

February 1992

EARNED INCOME TAX CREDIT

Advance Payment Option Is Not Widely Known or Understood by the Public





United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-246695

February 19, 1992

The Honorable Lloyd Bentsen
Chairman, Committee on Finance
United States Senate

The Honorable Dan Rostenkowski
Chairman, Committee on Ways and Means
House of Representatives

This report is in response to Section 11113 of the Omnibus Budget Reconciliation Act of 1990. Section 11113 requires that we, in conjunction with the Secretary of the Treasury, study the effectiveness of the earned income credit advance payment system. Accordingly, this report (1) identifies why so few employees take advantage of the advance payment option; (2) determines whether making advance payments imposes a burden on employers, especially small businesses; and (3) identifies problems in the administration of advance payments.

We are sending copies of this report to the Internal Revenue Service, the Office of Management and Budget, and other interested parties.

Please contact me at (202) 275-6407 if you or your staff have any questions concerning the report. Other major contributors to this report are listed in appendix IV.

A handwritten signature in cursive script that reads 'Jennie S. Stathis'.

Jennie S. Stathis
Director, Tax Policy and
Administration Issues

Executive Summary

Purpose

About 11.6 million low-income wage earners received \$6.5 billion in earned income credits for tax year 1989. The earned income credit is a refundable credit; workers who meet certain requirements can receive it if they file a tax return. Workers can receive the credit as a lump sum payment after filing a return or in advance as part of their paycheck. However, less than 1 percent of earned income credit recipients receive the credit in advance each year.

The Omnibus Budget Reconciliation Act of 1990 directed GAO to study the effectiveness of the earned income credit advance payment system. Specifically, GAO's objectives were to

- identify why few eligible workers take advantage of the advance payment option;
- determine whether making advance payments imposes a burden on employers, especially small businesses; and
- identify any problems the Internal Revenue Service (IRS) has experienced with administering the advance payment option.

Background

Congress enacted the earned income credit in 1975 (1) to assist low-income wage earners who were adversely affected by rising prices; (2) to offset the effects of social security taxes paid by these workers; and (3) to encourage these workers, who might otherwise receive welfare benefits, to seek employment. Beginning in 1979, workers could elect to receive the credit in advance payments from their employer along with their pay. To qualify for the credit in 1991, workers had to maintain a household for at least one qualifying child and earn less than \$21,250.

To determine why few eligible workers take advantage of the advance payment option, GAO obtained information from a sample of individuals who, based on income, were potentially eligible for the earned income credit. Although the responses obtained could not be generalized to the universe of eligible workers, GAO found some common themes regarding workers' low participation rate.

GAO also sent a questionnaire to (1) a nationwide sample of employers who, according to IRS records, made advance payments in 1989 and 1990 and (2) another sample of employers who did not. The sample of participating employers is representative of a partial universe of employers who have made advance payments; the sample of nonparticipating employers may not be representative.

Results in Brief

Less than 0.5 percent of those who received the earned income credit in 1989 got the credit in advance. GAO found that the low participation rate was due to a variety of factors. For example,

- many eligible workers and their employers were not aware of the advance payment option,
- IRS outreach efforts emphasized the earned income credit but not the advance payment option, and
- employees preferred a lump sum payment instead of smaller periodic payments.

When advance payments were made, the payments did not appear to impose a major burden on employers. Among employers who provided the credit in advance to their employees, about 65 percent reported little or no burden. This percentage was about the same for participating small businesses with 100 or fewer employees. Employers who reported some difficulty with advancing the credit cited factors such as software limitations and computations for temporary and part-time workers.

Conversely, the advance payment option created problems for IRS. Of an estimated 8,028 individuals who filed a tax return and definitely received the advance payment, an estimated 3,946 (49 percent) did not report that receipt on their return. Under IRS' returns processing procedures, these individuals could receive the credit again as a lump sum payment. GAO also estimated that about 45 percent of those who, according to IRS records, may have received the advance payment never filed a tax return. If no return is filed, IRS has no way of determining worker eligibility.

Since few low-income wage earners know about the advance payment option, it is difficult to determine the effectiveness of giving the credit in advance. A full evaluation of the option's effectiveness will have to await additional promotional efforts by IRS.

GAO's Analysis

Many Employees and Employers Were Not Aware of the Advance Payment Option

GAO's survey of 438 low-income wage earners showed that most were not aware of the earned income credit or the advance payment option. Many of those who were aware of the option said that they would prefer the credit in a lump sum payment. GAO's survey of employers who had not made advance payments showed that about 60 percent of them had no familiarity

with the credit or the advance payment option. If so few employees and employers knew about the advance payment, it is not surprising that few workers got the credit in advance. (See pp. 15-18.)

IRS' outreach materials and programs to date have focused almost exclusively on promoting the earned income credit to eligible workers but not on the advance payment option. Currently, IRS requires employers to inform employees of the earned income credit if the employee has no income withheld. Since 1990, employers could meet this requirement by including a statement on the employee's Form W-2. However, the IRS-approved statement does not mention the advance payment option. Also, when processing workers' returns, IRS does not inform employees who receive the credit that the advance payment option is available. (See pp. 18-19.)

IRS' informational materials for employers also need to better explain employers' roles and responsibilities in making advance payments. The main IRS publication providing employers with information on advance payments is Circular E, Employer's Tax Guide. However, GAO's survey showed that for employers who were familiar with the earned income credit, 20 percent of those who had made advance payments and 42 percent of those who had not found Circular E to be "somewhat" to "little or no help" in explaining advance payment procedures. (See pp. 19-20.)

Most Employers Did Not View Advance Payments As Burdensome

About 65 percent of the employers who had made advance payments and responded to GAO's question about administrative complexity and burden related to making advance payments indicated that the advance imposed little or no burden. This percentage was about the same for participating small businesses with 100 or fewer employees. Similarly, 47 percent of the employers who were familiar with the advance payment option but who had not made advance payments responded that making the payments would not be a problem. (See p. 21.)

Of the employers who had made advance payments, 35 percent indicated that the advance payment caused problems to varying degrees. For example, keeping track of employees who get the advance and reporting the advance on tax returns (IRS Forms 941, 942, or 943) each made up about 45 percent of the problems identified. Further discussions with employers indicated that these problems actually stemmed from in-house software limitations. Computations for temporary and part-time workers were also cited as a problem. (See pp. 21-22.)

Advance Payments Created Administrative Problems for IRS

The advance payment option introduced administrative problems for IRS. GAO estimated that about 49 percent of the workers who clearly received advance payments in 1989 and filed a tax return did not report receiving the credit. In this situation, IRS' returns processing procedures can result in giving the credit to the worker again. GAO also estimated that about 45 percent of those who, according to IRS records, might have received the advance payment never filed a tax return. In the case of nonfilers, IRS would not know the worker's eligibility. It is not until IRS runs its underreporter and nonfiler compliance programs some months later that it can identify these individuals. However, once a problem is identified, IRS does not follow up on noncompliant individuals unless the expected yield is sufficiently high to justify the cost of pursuit. These nonfilers may not owe taxes; instead, beginning this year, they may be entitled to supplemental credits. (See pp. 24-28.)

Recommendations

To ensure that eligible taxpayers are aware of the advance earned income credit option, GAO recommends that the Commissioner of Internal Revenue

- include information on advance payment of earned income credit in employee outreach material and programs,
- notify taxpayers who receive the credit about the advance payment option,
- encourage employers to notify employees who have no income tax withheld of the advance payment option, and
- clarify instructions on advance payments in Circular E.

To improve compliance of those people who receive the advance payment, GAO recommends that the Commissioner of Internal Revenue

- send, to individuals who do not file tax returns, a notice explaining their requirement to file; and
- explore ways to identify those individuals who claim the credit in advance but do not report it, so as to prevent them from receiving the credit a second time.

Agency Comments

IRS agreed in principle with most of GAO's recommendations that it needs to do more employee outreach and taxpayer education and discussed relevant actions that it had taken or would be taking to implement them. IRS stated, however, that it did not have the resources available to produce and mail an informational notice to earned income credit recipients telling them that they could receive the credit in advance. Although budget constraints are a

consideration, GAO believes that sending such a notice on a test basis for 1 year would provide a great deal of information on workers' preferences on how to receive the credit.

Regarding GAO's recommendations to improve taxpayer compliance, IRS stated that the best approach to addressing noncompliance by advance earned income credit recipients is to emphasize the filing of correct tax returns. Although IRS' stated efforts to improve taxpayer compliance are positive steps, GAO believes that IRS should still explore ways to identify noncompliance while the tax return is processed. Appendix III contains IRS' detailed comments and GAO's evaluation of those comments. (See pp. 50-55.)

Contents

Executive Summary		2
Chapter 1		10
Introduction	The Earned Income Credit	10
	Objectives, Scope, and Methodology	11
Chapter 2		14
IRS Needs to Do More to Promote the Advance EIC Payment Option	Some Employees Did Not Want the Advance Payment Option, but Many Were Not Aware of the Option	14
	Some Employers Were Not Aware of the Advance Payment Option, While Others Were Confused About Their Responsibilities	17
	While Employer Burden Appears Light, Some Employers Report Problems	21
Chapter 3		24
Advance Payments Created Compliance Problems	Noncompliance Rate Was High Among Taxpayers Who Received Advance Payments	24
	IRS Compliance Programs Can Detect Unreported Advance Payments	27
Chapter 4		29
Conclusions and Recommendations	Employees Need to Know About the Option to Make an Informed Choice	29
	IRS Needs to Tighten Up Its Compliance Efforts	30
	Recommendations	30
	Agency Comments and Our Evaluation	31
Appendixes	Appendix I: GAO Sampling Methodology and Technical Analysis	32
	Appendix II: Survey of IRS' EIC Advance Payment System	40
	Appendix III: Comments From the Internal Revenue Service	50
	Appendix IV: Major Contributors to This Report	56

Tables

Table 1.1: Basic EIC Amounts by Employee Income Levels--1991 Rates for One Child	11
Table 2.1: Employee Awareness of the EIC and Advance Payment Option	15
Table 3.1: Estimates of Advance Payments Reported and Not Reported by Filers for Tax Year 1989	26
Table 3.2: Estimates of Employee Eligibility for the EIC for Tax Year 1989	27
Table I.1: Sample of Participating Employers and Questionnaire Response Rates	33
Table I.2: Statistical Results of the Questionnaire Survey of Employers Who Made Advance Payments	34
Table I.3: Sample of Nonparticipating Employers and Questionnaire Response Rates	35
Table I.4: Statistical Results of the Questionnaire Survey of Nonparticipating Employers	36
Table I.5: Estimated Percentages and Numbers of Employees in Subpopulations	37
Table I.6: Estimated Worker Eligibility for the EIC	38
Table I.7: Estimated Numbers of Workers Reporting and Not Reporting Receiving the EIC on Their Tax Returns	38
Table I.8: Estimated Total Advance Payments Reported	38
Table I.9: Estimated Average Advance Payments Reported	38
Table I.10: Estimates of Workers' Eligibility and Reporting Status	39
Table I.11: Estimates of Total Advance Payments Reported Based on Workers' Eligibility and Reporting Status	39
Table I.12: Estimates of Average Advance Payments Reported Based on Workers' Eligibility and Reporting Status	39

Abbreviations

AFDC	Aid to Families With Dependent Children
EIC	earned income credit
IRS	Internal Revenue Service
VITA	Voluntary Income Tax Assistance

Introduction

About 11.6 million low-income wage earners received \$6.5 billion through the earned income credit (EIC) for tax year 1989. But our estimates showed that only about 40,000 of them took advantage of the chance to receive the credit in their paychecks. The EIC is to provide economic assistance to low-income wage earners with children. Those workers who qualify can get the credit either when they file their income tax returns or in periodic advance payments from their employers as part of their paychecks. In either case, the employee is legally required to file a tax return. Historically, very few employees have received the credit in advance from their employers. The Omnibus Budget Reconciliation Act of 1990 directed the Comptroller General to study the effectiveness of the EIC advance payment system and determine why so few employees take advantage of the advance payment option.

