

Preparer Regs: Require Proof of Residency for Refundable Credits

By Sam Rock

Sam Rock practices immigration law and handles income tax issues for immigrants. For almost eight years he owned and operated a return preparation service whose clients were primarily undocumented, Spanish-speaking workers. He testified in a nationally reported case in support of the privacy of tax return preparer records. The case ultimately went to the Supreme Court of Colorado and resulted in a judgment that precluded law enforcement officials from examining return preparer records to obtain proof that an individual is undocumented. In 2009 Rock served as the national director of the individual taxpayer identification number program of a national tax service.

In this article, the author encourages the IRS to adopt a due-diligence rule that would require all return preparers to obtain documentation of residency for all children claimed for the earned income tax credit, and the additional child tax credit.

The purpose of this article is to encourage the IRS to adopt a due diligence requirement that would require all tax return preparers to obtain documentation of residency for all children claimed for the earned income tax credit,¹ child tax credit (CTC),² and additional child tax credit (ACTC).³ In this article I will refer to those three credits as the “qualifying child-based credits.”⁴ The common theme for those three credits is that their value increases by claiming additional qualifying children on a tax return. The term “qualifying child” is a technical term that depends on the taxpayer’s relationship to the child, the child’s age, the amount of financial support provided to the child, and whether the child lived with the taxpayer for more than six months in the tax year. I will discuss the slight differences in the definition of qualifying child as applied to the EITC, CTC, and ACTC. Also, most of the discussion will be limited to the EITC and ACTC, which are refundable credits. A refundable credit is not limited to the tax owed, whereas the CTC is. While it is an important tax benefit and

causes underreporting of income, the CTC does not result in a payment of dollars from Treasury other than federal taxes withheld or estimated taxes paid by the taxpayer. As an industry participant, I recognize the importance of those credits for the low-income population and appreciate that they have pulled millions of taxpayers out of poverty. However, I have also witnessed the abuse of the system by unscrupulous return preparers and taxpayers searching for larger refunds. Fraud in the tax return preparation industry has become an epidemic.

Erroneous payments of ACTC and EITC are exceptionally concerning because they can often result in a payment to the taxpayer that is not a repayment of tax withheld or paid into Treasury by the individual. Refundable credits, such as the EITC and ACTC, are essentially cash payments to the individual who claims the credits. The claim for the payment is simply made by filing a tax return. Therefore, a refundable credit is more akin to a stimulus payment that is paid by Treasury than it is a refund.

Noncompliance Justifies Intervention

The EITC was originally passed in 1975 to allow low-income workers to offset their tax burden.⁵ It is now the nation’s largest anti-poverty program.⁶ EITC payments have increased from \$1.2 billion in their first year to \$43.7 billion in 2009.⁷ In tax year 2008, 23 million people received the EITC.⁸ Unfortunately, the program suffers from a high rate of noncompliance. Current estimates place the rate of noncompliance at 23 to 25 percent.⁹ In 2009 the IRS paid out approximately \$10 billion to \$12 billion in erroneous claims. I expect the American public would be amazed to know that approximately 23.7 million people annually receive stimulus-like EITC payments through the tax system, and that 23 to 25

⁵Government Accountability Office, “Earned Income Credit: Qualifying Child Certification Test Appears Justified, but Evaluation Plan Is Incomplete,” GAO-03-794 (Sept. 2003), at 4, *Doc 2003-21550*, 2003 TNT 191-29.

⁶Daniel P. Gitterman, Lucy S. Gorham, and Jessica L. Dorance, “Expanding the EITC for Single Workers and Couples Without Children (aka Tax Relief for Low-Wage Workers),” A Policy Brief Prepared for the Center on Poverty, Work and Opportunity at the University of North Carolina at Chapel Hill (Jan. 2007).

⁷Treasury Inspector General for Tax Administration, “The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments,” 2009-40-024 (Dec. 31, 2008), *Doc 2009-2517*, 2009 TNT 23-24.

⁸IRS, “Earned Income Tax Credit (EITC) Initiative, Report on Qualifying Child Residency Certification, Filing Status, and Automated Underreporter Tests” (2008).

⁹*Id.*

¹Section 32.

²Section 24.

³Section 24(d). This provision contains the limitations on the refundable portion of the CTC, which is called the ACTC.

