

# TAX OR WELFARE? THE ADMINISTRATION OF THE EARNED INCOME TAX CREDIT

Lawrence Zelenak\*

*The earned income tax credit (EITC) is a transfer program aimed primarily at low income working parents, administered by the Internal Revenue Service (IRS) as part of the federal income tax. Although generally tax-like in its administration, in substance it resembles nontax antipoverty transfer programs, such as Food Stamps and Temporary Assistance for Needy Families (TANF). In recent years, Congress has become concerned about EITC overpayments, and the IRS has responded by emphasizing EITC compliance more heavily than compliance with other aspects of the income tax—an emphasis that has been strongly criticized by advocates for the working poor. This Article compares the vigor of EITC enforcement with the vigor of overall federal tax enforcement and also with the vigor of welfare (Food Stamps and TANF) enforcement, along a number of dimensions. It concludes that the level of EITC enforcement lies between the low level of the rest of the income tax and the high level of nontax transfer programs, but that it lies considerably closer to the income tax end of the enforcement spectrum. Most significantly, the administration of the EITC resembles that of the rest of the income tax, and differs from that of other transfer programs, in that it is generally based on self-declared eligibility rather than on a bureaucratic determination of eligibility prior to the making of payments. The Article considers possible explanations for the differing enforcement practices, suggesting that the greater tolerance for tax underpayments than for welfare overpayments may be attributable to the phenomenon of “everyday libertarianism.” It also suggests that the treatment of the EITC as more tax-like than welfare-like is due to “protective coloration” derived from its placement within the Internal Revenue Code, a placement that is an accident of history. Finally, it argues that the historical accident is a happy one, as tax-based administration of the EITC, on balance, produces superior results to those that would be produced by welfare-based administration.*

INTRODUCTION .....	1868
A. Prologue: The EITC Precertification Controversy .....	1868
B. Tax Administration, Welfare Administration, and the EITC.....	1873
I. PRACTICES AND ATTITUDES: EITC COMPLIANCE AND ENFORCEMENT	
COMPARED WITH THAT OF TAX AND WELFARE .....	1876
A. Precertification.....	1876

---

\* Pamela B. Gann Professor of Law, Duke Law School. The author thanks Lily Batchelder, Leslie Book, and the participants in the UCLA Law Review Symposium for their comments.

1. The EITC .....	1876
2. Welfare (Food Stamp Programs and TANF).....	1878
3. Income Tax Benefits (Other Than the EITC).....	1879
4. Drawing the Comparison.....	1881
B. Administrative Resources Devoted to Enforcement.....	1881
C. Does the IRS Overemphasize EITC Audits Relative to Non-EITC Audits?.....	1884
D. Ratios of Overpayments of Benefits to Underpayments of Benefits for Welfare Programs, Non-EITC Tax Benefits, and the EITC.....	1887
E. EITC Criminal Enforcement Activity Compared With Federal Tax Prosecutions Generally, and With Welfare (Food Stamp and TANF) Prosecutions .....	1891
F. EITC Civil Sanctions Compared With Income Tax Civil Sanctions Generally, and With TANF and Food Stamp Civil Sanctions .....	1893
G. The EITC, Income Tax Refunds, and the Improper Payments Act .....	1896
H. Legislators' Comparisons of EITC Noncompliance With Income Tax Noncompliance Generally.....	1898
II. EXPLAINING THE DIFFERING COMPLIANCE AND ENFORCEMENT PRACTICES AND ATTITUDES.....	1900
A. Of Taxes, Transfers, and Everyday Libertarianism .....	1900
B. Of the EITC and Everyday Libertarianism .....	1902
C. The EITC, the Food Stamp Program, and the Costs of Everyday Libertarianism.....	1905
III. EXPLAINING THE EXISTENCE OF REFUNDABLE TAX CREDITS WITH SELF-DECLARED ELIGIBILITY .....	1906
A. The Perception of the EITC as More Tax Reduction Than Welfare: An Accident of History .....	1906
B. Other Refundable Tax Credits With Self-Declared Eligibility.....	1911
CONCLUSION.....	1915

## INTRODUCTION

### A. Prologue: The EITC Precertification Controversy

The earned income tax credit (EITC) provides a wage supplement—a sort of negative income tax—for some low wage workers, especially workers living with “qualifying child[ren].”<sup>1</sup> In the case of workers with two or more qualifying children, the amount of the credit can exceed \$4000. Unlike the vast majority of income tax credits, the EITC is refundable. If the amount of the credit exceeds the worker’s precredit income tax liability, the worker

---

1. I.R.C. § 32(c)(1)(A)(i) (2000).

receives a check from the government for the excess. In recent years, less than 20 percent of the total amount of EITC claimed has served to reduce precredit income tax liability; the remainder has resulted in payments from the government to the claimants.<sup>2</sup> Because it targets low wage workers, and because of its refundability feature, the EITC can be viewed as a welfare program that happens to be administered through the tax system.

In common with other taxpayer-favorable provisions of the federal income tax, the EITC is administered on the basis of self-declared eligibility. As with persons claiming other income tax deductions, exclusions, and credits, the EITC claimant makes the entries on her tax return required to determine the amount of EITC to which she is entitled, and pays less tax or receives a bigger refund as a result. This is in sharp contrast with the universal practice in welfare programs, such as Food Stamps and Temporary Assistance for Needy Families (TANF), in which the claimant must establish her eligibility to the satisfaction of a welfare bureaucracy before receiving any benefits.

In a study of EITC claims made on returns for tax year 1999, the Internal Revenue Service (IRS) estimated that between \$8.5 and \$9.9 billion of EITC claims should not have been paid; these claims paid in error constituted between 27.0 percent and 31.7 percent of total claims of \$31.3 billion.<sup>3</sup> The IRS study also determined that almost 25 percent of the overclaims were attributable solely to “qualifying child errors,” in which a taxpayer claimed as a qualifying child one who did not live with the taxpayer for a sufficient portion of the year, or who did not bear one of the statutorily specified relationships to the taxpayer.<sup>4</sup> Reacting to this study, and to Congressional pressure to reduce EITC overpayments, in April 2003 the IRS announced that it intended, beginning in July 2003, to ask 45,000 persons expected to claim the EITC on their 2003 tax returns “to provide more information on their relationship to and/or residency status of the qualifying children listed on their [2002] return.”<sup>5</sup> These 45,000 persons

---

2. In 2003, for example, the EITC reduced income tax receipts by \$5.099 billion and resulted in federal outlays of \$31.961 billion. OFFICE OF MGMT. & BUDGET, BUDGET OF THE U.S. GOV'T, FISCAL YEAR 2005: ANALYTICAL PERSPECTIVES 289 tbl.18-1, 1.126 (2004) [hereinafter OMB]. The \$5.099 billion revenue-reducing portion of the EITC was less than 14 percent of the \$37.060 billion total. *But see infra* note 180 (explaining that a substantial portion of EITC payments can be viewed as offsetting federal payroll and excise taxes).

3. INTERNAL REVENUE SERV., COMPLIANCE ESTIMATES FOR EARNED INCOME TAX CREDIT CLAIMED ON 1999 RETURNS 10-12 (2002), available at LEXIS, Tax Analysts, Tax Notes Today, 2002 TNT 41-11.

4. *Id.* at 13-14.

5. INTERNAL REVENUE SERV., IRS EXPLANATION OF EITC VERIFICATION INITIATIVE ¶ 5 (2003), available at LEXIS, Tax Analysts, Tax Notes Today, 2003 TNT 71-91.

would receive their 2003 EITC checks in a timely fashion only if they complied with the IRS's precertification requirements.<sup>6</sup> The 45,000 claimants selected for the program would include neither parents filing joint returns nor single mothers, since the IRS's studies indicated that qualifying child errors were uncommon among those groups.<sup>7</sup> Thus, the 45,000 would consist solely of fathers not filing joint returns, and nonparent claimants. If the experiment with the 45,000 went well, the IRS hoped to expand the precertification program to as many as 2 million EITC claimants (more than 10 percent of the 19 million total) by July 2004.<sup>8</sup>

Congressional Democrats and the media responded to the announcement with indignation. One or more senators placed a hold on the confirmation of Mark Everson as Commissioner of the IRS, in the hope that Mr. Everson would promise in writing to ensure that the precertification program would not unduly burden low-income taxpayers.<sup>9</sup> In the House, Representative Charles Rangel (with fourteen cosponsors) introduced a bill "[t]o prohibit the implementation of discriminatory precertification requirements for the earned income tax credit."<sup>10</sup> Section 1 of the bill consisted of a number of findings, including, "(3) There is no precedent . . . for denying or delaying a tax refund that is apparently properly claimed on a tax return merely because the taxpayer meets a certain profile," and "(5) No other family-related tax benefit, such as the dependency exemption or child tax credit, is subject to such a precertification requirement; and there is no such precertification requirement for abusive tax shelters purchased by corporations or for tax benefits claimed by higher income individuals."<sup>11</sup> The *New York Times* characterized the precertification plan as "harass[ing] the poor," and suggested that the IRS "should start focusing its enforcement efforts higher up the income scale."<sup>12</sup> Robert Greenstein of the Center on Budget and Policy Priorities did not object to precertification in principle, but he argued that plan modifications were needed to reduce the risk that the program would significantly discourage EITC claims by eligible persons.<sup>13</sup>

---

6. Those who did not precertify could still receive the credit by providing the required information with their return, but their EITC payment would be delayed until the IRS had completed its review of their documentation. *Id.* ¶15.

7. *Id.* ¶ 16.

8. *Id.* ¶ 17.

9. Amy Hamilton, *Everson's Nomination Turns Into Senate Free-for-All*, 99 TAX NOTES 461 (2003).

10. H.R. 1894, 108th Cong. (2003), available at LEXIS, Tax Analysts, Tax Notes Today, 2003 TNT 94-76.

11. *Id.* § 1.

12. Editorial, *The I.R.S. Goes After the Poor*, N.Y. TIMES, Apr. 27, 2003, § 4, at 12.

13. Robert Greenstein, *The New Procedures for the Earned Income Tax Credit*, 99 TAX NOTES 1525 (2003).

In response to its critics, the IRS announced in June 2003 that it was scaling back the program to require precertification only with respect to the qualifying child residency requirement; precertification of the relationship requirement would be abandoned.<sup>14</sup> Instead of expansion to 2 million claimants in 2004, the June Announcement said the IRS would “carefully study the results from this group [of 45,000] to determine the effect of certification on compliance and participation.”<sup>15</sup> The Announcement included a request for comments, and comments quickly followed. The dominant theme of the comments was that the program should be considered an experiment aimed at understanding how (if at all) precertification could be employed to improve compliance without discouraging participation. For example, Gene Steuerle claimed that “[t]he pilot study should be aimed not at testing a single procedure but, rather, multiple alternatives and procedures.”<sup>16</sup> In a similar spirit, the Tax Section of the American Bar Association requested that the IRS “identify . . . the categories of data and information that will be obtained through the pilot precertification program and describe how such data and information will assist the Service in curbing perceived high noncompliance.”<sup>17</sup> Less measured comments were forthcoming from Senator Max Baucus and forty-four other senators, who wrote to President Bush asking that he “require the IRS to halt further implementation” of the precertification program.<sup>18</sup> According to the Senators, “The IRS’s precertification program subjects only low-income working Americans to a harsher standard than other taxpayers—simply because they are claiming a tax benefit designed to assist the working poor.”<sup>19</sup>

The IRS retreated once again. In August 2003 it announced that the pilot program would involve only 25,000 claimants (“an adequate basis for

---

14. INTERNAL REVENUE SERV., ANNOUNCEMENT 2003-40: ADMINISTRATION OF THE EARNED INCOME CREDIT (2003), available at LEXIS, 2003-1 C.B. 1132.

15. *Id.*

16. Gene Steuerle, *Research Required for the EITC Precertification Procedure*, 100 TAX NOTES 259 (2003).

17. HERBERT N. BELLER, ABA SECTION OF TAXATION, ABA TAX SECTION SUBMITS COMMENTS TO IRS ON EITC PRECERTIFICATION PROGRAM: COMMENTS ON THE INTERNAL REVENUE SERVICE PILOT PRECERTIFICATION PROGRAM TO DETERMINE COMPLIANCE WITH THE RESIDENCY TEST FOR CLAIMING THE EARNED INCOME CREDIT WITH RESPECT TO QUALIFYING CHILDREN (2003), available at LEXIS, Tax Analysts, Tax Notes Today, 2003 TNT 137-36; see also Leslie Book, *EITC Noncompliance: What We Don't Know Can Hurt Them*, 99 TAX NOTES 1821 (2003) (“Before requiring millions of taxpayers to precertify EITC eligibility, which will no doubt decrease participation . . . we should more fully understand the nature of the problem . . . and evaluate the IRS’s precertification plan on a limited number of taxpayers.”).

18. MAX BAUCUS, BAUCUS, COLLEAGUES URGE END TO “BURDENSOME” EITC PRECERTIFICATION ¶ 46 (2003), available at LEXIS, Tax Analysts, Tax Notes Today, 2003 TNT 139-98.

19. *Id.* ¶ 22.

statistical verification”), and that the persons selected for the program would be required to file the residency documentation along with their tax returns, rather than in advance of return filing.<sup>20</sup> The program no longer involved precertification, if precertification refers only to actions taken before the filing of a tax return. In a more meaningful sense, however, the pilot still required precertification, since cash would not be paid to a claimant in the pilot program until her certification process had been completed. Whether precertification would be required of other claimants in other years depended on the results of the 2004 test: “[T]he IRS will carefully assess the pilot results and performance before deciding on how to proceed with the program.”<sup>21</sup>

The IRS released some preliminary results from the pilot program in May 2004, including the fact that almost 20 percent of the taxpayers selected for the study did not claim the credit on their 2003 returns.<sup>22</sup> It is unclear to what extent failures to claim the credit by taxpayers in the pilot program were due to the deterrent effect of precertification on EITC-ineligible taxpayers, and to what extent the program had the unintended effect of deterring credit-eligible taxpayers from claiming the credit. To attempt to resolve that uncertainty, the IRS is undertaking another precertification pilot program for 2005—also involving 25,000 taxpayers.<sup>23</sup> The 2005 program, however, draws about one-third of its taxpayers from the single community of Hartford County, Connecticut.<sup>24</sup> The Hartford portion of the test includes “an outreach campaign in the community in an effort to simulate what might happen if a certification requirement were imposed more broadly.”<sup>25</sup> The IRS announcement of the 2005 program emphasizes its research purpose. The announcement states that the Service “has reached no conclusion about the desirability of a certification requirement as part of the EITC program,” and that the Service “has no plans to impose a blanket qualifying child certification requirement until a thorough evaluation of the 2004 and 2005 tests is completed.”<sup>26</sup> The City of Hartford and several individual plaintiffs have filed suit in U.S. District Court to enjoin

---

20. INTERNAL REVENUE SERV., IRS TO LAUNCH EITC CERTIFICATION PILOT PROGRAM IN 2004 FILING SEASON, IR 2003-97 (2003), available at 2003 IRB Lexis 346.

21. *Id.*

22. Allen Kenney, *Early Results of EITC Child Certification Pilot Study Released*, 103 TAX NOTES 633, 633 (2004).

23. INTERNAL REVENUE SERV., 2005 EARNED INCOME TAX CREDIT CERTIFICATION TEST, available at <http://www.irs.gov/individuals/article/0,,id=118200,00.html>.

24. Allen Kenney, *Community Lashes out Over EITC Test*, 105 TAX NOTES 794, 795 (2004).

25. INTERNAL REVENUE SERV., *supra* note 23.

26. *Id.*

the singling out of Hartford, on the grounds that it is without statutory authorization and suffers from several constitutional infirmities.<sup>27</sup> For the time being, however, the test is proceeding.<sup>28</sup>

#### B. Tax Administration, Welfare Administration, and the EITC

The controversy over EITC precertification—and over the appropriate level of EITC compliance and enforcement efforts more generally—is a consequence of the EITC's status as a hybrid tax-transfer program. When the EITC is compared with other tax benefits, as to which self-declared eligibility is the norm, even considering a precertification regime for the EITC seems to reflect discrimination against the working poor. When the EITC is compared with other welfare-type transfer programs, however, it is surprising—almost shocking—that the government is willing to send checks for thousands of dollars to EITC claimants simply on their say-so, without any bureaucratic confirmation of eligibility. The general unwillingness of the government to make transfer payments based on self-declared eligibility is not limited to welfare-type programs. Transfer programs for the middle class (such as Social Security, Medicare, and subsidized college loans) also require an agency's determination of eligibility before transfers are made.<sup>29</sup>

Because the EITC is perceived as occupying a middle ground between tax and transfer status—a tax program in administrative terms, but largely a transfer program in economic effect—it is not surprising that it also is perceived as occupying a middle ground with respect to the appropriateness of precertification. While the welfare aspects of the EITC make precertification thinkable, the tax aspects create a presumption against it.