The Earned Income Credit

Congress enacted the EIC in 1975 (1) to assist low-income wage earners who were adversely affected by rising prices; (2) to offset the impact of the social security taxes paid by these workers; and (3) to encourage low-income individuals, who might otherwise receive welfare benefits, to seek employment. Because the EIC is a refundable credit, even employees who owe no income taxes can receive it if they file their tax returns.

Beginning in 1979, employees could elect to receive the credit in advance payments from their employer during the year along with their regular pay instead of as a lump sum refund or tax credit on their year-end federal income tax returns. One purpose of the advance payment mechanism is to provide employees with an immediate reward for their work effort rather than forcing them to postpone receiving the credit until they file their tax returns. A second purpose is to help low-income workers meet their day-to-day needs rather than having them wait until the end of the year for assistance.

The Omnibus Budget Reconciliation Act of 1990 increased the maximum amount for the basic credit and added (1) a higher credit rate for households with more than one qualifying child, (2) a supplemental credit for a qualifying child under 1 year old, and (3) a supplemental credit for health insurance premiums that covered a qualifying child. However, only the basic credit is available through advance payment. Workers qualifying for the higher credit for more than one child or the supplemental credits must claim the remainder on their tax returns. To qualify for the credit in 1991, an employee had to maintain a household for at least one child and earn less than \$21,250. For 1991, the maximum basic credit available to an

employee with one child and income between \$7,140 and \$11,250 was \$1,192. Table 1.1 lists various income amounts and their corresponding basic credits.

Table 1.1: Basic EIC Amounts by Employee Income Levels—1991 Rates for One Child

Annual Income	Annual basic EIC	Basic EIC on a weekly basis
\$5,000	\$839	\$16.13
10,000	1,192	22.92
15,000	742	14.27
20,000	146	2.81

To receive advance EIC payments, an employee must submit a Form W-5, Earned Income Credit Advance Payment Certificate, to his/her employer. The employer is to include the advance payment in the employee's paycheck. In 1991 this advance payment could have been almost \$23 a week (increasing to \$30 a week, in 1991 dollars, by 1994), depending on the employee's pay. At the end of the year, employers are to report the total amount of the EIC paid in advance on the employee's Form W-2, Wage and Tax Statement. The employee is required to file a tax return and report these payments.

Objectives, Scope, and Methodology

The Omnibus Budget Reconciliation Act of 1990 directed us to study the EIC's advance payment option. Our objectives were to identify

- why few eligible workers take advantage of the advance payment option;
- if the advance payment option imposes a compliance burden on employers, especially small businesses; and
- any problems the Internal Revenue Service (IRS) experiences with the administration of the advance payment option.

Because of the legislatively mandated reporting time frame, we did not have the time to select a statistically valid sample of employees to determine why so few have taken advance EIC payments. Therefore, we obtained information from 438 individuals who, on the basis of income, could potentially qualify for the EIC in 1991. These individuals came from the following groups:

- employees of Alameda County, California, who earned less than \$21,250;¹
- a randomly selected group of recipients of Aid to Families With Dependent Children (AFDC) who reported income to the Alameda County Department of Social Services during April 1991;
- recipients of federal Section 8 housing benefits who recertified their income during May 1991 in San Francisco and who agreed to talk with us; and
- random taxpayers using the services of IRS' Volunteer Income Tax Assistance (VITA) sites located in California, Georgia, Texas, and Washington during the 1991 filing season who were eligible for the EIC and who volunteered to respond to our survey.²

Although the responses obtained cannot be generalized to the universe of EIC-eligible employees, we identified some common themes to help explain the advance payment option's low participation rate. We also obtained information on employees' views from public interest groups such as the Center for Budget and Policy Priorities, located in Washington, D.C.; and the Congress for a Working America, located in Milwaukee, Wisconsin.

To determine if the advance EIC payment option imposes an undue compliance burden on employers and to identify possible differences in how participants and nonparticipants view any burden imposed, we sent a questionnaire to nationwide random samples of (1) 523 employers who, according to IRS records, had made at least one advance EIC payment between January 1989 and December 1990 and (2) 617 employers who had not made any payments of advance EIC, but who may have had employees eligible for the credit during this same time period. These employers included both business employers and household employers.

We pretested the employer questionnaire with five employers in the San Francisco area in order to minimize nonsampling errors. The sample of participating employers can be generalized to a partial universe of those employers who have made advance payments because responses for many employers in the sample were not available for analysis. The sample of nonparticipating employers cannot be generalized. Appendix I gives detailed information on the sample design. The sample sizes were chosen to produce a sampling error of 5 percent at the 95-percent confidence level. Because we frequently examined subpopulations of the data, we

¹We included Alameda County in our study because it has been very active in promoting the EIC, and county officials voluntarily provided information on employees and AFDC recipients in the county.

²The VITA sites were judgmentally selected. One of the criteria used in selecting the sites was to provide geographic coverage of the EIC-eligible taxpayers.

highlighted the sampling error in the text only when it exceeded 10 percent. Appendix II contains our questionnaire results.

We obtained additional information on the low participation rate and potential employer burden associated with the advance EIC payment from members of the American Society of Payroll Managers and 21 employers in the San Francisco Bay area. These latter employers were judgmentally selected on the basis of their number of employees and type of business. Employers included state and local governments and retail, service, and manufacturing trades. We also interviewed IRS officials in Washington, D.C.; in the Western Regional Office; and in the San Francisco, Sacramento, San Jose, and Los Angeles district offices. In addition, we talked with officials from (1) the social services departments in San Francisco and Alameda counties and (2) nonprofit organizations concerned with low-income individuals and families.

To determine whether IRS experiences administrative problems with the advance payment option, we analyzed IRS computer files containing records on 44,767 individuals whose tax year 1989 Forms W-2 indicated receipt of advance EIC payments. We compared a random sample of these files with IRS' income tax return records to determine whether these individuals filed tax returns and reported the advance payments on their returns. We also reviewed IRS compliance activities related to advance EIC payments and discussed these programs with IRS National Office officials.

We did our field work from December 1990 through October 1991 in accordance with generally accepted government auditing standards.

IRS Needs to Do More to Promote the Advance EIC Payment Option

Fewer than 0.5 percent of those who received the EIC in 1989 used the advance payment option. One reason for the low participation rate is that many eligible employees and their employers are not aware of this option. Another reason is that some employees prefer a single lump sum refund payment instead of smaller periodic payments. An additional related reason is that some employees fear receiving too much in advance payments that they will have to repay when they file their tax returns.

IRS has outreach efforts aimed at getting eligible employees to apply for the EIC. However, until recently, IRS' promotional materials have not mentioned the advance payment option, nor has IRS provided promotional materials to employers regarding the option. Although IRS does provide employers with information about the advance payment through instructions and other guidance, this information is not clear, and the resulting misunderstanding could make employers reluctant to provide employees with information on the advance payment option.

Other employers may not be inclined to inform their employees of the advance payment option because they believe that it would involve a substantial administrative burden. Among those employers who actually provided these payments to their employees, and who expressed an opinion, 65 percent reported that the advance payment generated little or no burden.¹ This percentage was about the same for participating small businesses with 100 or fewer employees. Those employers who cited some difficulty said the problems primarily stemmed from factors such as software limitations and computations for temporary and part-time workers.

Some Employees Did Not Want the Advance Payment Option, but Many Were Not Aware of the Option

The advance payment option has been available for 12 years. Although we could not identify data at IRS showing the participation rate over the last 12 years, the 1989 participation rate of less than 0.5 percent suggests that very few workers take advantage of advance payments. Yet, neither IRS nor others systematically studied why the option was seldom used. And in all those years, IRS has not changed the focus of its outreach efforts to bring greater attention to the advance payment option.

We obtained information from low-income workers, nonprofit organizations involved in EIC outreach efforts, and employers to try to learn more about why workers do not take advantage of the EIC advance payment option. Although they do not necessarily reflect the views of

¹This estimate excludes the "no basis to judge" category that was 6.6 percent of all participant responses.

employees nationwide, most of the employees surveyed generally stated that they did not know about the option. The employees who did know about the advance payment option preferred receiving one single annual payment instead of small periodic payments.

Surveyed Employees Were Generally Not Aware of the Advance Payment Option

We surveyed 438 potentially eligible low-income employees to get information on employee awareness of the EIC and advance payment option. We found that most employees were not aware of the EIC and very few were aware of the advance payment option. (See table 2.1.) Because those employees were not part of a statistically valid sample, the information obtained cannot be generalized to the universe of EIC-eligible employees.

Table 2.1: Employee Awareness of the EIC and Advance Payment Option

Employees surveyed	Number of employees	Employees who knew about EIC	Employees who knew about advance payment
VITA site customers	233	113	29
Alameda county	108	34	3
AFDC recipients	91	23	5
Section 8 recipients	6	2	0

Some Employees Preferred a Lump Sum, Others Feared Owing IRS

We found that lack of knowledge about the advance payment option may not be the only reason why few EIC-eligible taxpayers take it. Many of the individuals who knew of the advance payment option said they would prefer to receive the credit as a lump sum payment. For example, of the 29 VITA site respondents who were aware of the advance payment option, 9 said they did not ask for advance payment because they preferred a lump sum payment. In addition, 40 AFDC recipients contacted us to discuss the survey during our review. As a part of these discussions, we asked if they would prefer to receive the advance payment or a lump sum. Thirty AFDC recipients stated that they would prefer receiving the lump sum at the end of the year rather than having the credit in small amounts added to their paychecks during the year. We received similar comments from 10 employers who, in response to our questionnaire, stated that in spite of their efforts to promote advance payments, their employees preferred to receive the credit in a lump sum.

Also, several nonprofit groups we contacted that work with low-income workers and families said that some employees do not ask for advance

payments because they are afraid of owing IRS money at the end of the year. If an employee receives more in advance payments than ultimately entitled to, the difference must be paid back to IRS. We were told that these individuals might not have the money to repay IRS or could suffer financial hardship by doing so. Although this concern might dissuade some employees from asking for advance EIC payments, IRS data indicated that only about 7 percent of the employees who reported receiving advance payments in 1989 and who were eligible had to repay some amount of the credit when they filed a tax return. Another 27 percent of the employees who reported receiving the advance payment in 1989 had to repay the advance because they were found not qualified for the credit.