⁴The proposal would not extend to the dependent and child care credit because this is a nonrefundable credit. The CTC is nonrefundable. The calculation of the ACTC is based on the information entered to calculate the taxpayer’s CTC. Therefore, it is impossible to separate the CTC and ACTC.

percent of the payments are issued in error.¹⁰ The tax return preparers are the gatekeepers of the system. But the level of noncompliance shows that they are not adequately screening the claims. Most preparers now agree that regulation of the tax return preparation industry is a welcome change.

The IRS acknowledged the Government Accountability Office's conclusion from its 2003 compliance study that the primary source of fraudulent EITC claims were payments for children who did not live with the taxpayer.¹¹ Tax return preparers are required to exercise diligence in preparing tax returns.¹² They can be fined for failing to exercise diligence, and can in some circumstances be subject to criminal penalties. The code and regulations also contain specific due diligence questions for the EITC.¹³ However, tax return preparers are not required to obtain proof of residency for qualifying children in claims for the qualifying child-based credits. So the industry standard is to accept taxpayers' verbal affirmations. Of course, there are situations that would require a tax return preparer to obtain documentation of the residency of a child, such as when a taxpayer makes a statement that the child did not live with the taxpayer or that the taxpayer's income might not be sufficient to support all the children claimed on a return. But there is no clear-cut rule that requires taxpayers to provide proof of residency for children claimed for the EITC, CTC, or ACTC. I imagine that it would be difficult for a preparer who required documentation of residency for all claims to the EITC, CTC, and ACTC to stay in business. The taxpayers would simply gravitate toward preparers who would process their returns without documentation and in the least amount of time. A tax return preparer who self-imposed a proof-of-residency rule would probably struggle to find clients. The national tax return preparation companies and franchises simply cannot afford to write an internal standard that is higher than the industry standard.

In 2009 the IRS announced its intent to more extensively regulate all preparers. That initiative will surely enhance the overall integrity of the tax system. The IRS will initially require preparers to register, and then it will implement education and testing requirements. Although it will be effective, the preparer regulation regime will take years to implement. More important, the regulation of preparers without changing the standard of care in determining whether a child lived with a taxpayer

may not noticeably curtail erroneous claims for the EITC, CTC, and ACTC. Taxpayers will still have the ability to claim those credits without showing proof to the tax return preparers or the IRS that the child lived with the taxpayer. Regulation of preparers alone will not change the standard of care for determining the residency of a qualifying child. Only a well-defined standard imposed by the IRS will change what preparers can be expected to demand of their clients.

The GAO, IRS, the national taxpayer advocate, and the Treasury Inspector General for Tax Administration agree that the tax return preparation industry at least shares in the blame for the high rates of noncompliance in EITC claims.¹⁴ In tax year 2007, tax return preparers completed more than 87 million individual tax returns.¹⁵ The majority of the low-income individual tax return preparers are seasonal employees who are not licensed CPAs, attorneys, or enrolled agents. In all but a few states, anyone can prepare a tax return.¹⁶ Therefore the preparers can receive payment to prepare a tax return without any previous training, license, or demonstrable skill.¹⁷ The IRS estimates that there are between 900,000 and 1.2 million tax return preparers.¹⁸ As a result, the industry has been inundated with entities and individuals who are not tax professionals.¹⁹ In her 2002 annual report to Congress, National Taxpayer Advocate Nina Olson noted that high-margin tax-related products, such as refund anticipation loans, have attracted many nontraditional tax preparers to the industry (hereafter "2002 Olson report"). Her report states:

From used car dealers filing taxes so taxpayers can use their refunds as down payments toward automobiles, to preparers in check-cashing storefronts charging pay-day loan rates for refund loans and disappearing without a trace after April 15th, to preparers in

¹⁴GAO, "Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors," GAO-06-563T (Apr. 4, 2006), *Doc 2006-6440*, 2006 TNT 65-21. See also IRS Publication 4832, *Preparer Review* (rev. Dec. 2009); and TIGTA, "Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors," 2008-40-7 (Sept. 3, 2008), 2008-19366, 2008 TNT 178-23.

¹⁵IRS Publication 4832, *supra* note 14, at p. 6. Eighty-seven million returns were submitted through paid preparers.

¹⁶California, Maryland, New York, and Oregon all require registration. Oregon has specific competency requirements.