Moving from the particular issue of precertification to general compliance and enforcement efforts (including audit practices and the use of civil and criminal sanctions), and comparing the hybrid EITC with pure tax benefits and pure welfare benefits, a similar picture emerges. EITC enforcement efforts seem rather strict when compared with the IRS's overall tax enforcement practice, but lax when compared with the enforcement regimes for the Food Stamp and Temporary Assistance for Needy Families (TANF) programs. Although the vigor of EITC enforcement—as measured along various dimensions—falls

---

27. Allen Kenney, *Hartford to IRS: See You in Court*, 105 TAX NOTES 1305, 1305 (2004), available at LEXIS, Tax Analysts, Tax Notes Today, 2004 TNT 241-13.

28. *Id.*

29. See, e.g., SOC. SEC. ADMIN., SOCIAL SECURITY BENEFIT APPLICATION, available at <https://s3abaca.ssa.gov/pro/isba3/irib.cgi?WFORM=A>. Only after the form has been received and processed by the Social Security Administration does the claimant begin to receive benefits.

somewhere between that of overall federal tax enforcement and that of welfare enforcement, it consistently bears a closer resemblance to tax enforcement.<sup>30</sup>

An observer of the difference in compliance and enforcement practices between tax and transfer programs would conclude that the government must consider it much worse for a person to receive an unwarranted dollar of transfer payment than for a person to receive an unwarranted dollar of tax reduction. The observer also would conclude that the government considers the receipt of an unwarranted dollar of EITC as less troubling than an unwarranted dollar of pure transfer payment, but as more troubling than an unwarranted dollar of pure tax reduction. The observer might be puzzled by these attitudes. Regardless of the nature of a program (tax, welfare, or hybrid), Congress has decided that there is a proper amount of benefit a claimant should receive based on a particular set of facts. An excessive dollar of benefit is an excessive dollar of benefit, whether it happens to occur in the context of a nonrefundable tax break, a welfare payment, or a refundable tax credit. Why should Congress consider an extra dollar of EITC to be worse than an extra dollar of tax reduction from the charitable contribution deduction, but not as bad as an extra dollar's worth of food stamps? Should not Congress be equally concerned with all three types of errors? Or, if Congress were to distinguish between equal-dollar-amount errors in different programs, distributional concerns might suggest it should be *least* troubled by an extra dollar's worth of food stamps going to a very poor family, somewhat more troubled by an extra dollar of EITC going to a near-poor family, and most troubled by an extra dollar of tax reduction going to a wealthy family. Actual practices suggest precisely the opposite hierarchy of concern, however, and therein lies the puzzle. Why does tolerance for errors that leave individuals with too much money and the government with too little vary according to the tax, transfer, or hybrid nature of the program in which the errors occur?

This Article explores that puzzle. Part I of the Article is descriptive. It explains how, along a number of dimensions, statutes and administrative practices reflect an attitude that EITC overpayments are worse than excessive tax reductions, but not as bad as welfare overpayments. Part II is an attempt to understand the reasons for these attitudes. The analysis, which is necessarily speculative, is based on an extension of the work of Liam Murphy and Thomas Nagel in their recent book, *The Myth of Ownership: Taxes and*

---

30. For a detailed development of these comparisons, see *infra* Part I.



*Justice*.<sup>31</sup> Murphy and Nagel identify and critique a widely held belief in “everyday libertarianism,” which heavily influences the choice of substantive tax-and-transfer policies. The suggestion here is that everyday libertarianism comes into play at the compliance and enforcement stage as well, to make underpayment of tax seem a less serious concern than overreceipt of transfers. Part III ruminates on the special status of the EITC within the tax-versus-transfer paradigm. It reviews the historical development of the EITC as a hybrid program, and it suggests that the emergence of so significant a transfer program within the tax system was a highly contingent development. This historical accident has resulted in an administration of the EITC that is closer to standard tax administration than to standard welfare administration. This is evident, most obviously and significantly, in the continued use of self-declared eligibility in the face of calls for precertification.

Finally, the conclusion posits that the pattern of errors (overpayments and underpayments) and administrative costs produced by tax-type administration of the EITC is preferable to the pattern that would be produced by welfare-type administration of a substantively identical program, but that the continued existence of this pattern cannot be taken for granted. For proponents of the EITC in its current form, the price of continued self-declared eligibility for most recipients may be acceptance of a greater emphasis by the IRS on EITC compliance than on income tax compliance by more affluent taxpayers. Although in a perfect world EITC enforcement practices might treat the EITC as no different from any other tax provision (just as in a perfect world, welfare overpayments might be considered no worse than tax underpayments), strenuous objections to EITC compliance initiatives could easily prove counterproductive. The result might be the transfer of the EITC from tax to welfare administration, or even the repeal of the program in any form. If survival of the EITC as a tax-based program ultimately requires precertification for a small percentage of EITC claimants, and a higher audit rate for EITC claimants than for wealthy taxpayers, that is probably a price worth paying.

---

31. LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP: TAXES AND JUSTICE* (2002).

I. PRACTICES AND ATTITUDES: EITC COMPLIANCE  
AND ENFORCEMENT COMPARED WITH THAT OF TAX AND WELFARE

A. Precertification

1. The EITC

As explained in the introduction, the EITC operates on the basis of self-declared eligibility. Except for the 25,000 persons in the precertification pilot program, the 19 million EITC claimants receive the credit simply by declaring on their tax returns their eligibility for a specified amount of credit (attaching Schedule EIC if they have a qualifying child) and waiting for the credit check to arrive from the government. The IRS, in turn, generally issues the checks after only a mechanical review for errors apparent on the face of the return. Under I.R.C. section 6213(b)(1), the IRS has “math error authority” not to issue refund checks to the extent that the claimed refund amount is overstated as the result of “a mathematical or clerical error appearing on the return.” The statutory list of errors subject to this authority includes several error types peculiar to the EITC.<sup>32</sup> In fiscal year 2002, the IRS issued math error notices with respect to 1.1 million EITC returns—about 6 percent of all returns claiming the EITC.<sup>33</sup> Math error authority applies to all income tax refunds, however—not just to refunds generated by the EITC. This authority can be viewed as a minor limitation on the general rule that tax benefits are available on the basis of self-declared eligibility. It does not constitute precertification in the sense of certification before the filing of a return, but it does mean that returns—both EITC and non-EITC returns—receive a minimal level of review before checks are issued. Because of the very limited scope of the math error concept, math error authority does not seriously undermine the self-declared eligibility status of either EITC or of income tax benefits in general.

For a minority of EITC claims, however, the claimant does not receive the check until the IRS has conducted a more substantial review of one or more aspects of the credit eligibility claim. The qualifying child residency

---

32. These are: omission of a correct taxpayer identification number (I.R.C. § 6213(g)(2)(F) (2000 & Supp. I 2001)); claiming self-employment income for purposes of the EITC but not paying self-employment tax on the same income (I.R.C. § 6213(g)(2)(G)); failure to recertify when required to do so by I.R.C. section 32(k)(2) (I.R.C. § 6213(g)(2)(K)); and claiming as a qualifying child a child of whom the claimant is not the custodial parent, according to the Federal Case Registry of Child Support Orders (I.R.C. § 6213(g)(2)(M)).

33. INTERNAL REVENUE SERV., EARNED INCOME TAX CREDIT (EITC) PROGRAM EFFECTIVENESS AND PROGRAM MANAGEMENT FY 2002–FY 2003, at 7 (2003), available at [http://www.irs.gov/pub/irs-utl/eitc\\_effectivness.pdf](http://www.irs.gov/pub/irs-utl/eitc_effectivness.pdf).

precertification described in the introduction is one such instance, albeit one that applies to a tiny fraction of claimants. A larger number of claimants are affected by the recertification requirement imposed by section 32(k)(2).<sup>34</sup> If a taxpayer's EITC claim for any taxable year is denied (in whole or in part) by the IRS for some reason other than a math or clerical error, then the taxpayer is not entitled to any EITC for any subsequent year until the taxpayer has demonstrated eligibility to the satisfaction of the IRS.<sup>35</sup> In order to recertify, the taxpayer must attach a completed Form 8862 to her tax return, providing detailed information about any qualifying children, including their relationship to the taxpayer, their residency, and the school or the day care attended. A return with Form 8862 attached is automatically selected for audit, and the EITC refund is frozen until the claimant has established eligibility to the auditor's satisfaction.<sup>36</sup> This recertification requirement affects several hundred thousand claimants annually.<sup>37</sup>

Finally, there are EITC audits. In recent years, the IRS has audited approximately 400,000 EITC claims annually.<sup>38</sup> Virtually all EITC audits are "correspondence audits," conducted entirely by mail; face-to-face office audits of EITC claims are rare.<sup>39</sup> The standard practice is for the audit to be conducted before the EITC refund has been issued, and for the refund to be frozen pending the resolution of the audit.<sup>40</sup> Of course, an audit does not equal precertification if precertification refers only to certification prior to the filing of a return. In a more meaningful sense, however, an audit accompanied by a refund freeze is precertification, because the IRS must be satisfied that the claimant is eligible for the credit before the claimant receives any cash.

Fewer than 1 million EITC returns (out of a total of about 19 million) are subject to precertification. This number disregards math error authority review of returns (because of its minimal nature), but adds together all EITC

---

34. See also Treas. Reg. § 1.32-3 (2005), which elaborates on the statutory requirements.

35. I.R.C. § 32(k)(2) (2000).

36. GEN. ACCOUNTING OFFICE, NO. GAO-02-449, EARNED INCOME CREDIT: OPPORTUNITIES TO MAKE RECERTIFICATION PROGRAM LESS CONFUSING AND MORE CONSISTENT 6 (2002), available at <http://www.gao.gov/new.items/02449.pdf>.

37. See *id.* at 5 (In 1998, the first year of operation of the recertification program, 312,000 EITC claims on 1997 returns were disallowed in whole or in part, with the result that the filers of those claims could not receive the EITC in any later year until they had completed the recertification process.).

38. See INTERNAL REVENUE SERV., *supra* note 33, at 18 fig.12.

39. INTERNAL REVENUE SERV., NATIONAL TAXPAYER ADVOCATE: 2003 ANNUAL REPORT TO CONGRESS 27 (2003) (describing the IRS as having "virtually ceas[ed] local office audits for EITC returns").

40. *Id.* at 31, 35. If the taxpayer has claimed a refund of withholding or estimated tax, along with the EITC, only the EITC refund is frozen during the audit.

claims subject to the residency pilot program, recertification, and correspondence audits. For the remainder of EITC returns—far in excess of 90 percent—the income tax norm of self-declared eligibility applies.

## 2. Welfare (Food Stamp Programs and TANF)

In sharp contrast with the self-declared eligibility norm for the EITC, self-declared eligibility is unheard of for transfer programs such as TANF. Indeed, the requirement that an applicant establish eligibility to the satisfaction of a government agency before receiving benefits is at the core of welfare-based administration.

The federally financed Food Stamp program is administered by state welfare agencies in standard welfare fashion. Before receiving benefits, an applicant must go through a process that includes a “face-to-face interview with an eligibility worker.”<sup>41</sup> Federal law requires the state agency to verify much of the information furnished by the applicant before issuing food stamps.<sup>42</sup> In addition, states may elect to verify any other information furnished by the applicant affecting eligibility or level of benefits.<sup>43</sup> Beyond the initial certification, the state must require recertification (including another face-to-face interview) at least once every twelve months.<sup>44</sup>

Unlike the Food Stamp program, which features uniform federal rules for eligibility and benefit levels, TANF cash assistance eligibility rules and benefit levels vary greatly from state to state.<sup>45</sup> Despite the variation in substantive rules, all states administer TANF cash assistance using the traditional welfare precertification approach; no assistance is provided until the state welfare agency has reviewed the application and determined the amount of assistance (if any) to which the applicant is eligible. Federal law requires a state receiving TANF funds to “have in effect an income and eligibility verification system” meeting specified standards, and to apply the verification system to each TANF applicant.<sup>46</sup>

---

41. 7 C.F.R. § 273.2(e)(1) (2004).

42. Information which must be verified includes the amount of the applicant's income, as well as the applicant's Social Security number, residency, and identity. 7 C.F.R. § 273.2(f)(1).

43. 7 C.F.R. § 273.2(f)(3).

44. See 7 C.F.R. § 273.14 (describing the recertification process), and 7 C.F.R. § 273.10(f) (stating that certification periods may not be longer than twelve months).

45. For a summary of the eligibility and benefit rules of all the states, see OFFICE OF FAMILY ASSISTANCE, U.S. DEPT HEALTH & HUMAN SERVS., TEMPORARY ASSISTANCE FOR NEEDY FAMILIES PROGRAMS: FOURTH ANNUAL REPORT TO CONGRESS, XII-319 to XII-358 (2002).

46. 42 U.S.C. § 1320b-7(a) (2000). This requirement also applies with respect to state administration of the Food Stamp program. See also 42 U.S.C. § 609(a)(4) (providing for the imposition of penalties on states which fail to comply with the verification requirements).

### 3. Income Tax Benefits (Other Than the EITC)

Apart from the minimal review conducted under math error authority, taxpayers claiming tax benefits other than the EITC receive those benefits on the basis of their own say-so; self-declared eligibility is the norm. If one wants to claim a deduction for a contribution to charity or to an individual retirement account, or a credit for child care expenses or higher education expenses, one simply fills out the appropriate lines on Form 1040 (and perhaps on an accompanying schedule). In the case of an exclusion, the process is even simpler. If one claims that a particular receipt qualifies as a gift, for example, one simply omits any mention of that receipt from one's Form 1040. Having calculated one's tax liability based on the claimed tax benefit, one realizes that benefit either by including a smaller payment along with one's tax return (in the case of underwithholding) or by claiming and receiving a larger refund (in the case of overwithholding). Realizing the benefit by simply paying less tax is obviously a case of self-declared eligibility. Realizing the benefit by claiming and receiving a larger refund check is also an instance of self-declared eligibility, unless the IRS audits the return before issuing the refund. In the vast majority of cases, if a claim of a deduction, exclusion, or credit leads to a claimed refund of withholding or estimated taxes, the IRS will issue the refund check promptly, without making any effort to verify that the taxpayer really gave the claimed amount to charity, or spent the claimed amount on child care, or whatever the particular provision requires.<sup>47</sup>

In a letter responding to members of Congress concerned about the EITC residency precertification pilot program, Treasury Secretary John W. Snow claimed that the planned EITC precertification would not be unique in the administration of the income tax: "Similar to the EITC certification pilot, the IRS requires taxpayers to submit verification before claiming certain other tax benefits."<sup>48</sup> He gave as examples the requirement that an employer claiming the Work Opportunity Tax Credit<sup>49</sup> obtain state certification that an employee is a member of a targeted group,<sup>50</sup> and the requirement that a

---

47. See BORIS I. BITTKER ET AL., *FEDERAL INCOME TAXATION OF INDIVIDUALS* ¶ 47.03[1] (3d ed. 2002) (stating that refund claims based on allegedly excessive withholding are generally paid "automatically").

48. Letter from John W. Snow, Treasury Secretary, to Rosa L. Lauro, Representative, and 78 Other House Democrats ¶ 9 (Oct. 2, 2003), available at LEXIS, Tax Analysts, Tax Notes Today, 2003 TNT 196-44.

