

PARTNERSHIP FUND FOR PROGRAM INTEGRITY INNOVATION

PILOT CONCEPT: ASSESSING STATE DATA FOR VALIDATING EITC ELIGIBILITY

Pilot Concept. The Earned Income Tax Credit (EITC) is one of the Federal Government's largest anti-poverty programs. However, Internal Revenue Service (IRS) studies of EITC compliance have consistently shown that approximately 25% of claims are paid with some error due to various complexities in the eligibility requirements related to household residency and familial relationships. The U.S. Department of the Treasury (Treasury) proposes a Partnership Fund pilot to assess the availability, quality, completeness, and overall usefulness of State-administered benefits data, as well as State benefits screening processes, to help validate EITC eligibility. The pilot would address whether State data could identify both ineligible individuals who receive improper EITC payments and eligible individuals who are not claiming the EITC. The assessment will be conducted separate from, but parallel to, normal Federal EITC operations. The IRS's actual eligibility results based on EITC claims in a pilot State will be compared to simulated eligibility results based on analysis of existing State data and potential State data that could be collected from new benefits enrollment questions. The results of the pilot will be used to develop administrative changes and statutory proposals to improve EITC payments nationally.

Programs Affected. At the Federal level, the primary program affected will be the EITC. At the State level, programs with potentially useful data will include the Supplemental Nutrition Assistance Program (SNAP), Temporary Assistance for Needy Families (TANF), and State tax credit programs. The Treasury is proposing to conduct the data analysis with up to three States.

Measurable Impacts. The pilot will address all four of the Partnership Fund's goals.

- a) ***Improving payment accuracy.*** The pilot can help directly improve payment accuracy by producing methods to identify ineligible individuals who would otherwise receive an EITC payment.
- b) ***Improving administrative efficiency.*** The pilot could lead to improvements in the management of the EITC in a number of ways, including helping to reduce EITC audits through better validation of eligibility, ensuring that eligible taxpayers being audited receive their refunds timely by providing IRS auditors with better information, and by identifying claimants whose returns are associated with high likelihood of error.
- c) ***Improving service delivery.*** The results of the pilot can be used to develop strategies to minimize the burden and enhance the quality of communications with taxpayers by improving outreach efforts and audit processes. It can also help ensure fairness by shifting compliance efforts away from taxpayers genuinely confused about eligibility and refocusing on ineligible individuals inappropriately claiming the credit with incomes that are too high.

- 2) ***Reducing access barriers for eligible beneficiaries.*** The pilot could establish a process for identifying individuals who qualify for the EITC but have not claimed it. It will also produce methods to encourage eligible individuals to claim the EITC by making eligibility easier to validate and understand. Because the data analysis of the pilot will not affect EITC claims and payments for the upcoming filing season, the pilot itself can have no adverse impact on access to EITC or other benefits.

Expected Outcomes and Measurement Methodologies. The largest causes of EITC errors are improper claims and over-claims by taxpayers with children who did not meet the EITC eligibility requirement with respect to age, residency, relationship, or SSN criteria. Other errors typically result from misreporting earned income and filing status. There is good reason to believe that State benefits databases contain relevant data on all of the qualifying child attributes, as well as data related to the other causes of improper payments. Therefore, the primary outcome of the pilot will be an assessment of the quality and reliability of existing State data, by measuring both positive and negative eligibility matches between the IRS's actual EITC results for a given filing season and simulated results derived from an analysis of State data. Both the quantitative scale of the mismatches and, as important, the qualitative nature of the mismatches will be evaluated to determine the usefulness of State data in resolving EITC eligibility problems. Depending on the nature and quality of the State data, the pilot will directly measure the amount that could be saved by reducing improper payments.

The data matching analysis will be conducted in two stages. The first stage will entail direct information matching between IRS and State databases to identify the positive and negative eligibility matches. In the second stage, the results of the first stage will be validated by selecting a sample of the positive and negative matches and conducting interviews and individual case file research to determine the extent to which the automated database matching may have generated false positives and false negatives. This two stage process will ensure the credibility of the automated results by confirming actual family circumstances and will allow for the development of the most reliable data matching protocol that could be used nationally to improve EITC eligibility determinations.

Based on the primary outcome, a secondary outcome of the pilot will be a design for an enhanced EITC eligibility model using State data. This new model may entail the use of existing State databases or new data collected from new benefit screening practices. It may also lead to new statutory authorities to permit third-party certification of EITC eligibility, to allow for the equivalent of "math error" corrections to EITC claims using State data, or to implement a new EITC delivery model, such as a State-administered advance EITC program.