¹⁷TIGTA, *supra* note 14, at p. 1.

¹⁸IRS Publication 4832, *supra* note 14, at p. 8.

¹⁹In 2008 an IRS oversight board convened a panel of industry stakeholders. The panel stated that the overwhelming majority of the preparers favored entry-level requirements and enforcement of penalties. The panelists opined that the industry was a profession, not a seasonal, part-time job.

¹⁰*Id.*

¹¹*Id.* at p. 8.

¹²Section 6694(a) and (b).

¹³Section 6695(g).

migrant or immigrant communities getting a percentage fee of any (incorrect) refund — each of these preparation outlets provide a product, at a high cost to taxpayers who do not always have strong bargaining positions or additional preparation options. The high profit margin on tax return-related products, including refund anticipation loans, attracts legitimate and illegitimate preparers alike.²⁰

Eight years after the 2002 Olson report, tax returns are still completed by car dealers, check-cashing stores, pawnshops, barbershops, and myriad other businesses that cannot be considered full-time tax professionals. Those fly-by-night preparers are an affront to preparers who know the rules, care for their clients, and legitimately look at tax return preparation as a vocation. The 2002 Olson report recommended legislation that would regulate preparers, requiring minimum education requirements and testing.

The tax return preparation industry should bear part of the blame for the erroneous EITC payments. However, given the amount of material that has been published about the relatively low skill level of many return preparers, Treasury and Congress should recognize the need to tailor very specific diligence requirements for preparers who deal with low-income taxpayers. The skill level of tax return preparers ranges from relatively unskilled seasonal preparers who work at check-cashing stores to CPAs and lawyers. Tax returns for low-income taxpayers are usually completed by unlicensed seasonal preparers who are not CPAs, attorneys, or enrolled agents. These are preparers who in some cases have little or no tax training. They can simply buy the tax software and go into business. The skilled preparers who deal with low-income filers would appreciate regulation that would force unscrupulous or low-skilled preparers to act diligently. Frankly it would help the legitimate preparers compete, and they could report less than diligent preparers to the IRS. If preparers were all required to keep documentation of residency for qualifying children, the IRS could easily identify noncompliant preparers.

In 2009 the IRS commissioner announced a program to regulate all tax return preparers. Essentially, the commissioner said that unenrolled preparers were “practicing before the IRS” by filing a return and that the IRS had the authority to regulate them under Circular 230. By bringing unenrolled preparers within its administrative jurisdiction, the IRS now could require all return

preparers to obtain documentation of residency for qualifying children used in the calculation of qualifying child-based credits.

Document Residency to Cut Errors

The main factors in determining a taxpayer’s eligibility for and the amount of the EITC and ACTC are the taxpayer’s income, filing status, and number of qualifying children.²¹ A qualifying child is a foster child, stepchild, sibling, grandchild, nephew, or their descendant who lived with the taxpayer for more than six months of the tax year and was less than 19 years of age or a full-time student under the age of 24. Underreporting of income and inappropriate filing statuses account for some of the erroneous EITC payments.²² The underreporting of income and filing status are topics for another day. In this article, I will focus solely on the residency requirement for qualifying children. According to the EITC compliance studies, the qualifying child errors accounted “for the largest share of over-claims,” and the residency requirement is the “chief compliance issue” associated with erroneous claims associated with qualifying children.²³

In its 2003 report, the GAO recognized that taxpayers can obtain the EITC without first being found eligible for the benefit.²⁴ The report stated that the EITC is a unique government benefit in that it does not require the taxpayer to establish his eligibility for the benefit before obtaining it, unlike other government programs such as Social Security income.²⁵ To claim the EITC, CTC, and ACTC, the taxpayer simply claims the benefit on the tax return.²⁶ After filing, the IRS uses internal math and document-matching systems, audits, and criminal examination to hold or require the taxpayers to repay the refunds.²⁷

In the 2009 tax year, the EITC was expanded from two to three qualifying children. A taxpayer cannot increase the EITC by claiming more children than the maximum qualifying number in the tax year. For example:

Assume taxpayer has earned income of \$25,000 and four qualifying children. Taxpayer files as head of household and gets EITC of

²¹IRS Publication 596, *Appendix — Earned Income Tax Credit Table*. Taxpayers without children who are married filing jointly or filing single qualify for the EITC if their income falls below \$18,450 and \$13,450, respectively.