Another reason why many EIC-eligible individuals might not take the credit in advance is that the amount advanced might not represent a large increase in take-home pay. Our analysis of 1988 EIC recipients showed that about 52 percent earned between \$9,840 and \$18,576. The median credit for this group was \$416. If the credit was given in advance, we estimated that the credit would represent a small increase of 3.8 percent in take-home pay. As expected, the percentage increase was greater for individuals with less earned income. Our analysis showed that about 26 percent of the recipients earned less than \$6,240. Although the median credit for this group was \$507, we estimated that the credit would represent a 14.4-percent increase in take-home pay.

Whether the advance payment's low participation rate is a result of a preference for a lump sum or a fear of owing IRS, this preference for receiving the credit when the tax return is filed is similar to the tax planning behavior of most taxpayers. Historically, 75 percent of taxpayers have more income taxes withheld from their paychecks than needed and then get a refund at the end of the year. For tax year 1989 the average income tax refund was \$925. The average EIC received for the same year was \$560.

IRS' Outreach to Employees Has Not Emphasized Advance Payment Option

IRS' National Office sets outreach and other objectives regarding the EIC for its 63 district offices to meet. However, the National Office relies on each district to develop its own plans and programs for informing employees about the credit, and the district is left on its own to determine how much emphasis should be placed on advance payments. To date, IRS' efforts have involved developing and disseminating information on the credit to newspapers and other print media and to radio and television stations throughout the country. IRS also works with nonprofit groups and state and local agencies to publicize the credit. However, IRS' efforts have

concentrated on getting more EIC-eligible employees to file for the credit on their tax returns. IRS has not placed equal emphasis on informing employees that they can also ask to receive the credit in advance payments. IRS officials informed us that they are reluctant to promote the advance payment option because of taxpayer noncompliance.

This reluctance to promote the advance payment option has changed very little, even though the Omnibus Budget Reconciliation Act of 1990 required IRS to establish a program to increase public awareness of the EIC. The public awareness program was to be designed to ensure that individuals who may be eligible for the credit—including the new credits added to the basic credit for 1991—are informed of the availability of the credit and how to get it. IRS officials said that their priority in the public awareness program is to emphasize the changes to the credit and, in particular, the need for taxpayers to file, for the first time, a separate schedule to claim the credit. IRS has recently made some effort to promote the advance payment option. For example, in July 1991, IRS released a news article, targeted to employees, on the advance payment.

Because IRS has directed its outreach efforts at those workers who may be eligible for the EIC but are not currently receiving it, IRS is missing an opportunity to inform those who are currently receiving the credit about the advance payment option. Under current procedures, IRS computes the credit for workers who file their returns and appear to qualify for the credit but fail to claim it. IRS computed the credit for about 7 percent of EIC recipients in 1989 even though they did not claim it. In these cases, IRS sends a computer-generated notice, along with the refund check, to the worker. This notice states that the EIC was computed by IRS for the worker; the notice does not mention the advance payment option. IRS does not send any computer-generated notice to the over 11 million workers who claim the EIC when they file. IRS should notify all workers who receive the credit to ensure that they know about the advance payment option.

Some Employers Were Not Aware of the Advance Payment Option, While Others Were Confused About Their Responsibilities

IRS' outreach efforts have placed little emphasis on making employers aware of the advance EIC payment option and their role in making advance payments. As a result, many employers were not aware of the option. Many of those who did know about the advance payment option were confused about their responsibilities and liabilities when making the payments. IRS needs to inform employers about the advance payment option and provide clearer guidance regarding employers' responsibilities under the option.

**IRS Outreach to Employers
on the Advance Payment
Option Was Limited**

We sent a questionnaire to 617 employers nationwide who, according to IRS records, had not made advance EIC payments.² About 60 percent of the employers who responded said they had no familiarity with the credit or the advance payment option. Obviously, if employers are not aware of the option, they are not in a position to promote the advance payment option among their employees.

We found that one reason for employers' lack of knowledge was IRS' limited efforts to make employers aware of the option. Similar to the outreach programs aimed at employees, IRS' National Office sets outreach objectives for its district offices; these objectives have focused little attention on promoting the advance payment to employers. In our surveys, we asked participating and nonparticipating employers who were familiar with the EIC and/or advance payment option how they had gained this familiarity. IRS personal contacts; seminars and conferences; and newspapers, radio, TV, and magazines made up about 18 percent of the responses for participating and nonparticipating employers.

We judgmentally selected four IRS California district offices to visit and found that the level of coverage given advance payments, while it varied from district to district, was minimal. Although both the EIC and the advance payment may be discussed in small business workshops and the Seminar Tax Education Program—a program given to businesspersons at local colleges and universities—district officials told us that very little time was spent discussing the advance payment option. One district covered the advance payment option in seminars given to tax preparers. Another district covered the option in its small business workshops but only by way of explaining how to complete the Employers Quarterly Tax Return.

We believe that it is just as important to make employers aware of the advance payment option as it is for employees to know about it. If employers know about the option, they might—on their own initiative—inform their employees about it. Currently employers are not required to notify their employees about the advance payment option. However, they are required annually to notify employees who have no income tax withheld that they may be eligible for the earned income tax credit. IRS specifies the wording that employers must use when notifying employees about the credit. Since 1990, employers could meet this notice requirement by having it printed on the back of the employee copy of Form W-2. However, the notice requirement does not mention the advance payment option.

²See appendix I for a discussion of our survey methodology.

We believe that IRS should consider establishing a national outreach objective for its district offices that requires them to inform employers of the advance payment option during workshops, seminars, and other such meetings. Similarly, IRS should encourage employers to notify their employees of the option. At a minimum this could be done by revising the statement on the employee copy of Form W-2 to mention the advance payment option.

IRS' Guidance to Employers on Advance Payments Should Be Clarified

Some employers may be reluctant to get involved with advance payments because they do not understand their roles and responsibilities for making the payments. This lack of understanding may, in part, be due to unclear IRS instructions on how advance payments are made to employees, how payments are reported on employment tax returns, and what employers' responsibilities and liabilities are regarding these payments.

IRS' primary publication for providing employers with information on advance payments is Circular E, Employer's Tax Guide. In fact, in responding to our survey on how they learned about the EIC or the advance payment option, 64 percent of the responses from employers who had participated in the advance payment option and 69 percent of the responses from nonparticipant employers said that one way they learned about these programs was through Circular E. This publication discusses the eligibility requirements for the credit, the Form W-5 that employees submit to get advance payments, the methods for figuring the payments, and the requirement that employers report the payments to IRS on both employment tax returns and employee Forms W-2. However, there appear to be varying opinions as to how well Circular E describes the credit and the employers' roles and responsibilities when employees request advance payments. Among those employers who were familiar with the EIC, and who expressed an opinion, 20 percent of those who participated in the advance payment program and 42 percent of those who did not participate found Circular E to be somewhat to little or no help in explaining the procedures for making the advance payment.³

Among those who did not find Circular E particularly useful, some indicated a basic misunderstanding about the nature of the credit. For example, several employers said that a better way to put money into the hands of low-income workers would be to let employees claim additional

³These estimates exclude the "no basis to judge" category that was 16 percent of the participant responses and 43 percent of the nonparticipant responses. The confidence interval at the 95- percent confidence level for our estimate of 42 percent for nonparticipants ranges from 31 to 53 percent.

exemptions on their Forms W-4, Employee's Withholding Allowance Certificate. These employers apparently did not realize that the credit can be claimed by employees who owe no income tax. Since these employees most likely would not have any income tax withheld from their paychecks, increasing the number of exemptions claimed on their Forms W-4 would not increase their pay. This lack of understanding was evidenced by both large and small employers. Other employers were unsure where they would get the funds to make advance payments. They thought the payment had to be made from their business funds rather than from withheld income and employment taxes that would otherwise be paid to the government. Employers also expressed fear that they would be held financially liable for any advance payment made to ineligible employees.

Another concern about Circular E was that the instructions did not clearly describe the employer's roles and responsibilities. Several employers we talked with said they thought they were responsible for verifying the employee's eligibility for the credit and were not sure that they could. Circular E instructs employers that they must make advance payments to employees who "correctly" fill out their Forms W-5, Earned Income Credit Advance Payment Certificate. Whether "correctly" means that all spaces on the Form W-5 are filled out, or that the information provided by the employee is accurate, is not specified. In fact, an employer is not required to determine whether the information on a completed and signed Form W-5 is accurate. This information is, however, not contained in the Circular E instructions.

Circular E's instructions for reporting the advance payments on employment tax returns are also unclear. When completing an employment tax return, an employer is supposed to subtract the total advance payments made from the total employment taxes due. Neither Circular E nor the instructions on completing the employment tax return describes this simple step.

One reason for employers' misconceptions about the advance payment option may be that Circular E does not contain examples of how advance payments affect an employee's paycheck or an employer's employment tax return. Several employers we contacted said that clear examples illustrating advance payments on an employee's paycheck (an increase in the amount of the check) and the employment tax return (a reduction in the amount of employment tax paid to the government) would help their understanding of how the payments affect them and their employees.

While Employer Burden Appears Light, Some Employers Report Problems

About 65 percent of the employers who had made advance payments and who expressed an opinion about administrative complexity and burden related to making advance payments indicated that making advance payments imposed little or no burden.⁴ This percentage was about the same for participating small businesses with 100 or fewer employees.⁵ Similarly, 47 percent of the employers who were familiar with the advance payment option but who had not made advance payments, and who expressed an opinion, responded that making the payments would not be burdensome.⁶

Whether making EIC payments in advance is viewed as a burden may depend on the attitude of the individual employer. Some employers said advance EIC was a major burden because the cost to change an automated payroll system to accommodate the advance payments was not justified by the small number of employees who applied for advance EIC payments. Other employers, while acknowledging the cost of changing computer systems, said it was a one-time cost and subsequent advance EIC payments were not a burden. Other employers indicating administrative difficulties cited unique problems associated with temporary and part-time workers.

Most Problems Identified Resulted From Software Limitations

Our survey showed that about 35 percent of the employers who had made advance payments and who had expressed an opinion indicated that the payments caused problems to varying degrees. Of the various types of problems identified, keeping track of employees who get the advance and reporting the payment on tax returns (i.e., Forms 941, 942, or 943) each made up about 45 percent of the responses. We recontacted several of these employers and found that, in most cases, these employers processed their own payrolls. Employers noted that the problems they encountered actually resulted from limitations of their in-house computer software. This finding is consistent with our survey results that showed that, of the participating employers who responded that they incurred additional costs in making advance payments for employees, procuring and/or revising software made up about 65 percent of the responses.⁷

⁴This estimate excludes the "no basis to judge" category that was 6.6 percent of the participant responses.

⁵Because we did not know firm size when we drew our sample, we were not able to stratify into large and small firms. As a result, our percentages do not generalize to all small businesses.