49. I.R.C. § 51 (2000).

50. See IRS Form 8850 (used by employers to request certification from the appropriate state agency), available at <http://www.irs.gov/pub/irs-pdf/f8850.pdf>.

noncustodial parent receive a written waiver from the custodial parent in order to claim a dependency exemption.<sup>51</sup> He could have added several similar examples, such as the requirement that a taxpayer claiming the low income housing credit of I.R.C. section 42 must have received a Form 8609 from a state or local housing credit agency,<sup>52</sup> and the requirement that a taxpayer claiming a credit based on the rehabilitation of a certified historic structure must have received a project number and a certificate of completion from the National Park Service prior to filling Form 3468.<sup>53</sup>

Even if these were genuine instances of precertification under the income tax, they collectively would amount to a tiny erosion of the tradition of allowing taxpayers to claim tax benefits on their own say-so. In fact, however, none of these examples is a true instance of precertification, for the simple reason that in none of these situations does the IRS verify the accuracy of the required documentation or certification before issuing a refund based on the claimed tax benefit.<sup>54</sup> Contrary to the implication of Secretary Snow's letter, requiring that the taxpayer have documentation before claiming a tax benefit on a return, or even requiring the submission of the documentation along with the return, does not constitute precertification. These requirements *would* be part of a precertification process if the IRS delayed issuing refunds until it had reviewed the documentation submitted by the taxpayer, but the IRS does not do so.

---

51. I.R.C. § 152(e)(2). Secretary Snow also mentioned the registration process mandated for persons receiving monthly advance payments of the Health Coverage Tax Credit (HCTC) of I.R.C. section 35. For details of the registration process, see INTERNAL REVENUE SERV., PUB. 4181, CATALOG NO. 36370X, HEALTH COVERAGE TAX CREDIT INFORMATION PROGRAM KIT (2003). The HCTC, which was enacted in 2002, is a refundable tax credit equal to 65 percent of the cost of qualified health insurance for certain displaced workers (those receiving Trade Adjustment Assistance and those at least fifty-five years old and receiving benefits from the Pension Benefit Guaranty Corporation). Unlike the other examples cited by Secretary Snow, this registration process is a genuine case of precertification. As a refundable credit paid in monthly installments, the advance HCTC has more in common with welfare-type transfers programs than with run-of-the-mill tax benefits, so the preregistration requirement is not shocking. Taxpayers can receive the credit without preregistration, however, if they are content to wait and claim the credit in arrears when they file their tax returns. The HCTC is also discussed below, see *infra* text accompanying notes 190–194.

52. Treas. Reg. § 1.42-1T(d)(8)(ii) (2004) (setting forth the requirements relating to Form 8609).

53. Treas. Reg. § 1.48-12(d)(7) (2003) (imposing the certification requirement).

54. And, of course, if the claimed tax benefit reduces the amount of tax to be paid by the taxpayer along with his return, rather than increasing the size of a refund, the IRS cannot verify anything about the claimed tax benefit before the taxpayer uses it to reduce the size of his check to the government.

#### 4. Drawing the Comparison

Precertification will obviously tend to produce less overpayment of benefits than will self-declared eligibility. The different attitudes towards precertification under the EITC (very limited precertification), traditional welfare (universal precertification), and nonrefundable tax benefits (no precertification) suggest that Congressional tolerance is greatest for overpayment of tax benefits, least for overpayment of welfare benefits, and somewhere in between—but closer to the tax end of the spectrum—for overpayment of the EITC.

#### B. Administrative Resources Devoted to Enforcement

This section turns to a different kind of evidence of relative tolerances for overpayments—administrative costs as a percentage of benefits received by program participants. The assumption is that a high ratio of administrative costs to program benefits is likely to be associated with a low tolerance for overpayments, and a low ratio of costs to benefits is likely to be associated with a high tolerance for overpayments. The evidence on this issue points in the same direction as the evidence on precertification. The ratio of costs to benefits is highest for traditional welfare programs and lowest for nonrefundable tax benefits; the costs-to-benefits ratio for the EITC falls in between, but closer to the tax end.

In recent years, the total costs of administering the Food Stamp program have been in the neighborhood of \$4 to \$5 billion annually.<sup>55</sup> The value of food stamps issued is around \$20 billion per year (\$21.41 billion in 2003),<sup>56</sup> so Food Stamp administrative expenditures are roughly 20–25 percent of program benefits.

TANF is somewhat less expensive to administer relative to benefits. In fiscal year 2001, combined state and federal TANF administrative expenses came to \$2.3 billion.<sup>57</sup> Nonadministrative TANF expenditures totaled \$23.2 billion, with \$10.1 billion devoted to basic cash assistance, and the bulk of the remainder going to various forms of noncash assistance (including child care and

---

55. In 2003, the federal government's share of Food Stamp administrative expenses was \$2.467 billion. FOOD & NUTRITION SERV., FOOD STAMP PROGRAM PARTICIPATION AND COSTS, 1996–2003 (2004), at <http://www.fns.usda.gov/pd/fssummar.htm>. The FNS does not report combined federal and state administrative expenses. However, the bulk of the federal expenses represented reimbursement of half of the administrative expenses incurred by the states. See 7 U.S.C. § 2025(a) (2000) (providing for such reimbursement). This suggests that the total state administrative expenses were slightly less than twice the federal amount. See also Janet Holtzblatt, *Choosing Between Refundable Tax Credits and Spending Programs*, in 93 PROC. ANN. CONF. ON TAX'N 116, 121 (2001) (stating that the total Food Stamp administrative costs in 1998 were approximately \$4 billion).

56. FOOD & NUTRITION SERV., *supra* note 55.

57. OFFICE OF FAMILY ASSISTANCE, U.S. DEPT OF HEALTH & HUMAN SERVS. TEMPORARY ASSISTANCE FOR NEEDY FAMILIES PROGRAM: FIFTH ANNUAL REPORT TO CONGRESS, II-1 to II-11 (2003).

work-related education and training).<sup>58</sup> Considering cash and noncash assistance together, administrative expenses were just under 10 percent of program benefits.

The IRS does not attempt to calculate the total amount it spends administering the EITC. In 1997, however, Congress directed the IRS to spend approximately \$140 million annually, for the next five years, on various EITC “enforcement initiatives.”<sup>59</sup> The five-year period has ended, but the IRS continues to devote similar amounts to EITC compliance initiatives.<sup>60</sup> Tax returns filed for 2001 (the most recent year for which data are available) claimed \$33.38 billion in EITC.<sup>61</sup> Thus, the annual expenditures under the EITC compliance initiatives were less than 0.5 percent of program benefits. The dollars spent on these initiatives are not a complete measure of IRS spending on EITC administration, as the initiatives do not fund all costs of processing returns claiming the EITC.<sup>62</sup> However, because over 95 percent of EITC claimants would have filed returns even in the absence of the EITC, these unidentified costs may not greatly increase the cost of administering the EITC.<sup>63</sup> Even if the unidentified costs were as great as the enforcement initiative expenditures (which seems unlikely), administrative costs would still be only 1 percent, or less, of program benefits.<sup>64</sup> EITC administrative costs relative to distributed benefits therefore appear to be less than those of traditional welfare programs by a full order of magnitude.

If the available data on EITC administrative costs are less precise than one might wish, the situation is much worse with respect to the costs of administering nonrefundable tax expenditures. The income tax differs from both welfare and the EITC, viewed as a distinct program, in that its primary function is raising revenue rather than distributing benefits (as tax expenditures).

---

58. *Id.*

59. Balanced Budget Act of 1997, Pub. L. No. 105-33, § 5702, 111 Stat. 251, 648 (1997).

60. INTERNAL REVENUE SERV., 2003 DATA BOOK 37 tbls.30 & 57 (2003) (indicating the IRS spent \$145.8 million in fiscal year 2002, and \$143.7 million in fiscal year 2003, on “essential compliance and error reduction initiatives” for the EITC).

61. INTERNAL REVENUE SERV., INDIVIDUAL INCOME TAX RETURNS, TAX YEAR 2001, at 4 tbl.A (2004).

62. Holtzblatt, *supra* note 55, at 121 (noting the existence of EITC administration costs not covered by the initiatives).

63. *Id.*

64. In a year predating the EITC compliance initiatives, the General Accounting Office estimated EITC administrative costs at 1 percent of EITC benefits. GEN. ACCOUNTING OFFICE, REPORT NO. T-GGD-95-179, EARNED INCOME CREDIT: NONCOMPLIANCE AND POTENTIAL ELIGIBILITY REVISIONS 5 (1995) (reprinting *Earned Income Tax Credit: Hearing Before the Senate Committee on Finance*, 104th Cong. (1995) (testimony of Lynda D. Willis, GAO Associate Director for Tax Policy and Administrative Issues)), available at <http://www.gao.gov/cgi-bin/getrpt?T-GGD-95-179>.



Not surprisingly, the IRS makes no attempt to determine how its administrative expenditures should be allocated between the costs of administering the tax-increasing provisions of the Internal Revenue Code, and the costs of administering the tax-reducing provisions for deductions, exclusions, and credits. Without such an allocation, it is not possible to determine the ratio of the costs of administering tax expenditures to the dollar amount of benefits delivered as tax expenditures. It is possible, however, to establish some outer boundaries on the costs of administering nonrefundable tax benefits, and to compare the outer boundary amounts with the values of those tax benefits.

The overall IRS budget for fiscal year 2003 was \$9.835 billion, or \$9.690 billion after subtracting the \$145 million earmarked for EITC compliance programs.<sup>65</sup> For tax year 2004, the combined tax expenditure amount for the four most prominent itemized deductions—home mortgage interest, charitable contributions, state and local taxes, and medical expenses—was \$166.9 billion.<sup>66</sup> The tax expenditure for the deduction for contributions to Individual Retirement Accounts (available to both itemizers and nonitemizers) was \$13 billion.<sup>67</sup> Seven prominent exclusions—employer-provided health insurance, employer-provided pensions, capital gains at death, the inside build-up in life insurance and annuities, capital gains on personal residence sales, cafeteria plan benefits, and miscellaneous fringe benefits—came to \$291.8 billion.<sup>68</sup> Three leading nonbusiness credits—the child credit, the child care credit, and the higher education (Hope and Lifetime Learning) credit—added up to \$51.5 billion.<sup>69</sup> The sum of all these tax expenditures—deductions, exclusions, and credits—was \$523.2 billion. Even if (absurdly) the entire IRS budget were devoted to administering these individual income tax expenditures, with nothing

---

65. INTERNAL REVENUE SERV., BUDGET IN BRIEF: FISCAL YEAR 2005, at 4 (2004). The two largest budget categories, by far, were Processing, Administration, and Management (\$3.930 billion), and Tax Law Enforcement (\$3.705 billion). *Id.*

66. STAFF OF THE JOINT COMM. ON TAX'N, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2004–2008, DOC. NO. JCS-8-03, at 22–30 tbl.1 (2003), available at <http://www.house.gov/jct/s-8-03.pdf>. The amounts were: \$61.4 billion for the home mortgage interest deduction, \$36.6 billion for the charitable deduction (\$3.5 billion for contributions to health organizations, \$5.2 billion for contributions to educational organizations, and \$27.9 billion for contributions to all other organizations), \$63 billion for state and local taxes (\$18.7 billion for property taxes on owner-occupied homes, and \$44.3 billion for all other nonbusiness taxes), and \$5.9 billion for medical expenses. *Id.*

67. *Id.* at 28.

68. *Id.* at 22–30. The amounts were: \$96 billion for employer-provided health insurance, \$94.6 billion for employer-provided pensions, \$35.9 billion for gains at death, \$24.7 billion for life insurance and annuities, \$17.9 billion for gains on home sales, \$16.9 billion for cafeteria plans, and \$5.8 billion for miscellaneous fringes. *Id.*

69. *Id.* The amounts were: \$44.1 billion for the child credit, \$3.1 billion for the child care credit, and \$4.3 billion for the higher education credit. *Id.*

spent on the remaining tax expenditure items, on any inclusion provisions, on the corporate income tax, on estate and gift taxes, on payroll taxes, or on excise taxes, the IRS's \$9.690 billion non-EITC budget would still be only 1.85 percent of the value of these tax benefits. Thus, even without any information on how the IRS budget is allocated between the cost of administering nonrefundable income tax benefits and all other IRS functions, it can be concluded that the cost of administering the individual income tax benefits listed above is no more than 1.85 percent of benefits (on the extreme assumption that the entire IRS budget is devoted to administering those benefits), and no less than 0 percent of benefits (on the opposite extreme assumption).

This crude methodology is sufficient to establish that the ratio of administrative costs to program benefits under the EITC is much closer to the ratio for other tax benefits than to the ratio for Food Stamps and TANF. It is not sufficient, however, to establish whether the IRS emphasizes EITC compliance over other aspects of income tax compliance—in other words, whether the IRS acts as if a dollar of EITC overpayment is worse than a dollar of tax underpayment. The next section attempts to get at that question through a different approach, by comparing the IRS's EITC auditing practices with its non-EITC auditing practices.

### C. Does the IRS Overemphasize EITC Audits Relative to Non-EITC Audits?

The universal precertification required under traditional welfare programs is the equivalent of a 100 percent audit rate. Because enforcement of both the EITC and non-EITC tax provisions relies on limited audit coverage rather than on universal precertification, it is clear that the EITC administration is much closer, in this respect, to general income tax administration than to welfare administration. The possibility remains, however, that the IRS might overemphasize EITC audits relative to other audits. In fact, a glance at relative audit rates suggests that this is the case. For fiscal years 2000–2003, EITC issues accounted for about half of all individual income tax examinations.<sup>70</sup> Since EITC returns make up less than 20 percent of all individual income tax

---

70. TREASURY INSPECTOR GEN. FOR TAX ADMIN., REFERENCE NO. 2004-30-083, TRENDS IN COMPLIANCE ACTIVITIES THROUGH FISCAL YEAR 2003, at 8 (2004). For more precise data, see INTERNAL REVENUE SERV., REPORT TO CONGRESS: IRS TAX COMPLIANCE ACTIVITIES (2003), available at <http://www.irs.gov/taxstats/compliancestats/0,,id=117875,00.html>. EITC returns constituted 43.8 percent of all individual income tax returns examined in fiscal year 1996, 23.8 percent of all returns examined in 1997, 27.2 percent in 1998, 55.2 percent in 1999, 43.8 percent in 2000, 56.5 percent in 2001, and 51.9 percent in 2002. Author's calculations based on *id.* at tbls.5a & 5e.

returns,<sup>71</sup> this means that EITC returns are several times more likely to be selected for audit than non-EITC returns.<sup>72</sup> The disproportionate audit emphasis on the EITC seems sufficient to establish a prima facie case that the IRS over-emphasizes EITC enforcement activities. Indeed, this conclusion has been expressed by John Karl Scholz, a leading scholar of the EITC: “[I]f you consider the amount of noncompliant behavior uncovered for a dollar of I.R.S. enforcement resources, the amount of attention being given to the earned income tax credit is much too large.”<sup>73</sup> The picture becomes hazier, however, once the differing natures of EITC and non-EITC audits are factored in. Virtually all EITC audits are so-called correspondence audits (conducted entirely by mail, and limited to one or a few identified issues),<sup>74</sup> which are much less expensive than office and field audits. Although correspondence audits are also used for higher income taxpayers, a majority of audits of taxpayers reporting income of more than \$100,000 are face-to-face audits.<sup>75</sup>

Instead of focusing on relative audit rates, one might consider whether the percentage of the IRS’s enforcement budget devoted to the EITC exceeds the percentage of the tax gap<sup>76</sup> attributable to the EITC. Taking this approach, Leonard E. Burman of the Urban Institute calculated that the IRS devoted 3.8 percent of its total enforcement budget to the EITC in 2003, even though EITC noncompliance constituted only about 2.8 percent of the total tax gap.<sup>77</sup> This suggests that the IRS overemphasizes EITC enforcement relative to other income tax enforcement issues, but only moderately so. It is consistent

---

71. There were 130.7 million individual income tax returns filed in fiscal year 2003, of which 21.3 million claimed the EITC. INTERNAL REVENUE SERV., *supra* note 60, at 8 tbl.2, 12 tbl.5.

72. As a result of this disproportionate EITC auditing, in 1999 the audit rate for returns reporting less than \$25,000 income (1.36 percent) was actually higher than the audit rate for returns reporting more than \$100,000 income (1.15 percent). David Cay Johnston, *I.R.S. More Likely to Audit the Poor and Not the Rich*, N.Y. TIMES, Apr. 16, 2000, at A1.

73. *Id.*

74. In fiscal year 2002, the IRS conducted 367,314 EITC correspondence audits, 5790 EITC field audits, and 4655 EITC office audits. Author’s calculations are based on INTERNAL REVENUE SERV., *supra* note 70, at tbls.5b, 5c, 5d, 5f, 5g, & 5h. Correspondence audits constituted 97.2 percent of the 377,759 total EITC audits.

