

BILL THOMAS, CALIFORNIA,  
CHAIRMAN

PHILIP M. CRANE, ILLINOIS  
E. CLAY SHAW, JR., FLORIDA  
NANCY L. JOHNSON, CONNECTICUT  
AMO HOUGHTON, NEW YORK  
WALLY HERGER, CALIFORNIA  
JIM MCCREERY, LOUISIANA  
DAVE CAMP, MICHIGAN  
JIM RAMSTAD, MINNESOTA  
JIM NUSSLE, IOWA  
SAM JOHNSON, TEXAS  
JENNIFER DUNN, WASHINGTON  
MAC COLLINS, GEORGIA  
ROB PORTMAN, OHIO  
PHIL ENGLISH, PENNSYLVANIA  
J.D. HAYWORTH, ARIZONA  
JERRY WELLER, ILLINOIS  
KENNY C. HULSHOF, MISSOURI  
SCOTT McINNIS, COLORADO  
RON LEWIS, KENTUCKY  
MARK FOLEY, FLORIDA  
KEVIN BRADY, TEXAS  
PAUL RYAN, WISCONSIN  
ERIC CANTOR, VIRGINIA

ALLISON H. GILES,  
CHIEF OF STAFF

# Congress of the United States

## U.S. House of Representatives

COMMITTEE ON WAYS AND MEANS

1102 LONGWORTH HOUSE OFFICE BUILDING  
(202) 225-3625

Washington, DC 20515-6348

<http://waysandmeans.house.gov>

April 29, 2003

CHARLES B. RANGEL, NEW YORK,  
RANKING MINORITY MEMBER

FORTNEY PETE STARK, CALIFORNIA  
ROBERT T. MATSUI, CALIFORNIA  
SANDER M. LEVIN, MICHIGAN  
BENJAMIN L. CARDIN, MARYLAND  
JIM McDERMOTT, WASHINGTON  
GERALD D. KLECZKA, WISCONSIN  
JOHN LEWIS, GEORGIA  
RICHARD E. NEAL, MASSACHUSETTS  
MICHAEL R. McNULTY, NEW YORK  
WILLIAM J. JEFFERSON, LOUISIANA  
JOHN S. TANNER, TENNESSEE  
XAVIER BECERRA, CALIFORNIA  
LLOYD DOGGETT, TEXAS  
EARL POMEROY, NORTH DAKOTA  
MAX SANDLIN, TEXAS  
STEPHANIE TUBBS JONES, OHIO

JANICE MAYES,  
MINORITY CHIEF COUNSEL

The Honorable John Snow  
Secretary  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20590

Dear Secretary Snow:

I am writing to express my strong opposition to the proposed earned income tax credit (EITC) precertification program that was the subject of a recent New York Times article and editorial (attached). I would suggest that the IRS should pause before implementing this new program. It is unconscionable that the IRS would be asked to begin pre-audits of EITC tax credit taxpayers, beginning on July 1, 2003, without the explicit authorization of the Congress. Further, the Administration's plan would impose an unjustified increased burden on the working poor, serious taxpayer confusion and unfairness in our voluntary tax system.

Current law already denies the EITC, or imposes substantiation requirements similar to a precertification, in circumstances where an identified individual has made a prior improper EITC claim. The new precertification program differs significantly from current law in that individuals falling into certain broad categories would be required to be precertified even though they did nothing wrong--there were no instances of prior improper tax claims.

Secretary Snow

April 29, 2003

Page 2

For example, under the Administration's plan, single fathers, grandmothers, or adoptive parents claiming the EITC could face residency precertification requirements whereas married couples or mothers would not. This is a crude form of profiling that I am sure the Administration would oppose in other circumstances not involving a program for the poor. I am not aware of any precedent for denying or delaying a tax benefit that may be properly claimed on a tax return merely because the person falls into a broad class of taxpayers.

Further, the potential burden on EITC filers is well-documented by the U.S. General Accounting Office (GAO). In its review of the existing EITC certification program, GAO concluded that the IRS's program is unnecessarily burdensome for EITC taxpayers, of questionable value as an enforcement tool for the IRS, potentially confusing for taxpayers, and, as a consequence may discourage legitimate taxpayers from claiming the credit. The Administration's precertification plan essentially adopts the IRS system and features that GAO warns against. This is especially alarming because the plan will eventually require recertification of every EITC child and that some precertification actions would be required of groups of compliant EITC taxpayers every year.