The pilot will also help assess the political implications of using State data for the EITC, particularly in light of possible changes to the number and type of invalid EITC recipients suggested by the results of the pilot. Finally, the pilot will provide quantitative and qualitative information on the cost and level of effort required to access data across 50 different State systems under a national program.

To be clear, the data analysis will be conducted retrospectively on prior year's benefits data and EITC tax filings. During the pilot we would not intervene in the upcoming tax filing season to stop improper EITC payments to ineligible individuals or attempt to initiate new claims for eligible individuals, for two reasons. First, current law precludes use of third party data for EITC pre-certification. Such data could only be used to assist in an EITC audit, and not to adjust or correct a tax return. Second, the reliability and accuracy of State data and screening processes must be evaluated before taking any actions that would affect an individual's tax return or tax credit.

Potential Partners or Sponsors. At the Federal level, the key stakeholders for this pilot are the IRS and the Treasury's Offices of the Assistant Secretaries for Tax Policy, Financial Institutions, Fiscal, and Management. The Treasury's Office of Tax Policy would ensure that the pilot was conducted consistent with internal revenue rules, procedures, and statutes, and with other EITC improvement initiatives. The Office of Financial Institutions would ensure the pilot was coordinated with other Federal financial literacy and "tax time" payment programs for low and moderate income individuals. The Office of the Assistant Secretary for Management would ensure the pilot was integrated into the Treasury's efforts to reduce improper payments across the Treasury Department. The Office of the Fiscal Assistant Secretary would provide overall project management and coordination. The IRS's Office of Research would collaborate with State agencies to perform the data matching and data analysis.

At the State level, the key stakeholders will be the relevant public assistance departments as well as the Department of Revenue. The public assistance departments would provide technical and program resources to perform the data matching and analysis with the IRS, and the Department of Revenue would coordinate the pilot with any State-level tax credit programs, including data matching and analysis if possible. The proposed pilot has generated interest with several States with evidence of sufficient stakeholder buy-in for success.

In addition, the Treasury proposes to engage a contractor to assist in designing the data matching protocols, evaluating the results, designing a potential national EITC data matching program, and helping to formulate potential legal and operational changes to EITC administration in light of the pilot.

Estimated Operating Cost of Pilot. Funding is requested to conduct pilots in more than one State. The overall cost of implementing a pilot in connection with one State is estimated to be between \$300,000 and \$550,000. Of the total amount provided for a pilot in a State, funds will be allocated to three categories of activities: the first stage of technical data analysis, the second stage of qualitative validation of the data matching, and the Treasury's costs of engaging an independent consultant.

For the first stage of technical data analysis, funding will be used to cover State costs of general project management and of conducting the actual analysis, including the information technology and personnel costs associated with database mapping, extracts, security protocols, and reports. Such State costs are expected to include business and technical FTEs for two person-months,

plus costs for any third-party technical support, such as software engineering or database administration.

For the second stage of qualitative data confirmation, funding will be used cover the costs of validating actual family circumstances through interviews and case file reviews, which may be performed by contractors or perhaps by State personnel.

Remaining funds for a given State pilot will be used to cover the Treasury's cost to engage a contractor to help in designing the data matching protocols, evaluating the overall pilot results, and designing a potential national program. The Treasury is not seeking funding for its personnel costs, or for the IRS's personnel and technical costs.

Estimated Impact on Program Costs. The pilot will not affect the normal delivery of EITC payments, since the data assessment would be conducted separately from EITC operations. Thus, IRS's EITC administrative and overhead costs will not change. Compared to the size of EITC program costs – roughly \$50 billion in refundable tax credits – the pilot costs are not significant.

However, even modest improvements in the EITC improper payment rate would potentially save significant amounts of program funds. The current improper payment rate for EITC equates to \$12 billion annually. Thus, on average a one percent reduction in the improper EITC payments to individuals in one State equates to \$2.4 million annually. Therefore, the pilot has the potential to save significant amounts if it indicates that State data can improve the accuracy of EITC claims even marginally.

Pilot Implementation Issues. There are two potential pilot implementation issues: privacy and consent. The partner States would need to review their privacy statutes and program rules to ensure that data collected for public assistance programs could be re-used for the pilot's purposes, and whether the consent of the beneficiary is required. If consent is required, the timetable for implementing the pilot may be extended, but a State should be able to obtain the necessary approvals as part of the periodic re-certifications for State benefits.