⁶This estimate excludes the "no basis to judge" category that was 50 percent of the nonparticipant responses. The confidence interval at the 95-percent confidence level ranges from 35 to 59 percent.

⁷The confidence interval at the 95-percent confidence level ranges from 49 to 80 percent.

Some employers who processed their own payroll with in-house software said that the software would not handle advance payments. In these cases, the advance payment was processed by hand. However, the employers estimated that the cost in terms of both time and money was small. We did follow-up interviews with several questionnaire respondents. None of the respondents we spoke with said that processing advance payments manually was an undue burden. These employers indicated that the small number of employees receiving advance payments did not justify the cost of changing existing computer systems to accommodate the payments or to purchase new computer software that could handle advance payments. Generally, employers who used an outside payroll service or subscribed to payroll software that is updated periodically had no problem with processing advance payments.

Employers Face Administrative Difficulties for Temporary or Part-time Employees

Some employers stated that making advance payments to an employee whose hours vary each pay period, such as a temporary or part-time worker, created a problem. If a worker's hours or wages fluctuate each pay period, the amount of credit must be recalculated each time the worker is paid. This frequent recalculation creates an administrative problem for some employers. Further, since an employer must stop making advance payments when the employee's wages reach the income ceiling, keeping track of the cumulative wages paid a temporary or part-time worker may create a problem for some employers.

If a worker changes employers over the course of the year, the burden is likely to fall on the worker if the amount of credit advanced during the year is inaccurate. When too little advance payment is made, the worker will not have the money up front and will have to wait until after the return is filed to receive the balance as a refund. When the various employers advance too much of the credit during the year, the employee will have to repay IRS the difference upon filing. As we stated earlier, this is a cause of some concern for workers.

Employers Familiar With Advance Payment Said Burden Was Light

A recent study of the EIC discussed how some employers, who perceived administrative burdens associated with the advance payment option, might not inform their employees about the EIC out of fear that the employees would ask for the advance payment.⁸ If the employers who do not participate perceived a burden, this may be because of confusion or

⁸Saul D. Hoffman and Laurence S. Seidman, The Earned Income Tax Credit, W.E. Upjohn Institute for Employment Research (Kalamazoo, Mi: 1990).

Chapter 2
IRS Needs to Do More to Promote the
Advance EIC Payment Option

misinformation. Our results indicated that those employers who made advance payments did not consider the burden to be particularly onerous. Eighty-five percent of the participants reported that they did not incur any additional costs by making advance payments.⁹ Of those respondents who attempted to quantify the costs, 55 percent said the total costs to comply with employee requests for advance payments amounted to less than \$250.¹⁰

⁹This estimate excludes the "not applicable" category that was about 12 percent of the participant responses.

¹⁰This estimate excludes the "cannot estimate" category that was about 11 percent of the participant responses. The confidence interval at the 95-percent confidence level ranges from 39 to 71 percent.

Advance Payments Created Compliance Problems

Advance EIC payments posed a noncompliance problem because the credit was paid before IRS ensured that the worker was eligible. We found that IRS' Information Returns Master File contained a large number of erroneous advance payment entries. Even after we removed the obvious errors, we found additional sources of error and uncertainty when we examined a sample of returns. From this sample, we estimated that about 18,000 individuals who, according to IRS' records might have received the advance payment, never filed a tax return. We also estimated that another 15,000 individuals who filed a return might have received the advance payment, but, because of incomplete data, we were unable to verify whether they did. In addition, we estimated that approximately 8,000 individuals filed tax returns and clearly received advance payments. Of these, about 51 percent acknowledged that receipt on their returns and 49 percent did not.

IRS officials have expressed concern about the potential nonreporting of advance payments. Employees who receive advance payments must report them on their tax return. If no tax return is filed, IRS has no way of knowing whether the employee was in fact eligible for the credit. On the other hand, if an eligible worker files a tax return but does not report the advance payments, under IRS' current returns processing procedures, the worker could receive the credit again as a lump sum payment. From our sample, we found about 27 percent of those who clearly received the advance payment fit this category.

IRS has compliance programs that can identify individuals who receive the credit in advance but do not file, or who file but do not report the advance. However, these compliance checks are made many months after tax returns are filed. Although IRS identifies individuals who do not report advance EIC payments, it rarely follows up on them, nor does it pursue all nonfilers. These nonfilers may not owe taxes but instead may be entitled to new supplemental credits associated with the EIC. Therefore, we believe that, at a minimum, IRS could send nonfilers who received the credit notices informing them of their need to file a return.

Noncompliance Rate Was High Among Taxpayers Who Received Advance Payments

There is a risk in paying the credit in advance because IRS cannot determine a worker's eligibility for the credit until the worker files a tax return. An ineligible worker can receive advance payments each year simply by giving his or her employer a completed and signed Form W-5. If the worker does not file a tax return, IRS has no way of knowing the worker's eligibility. Paying the credit in advance also involves a risk because eligible

workers who do not report the receipt of advance payments may receive the credit again when they file their returns.

To obtain information on taxpayer compliance with the advance payment requirements, we obtained IRS data on the 105,442 Forms W-2 filed by employers for tax year 1989 that showed advance EIC payments. In reviewing these data, we found that about 58 percent of the Forms W-2 filed had erroneous entries showing that advance payments had been made. What appeared to be a payment of the credit in advance was in most cases a misplaced entry of withheld social security taxes. Because of time constraints, we did not determine the cause of these errors. Given the erroneous entries, we determined that the remaining universe of employer-filed Forms W-2 showing advance payments made in tax year 1989 was 44,767.

We randomly selected 329 Forms W-2; this sample is representative of the adjusted universe of 44,767 advance payments. We compared the W-2 information with IRS' Individual Master File to determine how many workers, according to the W-2 information, received the credit in advance and reported the advance payment on their tax returns. We found that 138 workers did not file tax returns for 1989, and 191 did file. Of the 191 workers who filed for tax year 1989, we obtained 156 tax returns.¹

In reviewing the 156 tax returns, we found that 74 of the returns did not have a copy of the sampled W-2 attached. We therefore excluded these 74 returns from our sample because we were not certain the advance was received. Of the remaining 82 returns, the W-2s attached to 23 returns indicated that the workers were erroneously classified as receiving the advance payment. This additional source of error reduced our estimated universe of potential advance payment recipients from 44,767 to about 41,600.² Thus, of the 156 tax returns reviewed, only 59 returns had W-2s showing receipt of some amount of advance payment.

In reviewing the 59 returns, we found that 30 individuals (51 percent) reported advance payments on their tax returns. From these 59 cases, we

¹IRS did not provide tax returns for the remaining 35 filers in time for us to include them in our analysis.

²We made our estimate by reducing the 329 sampled cases by 23 and applying the proportion (306/329) to the original estimated universe of 44,767.

**Chapter 3
Advance Payments Created Compliance
Problems**

estimated a universe of 8,028 individuals who clearly received the advance payment and filed tax returns.³ Table 3.1 shows that an estimated 3,946 individuals (49 percent) did not report the receipt of advance payment on their tax returns. We estimate the average unreported payment to be \$183.

Table 3.1: Estimates of Advance Payments Reported and Not Reported by Filers for Tax Year 1989

Reporting status	Number of employees	Percent of employees	Total amount of advance payment	Average amount of advance payment
Reported payments	4,082	51	\$1,228,167	\$301
Did not report payments	3,946	49	723,348	183
Total	8,028	100	\$1,951,515	\$243

Note: The differences between the amounts presented for the two reporting statuses are not statistically significant. Comparisons between the reporting statuses therefore may be misleading. See appendix I for the confidence intervals.

Of the 59 tax returns we reviewed, 38 individuals were eligible for the credit, but 16 of them did not report receiving the credit in advance. The 16 individuals received an average advance payment of \$280. Since these individuals also received the full amount of the EIC they were entitled to when they filed their tax returns, the amount they received in advance represented an overpayment.

Our review of the 59 tax returns also showed that 21 individuals received the credit in advance but were not eligible. In 14 cases, the individuals were not eligible because they did not have a qualifying child. For the remaining seven cases, the individuals were not eligible because their income exceeded the allowable limits. We also found that only 8 of the 21 ineligible individuals reported receiving the credit in advance on their tax returns. The remaining 13 individuals did not report receiving the credit in advance. The average amount of credit advanced and not reported was \$64. In table 3.2 we estimated employee eligibility for the EIC and whether employees reported receipt of the advance payment.

³We Estimated the Universe of Those Who Clearly Received the Advance Payment and Filed Returns by Applying the Proportion 0.19 (59/306) to the Estimated Universe of 41,600. the Interval at a 95-Percent Confidence Level Ranges From 6,170 to 9,900. Because We Were Unable to Obtain 35 Returns and 74 Others Did Not Have the W-2s We Were Looking For, It Is Possible That Another 36 Percent (109/306), or 15,000 Individuals, Could Have Received the Advance Payment.

Table 3.2: Estimates of Employee Eligibility for the EIC for Tax Year 1989

Eligibility and reporting status	Number of employees	Percentage of employees	Total amount of advance payment	Average amount of advance payment
Eligible				
Reported payments	2,994	37	\$1,070,627	\$358
Did not report payments	2,177	27	609,424	280
Not eligible				
Reported payments	1,088	14	157,769	145
Did not report payments	1,769	22	113,896	64

Note: The differences between the two reporting statuses are not statistically significant. Comparisons between the reporting statuses therefore may be misleading. See appendix I for the confidence intervals.

From our sample of 306 individuals, we found that 138 (45 percent) did not file tax returns. If we projected this percentage to the universe, we would estimate over 18,000 nonfilers. However, some of these "nonfilers" may not have received the advance payment and, therefore, may not have had an obligation to file. As noted earlier, we found that in 23 of the 82 cases (28 percent) in which the employee filed and the appropriate W-2 was attached, IRS' records were in error. If a similar proportion of erroneous records was included in our sample, then the number of actual nonfilers would be closer to 13,000.

IRS Compliance Programs Can Detect Unreported Advance Payments

IRS has two programs that are used to detect noncompliance with the advance payment option. The underreporter program identifies individuals who file tax returns but do not report all their income. The nonfiler program identifies individuals who have income but do not file their tax returns. The primary source for identifying potentially noncompliant taxpayers under both programs is information returns, such as Form W-2, on which employers report advance payments. IRS does not match W-2s and tax returns until 8 months after the close of the filing season. Once a problem is identified, however, IRS does not follow up on all noncompliant recipients of advance payments.

According to IRS officials, they do not pursue underreporter cases unless the potential yield is sufficiently high to justify the cost of pursuit. Also, IRS will not pursue cases in which an advance payment was made but no tax

return was filed, unless the employee's total income is high enough to meet the standard filing requirement. Under the new rules for the EIC such individuals may also be entitled to the new supplemental credits associated with the EIC and may need to file a return—as well as a new supplemental schedule—to get them. We believe that IRS should send these employees a notice informing them of their filing requirement. These individuals may not realize that even people with incomes too low to owe taxes have to file a return because they received advance payments.