75. For fiscal years 1996 through 2000, the percentage of audits of high-income (above \$100,000) taxpayers conducted as face-to-face audits ranged from a low of 62 percent to a high of 75 percent. GEN. ACCOUNTING OFFICE, REPORT NO. GAO-01-484, IRS AUDIT RATES: RATE FOR INDIVIDUAL TAXPAYERS HAS DECLINED BUT EFFECT ON COMPLIANCE IS UNKNOWN 8 (2001), available at <http://www.gao.gov/new.items/d01484.pdf>.

76. The tax gap is the difference between the amount of tax owed and the amount of tax actually collected. In the case of the EITC, the gap also includes excessive EITC refunds.

77. *Waste, Fraud, and Abuse: Hearing Before the House Comm. on Ways and Means*, 108th Cong. (2003) [hereinafter *Waste, Fraud, and Abuse Hearing*] (statement of Leonard E. Burman, Senior Fellow, The Urban Institute; Codirector, Tax Policy Center; Research Professor, Georgetown Public Institute), available at LEXIS, Tax Analysts, Tax Notes Today, 2003 TNT 138-32, ¶ 33.

with the hypothesis that EITC compliance efforts, although falling between the usual levels of welfare and tax enforcement efforts, are closer to the tax end of the spectrum.

It is conceivable, of course, that the expenditure pattern noted by Burman could have flowed purely from cost-benefit analysis, rather than from an inappropriate emphasis on the EITC. An economically rational tax administrator would attempt to equalize the marginal returns on enforcement dollars across the entire range of income tax compliance issues. In other words, the goal would be to produce the same amount of revenue from the last dollar spent on EITC examinations as from the last dollar spent on examinations focused on other compliance issues. This is more easily said than done, and no data are available as to how well the IRS is performing by this standard. There is, however, some information available from the General Accounting Office (GAO) concerning the average return on dollars spent on examinations of high-income (above \$100,000) taxpayers, compared with the average return on dollars spent on examinations of low-income (below \$25,000) taxpayers.<sup>78</sup> The low-income audits in the GAO's analysis were not limited to EITC issues, but EITC issues loom large in audits of low-income taxpayers. As with the Burman analysis, the GAO data suggest that the IRS over-emphasizes EITC enforcement, but not hugely so. Examining the ratio of taxes actually collected as a result of audits to the direct staff costs of audits, the GAO found that audits of high-income taxpayers were more productive than audits of low-income taxpayers, but less than twice as productive. The collections-to-costs ratio was 10:1 for individual nonbusiness returns of high-income taxpayers, while for low-income nonbusiness returns the ratios were 9:1 (for 1040A returns) and 5:1 (for other returns). The ratios were 6:1 for individual business returns of high-income taxpayers (for returns reporting nonfarm business activities on Schedule C) and 8:1 (for returns reporting farming activities on Schedule F), while the ratio for low income business returns was 5:1.<sup>79</sup>

---

78. GEN. ACCOUNTING OFFICE, REPORT NO. GGD-98-128, TAX ADMINISTRATION: IRS MEASURES COULD PROVIDE A MORE BALANCED PICTURE OF AUDIT RESULTS AND COSTS 31 tbl.III.2 (1998) (analyzing results of audits conducted in fiscal year 1992), available at <http://www.gao.gov/archive/1998/gg98128.pdf>.

79. An earlier GAO study, which considered additional taxes recommended (rather than actually collected) per audit hour, produced results broadly consistent with the later study. GEN. ACCOUNTING OFFICE, REPORT NO. GGD-96-91, TAX ADMINISTRATION: AUDIT TRENDS AND RESULTS FOR INDIVIDUAL TAXPAYERS 13 fig.6 (1996) (showing that for all return category comparisons, audits of high-income returns were more productive per audit hour than those of low-income returns, but less than twice as productive), available at <http://www.gao.gov/archive/1996/gg96091.pdf>; see also TREASURY INSPECTOR GEN. FOR TAX ADMIN., REFERENCE NO. 2004-30-005, KEY AREAS OF NONCOMPLIANCE AMONG SMALL

In addition to not isolating the *marginal* returns on enforcement dollars, the GAO study is less than ideal in its consideration of only the *direct* productivity of enforcement expenditures. That is, the study considers the tax dollars collected with respect to examined returns, but it makes no attempt to estimate the revenue *indirectly* produced by the general deterrence effect of audits (based on the tendency of “voluntary compliance” to increase in response to a perceived increase in the probability that noncompliance will be detected). If the IRS knew the combined direct and indirect revenue effects of various examination activities, it could then equalize the total (direct plus indirect) marginal productivity of examination dollars across all audit categories. Unfortunately, very little is known about the indirect productivity of audits. What little evidence there is suggests that indirect revenue effects may dwarf direct revenue effects, perhaps by an order of magnitude of eleven or more.<sup>80</sup> Given the probable size of the indirect effects, and the absence of any information whatsoever on the marginal indirect effects of EITC audit expenditures relative to other audit expenditures, one cannot claim with confidence that the IRS overspends on EITC enforcement relative to other aspects of income tax enforcement. Nevertheless, all the available evidence—inadequate though it certainly is—suggests that the IRS moderately overemphasizes EITC enforcement at the audit stage.

D. Ratios of Overpayments of Benefits to Underpayments of Benefits for Welfare Programs, Non-EITC Tax Benefits, and the EITC

Enforcement activities designed to prevent the receipt of excessive benefits (whether welfare or tax) will also tend to discourage receipt of appropriate levels of benefits. This is most obvious, perhaps, with respect to precertification. Precertification may be quite effective in preventing overpayments, but it may also lead to substantial underpayments as eligible persons are discouraged

---

BUSINESS AND SELF EMPLOYED TAXPAYERS COULD BE ADDRESSED THROUGH MORE EFFECTIVE USE OF CORRESPONDENCE EXAMINATIONS 5 (2003):

In recent years, the IRS has come under growing criticism for its focus on low-income taxpayers, especially due to the number of EITC examinations. While the IRS certainly cannot ignore the risks presented by SB/SE [Small Business/Self-Employed] Division taxpayers claiming the EITC, the workload selected for correspondence examinations . . . does not seem to be balanced against the compliance risks associated with other SB/SE Division taxpayers.

*Id.*

80. Alan H. Plumley, *The Impact of the IRS on Voluntary Tax Compliance: Preliminary Empirical Results*, 95 PROC. ANN. CONF. ON TAX'N 355, 358 (2003) (“[T]he average indirect effect of the audits started in 1991 was about 11.7 times as large as the average adjustment directly proposed by audits closed that year.”).

from applying by the time and effort required of them.<sup>81</sup> If the overpayment of benefits in a particular program is viewed as an especially bad thing, and the administration of the program is designed accordingly, one would expect that program to feature a high ratio of benefit underpayments to overpayments (with underpayments including both underpayments to participants and the lack of any payments to eligible nonparticipants). By contrast, a lower ratio of underpayments to overpayments would be expected of a program in which overpayments are not considered so terrible.

The hypothesis of this Article is that a dollar of welfare overpayment is considered more objectionable than a dollar of excessive tax reduction from the overclaiming of a tax benefit, and that a dollar of EITC overpayment is viewed as an intermediate case (although probably closer to the tax pole than to the welfare pole). If that is correct, one would expect that welfare programs would have a high ratio of underpayments to overpayments, that non-EITC income tax benefits would feature the opposite pattern, and that the EITC pattern would be somewhere in between. This section reviews the available evidence on that score.

The Department of Agriculture annually estimates the percentage of Food Stamp benefits paid in error; for fiscal year 2002, the overpayment error rate was 6.16 percent.<sup>82</sup> The Department also calculates an underpayment error rate, taking into account only underpayments to program participants. For 2002, the underpayment error rate was 2.10 percent.<sup>83</sup> Missing from these annual estimates are the underpayments resulting from the failure of eligible persons to apply for benefits. A recent study found that in September 2001, only 54 percent of eligible households were participating in the Food Stamp program.<sup>84</sup> The study also estimated that the dollar amount of benefits foregone by nonparticipants was 27.3 percent of the total amount that would have been paid if all eligible households had participated and received the correct amount of benefits.<sup>85</sup> Adding together the underpayment rate from the Department of Agriculture's annual study and the underpayment rate from the study of

---

81. See Holtzblatt, *supra* note 55, at 119 (detailing the high compliance costs imposed on Food Stamp participants by the application process).

82. HOUSE COMM. ON WAYS AND MEANS, 108TH CONG., 2004 GREEN BOOK 15-21, at tbl.15-7 (2004).

83. *Id.* at 15-21. The Department also determined that the rate of improper denials or termination of Food Stamp benefits in 2002 was 7.9 percent, but it did not attempt to determine the underpayment of benefits resulting from improper denials and terminations. *Id.* at 15-19.

84. KAREN CUNNINGHAM, TRENDS IN FOOD STAMP PARTICIPATION RATES: 1999 to 2001, at 7 tbl.2.1 (2003). The September participation rates varied somewhat from year to year, but were in the 50-60 percent range from 1997 through 2001. *Id.*

85. *Id.*

nonparticipants produces a total underpayment rate of close to 30 percent, and comparing that rate with the overpayment rate produces a ratio of underpayments to overpayments in the neighborhood of 5:1.

Little is known about the ratio of overclaims to underclaims for non-EITC income tax benefits. There is almost no published information on the magnitude of underclaims,<sup>86</sup> let alone studies comparing underclaims with overclaims. The lack of research interest in the underclaiming of income tax benefits (and the resulting overpayment of tax) is itself an interesting phenomenon. There is, of course, considerable research on underpayments of income tax—the so-called “tax gap.”<sup>87</sup> There are also a number of useful studies on both underpayments and overpayments of the EITC and of benefits administered by welfare bureaucracies.<sup>88</sup> There seems to be almost no interest, however, in the underclaiming of nonrefundable tax benefits. Perhaps this is because inaccuracy in the delivery of legislated benefits is considered an important issue only if it involves a drain on the Treasury or nonreceipt by the poor of desperately needed benefits, and the underclaiming of nonrefundable tax benefits implicates neither concern. Or perhaps it is generally assumed that the underclaiming of tax benefits must be minimal (especially given the ease with which tax benefits can be claimed, compared with welfare benefits), so that there is little to study.

In any event, the study that is most nearly on point for present purposes supports the intuition that overclaims of tax benefits greatly exceed underclaims. Examining data produced by intensive audits of 1982 tax returns randomly selected under the IRS's Taxpayer Compliance Measurement Program (TCMP), Joel Slemrod compared overclaims and underclaims of charitable

---

86. For a rare instance of such a study, see GEN. ACCOUNTING OFFICE, REPORT NO. GAO-02-509, TAX DEDUCTIONS: FURTHER ESTIMATES OF TAXPAYERS WHO MAY HAVE OVERPAID FEDERAL TAXES BY NOT ITEMIZING (2002), available at <http://www.gao.gov/new.items/d0250.pdf>. This study estimates that as many as 2.2 million 1998 returns claiming the standard deduction would have shown lower tax liabilities by itemizing deductions instead, and that the resulting overpayment of tax may have been as much as \$945 million. The study makes no attempt to compare this amount with tax reductions caused by overstatements of itemized deductions by other taxpayers.

87. For a description of the tax gap study currently being conducted by the IRS, see GEN. ACCOUNTING OFFICE, REPORT NO. GAO-03-614, TAX ADMINISTRATION: IRS IS IMPLEMENTING THE NATIONAL RESEARCH PROGRAM AS PLANNED (2003), available at <http://www.gao.gov/new.items/d03614>. For the most recently published IRS tax gap study, see INTERNAL REVENUE SERV., PUB. 1415, CATALOG NO. 10263H, FEDERAL TAX COMPLIANCE RESEARCH: INDIVIDUAL INCOME TAX GAP ESTIMATES FOR 1985, 1988, AND 1992 (1996).

88. See, e.g., the studies cited *supra* notes 82, 84 (with respect to food stamps) and *infra* notes 93, 95 (with respect to the EITC).

contribution deductions (as determined by TCMP auditors).<sup>89</sup> He found that TCMP auditors' total downward adjustments to contributions reported on returns equaled 8.9 percent of reported contributions, while upward adjustments were only 1.7 percent of reported contributions.<sup>90</sup> Thus, errors in favor of taxpayers exceeded errors in favor of the government by a ratio of more than 5:1.<sup>91</sup> As it happens, this is almost exactly the opposite of the Food Stamp error pattern, in which errors in favor of the government exceeded errors in favor of individuals by about 5:1.<sup>92</sup>

In its study of the \$31.3 billion of EITC claims on 1999 tax returns, the IRS concluded that between \$8.4 billion and \$9.9 billion of the claims should not have been paid.<sup>93</sup> The IRS also determined that 1999 EITC underclaims—on returns claiming some amount of EITC—were in the range of \$710 to \$765 million.<sup>94</sup> Thus, the study indicates that EITC overclaims exceeded underclaims by more than 10:1. The study is incomplete for present purposes, however, because it did not attempt to estimate underclaims resulting from eligible persons failing to claim the credit at all.<sup>95</sup> That gap in the analysis is filled, however, by the General Accounting Office, which estimated that for 1999 (the year of the IRS's study) about 4.3 million eligible households did not claim the credit, and that about \$2.7 billion of credit was

---

89. Joel Slemrod, *Are Estimated Tax Elasticities Really Just Evasion Elasticities? The Case of Charitable Contributions*, 71 REV. ECON. & STAT. 517, 517–22 (1989).

90. *Id.* at 519.

91. The 8.9 percent and 1.7 percent figures relate to claimed deduction amounts, not to the amount of tax liability associated with the claimed deduction amounts. Given the existence of a graduated rate structure, the ratio of tax underpayments to overpayments may differ somewhat from the ratio of overstated to understated deduction amounts.

92. Another perspective on the relative sizes of underclaims and overclaims of tax benefits is provided by IRS data on recommended additional tax and recommended refunds following audits. In fiscal year 2003, individual income tax audits resulted in \$4.56 billion of recommended additional tax, and only \$0.45 billion of recommended refunds, for a ratio of slightly over 10:1. INTERNAL REVENUE SERV., *supra* note 60, at 18 tbl.10, 25 tbl.13. Although the ratio is suggestive, for two reasons it cannot be interpreted as the ratio of tax benefit overclaims to tax benefit underclaims. First, unlike the TCMP returns used by Slemrod, these returns were not randomly selected; indeed, they were largely selected based on their revenue potential. Second, not all understatements of tax result from overclaims of tax benefits. For example, a large portion of the tax gap is attributable to failures to report income that is clearly taxable, but difficult for the IRS to discover (because it is not subject to withholding or to information reporting). Recommended additional tax attributable to such failures does not relate to the overclaiming of any tax benefit.

93. INTERNAL REVENUE SERV., *supra* note 3, at 10. This study has been the subject of a number of methodological critiques, arguing that it probably overstates the true level of overpayments. *See, e.g.*, ROBERT GREENSTEIN, CTR. ON BUDGET AND POLICY PRIORITIES, WHAT IS THE MAGNITUDE OF EITC OVERPAYMENTS? (2003), available at <http://www.centeronbudget.org/5-20-03eitc3.pdf>. In addition, the IRS's study does not reflect the effects of recent EITC compliance legislation, which may have reduced current overpayments below the 1999 level. *Id.*

94. INTERNAL REVENUE SERV., *supra* note 3, at 11 tbl.1.

95. *Id.* at 3 (noting that limitation in the study).



foregone by those nonparticipating households.<sup>96</sup> Adding together the underclaims by participants (as estimated by the IRS) and the underclaims by nonparticipants (as estimated by the GAO) produces total underpayments of about \$3.5 billion. The resulting ratio of overpayments to underpayments is somewhere between 2:1 and 3:1. This places the EITC somewhere between Food Stamps and nonrefundable tax benefits (but closer to nonrefundable tax benefits) with respect to the relative magnitudes of overpayments and underpayments. Like nonrefundable tax benefits and unlike Food Stamps, the EITC features errors in favor of individuals that are larger than its errors in favor of the government. On the other hand, the ratio of pro-individual errors to pro-government errors appears to be lower for the EITC than for nonrefundable tax benefits.