The new precertification program also demonstrates an extraordinary double standard. First, the audit rate of upper income individuals has been declining precipitously in recent years. For example, for taxpayers with incomes over \$100,000, the audit rate has declined from over 3% in the 1990's to as low as .75% in recent years. Treasury's own June 2002 report on tax compliance acknowledges that 91% of returns with incomes over \$100,000 claim deductions that the IRS cannot verify. Yet, the Administration does not propose a precertification of records for these taxpayers.

Secretary Snow  
April 29, 2003  
Page 3

Second, unincorporated businesses have very high rates of noncompliance, with various types of businesses having noncompliance rates significantly greater than the error rates for the EITC. For example, unincorporated businesses misreport 30% of their net income (totalling more than \$200 billion each year). This includes a stunning 80% noncompliance rate for informal suppliers and cash-run businesses. No one contends that these groups' noncompliance is due to honest error. Treasury's own June 2002 report acknowledges that sole proprietors account for a "significant portion of the tax gap." Yet, the Administration has not announced any new compliance efforts, or precertification of records, aimed at the longstanding and well-known noncompliance abuses by unincorporated businesses.

Third, the press is full of stories about tax shelters purchased by corporations like Enron and their executives, yet there is no move by this Administration to require precertification of tax shelter transactions being peddled by large accounting firms. No one contends that this noncompliance is due to honest error. Treasury's own June 2002 report acknowledges that compliance activities need to be directed toward abusive tax shelters. Noncompliance seems to be a problem for this Administration only if it involves poor people.

Much of the rhetoric about the high error rate in the EITC leaves the impression that it is due to fraud or deliberate noncompliance. The evidence suggests that many of the EITC errors are due to honest failures to comply with an overly complex statute. The fact that approximately two-thirds of all EITC claims challenged by the IRS ultimately are held to be in accordance with the law demonstrates that the error rate may be exaggerated.

Secretary Snow

April 29, 2003

Page 4

Further, seventy percent of EITC returns are completed by professional tax preparers whose "most common errors" relate to mathematical calculation of the EITC and their inability to fill out the EITC forms correctly. They will be the first to admit the difficulty of correctly filing an EITC return and why innocent mistakes are made.

The rhetoric about the high error rate knowingly ignores the fact that various EITC compliance reforms have been enacted into law in recent years which have been successful. In fact, IRS has testified that the EITC reforms made two years ago have reduced EITC overpayments by \$2 billion.

The rhetoric about the high error rate ignores GAO's finding that 4.3 million EITC-eligible taxpayers make the error of not claiming or receiving the credit to which they are entitled. In a recent study, GAO estimated that all qualifying households were eligible to claim a total \$23.5 billion of earned income credits at a time when the IRS estimated that only \$20.9 billion were properly claimed.

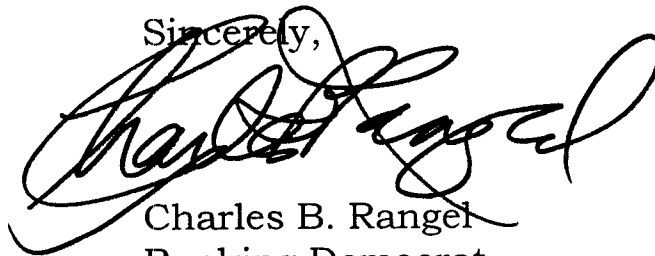
I am extremely doubtful that the EITC precertification program is authorized under current law. The Congress has explicitly authorized the Internal Revenue Service to impose additional information requirements only in circumstances where there has been prior noncompliance. That limited authorization strongly suggests that the current proposal goes beyond the authority granted by the Congress. While the Congress has funded a special examination program for EITC filers, it has not authorized a program to automatically deny, or delay, the credit to broad categories of taxpayers with no history of noncompliance.