Because of the time lag between filing and matching W-2s with tax returns, along with the low incomes of the individuals involved, it is unlikely that IRS would recapture much money even if underreporter cases were pursued. It would be more effective if IRS could detect unreported payments while processing tax returns rather than waiting 8 months until the W-2s are compared with tax returns to identify a problem. This procedure would at least prevent IRS from overpaying the EIC to eligible individuals.

Currently, IRS technology and returns processing procedures are not geared to identifying unreported advance payments when returns are processed at IRS service centers. IRS officials told us that having tax examiners review all returns that claim the EIC to see whether the W-2s show receipt of advance payments would be too costly and time consuming. IRS procedures do provide that if a return is pulled from the processing stream because of an arithmetic error, the W-2 is supposed to be checked against the return to see that all information is included and is consistent. While this procedure may be followed in most cases, we identified two cases in our sample in which it did not appear to have been followed.

Having information returns available at the time that returns are processed would help IRS in several areas besides checking on the receipt of advance payments. For example, it would allow IRS to be more confident that the refunds it is sending out to those who file—especially those who file electronically—are based on accurate information. Contemporaneous matching of information and tax returns is one of IRS' long-term goals.

Conclusions and Recommendations

To achieve the congressional intent that low-income wage earners have the option of getting the EIC as part of their paychecks, far more effort will have to be made to promote this option. Most importantly, employees and employers need to know that eligible workers have the option of getting the credit in periodic payments over the year. In addition, employers need clearer instructions on how the advance payment option works. Finally, IRS seems to be trying to minimize noncompliance by not promoting the advance payment option. There are some limited opportunities to pursue underreporters and nonfilers using existing enforcement programs. However, under existing returns processing technology, it is unlikely that enforcement efforts will be very effective.

Employees Need to Know About the Option to Make an Informed Choice

Most employees who receive the EIC do not get it in advance. Many employees, however, may prefer to receive the EIC as a lump sum. This preference is similar to the preference—held by many taxpayers—to have taxes overwithheld so as to receive a larger refund. In this way, taxpayers use the tax system as a way to accumulate a substantial amount of money rather than trusting that they will save from each paycheck. Others may be concerned that they will receive too much in advance payment and be required to repay the excess at a time when funds may be scarce.

On the other hand, many employees appear to be unaware of the existence of the advance payment option. In fact, we do not know how many employees would prefer the advance payment option because the awareness level is so low. IRS is doing very little, at present, to promote the option. Basically, it promotes the EIC in general with potentially eligible workers; IRS also requires employers to notify employees about the EIC but not about the advance payment option. To give the advance payment option a fair test, employees need to know about it. For example, IRS could notify all those who apply for and receive the credit about the advance payment option when it sends them a refund check.

IRS could also improve its outreach efforts to employers to make them more aware of the advance payment option. To ensure that employers help to promote the advance payment option and not discourage employee participation, IRS needs to help employers understand how the option works. IRS also needs to give employers clearer guidance on their responsibilities and better instructions as to how to complete the advance payment part of the employment tax return. Until IRS provides more and better information about the advance payment mechanism, we do not believe that the extent to which employees prefer the lump sum has been fairly tested.

Such improvements in outreach may also assuage some employers' concerns that the advance payment option is burdensome. Our survey showed that advance payments do not appear to impose an undue administrative burden on businesses, small or large. Employers who have experience with the advance EIC payment generally acknowledge that while there is some cost associated with making the payment, it is not unreasonable.

IRS Needs to Tighten Up Its Compliance Efforts

Currently, IRS does not appear to be paying much attention to individuals who receive the advance payment and then do not file tax returns. For those who file, the best place to deal with underreporting would be at the returns processing stage. Either at that point, or subsequently, notices should be sent to those who do not report, on their tax returns, advance payments that are shown on their W-2s.

As a result either of increased promotional efforts by IRS or others, or the increasing size of the credit, more people may choose the advance payment option. If they are legitimate claimants, congressional intent will be more closely approximated. However, if the noncompliance proportions of our sample apply to these new claimants, the amounts received by ineligible employees or by those who receive the credit a second time could increase substantially. On the other hand, if most people do prefer the lump sum, at least IRS will be more certain that it does not result from ignorance of the available options.

Recommendations

To ensure that eligible taxpayers are aware of the advance EIC option, we recommend that the Commissioner of Internal Revenue

- include information on advance payments of the EIC in employee outreach material and programs,
- notify taxpayers who receive the credit about the advance payment option,
- encourage employers to notify employees who have no income tax withheld of the advance payment option, and
- clarify instructions on advance payments in Circular E.

To improve compliance of those people who receive the advance payment, we recommend that the Commissioner of Internal Revenue

- send, to individuals who do not file tax returns, a notice explaining their requirement to file; and

- explore ways to identify those individuals who claim the credit in advance but do not report it, so as to prevent them from receiving the credit a second time.

Agency Comments and Our Evaluation

IRS agreed with our recommendations that it needs to do more employee outreach and taxpayer education as well as clarify its instructions to employers about the advance payment option. IRS stated, however, that it did not have the resources available to produce and mail an informational notice to EIC recipients telling them that they could receive the credit in advance. Although budget constraints are certainly a consideration, we believe that even if IRS sent such a notice on a test basis for 1 year, it would provide a great deal of information on EIC recipients' preferences on how to receive the credit.

IRS stated that the best approach to addressing noncompliance is to emphasize the filing of correct returns. IRS stated that because of the erroneous W-2 information relating to the advance payment, sending nonfiler notices to taxpayers who did not receive the EIC and who did not have a filing requirement would confuse the taxpayer. We believe that with a few simple edit checks the number of notices sent erroneously could be reduced substantially. Lastly, although IRS' revisions to Form 1040 and its efforts to redesign the Form W-2 should improve taxpayer reporting of advance payments, we believe IRS should still explore ways to identify noncompliance while the return is processed to prevent individuals from receiving the credit a second time. Appendix III contains IRS' detailed comments and our evaluation of those comments.

GAO Sampling Methodology and Technical Analysis

This appendix describes the sampling methodology we used to (1) identify factors that affect employer participation in the advance earned income credit (EIC) program, (2) determine whether the advance payment option imposes administrative burdens on employers, and (3) identify any administrative problems experienced by the Internal Revenue Service (IRS) because of the advance payment option. To answer the first two questions, we sent questionnaires to a sample of employers who had made advance payments and a sample of employers who had not. To answer the last question, we sampled IRS tax records for employees who, according to IRS data, received the credit in advance. The appendix also presents further details on the precision of the statistical estimates contained in the report.

The statistical estimates reported in chapters 2 and 3 are point estimates. The precision of these estimates varies with the quantitative relationship of a sample to a population. To illustrate, we reported a point estimate in chapter 2 that 65 percent of employers making advance payments did not find the administration of such payments to be a burden. In statistical terms that also describe the reliability of this estimate, we would say that we are 95 percent confident that between 60 and 71 percent of the nation's employers who made advance payments did not find administering these payments burdensome. There is a 5-percent chance that the confidence interval does not contain the actual population percentage.

In addition to sampling errors, surveys can also be subject to other types of systematic errors or biases that can affect results. Bias can affect both response rates and the way in which particular questions are answered by respondents. It is not possible to assess the magnitude of the effect of biases, if any, on the results of this survey.

Sampling Methodology and Analyses for Participating and Nonparticipating Employers

To obtain employer views on the advance payment option and to determine whether the advance payment option imposed an administrative burden on employers, we sent questionnaires to two groups of employers. The first group consisted of a random sample of employers who made advance payments. For this group, our results are generalized to a partial universe of participating employers because responses for many employers in the sample were not available for analysis. The second group consisted of a random sample of employers who did not make advance payments. Because of the sampling process used, the size of the nonparticipating universe could not be determined. Therefore, our results cannot be generalized to the universe of nonparticipating employers.

Participating Employers

This population contains employers who, according to IRS records, made advance payments during the period January 1989 through December 1990. Initially, IRS gave us a file containing 16,052 employers nationwide who filed IRS Forms 941, 942, or 943 showing that advance payments were made at least once during the specified time period. We reduced this population to 12,575 employers by eliminating employers who, on a quarterly basis, showed advance payments of less than \$1 or greater than \$10,000. Our preliminary work showed that amounts greater than \$10,000 were likely to be erroneous.

We took the adjusted universe of 12,575 employers and stratified it into two groups. Stratum I included 11,484 business employers who filed Forms 941 or 943; stratum II included 1,091 household employers who filed Forms 942. Using simple random sampling, we then independently selected 537 employers from stratum I and 126 employers from stratum II. The sample was then reduced by 140 employers (126 employers from stratum I and 14 employers from stratum II) because they were undergoing some type of IRS audit review or because they were located in Guam or Puerto Rico.¹ A questionnaire was sent to the remaining 523 employers. Table I.1 shows the number of employers sent questionnaires and the response rate.

Table I.1: Sample of Participating Employers and Questionnaire Response Rates

Stratum	Number of employers	Number of employers responding	Response rate (percent)
I	411	344	83.70
II	112	85	75.89
Total	523	429	82.03

Because of the reduced sample, the questionnaire results address a partial universe of 8,093 employers (7,618 to 8,568 employers at the 95-percent confidence level). On a weighted basis, the partial universe corresponds to between 60 and 68 percent of the overall universe. Weighted results of the questionnaire survey are shown in table I.2, together with their associated confidence intervals at the 95-percent confidence level.

¹We eliminated employers who were involved in IRS audits to avoid interfering with an ongoing audit. We eliminated employers located in Guam and Puerto Rico to save data collection resources.

**Appendix I
GAO Sampling Methodology and Technical
Analysis**

**Table I.2: Statistical Results of the
Questionnaire Survey of Employers Who
Made Advance Payments**

Employer response	Estimated number of respondents	Point estimate (percent)	Confidence interval at the 95-percent confidence level
Learned about advance payment option through Circular E	6,375	64	58 - 69
Learned about advance payment option through other IRS contacts or publications	6,375	18	14 - 22
Did not think Circular E was useful	5,214	20	15 - 25
Experienced little burden in administering advance payment option	5,924	65	60 - 71
Encountered problems in administering advance payment option	5,924	35	29 - 41
Was familiar with the advance payment option and did not incur additional costs	6,186	85	81 - 89
Was familiar with the advance payment option and encountered problems in terms of:			
Keeping track of employees	2,050	48	38 - 58
Reporting the advance payment on tax returns	2,050	45	35 - 55
Was familiar with the advance payment option and incurred additional costs:			
Incurred software-related costs	753	65	49 - 80
Incurred costs less than \$250	753	55	39 - 71

Note: Confidence intervals were computed using simple random sampling with replacement.

Nonparticipating Employers

IRS provided us with a sample of 5,941 employers who did not make any advance payments during the period January 1989 through December 1990. IRS used a systematic random sampling technique in which every 4,000th employer was selected from the IRS entity module. IRS then matched the selected employer against the IRS tax module to see whether the employer filed a Form 941, 942, or 943 return and did not make an advance payment. If these conditions were met, the employer was added to our sample. If not, IRS would continue to the next record in the tax module file until the conditions were met. Every time IRS had a match, it went back to the entity module and selected the next 4,000th employer. This method of sample selection did not enable us to determine the size of the universe of nonparticipating employers in the IRS tax module. It is also possible that this method of selection biased our results. Therefore, our results cannot be generalized to the universe of nonparticipating employers.