E. EITC Criminal Enforcement Activity Compared With Federal Tax Prosecutions Generally, and With Welfare (Food Stamp and TANF) Prosecutions

During a recent three-year period (2000–2002), the IRS initiated 196 criminal investigations relating to the EITC under its “questionable refund program.”<sup>97</sup> Over the same time frame, 129 EITC criminal investigations were recommended for prosecution under this program, and 137 convictions were obtained.<sup>98</sup> These investigations and prosecutions were generally aimed at promoters of schemes designed to produce refunds for large numbers of claimants, rather than at the individual claimants themselves.<sup>99</sup> Under a separate program aimed at fraud by return preparers, 54 investigations of EITC fraud by preparers were recommended for prosecution and 48 convictions were obtained.<sup>100</sup> Combining these two programs, there were 183 prosecution recommendations (61 per year) and 185 convictions (about 62 per year). Relative to the federal tax prosecution universe, these numbers are not particularly impressive. During fiscal year 2001, for example, the IRS initiated a total of 3284 criminal investigations and made 2335 referrals for prosecution, and the Justice Department

---

96. Letter from James R. White, Director of Tax Issues, General Accounting Office, to Representative William J. Coyne 2–3 (Dec. 14, 2001), reprinted in GEN. ACCOUNTING OFFICE, REPORT NO. GAO-02-290R, EARNED INCOME TAX CREDIT ELIGIBILITY AND PARTICIPATION 2–3 (2001), available at <http://www.gao.gov/newitems/d02290r.pdf>.

97. INTERNAL REVENUE SERV., *supra* note 33, at 13.

98. *Id.*

99. The 196 criminal investigations related to 20,095 returns, for an average of more than 100 returns per investigation. *Id.*

100. *Id.* at 14.

obtained 2251 convictions.<sup>101</sup> EITC noncompliance accounts for roughly 3 percent of the overall federal tax gap,<sup>102</sup> while the average number of EITC criminal referrals over the three-year period (61) was about 2.6 percent of the total referrals for 2001, and the average number of EITC convictions (62) was about 2.8 percent of the total convictions obtained in 2001. These numbers are only suggestive, of course, since the ratio of prosecution-worthy EITC cases to all prosecution-worthy federal tax cases is not necessarily the same as the ratio of the EITC-related tax gap to the total tax gap. The numbers do not, however, support the proposition that the IRS places a disproportionate emphasis on the EITC in its criminal enforcement activities.

The low level of EITC criminal enforcement contrasts sharply with the norm for transfer programs administered through the welfare system. Although the total size of the EITC (as measured by the dollar amount of benefits) is about 70 percent greater than that of the Food Stamp program,<sup>103</sup> EITC criminal enforcement activities are a small fraction of Food Stamp criminal enforcement activities. In the seven-year period from fiscal year 1996 through fiscal year 2002, the Department of Agriculture conducted 3492 criminal investigations related to Food Stamps (an average of 499 per year).<sup>104</sup> Over the same seven years, Department of Agriculture investigations resulted in 2969 Food Stamp related indictments (an average of 424 per year) and 2740 convictions (an average of 391 per year).<sup>105</sup> Food Stamp fraud is also investigated and prosecuted at the state level. In California alone, during the last three months of 2003, 781 prosecutions were filed for Food Stamp fraud and 775 convictions were obtained.<sup>106</sup> The Food Stamp prosecutions in this one state in just three months greatly exceeded the EITC prosecutions in the entire country in three years.

The states are also very active in prosecuting fraud under welfare programs other than Food Stamp. During the last three months of 2003, California filed 721 prosecutions for CalWORKS (the California version of TANF) fraud, and obtained 758 convictions.<sup>107</sup> On an annualized basis, both prosecutions and

---

101. INTERNAL REVENUE SERV., 2001 DATA BOOK 22 tbl.18.

102. *Waste, Fraud, and Abuse Hearing*, *supra* note 77, at ¶ 33.

103. In fiscal year 2003, Food Stamp benefits totaled \$21.4 billion. FOOD & NUTRITION SERV., *supra* note 55. Tax returns filed in the same fiscal year claimed \$36.9 billion of EITC. INTERNAL REVENUE SERV., *supra* note 71, at 12 tbl.5.

104. *Fraud, Waste, and Abuse in Mandatory Spending Programs: Hearings Before the House Comm. on the Budget*, 108th Cong. 4 (2003) (statement of Phyllis K. Fong, Inspector General, Dep't of Agric.), available at <http://www.budget.house.gov/hearings/fongstmnt070903.pdf>.

105. *Id.* at 8.

106. CAL. DEP'T OF SOC. SERV. DATA SYS. & SURVEY DESIGN BUREAU, FRAUD INVESTIGATION REPORT: OCT.–DEC. 2003, at 3 (2004).

107. *Id.* at 8, 9.

convictions would number around 3000—about fifty times the number of annual EITC prosecutions and convictions nationwide, despite the fact that total EITC benefits are about twelve times as great as total CalWORKS cash grants.<sup>108</sup> The ratio of prosecutions to program benefits under CalWORKS is about 600 times greater than the equivalent ratio for the EITC. Although the California numbers are particularly impressive, other states also prosecute welfare fraud much more aggressively than the federal government prosecutes EITC fraud.<sup>109</sup>

In sum, a comparison of the level of criminal enforcement of the EITC with overall federal tax criminal enforcement, and with welfare criminal enforcement (both state and federal), suggests that EITC fraud prosecutions are not excessive relative to federal tax prosecutions generally. Further, they are virtually nonexistent relative to prosecutions of Food Stamp and TANF fraud.

#### F. EITC Civil Sanctions Compared With Income Tax Civil Sanctions Generally, and With TANF and Food Stamp Civil Sanctions

Upon a final determination that a taxpayer fraudulently claimed the EITC, the taxpayer is ineligible to receive any EITC for ten years.<sup>110</sup> Upon a final determination that a taxpayer's EITC claim was based on "reckless or intentional disregard of rules and regulations," the taxpayer is EITC-ineligible for two years.<sup>111</sup> There is virtually no limit to the potential severity of these sanctions, in terms of dollars of penalty as a percentage of the dollars of improperly claimed credit. A fraudulent claim of \$1000 of credit, for example, might lead to the loss of more than \$40,000 of credit over the next ten years—a penalty of more than 4000 percent.<sup>112</sup>

---

108. EITC claimed on returns filed in fiscal year 2003 totaled \$36.9 billion. INTERNAL REVENUE SERV., *supra* note 71, at 12 tbl.5. Monthly cash grants under CalWORKS are in the neighborhood of \$250 million, resulting in annual grants of about \$3 billion. *See, e.g.*, CAL. DEP'T OF SOC. SERV. DATA SYS. & SURVEY DESIGN BUREAU, PUBLIC ASSISTANCE FACTS AND FIGURES FOR THE MONTH OF FEBRUARY 2004, at 1 (2004) (indicating CalWORKS cash grants of \$250.6 million for the month).

109. In New York, for example, felony prosecutions for welfare fraud averaged 102 per year from 1999 through 2003, and annual convictions averaged 90 over the same period. BUREAU OF JUST. RESEARCH AND INNOVATION, STATE OF N.Y. DIV. OF CRIM. JUST. SERVICES, FELONY DEFENDANT PROCESSING SUMMARY: INDICTMENTS FOR WELFARE FRAUD (2004). Florida prosecuted 849 cases of welfare fraud in fiscal year 2001–2002, and 973 cases in fiscal year 2002–2003. E-mail from Christo Tolia, Florida Office of the Auditor General, to Lawrence Zelenak (June 22, 2004) (on file with the author).

110. I.R.C. § 32(k)(1)(B)(i) (2000).

111. I.R.C. § 32(k)(1)(B)(ii).

112. At the other extreme, a sanction under I.R.C. section 32(k) will constitute no penalty at all for a taxpayer who would not have been entitled to claim any credit over the relevant time frame, even in the absence of the sanctions.

There are no analogous sanctions applicable to other improper positions taken on federal income tax returns. If an underpayment of income tax is due to negligence or to a "substantial understatement" of tax liability on a return, the taxpayer is generally subject to a penalty equal to 20 percent of the underpayment.<sup>113</sup> Even if an underpayment is due to fraud, the penalty is only 75 percent of the underpayment.<sup>114</sup> Aside from the special EITC sanctions, an improper claim of a deduction, credit, or exclusion on one year's return never makes a taxpayer ineligible to claim the same tax benefit in a later year. No matter how culpable a taxpayer was in wrongfully claiming a charitable deduction or a dependency exemption in one year, the taxpayer is not foreclosed from claiming the deduction or the exemption in a future year in which the taxpayer satisfies the substantive requirements. The draconian EITC sanctions, and the absence of any similar sanctions for improper income tax return positions not involving the EITC, suggest that Congress considers overpayments of the EITC to be much worse than underpayments of income tax.

The EITC sanctions much more closely resemble sanctions for misbehavior in connection with welfare programs (TANF and Food Stamps) than they resemble generally applicable income tax penalties. In the case of TANF, federal law requires the states to impose sanctions on persons who fail to comply with work requirements imposed as a condition of receiving cash assistance.<sup>115</sup> At a minimum, a state must reduce a family's cash grant pro rata for any month in which a family member fails to comply with a work requirement,<sup>116</sup> and the state may deny assistance to the entire family for that month.<sup>117</sup> The precise sanctions vary from state to state, but typically the first failure results in a reduction in the family's cash grant for one month or until the family member begins to comply, while repeated failures lead to termination of the

---

113. I.R.C. § 6662(a). The 20 percent penalty of section 6662 applies to underpayments attributable to improper EITC claims, just as it applies to income tax underpayments generally. There is uncertainty, however, as to whether an EITC overclaim results in an underpayment (as defined in I.R.C. section 6664(a)) if the overclaim served to create a negative tax liability (that is, a credit in excess of the taxpayer's precredit income tax liability), rather than to reduce a positive precredit income tax liability. Compare *Akhter v. Comm.*, T.C. Summ. Op. 2001-20 (holding that no underpayment exists in this situation, with the result that no penalty can be imposed under I.R.C. section 6662) with INTERNAL REVENUE SERV., PUB. NO. 200113028, SERVICE CENTER ADVICE (Feb. 26, 2001) (reaching the opposite conclusion). The same uncertainty exists with respect to the fraud penalty of I.R.C. section 6663, which also depends on the existence of an underpayment. For more on this issue, see Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 KAN. L. REV. 1145, 1181-82 (2003).

114. I.R.C. § 6663(a).

115. 42 U.S.C. § 607(e)(1) (2000).

116. 42 U.S.C. § 607(e)(1)(A). For example, if one member of a three-member family fails to comply, the family's grant must be reduced by at least one-third.

117. 42 U.S.C. § 607(e)(2)(B).

family's assistance for three to six months (although seven states impose lifetime sanctions on repeat offenders).<sup>118</sup> Federal law also requires the states to impose sanctions on TANF recipients who fail to cooperate with child support enforcement efforts,<sup>119</sup> and the states' child support sanctions are generally similar to their work requirement sanctions.<sup>120</sup> Finally, federal law denies assistance for ten years to any person found to have fraudulently misrepresented his residence in order to obtain assistance in two or more states.<sup>121</sup>

Federal law also requires the states to impose Food Stamp sanctions for failures to comply with the TANF work requirements. At a minimum, a state's rules must provide that the noncompliant person is ineligible for food stamps for one month after a first violation, for three months after a second violation, and for six months after a third violation.<sup>122</sup> A state may extend ineligibility to the entire family if the noncompliant person is the head of the household, and eighteen states have done so.<sup>123</sup> Permanent Food Stamp ineligibility (for the noncompliant person, but not for the entire family) is a state option for a third or later violation.<sup>124</sup> In addition, federal law provides that a person found intentionally to have made a false or misleading statement in order to obtain food stamps shall be ineligible to receive food stamps for one year after the first such determination, for two years after the second, and permanently after the third.<sup>125</sup>

As they are written, the EITC sanctions are roughly comparable to the TANF and Food Stamp sanctions in severity. Arguably, the EITC sanctions are even more severe—compare, for example, the ten-year disallowance for the first finding of EITC fraud with the one-year disallowance for the first finding of Food Stamp fraud. The rough equivalence vanishes, however, when the focus turns from the law on the books to actual enforcement practices. The TANF sanctions affect a significant number of people—135,800 families nationally (about 5 percent of the total caseload) during an average month in 1998.<sup>126</sup> By contrast, the two-year and ten-year EITC sanctions have been applied very sparingly. The EITC sanctions depend on a finding

---

118. GEN. ACCOUNTING OFFICE, REPORT NO. HEHS-00-44, WELFARE REFORM: STATE SANCTION POLICIES AND NUMBER OF FAMILIES AFFECTED 16-17 (2000), available at <http://www.gao.gov/new.items/he00044.pdf>.

119. 42 U.S.C. § 608(a)(2). The minimum reduction is 25 percent of the family's assistance, as long as the failure to cooperate continues.

120. GEN. ACCOUNTING OFFICE, *supra* note 118, at 18.

121. 42 U.S.C. § 608(a)(8).

122. 7 U.S.C. § 2015(d)(1)(C) (2000).

123. GEN. ACCOUNTING OFFICE, *supra* note 118, at 19.

124. 7 U.S.C. § 2015(d)(1)(C)(iii)(IV).

125. 7 U.S.C. § 2015(b)(1).

126. GEN. ACCOUNTING OFFICE, *supra* note 118, at 28.

that the taxpayer acted fraudulently or recklessly, but it is difficult for IRS auditors to determine the state of mind of a taxpayer making an improper EITC claim—especially when the vast majority of EITC audits are conducted by correspondence.<sup>127</sup> Moreover, the IRS has concluded that neither fraud nor recklessness in the claiming of the EITC can be inferred from the fact that a taxpayer fails to respond (or responds inadequately) to a request for documentation made in the course of a correspondence audit.<sup>128</sup> Because of the difficulties the IRS faces in determining that a taxpayer had one of the requisite mental states at the time of filing, the sanctions have not been imposed often. According to the Treasury Inspector General for Tax Compliance, the two-year ban was imposed on 8600 taxpayers during fiscal year 2003, and, as of July 2003 two-year bans were in effect with respect to approximately 18,000 taxpayers.<sup>129</sup> The 18,000 bans are less than 0.1 percent of the 19 million taxpayers who claim the EITC annually—a striking contrast with the 5 percent of the TANF caseload subject to TANF sanctions at any given time.

Considering the EITC sanctions both as they are written and as they are (or are not) applied, and comparing them with general income tax penalties and with welfare penalties, it once again appears that official concern with EITC noncompliance is greater than concern with income tax noncompliance generally (as evidenced by the uniqueness of the EITC sanctions within the income tax universe), but less than concern with welfare noncompliance (as evidenced by the much more extensive use of welfare sanctions than of the EITC sanctions).

#### G. The EITC, Income Tax Refunds, and the Improper Payments Act

An illustration of the tendency to think of EITC overpayments as worse than income tax underpayments—in fact, as different in kind—comes from the interpretation of the Improper Payments Information Act of 2002 by the Office of Management and Budget (OMB).<sup>130</sup> The Act

---

127. See Book, *supra* note 113, at 1182–84 (making this point in the context of a general discussion of the low level of use of the EITC sanctions).

128. INTERNAL REVENUE SERV., PUB. NO. 200245051, SERVICE CENTER ADVICE (2002).

129. Memorandum from Gordon C. Milburn III, Acting Deputy Inspector General for Audit, Treasury Inspector General for Tax Administration, to Commissioner, Small Business/Self-Employed Division & Commissioner, Wage and Investment Division (Dec. 10, 2004), *reprinted in* TREASURY INSPECTOR GEN. FOR TAX ADMIN., REFERENCE NO. 2005-40-015, FINAL AUDIT REPORT: APPLICATION OF THE EARNED INCOME CREDIT TWO-YEAR BAN COULD BE MORE CONSISTENT, ACCURATE, AND CLEAR TO TAXPAYERS 2 (2004).