Secretary Snow  
April 29, 2003  
Page 5

Finally, our tax system depends on the sense of voluntary compliance by taxpayers. Voluntary compliance is possible only if individuals believe that our system is being fairly enforced. The IRS audits 400,000 EITC taxpayer under current law practices, which is twice the rate of other individual taxpayers. Discriminatory enforcement actions against the working poor, such as the proposed EITC precertification requirements, coupled with failure to aggressively attack abuses by corporations, unincorporated businesses, and upper income individuals seriously threatens voluntary compliance.

I strongly urge that you pause and reconsider the unfair, discriminatory enforcement actions discussed in the New York Times in discussing the Administration's proposed EITC precertification plan.

Sincerely,

A handwritten signature in black ink, appearing to read "Charles B. Rangel", written in a cursive style.

Charles B. Rangel  
Ranking Democrat

# I.R.S. Tightening Rules for Low-Income Tax Credit

THE NEW YORK TIMES, FRIDAY, APRIL 25, 2003

By MARY WILLIAMS WALSH

The Internal Revenue Service is planning to ask more than four million of the working poor who now claim a special tax credit to provide the most exhaustive proof of eligibility ever demanded of any class of taxpayers.

The I.R.S., trying to prevent errors and cheating, says it needs greater proof of eligibility months before people claim the credit on their tax returns because its efforts to find errors through audits after the fact have not worked. Treasury officials estimate that \$6.5 billion to \$10 billion is lost to improper payments each year.

*Continued From Page A1*

were eventually approved.

The new rules apply to the earned-income tax credit, a provision enacted in 1975 and expanded several times. The credit has long had bipartisan support because it has lifted large numbers of people out of poverty without offering the sort of assistance often derided as handouts.

Instead of conventional welfare benefits, the earned-income tax credit provides an offset for the Social Security taxes low-income workers have already paid, along with a credit based on their earnings that is intended to give them an incentive to work. The credits vary according to income and family size, but no household with earned income above \$34,692 is eligible.

The average tax credit, paid by the government by check, was \$1,976 for households with children in 2001. That is less than the average food stamp benefit for households with children that year, \$2,904. But the I.R.S.'s proposed rules would make it much harder to qualify for the tax credit than for food stamps.

Republicans and Democrats have both supported expanding the tax credit, but as the cost of the program has risen, many Republicans have been vehement in saying that the program is riddled with errors and fraud.

President Bush has praised the tax credit. But his administration has also complained about fraud, and the president has asked Congress for \$100 million and 650 new employees to identify potentially erroneous claims before any money is paid out.

There is a similar effort with federally subsidized school lunches. Eric Bost, the under secretary of agriculture for food and nutrition, has increased efforts to weed out students who officials say are ineligible for free or subsidized school meals.

But some tax experts criticize the higher burden of proof as unfair and a wasteful allocation of scarce I.R.S. enforcement dollars. They say that corporations, business owners, investors and partnerships deprive the government of many times what the working poor ever could — through both illegal means and legal shelters — yet these taxpayers face no demands to prove the validity of their claims in advance with certified records and sworn affidavits.

Others warn that the proposed I.R.S. rules will set a standard of proof so high that it will be difficult, and in some cases impossible, for honest taxpayers to meet it. As a result, some people entitled to the tax credit will no longer receive it. And

those who do manage to file successful claims will almost certainly have to pay commercial tax preparers more for helping them with the extra paperwork.

"There is this double standard," said Robert Greenstein, executive director of the Center on Budget and Policy Priorities, a research group in Washington financed mainly by large foundations. "The losses are larger in other areas of the tax code, but somehow a different standard gets applied to this."

Nina E. Olson, the I.R.S. taxpayer advocate, said in her report to Congress this year that two-thirds of audited claims for the tax credit

*Continued on Page C4*

Asked about the I.R.S. proposal, the Treasury issued a statement saying it was committed to reducing "the unacceptably high error rate" and "to get the benefit to those who are entitled but only to those that truly qualify."

A Treasury official who insisted on not being identified said it was unfair to judge the size of the overpayment problem on the basis of just one year's tax credit, because the overpayments can continue year after year until each minor child listed on a false claim turns 18.

"It's a permanent thing," she said. "The I.R.S. tends to take things that are permanent very seriously, and put a lot of resources into them."

She added that screening out false claimants in advance could be characterized as a benefit to the poor, because such taxpayers would no longer have to have their claims audited, or scrounge for a way to pay back the money with interest if their claims are denied.