We took the initial sample of 5,941 nonparticipating employers and divided it into three strata for subsampling. We developed this stratification to systematically include three types of employers. Stratum I included 5,256 business employers who filed Forms 941 or 943; stratum II included 638 household employers who filed Forms 942; and stratum III included 47 public employers. We then used systematic random sampling to select 437 employers for stratum I and 200 employers for stratum II. We kept all 47 public employers in stratum III. Thus, our overall sampling effort included 684 employers in three strata.

We further reduced our subsample of 684 nonparticipating employers by eliminating employers who were involved in IRS audits or located in Guam or Puerto Rico. The adjusted sample included 617 nonparticipating employers. We then sent a questionnaire to each of these employers. Table I.3 shows the sample size by stratum and questionnaire response rate.

Table I.3: Sample of Nonparticipating Employers and Questionnaire Response Rates

Stratum	Number of employers	Number of employers responding	Response rate (percent)
I	380	275	72.37
II	195	133	68.21
III	42	38	90.48
Total	617	446	72.28

The questionnaire results were weighted to account for stratum size and then combined across strata. Table I.4 shows the questionnaire results for the nonparticipating employers. The reliability of the point estimates is shown using the confidence interval at the 95-percent level.

**Table I.4: Statistical Results of the
Questionnaire Survey of
Nonparticipating Employers**

Employer response	Estimated number of respondents	Point estimate (percent)	Confidence Interval at the 95-percent confidence level
Familiar with advance payment option	1,519	40	35 - 46
Not familiar with advance payment option	2,250	60	55 - 65
Learned about advance payment option through Circular E	1,519	69	61 - 77
Learned about the advance payment option through other IRS contacts or publications	1,519	18	12 - 25
Knew about advance payment option and found Circular E of little help	1,428	42	31 - 53
Indicated that advance payment option was not an administrative burden	817	47	35 - 59

Note: Confidence intervals were computed using simple random sampling with replacement.

Sampling Methodology for Analyses of IRS' Administration of Advance Payments

To identify any problems IRS has experienced in administering the advance payment option, we evaluated employee filing characteristics for a simple random sample of employees. Initially, we used IRS' Information Return Master File and identified 105,442 Forms W-2 filed by employers for tax year 1989 that showed an advance payment of the EIC. In reviewing these data, we found that about 58 percent of the Forms W-2 filed had erroneous entries showing that advance payments had been made. The erroneous entries were predominantly misplaced entries of withheld social security taxes. After removing these erroneous Forms W-2 from our initial universe, there were 44,767 Forms W-2 remaining.

We selected a simple random sample of 329 Forms W-2 from the reduced universe of 44,767 potential advance EIC participants. We then requested IRS tax records corresponding to the sampled Forms W-2 to determine whether each employee filed a tax return and reported receiving the advance payment. Of the 329 sampled employees who, according to IRS records, received the EIC in advance in 1989, we found that 138 did not file returns. We reviewed the tax returns for 156 of the 191 workers who filed 1989 tax returns. IRS was unable to provide us with the tax returns for the remaining 35 workers in time for our analysis.

In reviewing the remaining 156 tax returns, we found that 74 did not have the sampled Forms W-2 attached that matched the IRS Information Return Master File showing advance payment had been made. Twenty-three returns showed that the workers were erroneously classified as receiving advance payment of the credit. Only 59 returns were useful for our analysis because the returns had the Forms W-2 attached showing the advance payment. Consequently, our estimates derived from this sampling process apply to only 18 percent (59/329) of the original population of 44,767 potential recipients of the advance EIC. Table I.5 shows the point estimates for the subgroups and the associated confidence interval at the 95-percent confidence level.

Table I.5: Estimated Percentages and Numbers of Employees in Subpopulations

Employee status	Point estimate		Confidence interval at the 95-percent confidence level	
	Percent	Number of employees	Percent	Number of employees
Did not file a return	42	18,778	37 - 47	16,390 - 21,170
Returns obtained:				
Usable W-2	18	8,028	14 - 22	6,170 - 9,900
Misclassified	7	3,130	4 - 10	1,900 - 4,370
W-2 missing	22	10,069	18 - 27	8,000 - 12,100
Return not obtained	11	4,762	8 - 14	3,270 - 6,260
Total	100	44,767		

To determine the level of taxpayer compliance with the advance payment option, we reviewed the 59 sample returns with a Form W-2 attached that showed an advance payment had been made. The following series of tables shows the point estimates and associated confidence intervals for (1) worker eligibility, (2) the extent to which the workers reported receiving the advance on their tax returns, and (3) the average and total annual amount of credit received in advance. Differences between categories in the following tables generally are not statistically significant. Comparisons between any two categories therefore may be misleading.

**Appendix I
GAO Sampling Methodology and Technical
Analysis**

Table I.6: Estimated Worker Eligibility for the EIC

Eligibility status	Point estimate		Confidence interval at the 95-percent confidence level	
	Universe	Percent	Number	Percent
Eligible	5,171	64	3,622 - 6,719	52 - 76
Not eligible	2,857	36	1,673 - 4,042	24 - 48
Total	8,028	100		

Table I.7: Estimated Numbers of Workers Reporting and Not Reporting Receiving the EIC on Their Tax Returns

Reporting status	Point estimate		Confidence interval at the 95-percent confidence level	
	Universe	Percent	Number	Percent
Reported	4,082	51	2,687 - 5,477	38 - 64
Did not report	3,946	49	2,572 - 5,320	36 - 62
Total	8,028	100		

Table I.8: Estimated Total Advance Payments Reported

Reporting status	Point estimate of total dollars	Confidence interval at the 95-percent confidence level, total dollars
Reported	\$1,228,167	\$709,541 - 1,746,793
Did not report	723,348	346,966 - 1,099,730
Total	\$1,951,515	\$1,327,154 - 2,575,875

Table I.9: Estimated Average Advance Payments Reported

Reporting status	Point estimate of average dollars	Confidence interval at the 95-percent confidence level, average dollars
Reported	\$301	\$225 - 377
Did not report	183	111 - 255
Average	\$243	\$189 - 297

We also used the 59 sample returns to analyze taxpayer compliance in a reduced universe by comparing the workers' eligibility and reporting status. The next series of tables shows the point estimates and associated confidence intervals for (1) a comparison of worker eligibility and reporting status, (2) the total annual amount of credit received in advance based on worker eligibility and reporting status, and (3) the average amount of credit received in advance based on worker eligibility and reporting status. The estimates are based on the subpopulations of 5,171

eligible, or 2,857 ineligible, employees as shown in table I.6. Differences between categories in the following tables generally are not statistically significant. Comparisons between any two categories therefore may be misleading.

Table I.10: Estimates of Workers' Eligibility and Reporting Status

Eligibility and reporting status	Point estimate		Confidence interval at the 95-percent confidence level	
	Universe	Percent	Number	Percent
Eligible and reported	2,994	58	1,673 - 4,042	42 - 74
Eligible, did not report	2,177	42	1,135 - 3,219	26 - 58
Ineligible but reported	1,088	38	342 - 1,835	17 - 59
Ineligible, did not report	1,769	62	825 - 2,713	41 - 83

Table I.11: Estimates of Total Advance Payments Reported Based on Workers' Eligibility and Reporting Status

Eligibility and reporting status	Point estimate of average dollars	Confidence interval at the 95-percent confidence level, total dollars
Eligible	\$1,680,031	\$1,327,466 - \$2,032,596
Ineligible	271,551	153,400 - 389,702
Eligible and reported	1,070,627	805,708 - 1,335,546
Eligible, did not report	609,424	378,334 - 840,514
Ineligible but reported	157,769	69,833 - 245,705
Ineligible, did not report	113,896	45,987 - 181,805

Table I.12: Estimates of Average Advance Payments Reported Based on Workers' Eligibility and Reporting Status

Eligibility and reporting status	Point estimate of average dollars	Confidence interval at the 95-percent confidence level, average dollars
Eligible	\$325	\$257 - 393
Ineligible	95	54 - 136
Eligible and reported	358	269 - 446
Eligible, did not report	280	174 - 386
Ineligible but reported	145	64 - 226
Ineligible, did not report	64	26 - 103

Survey of IRS' EIC Advance Payment System

Note: Percentages are based on the weighted responses of 446 nonparticipants and 429 participants who responded to the questionnaire. Percentages of nonparticipants' (NP) and participants' (P) responses are shown at the end of each question option or in the corresponding boxes.

The percentages shown in the questionnaire were computed on the basis of total responses to each question—not the number of respondents. Therefore, the percentages shown in the questionnaire may differ from the corresponding percentages shown in the text.



United States General Accounting Office

Survey of IRS' Earned Income Credit Advance Payment System

Introduction

The U.S. General Accounting Office (GAO), an independent agency of Congress, is evaluating the Internal Revenue Service's (IRS) operations concerning the earned income credit (EIC) advance payment system. GAO is not a part of any other federal agency, including IRS. The purpose of this questionnaire is to assist us in determining the following: the effectiveness of the earned income credit advance payment system; the reasons why so few employees take advantage of the system; ways to alleviate administrative complexity, if any, for businesses; and any other problems in the administration of the system.

The EIC is a tax credit available to certain employees who have at least one child living in their home. The credit is based on a percentage of each employee's wages. Any portion of the EIC that exceeds the employees' tax liability is refunded to the employee by IRS. For 1990, the ceiling on earned income was \$20,264. The EIC could have been as much as \$953. If the employee chooses, he/she can receive the EIC during the year in advance payments along with regular pay rather than waiting to claim it on his/her tax return. To get advance payments, the employee must complete a Form W-5 (*Earned Income Credit Advance Payment Certificate*) and give it to his/her employer. The employer generally makes the advance EIC payment from withheld income and social security taxes that would have otherwise been forwarded to the IRS.

The questionnaire should be answered by an individual(s) familiar with preparing your employer tax returns (Forms 941, 942, or 943) and the related instructions that cover advance payment of the earned income credit.

Your responses will be treated confidentially, combined with other responses and reported only in summary form to the Congress. The questionnaire is numbered only to aid us in our follow-up efforts and will not be used to identify you with your responses. After the questionnaires have been processed, the link between your organization and your responses will be destroyed and no one will be able to tell how you or any other employer answered.

The questionnaire can be completed in about 10 minutes. Most of the questions can be easily answered by checking boxes or filling in blanks. Space has been provided for any additional comments at the end of the questionnaire. If necessary, additional pages may be attached.

Please return the completed questionnaire in the enclosed self-addressed envelope within 10 days. In the event the envelope is misplaced, please mail the completed questionnaire to:

U.S. General Accounting Office
Ms. Suzy Foster
Suite 900
1275 Market Street
San Francisco, CA 94103

If you anticipate any difficulty in returning the questionnaire promptly or if you have any questions, you may call Ms. Suzy Foster or Mr. Ralph Block on (415) 556-6200.