130. Pub. Law No. 107-300, 116 Stat. 2350 (2002).

requires each federal agency, following guidance from the OMB, to identify every program it administers that “may be susceptible to significant improper payments,” and to report on the steps it has undertaken to reduce such payments.<sup>131</sup> The Act defines payment to include “any payment . . . made by . . . a federal agency . . . [and] derived from federal funds,”<sup>132</sup> and it defines a payment to be improper if it “should not have been made” at all or if “it was made in an incorrect amount.”<sup>133</sup>

What programs administered by the IRS produce significant improper payments under these definitions? The EITC obviously does. In addition, however, improper refunds of withholding and estimated tax payments meet the statutory definition of improper payments.<sup>134</sup> When a taxpayer initially pays the proper amount of income tax through withholding or estimated tax, and later receives a refund by filing a tax return showing a tax liability lower than the correct amount, the refund easily fits within the Act’s definition of an improper payment. The refund payment is made by a federal agency out of federal funds (since the government is entitled to retain withholding payments not in excess of a taxpayer’s proper tax liability), and the refund should not have been made.<sup>135</sup>

Despite the rather obvious application of the Act to improper refunds, the only program administered by the IRS for which the OMB has requested improper payment information is the EITC.<sup>136</sup> (As one would expect, the OMB also identifies various nontax welfare-type programs as sources of improper payments, including the Food Stamp program and TANF.)<sup>137</sup> The OMB’s failure to notice the applicability of the Act to improper refunds mirrors a report on improper payments by federal agencies issued by the

---

131. *Id.* §§ 2(a), 2(c).

132. *Id.* § 2(d)(3).

133. *Id.* § 2(d)(2)(A).

134. The legislative history of the Act does not address the question of whether the Act applies to improper refunds of withholding and estimated tax payments. S. REP. NO. 107-333, at 3 (2002), reprinted in 2002 U.S.C.C.A.N. 1459, 1461.

135. The government can end up with too little tax collected from a taxpayer either because the taxpayer initially pays the correct amount and later receives an improper refund, or because the taxpayer never pays the tax. Since the net effects of the two situations are the same, it may seem odd that the first situation should be subject to the Act while the second is not. The distinction is compelled, however, by the statutory language.

136. OFFICE OF MGMT. BUDGET, MEMORANDUM NO. 03-13, IMPROPER PAYMENTS INFORMATION ACT OF 2000, EXHIBIT 57B (May 21, 2003). It is not clear whether the OMB considers the EITC to be subject to the Act in situations where an improper EITC claim does not lead to the issuance of a check from the government to the taxpayer—that is, where the claimed EITC is less than the taxpayer’s precredit tax liability, so that the claimed credit reduces the taxpayer’s payment to the government rather than creating a payment from the government to the taxpayer.

137. *Id.*

GAO shortly before the Act became law, which discusses improper EITC payments at some length but never mentions improper refunds.<sup>138</sup>

This blind spot, shared by the OMB and the GAO, is probably attributable to the notion (perhaps more subconscious than conscious) that amounts paid as withholding or estimated tax continue to be, in some sense, the taxpayer's own money, even when the amounts paid do not exceed the taxpayer's correct tax liability.<sup>139</sup> Under this view even an improper refund of withholding is seen as returning to the taxpayer his own money, thus blinding the OMB and the GAO to the fact that such refunds clearly fit within the category of improper payments by federal agencies. Anyone locked in the mindset demonstrated by the OMB and the GAO will consider an improper refund of the taxpayer's own money to be a much less serious problem than an improper EITC payment (which transfers to the recipient not the taxpayer's own money, but the money of some *other* taxpayer).

Although in most respects EITC overpayments are treated as more akin to income tax underpayments than to welfare overpayments (as described in previous portions of this Article), that is not true in the case of the OMB's interpretation of the Improper Payments Information Act. From the OMB's perspective, EITC overpayments join Food Stamp and TANF overpayments in ignominy, while underpayments of tax resulting from improper refunds of withholding do not.

#### H. Legislators' Comparisons of EITC Noncompliance With Income Tax Noncompliance Generally

Opinions expressed by members of Congress as to the relative seriousness of income tax underpayments and EITC overpayments are sharply divided. On one side are those, such as Senator Edward M. Kennedy, who consider EITC compliance to be simply one aspect of income tax compliance, and who argue that the EITC should be enforced no more strictly than the income tax is generally enforced. According to Senator Kennedy:

The amount of money lost to the government by tax avoidance schemes utilized by high-income taxpayers dwarfs the amount attributable to improper EITC claims. By devoting more of its scarce resources to

---

138. GEN. ACCOUNTING OFFICE, REPORT NO. GAO-02-749, FINANCIAL MANAGEMENT: COORDINATED APPROACH NEEDED TO ADDRESS THE GOVERNMENT'S IMPROPER PAYMENTS PROBLEMS 13, 17-18 (2002).

139. For more on this inclination to view a taxpayer's entire pretax income as the taxpayer's own money—including the amount owing to the government as taxes—see *infra* text accompanying notes 144-149.



policing the EITC, the IRS will be taking compliance resources away from reviewing those high income tax returns where the greatest amount of lost tax revenue occurs.<sup>140</sup>

Other legislators, however, have argued that the EITC has nothing of substance to do with the income tax, is really a welfare program, and should be enforced by the stricter methods typical of welfare programs. Responding to claims that EITC overpayments should be analyzed as part of the overall tax gap, Representative Rob Portman remarked:

We are talking about apples and oranges here. We are talking about a program that is a cash benefit. Eighty to 85 percent of it, whether you call it welfare or not, is a nonrefundable [sic] credit and that is a cash benefit program. You all keep talking about the tax gap. This is not part of the tax gap, folks. This is not taxes [sic] that are not being collected or paid. This is whether we are paying out too much or not. It is an entirely different parameter.<sup>141</sup>

The legislators on both sides of this debate may well agree with each other—and with the general public—that a dollar of welfare overpayment is worse than a dollar of income tax underpayment.<sup>142</sup> If so, the legislators'

140. Letter from Sen. Edward M. Kennedy to the Internal Revenue Service ¶ 1 (July 15, 2003), available at LEXIS, Tax Analysts, Tax Notes Today, 2003 TNT 171-18. Representative Charles Rangel has expressed similar sentiments:

Treasury's . . . report acknowledges that sole proprietors account for a "significant portion of the tax gap." Yet, the Administration has not announced any new compliance efforts, or precertification of records, aimed at the longstanding and well-known noncompliance abuses by unincorporated businesses. [T]he press is full of stories about tax shelters . . . , yet there is no move by this Administration to require precertification of tax shelter transactions being peddled by large accounting firms. . . . Noncompliance seems to be a problem for this Administration only if it involves poor people.

Letter from Representative Charles B. Rangel to Treasury Secretary John Snow (Apr. 29, 2003), available at LEXIS, Tax Analysts, Tax Notes Today, 2003 TNT 84-10.

141. *Internal Revenue Service's 1995 Earned Income Tax Credit Compliance Study: Hearing Before the House Comm. on Ways and Means*, 105th Cong. 67 (1997) [hereinafter *1995 House EITC Hearing*] (statement of Rep. Rob Portman). The same sentiment was expressed in the same hearing by Rep. Clay Shaw:

Eighty to 85 percent [of EITC dollars] is taxpayers' money that is being paid to people as part of a welfare program. If you compare it with some of the other welfare programs . . . , AFDC only has an error rate of 6 percent. Food stamps only has an error rate of 7 percent. I think it is always important in all of these areas to get compliance, but this is a question of Federal money being paid out. It is not a question of income being reported.

*Id.* at 63.

142. In a survey of public opinion in twenty-nine countries, including the United States, M.D.R. Evans and Jonathan Kelley found that respondents in all twenty-nine countries considered cheating on one's income tax (by not reporting all of one's income) to be less seriously wrong than committing welfare fraud (by giving false information to the welfare bureaucracy). M.D.R. Evans & Jonathan Kelley, *Are Tax Cheating and Welfare Fraud Wrong? Public Opinion in 29 Nations*, 3 AUSTRALIAN SOC. MONITOR 93 (2001). Asked to classify each type of behavior as "seriously wrong," "wrong," "a

disagreement would be limited to whether the EITC should be classified as part of the income tax or as a welfare program. Their statements suggest the possibility that current practices—treating EITC compliance as a more serious concern than income tax compliance generally, but as a less serious concern than welfare compliance—may have arisen not because particular individuals situate the EITC midway on a continuum running from income tax to welfare, but as the result of a compromise between some individuals who see the EITC purely as a tax program and others who view it entirely in welfare terms. On the other hand, those legislators who have commented on this issue may be those with the most extreme views (and may have exaggerated the strength of their own views).

## II. EXPLAINING THE DIFFERING COMPLIANCE AND ENFORCEMENT PRACTICES AND ATTITUDES

### A. Of Taxes, Transfers, and Everyday Libertarianism

Actual compliance and enforcement practices, and expressions of opinion by legislators and by the public,<sup>143</sup> all suggest that it is worse for an individual to receive one dollar too many in welfare benefits than it is for an individual to pay one dollar too few in tax. Since each sort of mistake results in the individual ending up with one dollar too many and the government with one dollar too few, it is not obvious why the welfare mistake should be viewed as more serious than the tax mistake. From a utilitarian standpoint, the usual attitudes seem precisely backwards, since a poor person will realize a greater utility gain from an unwarranted dollar of welfare than a nonpoor person will realize from an unwarranted dollar of tax reduction. What, then, explains the widely held belief that too-high welfare benefits are more objectionable than too-low tax payments?

In *The Myth of Ownership: Taxes and Justice*, Liam Murphy and Thomas Nagel suggest that almost everyone—politicians, the public, and policy wonks alike—uses a framework of “everyday libertarianism” when thinking about questions of tax and transfer policy.<sup>144</sup> Everyday libertarianism is the

---

bit wrong,” or “not wrong,” American respondents gave income tax cheating a mean characterization very close to “wrong,” while their mean characterization for welfare fraud was roughly halfway between “wrong” and “seriously wrong.” *Id.* at 97 tbl.1. The Evans and Kelley study appears to be the only one comparing public attitudes toward income tax underpayments and welfare overpayments, and there are no reported studies on how public attitudes toward EITC compliance compare with attitudes toward income tax and welfare compliance.

143. For the evidence regarding public opinion, see *id.*

144. MURPHY & NAGEL, *supra* note 31, at 31.

belief—"unexamined and generally nonexplicit,"<sup>145</sup> which only adds to its power—that people earn their income without any assistance from the government. As a result, the government bears a heavy burden of justification when it decides to tax away any portion of a person's pretax income. Everyday libertarianism's presumption in favor of the pretax distribution of income disfavors both taxes and transfer payments. Some taxes and transfer programs are enacted, of course—in part because of the need to finance public goods and in part because the utilitarian appeal of redistribution sometimes overcomes everyday libertarianism's presumption against it. Nevertheless, the levels of taxation and of transfers are much lower than if everyday libertarianism did not dominate the public finance debate.

Murphy and Nagel argue (and I agree) that everyday libertarianism is simply wrong—a "robust and compelling fantasy."<sup>146</sup> It is wrong because pretax income, of which everyday libertarianism is so fond, is a myth. Without taxation there would be no government, without government there would be anarchy, and with anarchy there would be no income.<sup>147</sup> If there would be no income without taxes, then there is no such thing as pretax income. And if pretax income does not exist, then people cannot be presumptively entitled to it. Instead, "[a]ll they can be entitled to is what they would be left with after taxes under a legitimate system, supported by legitimate taxation—and this shows that we cannot evaluate the legitimacy of taxes by reference to pretax income."<sup>148</sup>

Murphy and Nagel consider at length how everyday libertarianism and the myth of pretax income shape the substantive rules of tax and transfer systems, but they do not consider what effect everyday libertarianism might have on attitudes toward compliance and enforcement issues in tax and transfer programs. It is conceivable that everyday libertarianism would have no effect at the compliance and enforcement level. Under this hypothesis, although substantive legal obligations and rights with respect to taxes and transfers are established in the shadow of everyday libertarianism, once those rules have been established, we want people to have exactly the amount of post-tax-and-transfer income called for by those rules. Thus, we are equally unhappy whether a person ends up with too much because he pays too little tax or because he receives too much welfare. As logical as that attitude might be, it does not seem to be the dominant response. Although

---

145. *Id.* at 36.

146. *Id.* at 176. For my agreement, see Lawrence Zelenak, *The Myth of Pretax Income*, 101 MICH. L. REV. 2261 (2003) (book review).

147. MURPHY & NAGEL, *supra* note 31, at 32.

148. *Id.* at 32–33.

unremarked by Murphy and Nagel, everyday libertarianism seems to come into play a second time, at the compliance and enforcement stage. Under this second-level influence of everyday libertarianism, the money one is legally required to pay as tax is still seen as being one's own money (in a somewhat attenuated sense, to be sure). When a person fails to pay a tax he is keeping his own money, and a person's keeping his own money is not a terribly objectionable result. The ghost of the claim to one's pretax income survives the enactment of the tax statute requiring one to pay part of that income to the government. This contrasts sharply with the everyday libertarian view of overpayments of welfare. Neither the substantive legal rules nor everyday libertarianism gives a person any semblance of a right to a welfare overpayment. Far from being viewed as a mere keeping of one's own money, receipt of a welfare overpayment is viewed as the wrongful taking of the pretax income of others, and as such it is an unmitigated wrong.<sup>149</sup>

If one agrees with Murphy and Nagel as to the emptiness of everyday libertarianism, and if one agrees with this Article's suggestion that the differing attitudes toward tax and welfare compliance are attributable to everyday libertarianism, then one must conclude that the prevailing belief that welfare overpayments are worse than tax underpayments is simply wrong. Changing that belief, however, may be almost impossible.<sup>150</sup>

## B. Of the EITC and Everyday Libertarianism

If everyday libertarianism produces much stricter enforcement efforts for transfer programs than for tax programs, one would expect enforcement efforts with respect to the refundable portion of the EITC (that is, the EITC to the extent it exceeds pre-EITC federal income tax liability) to mirror TANF and Food Stamp enforcement efforts. In particular, one would expect to find welfare-type comprehensive precertification requirements imposed on all applicants for the credit. As demonstrated earlier, however, the reality is quite different. EITC enforcement efforts occupy a middle ground between loose tax enforcement and strict welfare enforcement, and

---

149. Another possible explanation for the greater disapproval of welfare cheating than of tax cheating is that most of those sitting in judgment (legislators and members of the public responding to opinion polling) are reluctant to come down too hard on tax cheating because they have done a little of it themselves, but have no similar reason to refrain from condemning welfare fraud. This explanation is not, of course, incompatible with the one offered in the text.

150. On the difficulty or impossibility of convincing significant numbers of people to abandon everyday libertarianism, see MURPHY & NAGEL, *supra* note 31, at 176, and Zelenak, *supra* note 146, at 2262-63.

in most respects they are closer to standard tax practices than to standard welfare practices.

It appears that form heavily influences attitudes and practices in this area, and that perceptions (of legislators, and perhaps of the public as well) are heavily influenced by the placement of the EITC within the tax system rather than within the welfare bureaucracy. The EITC is a transfer program with the protective coloration of a tax program. That coloration is not sufficient to disguise completely its transfer nature, but it does confuse the issue enough that EITC overpayments are viewed as much less objectionable than welfare overpayments. This does not explain, of course, how the EITC came to be located within the income tax. That is the topic of Part IV of this Article, which argues that the placement of the EITC within the Internal Revenue Code was an historical accident, the result of a combination of circumstances unlikely to be replicated in the development of other transfer programs.

The focus of this section, however, is on whether something other than the EITC's placement within the income tax might explain the greater tolerance for EITC overpayments than for welfare overpayments. The Food Stamp program provides a useful comparison. There are, of course, important design differences between the EITC and the Food Stamp Program, beyond the difference between tax-based and welfare-based administration. Perhaps the differing attitudes toward EITC and Food Stamp compliance are explained by the differing purposes of the two transfer systems, as evidenced by these design differences. There are three major design differences, apart from tax versus welfare administration. First, Food Stamp eligibility and benefit levels are keyed to monthly income<sup>151</sup> in contrast with the annual income determinations used for the EITC. As a result, the Food Stamp program can respond to changing circumstances much more quickly than the EITC; Food Stamps thus can function as emergency relief and the EITC cannot. Second, the poorest of the poor—those with no income—get nothing from the EITC but are eligible for the largest Food Stamp allotments. Rather than being a pure antipoverty program, the EITC is a wage subsidy, phased in as earned income increases above zero and not phased out until earned income exceeds the annual full-time minimum wage.<sup>152</sup> The Food Stamp program has a much sharper antipoverty focus. The largest benefits go to those with no income, and the phaseout of benefits begins when income is far below the

---

151. 7 U.S.C. §§ 2014, 2017 (2000) (keying Food Stamp program determinations to monthly income).

