS has administered the EITC ever since it was first enacted in 1975. Despite more than 30 years of responsibility, it has conducted only a few studies of this extraordinarily large program, and each has had serious design deficiencies. In particular, to this date, the IRS cannot even classify well the nature of the errors that it purports to find in the EITC. For instance, what percentage of over-claims are due to children

who spend less than half a year in every household, to double claims by divorced parents, to double claims by parents and grandparents in the same household, and to grandparents who claimed the credit and provided partial but inadequate household support? What percent of claims involve income that really cannot be verified? When these errors are present, to what extent are they minor and easily dealt with through some minor household rearrangement of its financial or child care affairs if the taxpayer merely understood the law?

The new IRS procedure itself is going to be conducted without that base of knowledge. It necessarily must be followed by an accompanying assessment or study of its successes and failures. The Service would make a gigantic mistake if it merely developed some modest statistics on the number of filers who still claimed the credit or did not fill out certain lines on a single form or on the number of people who did not respond to the IRS mailing. Instead, the study must break down the precertification process into several parts.

First, it must have a more rigorous way of indicating exactly what percent of taxpayers fall into various error categories and within those categories the extent of the error. For instance, it must provide statistics on absent fathers and grandparents separately and must indicate whether they provide partial but inadequate household support, or none at all.

If the IRS conducts the study as currently planned, many commentators have made it clear that the Service will get a huge nonresponse rate. The Service cannot then wash its hands, but must try to determine the nature and cause of that nonresponse. Conducting the precertification before filing season will mean that many taxpayers will not be able to rely on their normal tax form preparers for help. How important will this be? Many individuals will have language barriers. What will be the rate of nonresponse among English-as-a-second-language (ESL) citizens relative to other citizens?

From the start, the IRS must design the study so that it provides data on alternative and related procedures. For example, the process now contemplates asking for verifiable information from taxpayers on the basis of one form. In my view, it should develop alternative forms, rather than assuming from the start that whatever form it compromises on at the beginning is ideal and would necessarily be the same as what it would implement on a wider scale. One way to gather greater information is to adopt stricter and looser ver-

sions of the form, with the looser version asking for less information or simpler verification. A follow-up team of auditors could then contact a subset of taxpayers to provide fairly complete and similar sets of information that would be in excess of what any form required. One part of the follow-up study would then compare whether, based on the comprehensive information set, the strict form really did much better than the less strict form at reducing errors. For some purposes, even subsamples of 100 or 200 taxpayers might be adequate to provide statistically significant information.

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Still another examination should be made when the certification needs to be done. Will precertification do substantially better than certification at time of normal filing, with refund checks held up for those who do not certify? Many predict that the nonresponse rate in the pre-filing season will force the certification process into the tax filing season. How will winners and losers sort out under the alternative procedures? What will be the error rates on the two groups?

Throughout much of the study, attention must be paid to two types of errors: ineligible filers who claim the credit (let's call this Type 1 error) and eligible filers who do not (Type 2 error). The study must have some way of measuring the effect of alternative design schemes on the number of Type 2 as well as Type 1 errors. Again, this probably requires a fairly thorough follow-up procedure with a subset of those involved in the pilot study. Final decisions on the procedure eventually to be used would try to reduce Type 1 errors without inordinately increasing Type 2 errors.

In distinguishing between Type 1 and Type 2 errors, the IRS must also figure out in advance how to take account of the fact that precertification neither makes a taxpayer eligible for a credit or denies eligibility. Some taxpayers will mistakenly believe precertification actually certifies one way or the other. A poll might be required to determine the extent to which this problem arises. Along these lines, some statistical data will be required to figure out the extent to which precertified people incorrectly file for the credit even though income, change in filing status, change in household residence of the child, or other factors later make them ineligible. Note that many of these suggestions have one element in common. The pilot study should be aimed not at testing a single procedure but, rather, multiple alternatives and procedures. It must create alternative tests not only of different forms, but of the accuracy and feasibility of alternative follow-up procedures to each initial procedure.