Thank you for your cooperation.

**Appendix II
Survey of IRS' EIC Advance Payment System**

		<u>WEIGHTED ESTIMATES *</u>	
		<u>NON PARTICIPATING</u>	<u>PARTICIPATING</u>
<p>4. For the year 1990, an employee with earned income (wages) under \$20,264 could potentially be eligible for the earned income credit.</p> <p>For 1990, please estimate how many employees were paid less than \$20,264 by your organization. (Enter number. If none, enter "0.")</p>			
(Estimated number of employees)	100 or fewer employees	N = 3,352 Average = 4.85	N = 5,453 Average = 15.99
	More than 100 employees	N = 2,471 Average = 104.69	N = 2,459 Average = 1,668
<p>5. Prior to receiving this questionnaire, how much familiarity, if any, did you have with the EIC and/or the EIC <u>advance</u> payment system? (Check one.)</p>			
1.	<input type="checkbox"/> No familiarity (Skip to Question 22.)	N = 3,769 59.70 %	N = 8,094 21.24 %
2.	<input type="checkbox"/> Some familiarity	23.32 %	24.17 %
3.	<input type="checkbox"/> Moderate familiarity	11.46 %	29.40 %
4.	<input type="checkbox"/> Great familiarity	4.09 %	17.94 %
5.	<input type="checkbox"/> Very great familiarity	1.43 %	7.25 %
		(Continue to Question 6.)	
<p>6. Which of the following best describes how you learned about the EIC and/or the <u>advance</u> EIC payment system? (Check all that apply.)</p>			
1.	<input type="checkbox"/> Personal contact by an IRS representative	N = 1,629 .06 %	N = 7,883 .65 %
2.	<input type="checkbox"/> Circular E or other IRS tax publication	64.09 %	51.38 %
3.	<input type="checkbox"/> Seminar, conference, or other informational meeting	8.72 %	8.63 %
4.	<input type="checkbox"/> Newspaper, radio, TV, magazine, or other professional publication	8.41 %	5.81 %
5.	<input type="checkbox"/> Request from employee or employee group	.74 %	25.56 %
6.	<input type="checkbox"/> Other (Please specify.)	17.99 %	7.98 %

**Appendix II
Survey of IRS' EIC Advance Payment System**

	WEIGHTED ESTIMATES *	
	NON PARTICIPATING	PARTICIPATING
7. Did your organization make any <u>advance</u> payments of the earned income credit to any of your employees during the year 1990? (Check one.)	N = 1,520	N = 6,374
1. <input type="checkbox"/> Yes (Continue to Question 8.)	1.58 %	70.38 %
2. <input type="checkbox"/> No (Skip to Question 9.)	98.42 %	29.62 %
8. To obtain <u>advance</u> payment of the earned income credit, an employee must file FORM W-5, <i>Earned Income Credit Advance Payment Certificate</i> , with his/her employer. For 1990, how many Forms W-5 did you receive in total from your employees? (Enter number. If none, enter "0.")		
Employers with 100 or fewer employees	N = 3,352 Average = 0.06	N = 5,453 Average = 5.37
(Total number of Forms W-5 received)		
More than 100 employees	N = 2,471 Average = 0.05	N = 2,459 Average = 24.00
9. Does any department within your organization, such as payroll, inform employees that the earned income credit is available to those who are eligible? (Check one.)	N = 1,459	N = 6,310
1. <input type="checkbox"/> Yes (Continue to Question 10.)	33.24 %	61.13 %
2. <input type="checkbox"/> No	62.10 %	32.63 %
3. <input type="checkbox"/> Don't know	4.66 %	6.24 %
	} (Skip to Question 13.)	
10. Which of the following best describes the manner in which you inform your employees of the earned income credit? (Check all that apply.)	N = 537	N = 4,888
1. <input type="checkbox"/> Provide copy of IRS' Notice 797 (<i>Notice of Possible Federal Tax Refund Due to the Earned Income Credit</i>)	34.64 %	41.14 %
2. <input type="checkbox"/> Newsletter, memorandum, or other internal document	7.82 %	13.99 %
3. <input type="checkbox"/> Word of mouth, such as staff meetings	45.07 %	33.74 %
4. <input type="checkbox"/> Other (Please specify.)	12.48 %	11.13 %

**Appendix II
Survey of IRS' EIC Advance Payment System**

	WEIGHTED ESTIMATES *	
	<u>NON PARTICIPATING</u>	<u>PARTICIPATING</u>
11. Does your organization inform its employees that they may receive payment of the earned income credit through an <u>advance payment</u> in their pay check? (Check one.)	N = 470	N = 3,836
1. <input type="checkbox"/> Yes (Continue to Question 12.)	78.81 %	90.62 %
2. <input type="checkbox"/> No	19.36 %	8.26 %
3. <input type="checkbox"/> Don't know	3.83 %	1.12 %
} (Skip to Question 13.)		
12. Which of the following best describes the manner in which you inform your employees of the <u>advance</u> earned income credit payment? (Check all that apply.)	N = 425	N = 4,422
1. <input type="checkbox"/> Provide copy of IRS' Notice 797 (Notice of Possible Federal Tax Refund Due to the Earned Income Credit)	34.59 %	40.84 %
2. <input type="checkbox"/> Newsletter, memorandum, or other internal document	9.18 %	14.02 %
3. <input type="checkbox"/> Word of mouth, such as staff meetings	53.41 %	35.84 %
4. <input type="checkbox"/> Other (Please specify.)	2.82 %	9.29 %

**Appendix II
Survey of IRS' EIC Advance Payment System**

**B. Administrative Problems with
Advance EIC Payments**

The objective of this section is to obtain information on the administrative complexity and burden, if any, of advance EIC payments.

WEIGHTED ESTIMATES *

	<u>NON PARTICIPATING</u>	<u>PARTICIPATING</u>
--	--------------------------	----------------------

	N = 1,472	N = 6,344
13. How much of a problem, if any, is it for your organization to make <u>advance</u> EIC payments to your employees? (Check one.)		
1. <input type="checkbox"/> Little or no problem (Skip to Question 15.)	23.44 %	61.07 %
2. <input type="checkbox"/> Some problem	9.65 %	15.51 %
3. <input type="checkbox"/> Moderate problem	7.88 %	12.28 %
4. <input type="checkbox"/> Great problem	8.36 %	3.17 %
5. <input type="checkbox"/> Very great problem	.82 %	1.36 %
6. <input type="checkbox"/> No basis to judge (Skip to Question 15.)	49.86 %	6.62 %
(Continue to Question 14.)		
14. Which of the following best describes the problems, if any, caused by <u>advance</u> EIC payments? (Check all that apply.)	N = 1,149	N = 4,040
1. <input type="checkbox"/> Determining how much to pay	24.28 %	14.85 %
2. <input type="checkbox"/> Keeping track of employees who get <u>advance</u> EIC	21.41 %	24.36 %
3. <input type="checkbox"/> Processing the payment to the employee	14.62 %	13.44 %
4. <input type="checkbox"/> Reporting payment on tax returns (Forms 941, 942, or 943)	17.75 %	23.00 %
5. <input type="checkbox"/> Reporting payment on Form W-2	16.45 %	14.83 %
6. <input type="checkbox"/> Other (Please specify.)	5.48 %	9.53 %

**Appendix II
Survey of IRS' EIC Advance Payment System**

	WEIGHTED ESTIMATES *	
	<u>NON PARTICIPATING</u>	<u>PARTICIPATING</u>
15. Overall, how easy or difficult is it to understand the IRS' instructions on making <u>advance</u> EIC payments, including filling out your employer's tax returns (Forms 941, 942, or 943)? (Check one.)	N = 1,460	N = 6,194
1. <input type="checkbox"/> Very easy	7.88 %	22.94 %
2. <input type="checkbox"/> Somewhat easy	10.48 %	20.33 %
3. <input type="checkbox"/> Neither easy nor difficult	19.73 %	26.82 %
4. <input type="checkbox"/> Somewhat difficult	19.66 %	15.69 %
5. <input type="checkbox"/> Very difficult	1.85 %	2.07 %
6. <input type="checkbox"/> No basis to judge	40.41 %	12.16 %
16. How helpful, if at all, is IRS' Circular E, <i>Employer's Tax Guide</i> , in explaining the procedures for making <u>advance</u> EIC payments to employees? (Check one.)	N = 1,428	N = 6,216
1. <input type="checkbox"/> Very greatly helpful	6.09 %	9.64 %
2. <input type="checkbox"/> Greatly helpful	10.92 %	24.39 %
3. <input type="checkbox"/> Moderately helpful	15.55 %	33.06 %
4. <input type="checkbox"/> Somewhat helpful	20.17 %	13.71 %
5. <input type="checkbox"/> Little or no helpfulness	4.48 %	3.09 %
6. <input type="checkbox"/> No basis to judge	42.79 %	16.12 %

**Appendix II
Survey of IRS' EIC Advance Payment System**

17. Assume that the number of employees requesting advance EIC payments increased. How much of a problem, if any, for your organization would each of the following increases be? (Check one box in each row.)

If the number of employees requesting advance EIC payments . . .		Little or no problem (1)	Some problem (2)	Moderate problem (3)	Great problem (4)	Very great problem (5)	No basis to judge (6)
1. somewhat increased	NP	22 %	13 %	15 %	4 %	2 %	44 %
	P	55 %	19 %	11 %	2 %	1 %	12 %
2. moderately increased	NP	19 %	8 %	21 %	7 %	3 %	44 %
	P	49 %	18 %	16 %	4 %	1 %	12 %
3. greatly increased	NP	17 %	7 %	11 %	15 %	6 %	49 %
	P	36 %	19 %	20 %	8 %	3 %	13 %
4. very greatly increased	NP	18 %	5 %	11 %	7 %	15 %	45 %
	P	35 %	15 %	21 %	8 %	8 %	13 %

Number of non-participating (NP) employers who answered Question 17 is estimated at 1,194.

Number of participating (P) employers who answered Question 17 is estimated at 5,671.

Note: Percents may not add due to rounding.

WEIGHTED ESTIMATES *

	NON PARTICIPATING	PARTICIPATING
--	-------------------	---------------

	N = 1,402	N = 6,186
18. Has your organization incurred <u>any</u> additional costs (such as overtime costs, hiring new employees, or purchasing computer services) in complying with employee requests to receive <u>advance</u> EIC payments? (Check one.)		
1. <input type="checkbox"/> Yes (Continue to Question 19.)	1.71 %	12.17 %
2. <input type="checkbox"/> No	37.73 %	74.73 %
3. <input type="checkbox"/> Don't know	2.57 %	1.39 %
4. <input type="checkbox"/> Not applicable (No request for advance payments)	57.99 %	11.70 %

(Skip to Question 22.)