²²GAO, *supra* note 5, at 14.

²³IRS, *supra* note 8, at 8.

²⁴GAO, *supra* note 5, at 7.

²⁵*Id.*

²⁶*Id.*

²⁷*Id.* at 8.

²⁰National Taxpayer Advocate Nina Olson, 2002 Annual Report to Congress, *Doc 2003-568, 2003 TNT 12-11*, at 225.

\$3,844. Taxpayer cannot increase the EITC by claiming the fourth child on the return. The EITC will still be \$3,844 if taxpayer claimed four qualifying children for the EITC.²⁸

As a result of the limitation on the number of children that can be used to increase the EITC, taxpayers often have children that cannot be claimed on their tax return to increase their EITC. Because taxpayers cannot use Social Security numbers to increase their own EITC, Social Security numbers are often used by another taxpayer, thereby inflating the other person's tax refund. Unfortunately, selling, trading, and lending Social Security numbers is a business during tax season.

In 2002 Treasury and the IRS convened a task force to identify ways to address EITC noncompliance issues raised in a 1999 GAO EITC compliance study.²⁹ The 1999 compliance study identified qualifying children, filing status, and income reporting errors as three major sources of EITC noncompliance.³⁰ In December 2003 the IRS began testing a program that requires taxpayers to verify the residency of qualifying children claimed for the EITC.³¹ The EITC task force and residency certification program were initiated, at least in part, to address EITC issues identified in the 1999 GAO EITC compliance study.³² In 2008 the IRS published the findings of its study in a report titled "Earned Income Tax Credit (EITC) Initiative, Report on Qualifying Child Residency Certification, Filing Status, and Automated Underreporter Tests" (hereafter "2008 EITC initiative report").³³ Interestingly, in a survey of the test and control groups, over two-thirds of those who responded to the survey believed that taxpayers should be required to prove they met the EITC requirements before receiving the payments.³⁴ The drafters of the report also concluded that a certification program could prevent ineligible taxpayers from claiming the EITC and that a small number of people appeared to have been deterred by the document certification requirement.³⁵ A cost-benefit analysis is always necessary when considering actions that would affect taxpayers. The balance clearly favors a documenta-

tion requirement, especially when implemented at little cost to the government through tax preparers.

Verify Claims by ITIN Filers

Any efforts to curb erroneous claims to the EITC with a preparer-based residency certification program should be designed to encompass erroneous claims to the ACTC, as both credits are triggered by claiming qualified children on a tax return. The ACTC can result in a payment of a refundable credit to a taxpayer of up to \$1,000 per child. In the fall of 2010, Congress will debate whether to reduce the credit back to the pre-Bush tax cut level of \$500 per child. This debate would be a good time to discuss the qualifying child documentation requirement for ITIN filers that claim the CTC and ACTC.

Except for several nuances, the definition of a qualifying child is the same for the ACTC and EITC. A qualifying child for purposes of the ACTC must be less than 17 years of age in the tax year, and the dependent cannot have provided more than 50 percent of his own support. Again, the taxpayer is not required to provide any proof of residency to claim the credit and can assert the claim by filing the return.

On March 31, 2009, TIGTA published a report in which it identified false claims to the CTC and ACTC as a serious problem in the population of taxpayers filing tax returns with an individual taxpayer identification number (ITIN) (hereafter "2009 TIGTA report").³⁶ In 2004, I coauthored a letter to the House Ways and Means Subcommittee on Oversight that raised similar issues in the ITIN filing population. I did not find any other reports or studies that attempted to identify the value or cause of erroneous claims to the ACTC outside the ITIN filing population. Therefore, I do not know how many total taxpayers claimed the ACTC, or non-compliance estimates in the Social Security filing population.

Over-claims to the CTC and ACTC are not limited to the ITIN filing population. This credit can be claimed by many individuals who would not be considered low income. Some individuals are eligible to receive the CTC and ACTC when they are not eligible to receive the EITC or are on the lower end of the EITC scale. Some examples of when a taxpayer would receive the CTC and ACTC but would not receive any or only a small EITC payment are: (1) the taxpayers' income is above or at the higher end of the EITC phaseout, (2) one or both

²⁸IRS Publication 596, *supra* note 21.