"These people didn't invest the money they got in the earned-income tax credit," she said. "They went out and bought their kids sneakers."

The new measures, which are expected to be published for public comment shortly, are scheduled to begin in July, when the first 45,000 taxpayers who fit into a "high-error category" will be asked to submit proof of their eligibility within six months. The program will accelerate to two million taxpayers in 2004. Eventually some four million "high

1/3

## Where the Money Is

In an effort to reduce overpayments of the earned-income tax credit, the Internal Revenue Service plans to require four million to five million low-income people to provide exhaustive advance documentation of their eligibility; the average credit paid is less than \$2,000 per family. I.R.S. estimates suggest that tax evasion and avoidance by other taxpayers cost it far more.

### ESTIMATES OF TAXES THE I.R.S. SAYS ARE AVOIDED, EVADED OR NOT PAID

Individuals\*

**\$132 billion**

Offshore accounts†

**\$70 billion**

Corporations\*

**\$46 billion**

Partnership investors‡

**\$30 billion**

### UNDESERVED EARNED-INCOME TAX CREDITS PAID

**\$6.5 billion to \$10 billions**

\*1992 I.R.S. figures adjusted for 40 percent economic growth through 2002.

†2001 I.R.S. estimates.

‡Current I.R.S. estimates.

Source: Figures based on I.R.S. reports

The New York Times

error" claimants — a fifth of the 19 million who now claim the tax credit — will be required to submit advance proof of their eligibility.

The high-error category encompasses all claimants except married taxpayers filing joint returns and single mothers; it includes fathers with sole custody of children, grandparents, aunts, uncles, foster parents and others. They will have to provide papers proving that the relationship with the children claimed is as claimed, and that the children lived with them for at least six months of the year.

Only a few types of evidence will be acceptable to the I.R.S., and some are documents that will be difficult or impossible for people to get within the six-month deadline. To prove their relationships to children, for

example, they are expected to produce marriage certificates, in some cases for other people's marriages; for marriages that took place abroad; and in a few cases for marriages of great-grandparents and great-great-grandparents.

Even American weddings may be hard to document adequately in less than six months. The State of California, for example, warns on its Web site that it may take "up to two to three years" to issue copies of marriage certificates, "due to budgetary constraints." The State of Ohio does not even issue copies of marriage certificates, only "marriage abstracts," which are not certified documents and take six months to obtain in any case.

New York State will not issue certificates to people who were married in New York City. New York City will not issue the certificates to anyone but the husband and wife, "or someone with written authorization from them." The I.R.S. plan does not offer any guidelines for the children of couples in common-law marriages.

To prove where a child lived, the I.R.S. will require claimants to produce school records, medical records, leases or similar documents that show both the filer's and the child's names and address, and state specifically the range of dates when they lived there together.

Filers who have no such documents will be allowed to produce instead a sworn affidavit from a school official, employer, member of the clergy or other person in a quasi-official capacity, specifically stating under penalty of perjury that he or she has "personal knowledge" that the taxpayer and child lived together during the dates cited. An affidavit from a landlord, who may live far away, would be accepted, but not one from a building superintendent who lives on the premises.

This requirement contrasts with the proof needed to get food stamps. Food stamp offices rely heavily on third-party statements, but accept them from neighbors, building managers and others likely to know the living arrangements of recipients. And the food stamp offices do not require these third parties to swear under penalty of perjury that they have "personal knowledge."

The food stamp error rate is estimated at 7 percent.

An I.R.S. briefing paper on the new rules states that in 1999 the Treasury lost \$8.5 billion to \$9.9 billion by paying earned-income tax credits to

filers who should not have received them. A separate analysis, by two Treasury Department specialists, says subsequent measures may have reduced these erroneous payments by \$2 billion.

By comparison, corporations managed to sidestep as much as \$54 billion in 1998, by hiding about \$155 billion in profits in tax shelters, according to a study by a Harvard economist, Mihir A. Desai.

The I.R.S.'s most recent attempt to measure tax cheating — based on 1988 data and published in 1992 — showed that the biggest tax dodgers by far were people running their own businesses. They cost the Treasury about \$38 billion in lost 1992 taxes by failing to report all their income.