152. I.R.C. § 32(b)(2) (2000) (EITC phase-out rules).

poverty level.<sup>153</sup> Third, Food Stamp benefits are provided in kind (more precisely, in vouchers exchangeable only for in-kind benefits), while EITC benefits are provided in cash.<sup>154</sup>

Can any of the differences in the purposes of the two programs, as evidenced by these three design differences, explain the greater tolerance for EITC overpayments than for Food Stamp overpayments? It is difficult to answer that question in the affirmative. All three of the design differences suggest that it is more important that persons eligible for food stamps receive the benefits to which they are entitled, than it is for persons to receive the EITC to which they are entitled. Compared with the EITC, food stamps: (1) are aimed at meeting more urgent needs (as evidenced by the use of monthly rather than annual income as the measure of need); (2) are aimed at a poorer population (as evidenced by the fact that persons with no income receive the largest Food Stamp benefits, but are entitled to no EITC); and (3) are aimed at a more fundamental need (for food, rather than for cash, which can be spent on anything). All three distinctions indicate that underpayments of Food Stamps are worse errors than equal-dollar underpayments of EITC. This does not directly address the question of the relative seriousness of Food Stamp and EITC overpayments, but as a practical matter there is a tradeoff—accepting greater overpayment errors generally will be the price of reducing underpayment errors (including underpayment errors attributable to nonparticipation). Thus, the greater concern for avoiding underpayments in the Food Stamp context suggests—contrary to fact—that there should be a greater tolerance of Food Stamp overpayments than of EITC overpayments.

There is also a more direct way in which the three design differences indicate that EITC overpayments should be of greater concern than Food Stamp overpayments. In the case of the EITC, ineligible recipients of benefits are generally similar, in terms of income and family size, to eligible recipients—overpayments of benefits tend to be near misses, so to speak.<sup>155</sup>

---

153. 7 U.S.C. § 2014(a) (Food Stamp program phase-out rules).

154. Under standard economic analysis, if a household spends more on food than its Food Stamp allotment (which is the case with all but the very poorest households), it should regard food stamps as the equivalent of cash, and should spend no more on food than if it had received cash assistance rather than food stamps. Robert A. Moffitt, *Lessons From the Food Stamp Program, in VOUCHERS AND THE PROVISION OF PUBLIC SERVICES* 119, 132 (C. Eugene Steuerle et al. eds., 2000). Thus, the in-kind aspect of Food Stamps should have very little practical significance. Reality has not fully cooperated with theory, however, and empirical studies have consistently found that the receipt of food stamps increases a household's spending on food significantly more than the receipt of an equivalent amount of cash. *Id.* at 131–35 (reviewing the literature). Congress appears to like this effect, and so has demonstrated no interest in “cashing out” the Food Stamp program. *Id.* at 135.

155. Jeffrey B. Liebman, *Who Are the Ineligible EITC Recipients*, 53 NAT. TAX J. 1165 (2000).

If, as seems likely, the same holds true with respect to Food Stamps, then Food Stamp overpayments will go to a generally needier group than EITC overpayments (because, given the designs of the two programs, eligible Food Stamp recipients are generally needier than eligible EITC recipients). The upshot is that Food Stamp overpayments would produce greater utility gains for their recipients than would EITC overpayments, and so would be more acceptable from a utilitarian perspective. This perspective is not reflected in current practices, which take much greater pains to prevent Food Stamp overpayments than to prevent EITC overpayments.

Although all three of the major design differences between the EITC and the Food Stamp program suggest that EITC overpayments are worse than equal-dollar Food Stamp overpayments, compliance practices are heavily skewed in the opposite direction.<sup>156</sup> The lesson would seem to be that any effect of substantive program design on attitudes toward errors in the two programs is overwhelmed by differences in attitudes toward errors in tax-based programs versus errors in welfare-based programs.<sup>157</sup>

### C. The EITC, the Food Stamp Program, and the Costs of Everyday Libertarianism

The overall cost of administering a transfer program can be understood as the combined cost of overpayments and direct administrative expenses, expressed as a percentage of total program costs (including benefits delivered to eligible recipients). As Janet Holtzblatt has noted, the overall costs of admin-

---

156. The interrelationship between the substantive design features of the Food Stamp program and its location within the welfare bureaucracy is somewhat ironic. Two aspects of Food Stamp design—the reliance on monthly rather than annual income, and the distribution of in-kind benefits rather than cash—would make tax-based administration of the program difficult or impossible. These two design aspects are hallmarks of a program as to which underpayments of benefits would be particularly troubling, yet these two design aspects necessitate assigning the program to welfare-based administration, in which high rates of underpayments are endemic.

157. An alternative explanation for stricter enforcement under the Food Stamp program than under the EITC might be based on a distinction between the “deserving poor” and the “undeserving poor” (to quote Alfred P. Doolittle of *Pygmalion* and *My Fair Lady*). If the Food Stamp program is viewed by the public and by politicians as a program largely for the nonworking (and thus “undeserving”) poor, whereas the EITC is viewed as a program for the working (and thus “deserving”) poor, perhaps the public and politicians are less tolerant of Food Stamp overpayments than of EITC overpayments because they view the former as going to the undeserving poor and the latter as going to the deserving poor. The problem with this explanation is that a leading cause of Food Stamp overpayments is the nondisclosure of earned income. *Food Stamp Verification Act of 1998: Hearing on H.R. 4366 Before the Subcomm. on Dep’t Operations, Nutrition, and Foreign Agric. of the House Comm. of the Agric.*, 105th Cong. 9 (Aug. 5, 1998) (prepared testimony of Shirley R. Watkins, Undersecretary for Food and Nutrition Services, U.S. Dep’t of Agric.). Thus, if desert is a matter of having earned income, recipients of excessive food stamps very often have the same deserving poor status as recipients of excessive EITC.

istering the EITC and the Food Stamp Program are very similar by this standard, with “about 25 cents out of every dollar . . . spent on either administrative costs or erroneous payments” in both programs.<sup>158</sup> The difference is that the EITC involves minimal direct administrative expenses and overpayments equaling about 25 percent of program costs, while the Food Stamp program involves direct administrative expenses constituting 19 percent of program costs and overpayments of less than 8 percent of program costs.<sup>159</sup> As David A. Weisbach and Jacob Nussim have recently observed, a comparison of the Food Stamp cost pattern with the EITC cost pattern suggests that we would rather “throw away [19 percent of total program expenditures] on administrative costs . . . than transfer it to individuals.”<sup>160</sup> They argue that the Food Stamp cost pattern—incurring “a dollar of administrative costs to prevent a dollar of overpayments,” compared with the alternative of tax-based administration—“cannot be justified.”<sup>161</sup> To be fair to the Food Stamp program, it might well be defensible to incur one dollar (or even more) of administrative costs to prevent one dollar of overpayments attributable to fraud, but to the extent that the overpayments in question would go to poor and honest recipients, one can only agree with Weisbach and Nussim. The strange preference for burning money on administration rather than transferring it to the poor as Food Stamp overpayments can be understood only as a manifestation of the error of everyday libertarianism.

### III. EXPLAINING THE EXISTENCE OF REFUNDABLE TAX CREDITS WITH SELF-DECLARED ELIGIBILITY

#### A. The Perception of the EITC as More Tax Reduction Than Welfare: An Accident of History

The EITC is unique among antipoverty transfer programs in its absence of a general precertification requirement. In no other antipoverty program can a person simply fill out a form declaring that he meets the program’s eligibility standards, mail it in, and receive a substantial check (or in-kind benefit) in return. For that matter, even transfer programs for the middle class—such as Social Security, Medicare, and college loan subsidies—require precertification. Except for the EITC, the government almost never makes

---

158. Holtzblatt, *supra* note 55, at 122.

159. *Id.* at 121–22.

160. David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 1012 (2004).

161. *Id.* at 1011.



transfer payments to anyone—poor, middle class, or rich—simply on their own say-so.<sup>162</sup> On the other hand, the government routinely permits taxpayers to claim, based on nothing more than their own say-so, exclusions, deductions, and credits that reduce their income tax liability. This differing treatment of dollars of transfer payments and dollars of tax reduction may make little sense,<sup>163</sup> but it is deeply embedded in public attitudes, legislative attitudes, and administrative practices. The mystery is how the EITC came to occupy its unique position as the only major transfer program operating on the basis of self-declared eligibility. The tentative explanation, developed in this section, is that the EITC's unique position is an accident of the way in which the EITC happened to develop.

When the EITC was first enacted (as a temporary measure) in 1975,<sup>164</sup> the Senate Finance Committee conceptualized the credit as an offset to the payroll tax burden imposed on low wage workers: "The credit is set at 10 percent in order to correspond roughly to the added burdens placed on workers by both employee and employer social security contributions."<sup>165</sup> The original credit was set at 10 percent of the first \$4000 of earned income—a rate almost identical with the then-prevailing 9.9 percent rate of the payroll tax relating to Social Security (OASDI) benefits, and somewhat less than the then-prevailing 11.7 percent payroll tax burden created by the combination of the 9.9 percent OASDI tax rate and the 1.8 percent rate of the tax relating to Medicare (HI) benefits.<sup>166</sup> Then as now, both the OASDI and HI taxes were divided equally between employer and employee. The 9.9 percent OASDI rate was the sum of a 4.95 percent tax on the employee and an equal tax imposed on the employer, and the 1.8 percent HI rate was the sum of two 0.9 percent rate taxes. As the Finance Committee Report on the original EITC indicates, the correspondence between the EITC and the payroll tax burden was not exact; a worker earning \$4000 would face a payroll tax burden of \$468 (considering both the employee and employer taxes), but would receive a credit of only \$400.

---

162. The "almost never" qualification relates to the partial refundability of the child tax credit (I.R.C. § 24 (2000)) and to the refundable health insurance tax credit provided (for a very small class of eligible persons) by I.R.C. section 35. For a discussion of these two provisions, see *infra* text accompanying notes 181–194.

163. See STANLEY S. SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* 132 (1973) ("A Government that decides it is wise to pay out tax credit money via a simple tax schedule would be highly irrational if it also decided that it would be unwise to pay the same amount directly on the same basis.").

164. Tax Reduction Act of 1975, Pub. L. No. 94–12, § 204, 89 Stat. 26, 30.

165. S. REP. NO. 94–36, at 11 (1975), *reprinted in* 1975 U.S.C.C.A.N. 54, 63–64.

166. TAX POLICY CTR., *HISTORICAL PAYROLL TAX RATES*, available at [http://www.taxpolicycenter.org/TaxFacts/TFDB/Content/PDF/ssrate\\_historical.pdf](http://www.taxpolicycenter.org/TaxFacts/TFDB/Content/PDF/ssrate_historical.pdf).

Interestingly, the Committee Report drew no distinction between employee and employer payroll taxes, and considered the EITC to be equally appropriate as an offset to both taxes. This makes good economic sense, because there is a consensus among economists that virtually the entire burden of the payroll tax—both the portion nominally imposed on employers and the portion nominally imposed on employees—falls on workers.<sup>167</sup> Still, given the strong tendency to think of taxes in terms of their nominal imposition rather than their economic incidence,<sup>168</sup> it is somewhat surprising that the Finance Committee was enlightened enough to consider it appropriate to give workers a tax credit to offset a tax technically imposed on employers rather than on the workers themselves.<sup>169</sup>

Once the Finance Committee had accepted the view that workers really pay the employee *and* employer payroll taxes, it would have been natural to view the EITC as a refundable credit (that is, as a transfer program rather than as tax relief) in name only. Yes, the EITC was officially part of the income tax, and within the confines of the income tax it was technically refundable. However, in the broader context of income tax plus employee's payroll tax plus employer's payroll tax, it was not truly refundable because the amount of the credit could never exceed (or even quite equal) the credit recipient's payroll tax burden. If Congress viewed the original EITC as not truly refundable—as appears to have been the case—this would explain why Congress was initially willing to allow taxpayers to receive the credit on the basis of self-declared eligibility. Self-declared eligibility was (and is) the norm for tax breaks. Viewing the EITC as a tax break in substance, rather than as a transfer program, Congress naturally provided for self-declared

---

167. JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE GREAT DEBATE OVER TAX REFORM 72–75 (2004) (explaining that the economic incidence of a tax is unaffected by its nominal imposition, and that almost the entire burden of any tax on labor falls on workers).

168. For a description and discussion of this tendency, see Edward J. McCaffery, *Cognitive Theory and Tax*, 41 UCLA L. REV. 1861, 1876 (1994).

169. This enlightened view may have been driven by the self-employment tax, which in effect imposes both payroll taxes—employer and employee—on self-employed individuals. With respect to the self-employment tax, the EITC was not merely a *quasi* offset; it was—and still is—an *official* offset. See I.R.C. § 6401(b) (2000), which provides that the EITC first offsets taxes imposed by subtitle A of the Internal Revenue Code, before any excess of EITC over subtitle A taxes is treated as an overpayment. The self-employment tax is imposed by I.R.C. section 1401, which is contained in chapter 2 of subtitle A (the employer and employee payroll taxes for non-self-employed persons, by contrast, are contained in subtitle C of the Code). If self-employed persons are viewed as paying the entirety of the self-employment tax, and if the combined employer and employee taxes are to employed persons as the self-employment tax is to self-employed persons, then consistency would require viewing employed persons as paying both the employer tax and the employee tax.

eligibility.<sup>170</sup> One can only speculate, but it seems likely that in 1975, an EITC in excess of payroll taxes and featuring self-declared eligibility would have been politically impossible, given the lack of any precedent for a true transfer program based on self-declared eligibility.

Legislation enacted in 1984 raised the EITC rate from 10 percent to 11 percent,<sup>171</sup> and 1986 legislation increased it again, to 14 percent.<sup>172</sup> The payroll tax burden had also increased, however, so neither the 1984 legislation nor the 1986 legislation raised the credit rate above the combined burden of the employer's and the employee's payroll taxes.<sup>173</sup> Only with legislation enacted in 1990 did it become possible for a worker to receive a truly refundable EITC—that is, an EITC in excess of his total payroll tax burden.<sup>174</sup> This legislation created different credit rates based on the number of qualifying children—16.7 percent for a worker with one child, and 17.3 percent for a worker with two or more children.<sup>175</sup> The potential for a truly refundable credit was minor, however, since the credit percentages only slightly exceeded the total payroll tax burden (15.3 percent in 1991).<sup>176</sup> If one believed that self-declared eligibility was acceptable for tax breaks but not for transfers, and that the EITC became a transfer (in part) when its rate exceeded the total payroll tax rate, then one might have objected to the

---

170. One might have supposed that the Finance Committee's understanding of the EITC as offsetting the payroll tax would have created a political problem with respect to the right of low-wage workers to receive Social Security benefits upon their retirement. The view is widespread, and officially promoted, that the right to receive Social Security benefits is *earned* by the payment of Social Security taxes. For example, the Social Security Administration's website has a section for "kids and families," which explains that "[s]ince each worker pays Social Security taxes, each worker earns the right to receive Social Security benefits without regard to need." SOC. SEC. ADMIN., FREQUENTLY ASKED QUESTIONS: HOW DOES IT WORK, available at <http://www.ssa.gov/kids.workfacts.htm> (last visited Mar. 17, 2005). Given this widely held view, it might seem that the entitlement of long-term EITC recipients to Social Security benefits would be at political risk if they were seen as paying virtually no payroll tax after taking the EITC into account. For some reason, however, this has never become an issue.

171. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 1042(a), 98 Stat. 494, 1043. The increase was effective beginning in 1985.

172. Tax Reform Act of 1986, Pub. L. No. 99-514, § 111(a), 100 Stat. 2085, 2107. The increase was effective beginning in 1987.

173. In 1985, the total payroll tax burden was 14.1 percent (consisting of an OASDI burden of 11.4 percent and an HI burden of 2.7 percent); in 1987 the total payroll tax burden was 14.3 percent (consisting of an OASDI burden of 11.4 percent and an HI burden of 2.9 percent). TAX POLICY CTR., *supra* note 166.

174. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11111, 104 Stat. 1388, 1388-408.

175. These were the rates for 1991; small increases in the rates were scheduled for later years, but these were largely superseded by the bigger increases enacted in 1993.

176. TAX POLICY CTR., *supra* note 166 (The 15.3 percent total burden consisted of an OASDI burden of 12.4 percent and an HI burden of 2.9 percent).