²⁹GAO, *supra* note 5.

³⁰*Id.* at 1. See also IRS note 23, *supra* note 8, at 7.

³¹GAO, *supra* note 5, at 1.

³²*Id.* at 9. The study showed that 46 to 50 percent of the total returns claiming the EITC obtained too much of the credit, constituting between 27 and 32 percent of total EITC dollars claimed in 1999.

³³IRS, *supra* note 8.

³⁴*Id.* at 18.

³⁵*Id.* at executive summary.

³⁶TIGTA, "Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims," 2009-40-057 (Mar. 31, 2009), 2009-8672, 2009 TNT 72-17.

of the taxpayers on a return file with an ITIN,³⁷ or (3) the taxpayer is claiming more than the maximum number of qualifying children that can be used for purposes of the EITC.³⁸ The EITC begins to phase out between \$16,420 and \$43,279. The phase-out for the ACTC is significantly higher: (1) \$110,000 for married couples filing jointly, (2) \$75,000 for individuals filing as head of household or qualifying widower, and (3) \$55,000 for single filers.

The 2009 TIGTA report indicated that the ACTC was incorrectly claimed by taxpayers who filed with an ITIN.³⁹ The report concluded that the IRS and private ITIN acceptance agents were processing claims to the ACTC even though the documentation submitted with the Form W-7 for a dependent did not support the claim to the CTC or ACTC. TIGTA also found that IRS employees charged with processing Form W-7 applications filed with a Form 1040 were instructed not to disallow the CTC or ACTC when documentation submitted with the tax return indicated that the child did not live with the taxpayer, and that they were to follow the taxpayer's intent as stated on the tax return.⁴⁰ In response to TIGTA's suggestion, the IRS stated that it did not have a mechanism to reject the credits other than during an exam or audit.⁴¹ In an attempt to eradicate those claims, TIGTA proposed legislation that would tie eligibility for the CTC and ACTC to whether the qualifying child has a Social Security number. TIGTA's suggestion to require a Social Security number would require legislation. It would also exclude all ITIN qualifying children from being claimed for the CTC and ACTC. Congress has been made aware that undocumented individuals are eligible to claim the CTC and ACTC and has not acted to change the credits to require a Social Security number. TIGTA's concerns about erroneous claims to the CTC and ACTC within the ITIN filing population can be addressed by requiring return preparers to obtain proof of residency of the children claimed for the CTC and ACTC.

Consequences of Immigration Reform

Policymakers should look to the 2009 TIGTA report as a guidepost in debating the tax cost of

immigration reform. The report shows that immigration reform will, under current tax law, result in a tax refund tsunami. The 2009 TIGTA report stated that approximately 66 percent of all taxpayers filing a tax return with an ITIN obtained the ACTC.⁴² The overwhelming majority of ITIN filers are tax residents who are required to file their tax returns with an ITIN because they cannot obtain a Social Security number, which means they are working without authorization. Approximately 1.8 million ITIN returns were filed in 2008. If Congress were to pass immigration reform, the remainder of the undocumented filers — 7 million to 10 million people — would also file returns. Some proponents of the reform have suggested that the treasury would generate tax dollars if the reform applicants are required to file back tax returns as part of the legalization process.

Well-intentioned proponents of immigration reform who suggest that the reform will result in a tax revenue boom should study the dependency rules for family members living in Mexico, the ACTC, and retroactive EITC.⁴³ Under current law, a taxpayer can claim refunds for three prior years. Therefore, the taxpayers would be filing not one but three years of refunds, resulting in a potential filing of approximately 21 million returns. Many of those individuals can claim family members in Mexico to reduce their taxable income to zero.⁴⁴ If the filing statistics for returns filed as a result of immigration legislation track the current ITIN filing statistics, then 66 percent of reform-related tax returns would receive the ACTC. Thus, 66 percent of the 21 million ITIN returns that would be filed as a result of immigration reform would include claims for ACTC-based refunds, and many of the others would owe zero in tax. After obtaining Social

⁴²TIGTA, *supra* note 36.

⁴³ILM 200028034, *Doc 2000-18984*, 2000 TNT 137-47. Taxpayers can retroactively claim the EITC for prior years after a family obtains Social Security numbers. See Francine T. Lipman, "The Taxation of Undocumented Immigrants: Separate, Unequal, and Without Representation," *Harvard Latino Law Rev.*, vol. 9, Spring 2006.