**Appendix II
Survey of IRS' EIC Advance Payment System**

	<u>WEIGHTED ESTIMATES *</u>	
	<u>NON PARTICIPATING</u>	<u>PARTICIPATING</u>
19. Which of the following, if any, generates the additional cost incurred to comply with employee requests for advance payment of EIC? (Check all that apply.)	N = 24 *	N = 809
1. <input type="checkbox"/> Overtime		9.02 %
2. <input type="checkbox"/> Hiring additional employees		0.00 %
3. <input type="checkbox"/> Purchasing computer software and/or revising present software		60.82 %
4. <input type="checkbox"/> Service bureau, bookkeeper, or payroll agent		30.16 %
5. <input type="checkbox"/> Other (Please specify.) _____		0.00 %
20. For 1990, estimate your additional cost, if any, incurred in order to comply with employee requests for advance EIC payments. (Check one.)	N = 24 *	N = 753
1. <input type="checkbox"/> No cost		5.71 %
2. <input type="checkbox"/> \$1 to \$250		48.87 %
3. <input type="checkbox"/> \$251 to \$501		19.92 %
4. <input type="checkbox"/> \$501 to \$1,000		8.50 %
5. <input type="checkbox"/> \$1,001 to \$1,500		0.00 %
6. <input type="checkbox"/> \$1,501 to \$2,000		2.79 %
7. <input type="checkbox"/> \$2,001 or more (Please specify.) \$ _____		2.79 %
8. <input type="checkbox"/> Cannot estimate		11.42 %
* The number of non-participant responses was too small to provide meaningful estimates.		

**Appendix II
Survey of IRS' EIC Advance Payment System**

	<u>WEIGHTED ESTIMATES *</u>	
	<u>NON PARTICIPATING</u>	<u>PARTICIPATING</u>
21. For 1990, estimate the number of additional hours, if any, expended in order to comply with employee requests for advance EIC payments. (Check one.)	N = 24 *	N = 753
1. <input type="checkbox"/> No additional time		8.50 %
2. <input type="checkbox"/> 1 to 25 hours		77.29 %
3. <input type="checkbox"/> 26 to 50 hours		5.71 %
4. <input type="checkbox"/> 51 to 100 hours		1.79 %
5. <input type="checkbox"/> 101 to 150 hours		0.00 %
6. <input type="checkbox"/> 151 to 200 hours		0.00 %
7. <input type="checkbox"/> 201 or more hours (Please specify.) _____ hours		0.00 %
8. <input type="checkbox"/> Cannot estimate		5.71 %

* The number of non-participant responses was too small to provide meaningful estimates.

Comments From the Internal Revenue Service

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

13-33

Ms. Jennie S. Stathis
Director
Tax Policy and Administration Issues
General Government Division
United States General Accounting Office
Washington, DC 20549

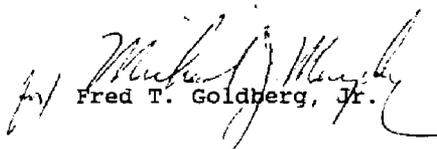
Dear Ms. Stathis:

We have reviewed your recent draft report entitled, "Earned Income Tax Credit: Employers and Employees are Confused About or Unaware of Advanced Payment Option." Our detailed comments on the specific report recommendations are enclosed.

We agree that the Internal Revenue Service can do more to inform both employers and employees about the advance payment option. This year we are prominently featuring the advance payment option in Publication 596, Earned Income Credit. We are also including the advance payment option in our video media campaign, such as the nationwide tax show over the Public Broadcasting System. To improve reporting of advance earned income credit payments, we are now providing a separate line on Form 1040 specifically for reporting these payments. We are also undertaking a redesign of Form W-2 that will, we believe, result in more accurate reporting of advance earned income credit payments.

Best regards.

Sincerely,


Fred T. Goldberg, Jr.

Enclosure

Appendix III
Comments From the Internal Revenue Service

IRS COMMENTS ON RECOMMENDATIONS
CONTAINED IN GAO DRAFT REPORT ENTITLED
"EARNED INCOME CREDIT: "EMPLOYERS
AND EMPLOYEES ARE CONFUSED ABOUT
OR UNAWARE OF ADVANCED PAYMENT OPTION"

Recommendation: Include information on advance payments of earned income credit in employee outreach material and programs.

Comment:

We agree that the education effort can be enhanced, and we will begin work in modifying the outreach materials and programs.

Recommendation: Notify taxpayers who receive the earned income credit about the advance payment option.

Comment:

We estimate the cost of producing and mailing a notice to all taxpayers who receive the earned income credit but who have not elected to receive advance payments to be approximately \$2 million. Unfortunately, we do not at present have the resources and funding to undertake a program of this sort. However, we are endeavoring to include information on the advance payment option in Circular E, Employer's Tax Guide, on Form W-2, in Publication 596, Earned Income Credit, and in our print and video outreach materials.

See comment 1.

Recommendation: Require employers to notify employees who have no income tax withheld of the advance payment option.

Comment:

IRS can encourage but cannot require employers to make such notifications and there are no statutory sanctions on employers who fail to meet such a requirement. We are, however taking certain actions that should result in increased employer and employee awareness of the advance payment option. The 1992 revision of the official Form W-2, developed by IRS, will contain information on how to apply for advance earned income credit payments. IRS Notice 797 (Rev. October 1991) which employers may use in lieu of the statement on Form W-2 now contains information on how to apply for advance earned income credit payments. We are also considering how to revise the Form W-4 to advise employees of the availability of the advance payment option and to refer them to Form W-5, Earned Income Credit Advance Payment Certificate.

See comment 2.

Appendix III
Comments From the Internal Revenue Service

Recommendation: Clarify instructions on advance payments in Circular E.

Comment:

We agree with the recommendation. The January 1992 revision of Circular E was approved for print before we could consider any changes in response to the GAO recommendations. We will review the discussion of the advance payment option and make appropriate changes for the January 1993 revision. Our efforts will focus on providing examples that would be helpful to employers in understanding how they advance the credit and how they make a claim for amounts advanced. Also we will clarify the employer's responsibilities and liabilities in advancing the earned income credit.

Recommendation: Send a notice explaining the return filing requirements to individuals who receive advance earned income credit payments but who do not file a tax return.

Comment:

The notices GAO proposes be sent would be based on Form W-2 information. As the draft GAO report notes on page 28, the W-2 information relating to advance earned income credit payments is subject to a high error rate. In the W-2 sample examined by the GAO auditors, the error rate was 58 percent. The advance earned income credit data on Form W-2 are reconciled and corrected in the combined annual wage reporting program. However, the corrected W-2 data are not available at the time IRS runs the underreporter and nonfiler programs. Given this high error rate, we believe it would be confusing to taxpayers, who are not filing because they are not required to file.

Recommendation: Explore ways to identify individuals who claim the credit in advance but do not report it, while the return is being processed to preclude giving it again.

Comment:

As the draft GAO report notes on page 33, IRS systems are not geared to detecting unreported advance earned income credit payments at the time returns are processed. Additionally, as noted, the advance earned income credit data reported on Form W-2 is subject to a high error rate.

Now on p. 25.

See comment 3.

Now on p. 28.

See comment 4.

Appendix III
Comments From the Internal Revenue Service

Given these constraints, we believe the best approach to noncompliance by advance earned income credit payment recipients is a proactive one that emphasizes the filing of correct returns. We now provide a separate dedicated line on Form 1040 on which to report advance earned income credit payments. For tax year 1989, the year the GAO auditors examined, advance earned income credit payments were a write-in item on line 53 of Form 1040. In addition, we are undertaking a redesign of the Form W-2 for tax year 1993 that we believe will increase the accuracy of the advance earned income credit payment information reported on Form W-2. We expect that these two changes will result in increased reporting of advance earned income credit payments.

The following are GAO's comments on the Internal Revenue Service's letter dated January 13, 1992.

GAO Comments

1. IRS stated that it did not have the resources available (estimated \$2 million) to undertake a program to produce and mail an informational notice to all earned income recipients telling them of the advance payment option. Although budgetary constraints cited by IRS are certainly a consideration, we believe that sending such a notice on a test basis for 1 year would provide a great deal of information on earned income recipients' preferences on how to receive the credit. If, after the test period, earned income recipients still prefer to receive the credit in a lump sum payment, then the cost effectiveness of the notice would be questionable.

2. IRS stated that it did not have the authority to require employers to notify employees who have no income tax withheld of the advance payment option. We modified our recommendation to better reflect our intention that IRS should work with employers to increase employee awareness of the advance payment option. We believe that recent steps taken by IRS, such as the 1992 revision to the Form W-2 and the recent revision to IRS Notice 797, are a good start at improving employee awareness.

3. IRS stated that because of the 58-percent error rate we found in the W-2 information relating to the advance payment, sending nonfiler notices to taxpayers who did not receive the EIC and who did not have a filing requirement would confuse the taxpayer. We estimated that if the W-2 records were error free, about 47,000 nonfiler notices would be sent to these taxpayers. With a few simple edits, this total could be cut in half. IRS sent out nearly 2 million nonfiler notices in 1989. Sending notices to advance payment nonfilers would represent about a 1-percent increase in nonfiler notices sent. Furthermore, IRS' concern about the erroneous W-2 information may not be as great a concern in the near future. IRS stated that it is undertaking a redesign of the tax year 1993 Form W-2 that it believes should increase the accuracy of the EIC advance payment information reported on W-2s.

Individuals receiving the EIC in advance payments are required to file a tax return. We believe that, at a minimum, IRS should send a notice to these taxpayers informing them that if they received the EIC in advance, they have to file a tax return. Without filing a tax return, IRS does not even know whether the individual qualified for the credit. The notice could also inform

the nonfiler that by filing a tax return they may also be entitled to additional supplemental credits.

4. IRS stated that the best approach to addressing noncompliance by advance EIC recipients is to emphasize the filing of correct tax returns. We believe that IRS' revisions to the Form 1040 and its efforts to redesign the Form W-2 should improve taxpayer reporting of advance payments. Nonetheless, we believe IRS should still explore ways to identify noncompliance while the return is processed.

Major Contributors to This Report

**General Government
Division, Washington,
D.C.**

**Thomas McCool, Assistant Director, Tax Policy and Administration Issues
John Hutton, Assignment Manager**

**San Francisco Regional
Office**

**Ralph Block, Regional Assignment Manager
Suzy Foster, Evaluator-in-Charge
Elizabeth Olivarez, Evaluator
Hans Bredfeldt, Operations Research Specialist
Samuel Scrutchins, Evaluator
Ann Walker, Evaluator
Dexter Porter, Evaluator**

UNITED STATES DEPARTMENT OF JUSTICE

FEDERAL BUREAU OF INVESTIGATION

WASHINGTON, D. C. 20535

TO: SAC, [REDACTED] FROM: SAC, [REDACTED]

RE: [REDACTED]

DATE: [REDACTED]

CLASSIFICATION: [REDACTED]

EXEMPTION: [REDACTED]

APPROVAL: [REDACTED]

DATE: [REDACTED]

BY: [REDACTED]

AGENCY: [REDACTED]

FILE NO: [REDACTED]

DATE: [REDACTED]

**United States
General Accounting Office
Washington, D.C. 20548**

**First-Class Mail
Postage & Fees Paid
GAO
Permit No. G100**

**Official Business
Penalty for Private Use \$300**