The same I.R.S. study found that people who wrongly took tax credits of all types — including earned-income tax credits — cost the Treasury less than \$6 billion in 1992.

That 1992 study drew complaints of I.R.S. heavy-handedness from the agency's critics, and Congress stopped appropriating money for comprehensive efforts to measure tax cheating. But money to measure overpayments on the earned-income tax credit survived. From 1993 to 1999, the I.R.S. undertook four studies of how much was improperly paid to the working poor.

These studies showed that there was, in fact, a high rate of erroneous claims for the earned-income tax credit. Some involved cheating. Many more involved disputes over which parent was entitled to the credit for the same child, one aspect

of the complexity of this part of the tax code. The errors persist even though 70 percent of all claimants pay tax preparers to file their returns.

"Most of these people are marginal people," said Sheldon S. Cohen, who served as I.R.S. commissioner under President Lyndon B. Johnson. "They don't go to a first-class C.P.A. or tax lawyer. They go to a guy in the neighborhood."

Prompted by the overpayment data, the I.R.S. stepped up its audits of people claiming the earned-income tax credit in 1995. The most recent I.R.S. databook shows that 300,000 people who claimed the credit were audited in 2002, or about one in every 64. By contrast, one of every 120 taxpayers with annual incomes over \$100,000 was audited, as were about one in 400 partnerships, which are primarily owned by the wealthy.

Last year, the Office of Management and Budget pronounced the audits of people who claimed the earned-income tax credit "ineffective," and the Treasury created a task force to find a new way of weeding out the erroneous claims.

Mr. Cohen, now a senior counsel at the Washington office of Morgan, Lewis & Bockius, said the government seemed to value more the dollars it paid out than those it was due but failed to collect.

"If they give you money, they want an exact accounting for it," he said. "If they don't collect the money, then they really don't care."

---

*A new burden of  
proof as an agency  
aims at fraud.*

---



## The I.R.S. Goes After the Poor

The Internal Revenue Service is planning to impose oppressive new documentation requirements on taxpayers applying for the earned-income tax credit, which for more than a quarter-century has been an important source of income for the working poor. Notwithstanding the agency's claim that the requirements are necessary to prevent fraud, the new policy is deeply flawed. It is unfair, particularly in view of the fact that the I.R.S. is devoting diminishing resources to tax cheating by corporations and the wealthy. And it is so burdensome it will drive many poor taxpayers to give up a tax break they are legally entitled to take.

The earned-income tax credit, which was enacted in 1975, has long been popular across the political spectrum. The credit, which works in part by refunding taxes that have already been paid, supplements the salaries of low-wage workers. The average earned-income tax credit is not large, but it makes a big difference to its 19 million recipients, all with household earned income of less than \$35,000.

In the name of cutting down on fraud, the I.R.S. has decided that millions of taxpayers who claim the earned-income tax credit will have to submit extensive proof of eligibility. Many taxpayers who claim custody of children will have six months to come up with marriage certificates, in some cases for other people's marriages, or marriages outside the country. To prove a child's residence, taxpayers

will need to produce elaborate records or affidavits.

These onerous new rules will prevent many poor people from claiming the credit. Taxpayers in some states will find that they cannot obtain the documents in time. California, for example, can take three years to provide a copy of a marriage certificate. Some frustrated taxpayers will no doubt simply forgo the tax credit. Others will spend a good percentage of it on paid tax advisers to help them comply with the new rules.

By the I.R.S.'s own estimates, the money lost to the Treasury through the earned-income tax credit amounts to up to \$10 billion a year. That is not insignificant, and the I.R.S. ought to look for ways to root out fraud that will not pose an undue burden on honest people who deserve the credit. But it falls far short of estimates for other categories: \$132 billion for individual taxpayers, \$70 billion for offshore accounts and \$46 billion for corporations. Yet the I.R.S. has been scaling back its enforcement in these areas. In the last decade, tax investigations have fallen by 37 percent, and prosecutions for tax crimes are down 50 percent.

If the I.R.S. wants to harass the poor, and undermine a key incentive for taking low-wage jobs, it should keep doing what it is doing. But if it is interested in increasing tax compliance, and bringing in more lost tax dollars, it should start focusing its enforcement efforts higher up the income scale.