⁴⁴Section 152(a)-(f). Many Mexican nationals could reduce their taxable income to zero. They could properly claim family members who live in Mexico as long as the taxpayer provided more than 50 percent of the financial resources of the family member in the tax year. The U.S. Agency for International Development reported a GDP per capita for individuals living in Mexico of \$6,882, but that 53 percent of the population had annual incomes of less than \$720. Therefore, the Mexican taxpayers could legitimately claim a family member in Mexico as a dependent by sending less than \$400 per year to Mexico for the individual. See <http://www.usaid.gov/policy/budget/cbj2006/lac/mx.html>.

³⁷Section 32(m). If the filing status is married filing jointly, both the primary taxpayer and spouse must have Social Security numbers.

³⁸In 2009 the number of qualifying children used to calculate the EITC increased from 2 to 3.

³⁹TIGTA, *supra* note 36.

⁴⁰*Id.* at recommendation 3.

⁴¹The IRS should have the ability to reject a credit during processing of an ITIN application if the documentation submitted with the application for the ITIN is contrary to the taxpayer's claim that the child lived in the United States for the required period to obtain the CTC or ACTC.

Security numbers for themselves and family members through the legalization program, the individual could retroactively claim the EITC for the previous three years as long as the taxpayer and qualifying children meet the residency, age, and income requirements.⁴⁵ Therefore, immigration reform would not be a tax-revenue-generating proposition, but rather a huge tax refund burden — possibly in the tens of billions of dollars.⁴⁶ I am a proponent of immigration reform. There are many social benefits of immigration reform. But expanding the tax coffers with unpaid taxes of the reform applications would not be a reality of immigration reform under the current tax code.

I estimate that the percentage of erroneous claims for the ACTC for ITIN filers is higher than erroneous claims for EITC for the Social Security number filing population. Those taxpayers are particularly susceptible to unscrupulous preparers, and the tax clients have very little knowledge about or history with the tax system. Many of these individuals speak limited English and may not appreciate why a particular tax service quotes a tax refund higher than another preparer, or that the inflated refund might have been because of improper claims to the CTC and ACTC. In immigrant communities, tax returns are completed in restaurants, grocery stores, money-wiring outlets, and multi-service vendors. Although the national chains have made some headway into those ITIN markets, they still are insignificant players in the ITIN industry. As a result, tax return preparers in low-income ITIN markets receive little training and do not have the support that could be expected of preparers who work for more established services. A simple documentation requirement would help compliance within the ITIN filing population by providing a simple diligence test for preparers working with this population. If Congress and the administration pass immigration reform without requiring preparers to obtain proof of residency or tying the CTC and ACTC to a Social Security number, Treasury

will end up paying out billions of dollars in erroneous CTC and ACTC claims for dependents who live outside the United States.

Using ERO Agreements as Leverage

Tax return preparers should be required to obtain and keep for three years proof of residency for qualifying children claimed for the EITC, CTC, or ACTC. That could be done by regulation, amendment to the forms, or even as a requirement to participate in the IRS Electronic Return Originator (ERO) program.

Leveraging the ERO program might be the most effective way to implement a documentation requirement. The majority of paid preparers receive payment for their services through electronic bank products.⁴⁷ Their fees are deducted from their clients' refunds.⁴⁸ The IRS has broad power to administer the program.⁴⁹ The controlling document for the ERO program, IRS Publication 1345, already requires preparers to keep Form 8879, "IRS E-File Signature Authorization," and the Form W-2 or Form 1099 used in the preparation of tax returns that are electronically filed. If the IRS were to use Publication 1345 to implement the standard, then it should draft the language to require preparers to retain the documents for returns filed electronically or on paper. Extending the requirement to paper returns could be a condition of participating in the ERO program. Participation in the ERO program is a payment mechanism for most preparers. Therefore, participation in the program is crucial to their survival. So preparers would comply with this requirement to avoid losing their ability to file client returns electronically.

The IRS could change some of its forms to remind return preparers and inform taxpayers about the requirement. By changing the forms, the IRS could ensure that the preparers collect the documents for paper and electronically filed returns. Only current-year returns can be filed electronically. The IRS could change Form 8867, "Paid Preparer's EITC Checklist," to encompass the CTC and ACTC and include a line item stating that the tax return preparer saw and maintained a copy of documentation establishing that each qualifying child lived with the taxpayer. Forms 1040 and

⁴⁵ILM 200028034, *supra* note 43.