1990 legislation. On the other hand, one also might have held one's tongue, given the very modest size of the net transfers—\$115, at most—produced by the 1990 expansion of the credit.<sup>177</sup> In any event, the House Ways and Means Committee held its collective tongue; the Committee Report on the 1990 legislation does not mention that the legislation created the possibility of an EITC in excess of total payroll taxes.<sup>178</sup>

The 1993 expansion of the EITC, however, was a different matter.<sup>179</sup> It provided for gradual increases in the credit rates, eventually reaching 34 percent for claimants with one qualifying child, and 40 percent for claimants with two or more qualifying children (these remain the credit rates today). Each credit percentage is more than twice the total payroll tax rate, which has held steady at 15.3 percent since 1990. The person who might have restrained himself from objecting to the de minimis net transfer made possible by the 1990 Act could hardly have viewed the net transfers created by the 1993 Act as trivial.<sup>180</sup> Even then, however, no one spoke up. The 1993 expansion of the EITC was not accompanied by any Congressional discussion of whether self-declared eligibility remained appropriate for what was now a multibillion dollar transfer program by any definition.

Why did no one speak up? The most plausible explanation is that Congress accidentally performed a sort of bait-and-switch on itself. Early on, Congress was comfortable with self-declared eligibility for the EITC because it viewed the credit as a de facto reduction in the payroll tax, rather than as a true welfare-type transfer program. By the early 1990s, Congress appeared largely to have forgotten the original understanding of the relationship between the credit and the payroll tax, and so did not even seem to notice when new legislation violated that original understanding. The Congress of 1975 would have viewed the Congress of 1993 as fundamentally changing the nature of the EITC, and the Congress of 1975 would probably

---

177. The maximum EITC in 1991 for a taxpayer with two or more qualifying children was \$989 (17.3 percent of the first \$5714 of earned income). This was \$115 more than the total payroll tax of \$874 imposed on wages of \$5714 (at the rate of 15.3 percent).

178. H.R. REP. NO. 101-881, at 278 (1990) (the relevant void).

179. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13131, 107 Stat. 312, 433.

180. Even after the credit increases of the 1993 Act had been fully phased in, the substantial majority of EITC dollars served to offset federal taxes. For tax year 2000, a Treasury study found that about 81 percent of EITC dollars offset federal tax liabilities (income, payroll, and excise), with only 19 percent constituting net transfers. Holtzblatt, *supra* note 55, at 118. The study's inclusion of excise taxes is rather idiosyncratic; there has never been a widely held understanding that offsetting federal excise taxes is one of the purposes of the EITC. In any event, 19 percent of total EITC dollars is about \$7 billion (see OMB, *supra* note 2, at 289, indicating EITC benefits of \$37.060 billion for 2003), so the 19 percent figure hardly qualifies as de minimis.

have been unwilling to extend self-declared eligibility to the genuinely refundable EITC of the 1993 legislation. The minor, genuine refundability of the 1990 Act may have served as the “camel’s nose under the tent” for the 1993 legislation, or perhaps the connection between self-declared eligibility and the absence of true refundability had so faded by 1993 that the 1993 legislation could have been enacted even without the 1990 precedent. It seems highly unlikely, however, that the Congress of 1993 (or any other year) would have enacted from scratch a multibillion dollar transfer program with self-declared eligibility. The 1993 result could not have been reached without the developments of the previous two decades, during which Congress first accepted a transfer program with self-declared eligibility because it viewed the program as a *de facto* tax reduction rather than as a transfer program, and then became so accustomed to the self-declared eligibility aspect of the program that it reflexively retained self-declared eligibility when it turned the EITC into a true transfer program.

#### B. Other Refundable Tax Credits With Self-Declared Eligibility

The preceding discussion has argued that Congress is generally unwilling to accept the idea of a transfer program with tax-type administration (and with self-declared eligibility in particular), and that Congress created such a program in the case of the EITC only because of the peculiar circumstances of the credit’s development—circumstances that are not likely to be repeated in the case of other programs. However, the EITC is not quite unique in its status as a refundable tax credit featuring self-declared eligibility. The child tax credit (CTC) is partially refundable, and the fuels tax credit (FTC) and the health coverage tax credit (HCTC) are fully refundable, and all are administered with the self-declared eligibility typical of tax breaks.<sup>181</sup> When these provisions are examined closely, however, none of them suggests a general Congressional openness to transfer programs with self-declared eligibility. This section will consider the circumstances of the CTC in some detail, followed by shorter discussions of the other two credits.

The CTC was first enacted in 1997.<sup>182</sup> In its original incarnation, the CTC was generally not refundable, but in the case of a taxpayer with three or more qualifying children, the credit was refundable to the extent of the excess (if any) of the taxpayer’s payroll tax liability over the taxpayer’s

---

181. I.R.C. §§ 24, 34, 35 (2000) (the CTC, FTC, and HCTC, respectively).

182. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 101, 111 Stat. 788, 796.

EITC.<sup>183</sup> As is apparent from its design, this refundability feature was intended as a de facto offset for payroll taxes (but only those payroll taxes not already offset by the EITC), rather than as a true transfer program. As such, it fit easily within the precedent established by the EITC in its original, not-truly-refundable form. In fact, the absence of true refundability was more obvious with the CTC than with the original EITC, both because the refundability of the CTC was explicitly tied by statute to the amount of payroll tax paid, and because CTC refundability was limited to the employee's share of the payroll tax burden.

In 2001, however, Congress significantly expanded the refundability of the CTC.<sup>184</sup> As amended in 2001, I.R.C. section 24(d) now provides that the credit is refundable—for taxpayers with any number of qualifying children—to the extent of 15 percent of the amount by which a taxpayer's earned income exceeds \$10,000.<sup>185</sup> Does the 2001 legislation indicate that Congress is now open to self-declared eligibility for transfer programs, even when (1) the transfer program is distinct from the EITC, and (2) the program is not conceptualized as a de facto payroll tax refund?

It probably does not so indicate, because of the connection in the legislative mind between the 2001 CTC amendment and the EITC. The history of the 2001 legislation indicates that many members of Congress understood the phased-in refundability of the CTC (as earned income increases above \$10,000) as a substitute for a decrease in the phase-out rate of the EITC. The phase *in* of the CTC operates over roughly the same income range as the phase *out* of the EITC, so the combination of the two has the same effect (in the income range where both the phase in and the phaseout apply) as simply decreasing the EITC phase-out rate to 0.98 percent for a taxpayer with one qualifying child and to 6.06 percent for a taxpayer with two or more qualifying children.<sup>186</sup> Writing shortly after the enactment of the 2001

---

183. I.R.C. § 24(d), as enacted by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 101, 111 Stat. 788, 797-98. The current form of this provision is located at I.R.C. section 24(d)(1)(B)(ii). The reason for the limitation of the refundability feature to taxpayers with three or more children is obscure, but it may have been in recognition of the fact that the EITC is not increased because a taxpayer has more than two qualifying children.

184. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 201, 115 Stat. 38, 45-46.

185. *Id.* The refundability calculation was based on 10 percent of the excess, rather than 15 percent, for years prior to 2004. The \$10,000 amount is adjusted for post-2000 inflation. The 1997 partial refundability formula is also retained as an alternative, for those few taxpayers who fare better under it than under the new formula.

186. The 0.98 percent figure is the 15.98 percent phase-out rate for the one-child EITC, reduced by the 15 percent phase in rate of the CTC. The 6.06 percent figure is the 21.06 percent phase-out rate for the two-children EITC, reduced by the 15 percent phase-in rate of the CTC.

Act, Gene Steuerle explained that Congress understood the new CTC refundability rules as the practical equivalent of expanding the EITC (by reducing its phase-out rates) while leaving the CTC unchanged. Nevertheless, it opted for the more circuitous means of achieving that result for two nonsubstantive reasons:

First, President Bush and leaders of Congress wanted to prevent the tax bill from being overwhelmed with additional provisions. . . . They interpreted this process rule to mean that major amendments to the EITC . . . were not allowed. Second . . . [m]any thought it would be easier to explain that low-income households would get some portion of the new child credit rather than that taxable households would get the child credit but that others would get a slower phaseout of the EITC.<sup>187</sup>

To the extent that members of Congress viewed the new CTC refundability provision as a de facto enlargement of the EITC, the 2001 legislation does not indicate a general Congressional openness to non-EITC transfer programs with self-declared eligibility.<sup>188</sup>

A less extended discussion suffices for two other refundable tax credits. The fuels credit of I.R.C. section 34 is technically refundable (that is, the credit is allowed even if it exceeds the taxpayer's precredit income tax liability), but it functions as a refund of excise taxes paid on gasoline and special fuels by farmers and certain other specified taxpayers. In fact, eligible taxpayers may choose between claiming the fuels credit and receiving an explicit excise tax refund.<sup>189</sup>

Finally, the refundable Health Coverage Tax Credit (HCTC) of I.R.C. section 35, enacted by the Trade Adjustment Assistance Reform Act of 2002,<sup>190</sup> equals 65 percent of qualified health insurance premiums for eligible persons. Eligibility is limited to a select group of displaced workers and retirees, consisting

---

187. Gene Steuerle, *How Complexity Arises for Low-Income Taxpayers*, 92 TAX NOTES 561, 561 (2001); see also Heidi Glenn, *Key Tax Cut Players Agree to Advance \$1.35 Trillion Joint Mark*, 91 TAX NOTES 1031, 1032 (2001) (reporting that moderate members of the Senate Finance Committee successfully argued that "[t]ying a partially refundable child credit to earnings would reduce the inherent work disincentive under the EITC [phase-out] structure").

188. There is an additional way in which some members of Congress may have conceptualized the 2001 CTC amendment as other than a true transfer program. The 15 percent phase-in rate for the CTC, as earned income rises above \$10,000, is strikingly close to the 15.3 percent total payroll tax rate (counting both the employee share and the employer share). Rather than being viewed as a genuine transfer program, the CTC phase in could be viewed as a mere "turning off" of the payroll tax (except for a 0.3 percent remnant) over the range of the CTC phase in. If Congress had simply turned off the payroll tax over that income range, that would not have been viewed as a transfer program, and achieving the same effect through the CTC amendment might be similarly viewed.

189. I.R.C. § 34(b) (2000) (providing that a taxpayer is not eligible to claim the fuels credit if he files a claim for an excise tax refund under I.R.C. section 6421(i) or section 6427(k)).

190. Pub. L. No. 107-210, § 201, 116 Stat. 933, 954 (2002).

of (1) certain workers who have lost their jobs due to the effects of international trade, and (2) persons who are over the age of fifty-five (but who are not entitled to Medicare) and who are receiving benefits from the Pension Benefit Guaranty Corporation.<sup>191</sup> An eligible person can choose either (1) to receive the credit as reimbursement for premiums paid during the preceding year, by claiming it on his income tax return, or (2) to use the advance payment option, under which the government pays 65 percent of the participant's health insurance premium to the insurer each month.<sup>192</sup> Use of the advance payment option requires the claimant to complete a registration (that is, precertification) process before any payments are made.<sup>193</sup> The lump-sum-in-arrears alternative, however, uses the self-declared eligibility process typical of tax administration. The lump sum alternative is a transfer program (to the extent the credit exceeds a claimant's precredit income tax liability) based on self-declared eligibility, without the peculiar history of the EITC. It thus calls into some question this Article's claim for the uniqueness of the EITC. On the other hand, the amount of money involved in the program is very small by federal budget standards—only about \$0.1 billion per year.<sup>194</sup> This figure includes both advance payments and lump sum credits. No data are available on the relative sizes of advance payments and lump sum payments, but Congress may well have anticipated that the substantial majority of claimants would use the advance payment option. Since eligible persons must be unemployed and must have health insurance coverage, Congress may have supposed that few claimants could handle the cash flow problem of initially paying 100 percent of premiums and later receiving a lump sum reimbursement; if so, the dollar amount of lump sum credit received on the basis of self-declared eligibility would be small indeed. In sum, the dollars involved in HCTC paid on the basis of self-declared eligibility are too small for the HCTC to challenge the EITC's status as the only *significant* federal transfer program administered on the basis of self-declared eligibility. Only time will tell whether Congress will eventually apply the HCTC precedent to more significant transfer programs, but that seems unlikely, given the long history of unwillingness to permit self-declared eligibility in transfer programs.

---

191. I.R.C. § 35(c).

192. I.R.C. § 7527.

193. For an explanation of the process, see INTERNAL REVENUE SERV., *supra* note 51.

194. STAFF OF THE JOINT COMM. ON TAX'N, *supra* note 66, at 27 tbl.1. This estimate is for the entire cost of the program, so it includes both HCTC used to reduce precredit income tax liability and the portion of the credit in excess of tax liability.



## CONCLUSION

As noted earlier, if total administrative costs of a transfer program are defined as direct administrative costs plus overpayments of benefits, then the costs of tax-based administration of the EITC and welfare-based administration of Food Stamps are very similar (adjusted for program size).<sup>195</sup> The difference, however, is that most of the Food Stamp costs are direct costs of administration, whereas most of the EITC costs are overpayments. If one reasonably concludes that it is better to make overpayments to the near-poor than to burn money on administration, and that most overpayments go to the near-poor,<sup>196</sup> then the EITC cost pattern is preferable to the Food Stamp pattern. In addition, the participation rate (that is, the percentage of eligible persons who receive benefits) is much higher with the EITC's self-declared eligibility than with the Food Stamp program's precertification requirement. Among families with children, the EITC participation rate is close to 90 percent.<sup>197</sup> As a result of the burdens of the precertification process, however, the participation rate for Food Stamps is only a little higher than 50 percent.<sup>198</sup> Taking into account all three factors—direct administrative costs, overpayment rates, and participation rates—the tax-based administration of the EITC appears clearly superior to the welfare-based administration of the Food Stamp program.<sup>199</sup> Although Congress may have stumbled into the present condition of the EITC as a transfer program without precertification, the resulting program is attractive on the merits.

For those who value the tax-based administration of the EITC, it is important to appreciate how historically contingent—and possibly fragile—the existence of the program is in its current form. Certainly it makes sense for EITC proponents to fight against universal precertification, because that would rob the EITC of the most important characteristic of tax-based administration. At the moment, however, even with the various EITC compliance initiatives, overall EITC enforcement efforts remain much more similar to ordinary tax

---

195. See *supra* text accompanying notes 158–161.

196. See *supra* text accompanying note 155.

197. According to the GAO, the participation rate is 96.0 percent among eligible families with one child, 93.0 percent among eligible families with two children, and 62.5 percent among eligible families with three or more children. GEN. ACCOUNTING OFFICE, *supra* note 96, at 2 tbl.1. The weighted average of the three participation rates is approximately 87 percent (author's calculation). The participation rate is lower—about 45 percent—among taxpayers eligible for the small, no-child EITC. *Id.* The overall participation rate is about 75 percent. *Id.*

198. CUNNINGHAM, *supra* note 84, at 7 tbl.2.1. For a good summary of the burdens imposed on working families participating in the Food Stamp program, see Holtzblatt, *supra* note 55, at 119.

199. See Weisbach & Nussim, *supra* note 160, at 1010–12 (reaching the same conclusion).

enforcement than to welfare-type enforcement. It may not be wise, then, for EITC proponents to object to every respect in which EITC enforcement may be more rigorous than income tax enforcement generally. Vociferous objections could easily backfire, in either of two ways. First, the objections might lead Congress to reject the EITC-as-tax analogy in favor of the EITC-as-welfare analogy, and so to transfer the program from the IRS to the welfare bureaucracy (or to keep the program within the IRS but to require universal precertification). Second, Congress might initially defer to the objections and refrain from special EITC compliance initiatives, only to decide later that the level of noncompliance was unacceptable and that the entire credit should therefore be repealed.<sup>200</sup> In a perfect world, the EITC might not be enforced any more strictly than the rest of the income tax—but in the real world, the surprise is that the EITC is enforced only slightly more strictly than the rest of the Internal Revenue Code. It would be a shame if that surprisingly good situation were lost in pursuit of perfection.

---

200. For evidence that influential members of Congress could respond to high levels of EITC noncompliance by replacing tax-based administration with welfare-based administration, or by repealing the program in its entirety, see 1995 *House EITC Hearing*, *supra* note 141, at 63, 67 (statements of Rep. Portman and Rep. Shaw) and accompanying text.