⁴⁶If 66 percent of the estimated 21 million returns resulted in an ACTC-based refund of \$1,500, the ACTC-based tax refund burden of immigration reform could be more than \$21 billion. See TIGTA, *supra* note 36. This amount does not include the retroactive EITC. After legalizing and obtaining a Social Security number through the reform, the beneficiaries would be entitled to claim the EITC in future years and to retroactively claim the EITC for the prior three years, if they meet the residency, income, and other requirements. Thus, the tax refund cost of the immigration reform will be the claims for refunds for the current tax year and prior three years based on the ACTC and EITC. During the 2006 congressional immigration debate, legislators recognized the cost of the retroactive EITC but did not seem to recognize the risks posed by the ACTC.

⁴⁷The bank products can be tax refund loans or refund assistance products. Taxpayers are charged interest for tax loans, commonly referred to as RALs. Refund assistance products are not loans but function more as escrow agreements that allow banks to pay preparers from the tax refund.

⁴⁸IRS Publication 4832, *supra* note 14, at 7-9. Of the 87 million tax returns completed by paid preparers, 61.8 million were submitted electronically through tax return preparation software.

⁴⁹*Id.* at 18.

1040A could include a checkbox on the line item for each of the credits, whereby the preparer would affirm that he saw and maintained a copy of documentation establishing the residency of each qualifying child.

The IRS's 2008 EITC initiative report contains a detailed discussion of acceptable documentation for claims to the EITC.⁵⁰ The IRS uses a documentation standard to test the residency of qualifying children during taxpayer examinations. The preparers should be expected to obtain the same types of documents that are requested by the IRS. IRS forms 886-H-EIC, 886-H-HOH, and 866-H-DEP explain the documentation requirements to establish eligibility to claim the EITC, file with head of household status, or claim a dependency exemption. The list of documents stated in those forms to establish residency would presumably be the forms that would be acceptable for tax return preparers.

The ITIN program is a working example of a documentation standard. Recall that most ITIN taxpayers are individuals who are working in the United States without documentation. Many speak limited English. Needless to say, the process to obtain an ITIN for an undocumented worker who speaks limited English is complicated and intimidating. To obtain an ITIN, a taxpayer must submit to the IRS or an ITIN acceptance agent two documents establishing the identity of the ITIN applicant. The documents must be originals or certified copies. By 2003 the IRS had issued more than 7 million ITINs.⁵¹ Often, the taxpayers must obtain original documents from another country to apply for the ITINs. If ITIN taxpayers can obtain documents from abroad to apply for an ITIN, it is realistic to expect all taxpayers to produce a document from a school, medical provider, landlord, or government agency to establish the child's residency.

Any verification requirement should identify limited exceptions for individuals in disaster areas or other individuals who cannot obtain medical records, government records, or school records to justify the residency requirement. The IRS's 2008 EITC initiative report recognized the need for limited exceptions and allowed individuals to use pre-prepared affidavits from third parties to substantiate the residency of the qualifying child. The report noted that third-party affidavits were easier

to obtain and had a higher rate of acceptance than records or official letters.⁵²

Conclusion

The root of overclaiming for refundable child-based credits, is obvious: These benefits can be submitted and will be processed without documentation of eligibility for the benefits. My proposal is one way to preserve the partnership of government and private enterprise in the processing of low-income tax returns. If the IRS were to require preparers to obtain documentation of residency for all qualifying child-based credits, the tax return preparation industry would have an effective tool to self-regulate. Return preparation is a competitive industry. Preparers would quickly learn that they can eradicate unethical or unknowledgeable preparers by reporting individuals who fail to keep documentation of residency for the qualifying child-based credits. Preparers cannot self-impose this type of standard without destroying their business. They need leverage to demand the documentation from the clients and to stay competitive in the industry.

⁵²IRS, *supra* note 8, at 14.

⁵⁰IRS, *supra* note 8.

⁵¹GAO, "ITIN Numbers Can Be Improperly Obtained and Used," GAO-04-529T (Mar. 10, 2004), *Doc 2004-5115*, 2004 TNT 48-55.