H&R BLOCK

William C. Cobb
President & CEO

February 5, 2014

The Honorable Charles Boustany, Chairman
The Honorable John Lewis, Ranking Member
U.S. House of Representatives
Committee on Ways & Means
Subcommittee on Oversight
1102 Longworth House Office Building
Washington, DC 20515

Re: February 5, 2014 Hearing with IRS Commissioner Koskinen

Dear Chairman Boustany and Ranking Member Lewis:

On behalf of H&R Block, please accept this letter and the attached statement for today's hearing record.

H&R Block is the world's largest consumer tax services provider, filing more than 625 million returns worldwide since 1955. Last year, we filed more than 22 million U.S. individual income tax returns — about 15 million returns in our offices and another 7 million through our do-it-yourself (DIY) offerings. We likely help more people face-to-face every year than the Internal Revenue Service (IRS).

As the largest provider of both in person tax assistance and DIY software offerings, we have a unique perspective into tax filing trends. In addition, filing 1 in 5, or more than 5 million, Earned Income Tax Credit (EITC) returns gives us unparalleled insights into the taxpayers who claim this credit. Being one of the largest filers of EITC returns, we have been monitoring the longstanding issues and challenges facing the IRS in administering this credit, particularly the improper payment rate.

H&R Block is committed to assisting Commissioner Koskinen and the IRS to reduce the improper payment rate and combat the filing of fraudulent returns. To that end, we believe that the IRS and the Department of Treasury can take three steps which, if taken immediately, may help reduce the improper payment rate quickly. These are:

- Ensure that all taxpayers, whether they self-prepare or use a paid preparer, answer the same questions to determine eligibility for the EITC, and
- Prohibit more than three tax refunds to a single bank account, and,

- Provide data on the specific sources of the improper payment rate such as
    a. Fraud versus complexity/confusion, and
    b. Self-prepared returns versus paid preparer returns.

While H&R Block primarily helps middle- and lower-income taxpayers, we serve clients from across the income spectrum. As a result, we do not take positions on the merits of specific tax code provisions. This includes the various different proposals to restructure the EITC. However, we would appreciate the opportunity to discuss the administrative impacts to both the IRS and the individual taxpayer that each of these proposals may have.

The attached statement contains specific information in support of the proposals listed above. It also includes our current thoughts about the potential for improper payments of the new premium tax credit to purchase health insurance.

In addition, H&R Block has a long history of supporting minimum standards for, and oversight of, tax return preparers. We believe that implementing such standards and oversight will also help reduce the improper payment rate. While we did not agree with all aspects of Treasury's implementation of the Registered Tax Return Preparer program, especially the use of an expensive testing provider that had limited geographic availability, we continue to support these efforts. Should the United States Court of Appeals for the District of Columbia Circuit rule that Treasury did not have authority to implement this program, we will look forward to working with Congress and Treasury to draft any legislation that may be necessary to implement minimum tax preparer standards as a formidable tool in the fight against fraud.

We would be happy to answer any questions you, other Members of the Committee, or staff may have.

Thank you for your consideration.

William C. Cobb

William C. Cobb
Chief Executive Officer

Attachment

STATEMENT OF
H&R BLOCK
REGARDING EITC AND ACA CREDIT IMPROPER PAYMENTS
TO THE HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
February 5, 2014 Hearing
with IRS COMMISSIONER KOSKINEN

I. REDUCING THE EITC IMPROPER PAYMENT RATE

a. Background on the Improper Payment Rate

The Improper Payments Information Act of 2002 (IPIA)[1] requires Federal agencies to estimate the amount of improper payments made each year. Agencies must report to Congress regarding the causes of these erroneous payments and steps that will be taken to reduce them. Complementing this law, the Improper Payments Elimination and Recovery Act of 2010 (IPERA)[2] strengthened the improper payment reporting requirements imposed on Federal agencies.

IPERA and IPIA require Federal agencies to reduce the improper payment rate for any high-risk susceptible program to below 10% and to estimate and report the amount of improper payments made each year. As it applies to the Treasury Department and the Internal Revenue Service (IRS), IPERA requires the Treasury Inspector General and the Treasury Inspector General for Tax Administration (TIGTA) to annually review and report on the IRS's compliance with improper payment requirements. According to the Treasury Department Agency Financial Report for Fiscal Year 2013 released on December 16, 2013, (Treasury Financial Report), the Earned Income Tax Credit (EITC) is Treasury's only high-risk susceptible program.

The EITC improper payment rate, reported annually as part of the IRS National Research Program, has remained consistently above 20% for over 10 years. After a few years of decline, the most recent estimate, ***based on 2009 data,*** provided in the Treasury Financial Report, projects that the improper payment rate ***increased*** from 21 to 24.6 percent in 2012 to 22.1 to 25.9 percent in 2013 and that the total improper payments increased from \$11.6 to \$13.6 billion to \$13.3 to \$15.6 billion.[3]

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[1] Pub. L. No. 107-300, 116 Stat. 2350 (2002).
[2] Pub. L. No. 111-204, 124 Stat. 2224, 2227 (codified at 31 U.S.C. § 3321 note) (2010).
[3] Department of the Treasury, Agency Financial Report: Fiscal Year 2013 at 210, available at http://www.treasury.gov/about/budget-performance/annual-performance-plan/Documents/2013%20Department%20of%20the%20Treasury%20AFR%20Report%20v2.pdf (Dec. 2013) [hereinafter 2013 Treasury Financial Report].

b. IRS Should Provide Data on the Sources of Improper Payments

According to the Treasury Financial Report, the root causes of EITC improper payments are authentication errors (70 percent) and verification errors (30 percent).

Authentication errors "include errors associated with the inability to authenticate qualifying child eligibility, mainly relationship and residency requirements, filing status, when married couples file as single or head of household, and eligibility in nontraditional and complex living situations."[4] Verification errors "relate to improper income reporting which allows claimants to fall within the EITC income limitations and qualify for EITC. The errors include both underreporting and overreporting of income by both wage earners and taxpayers who report being self-employed."

However, the Treasury report does not discuss what portion of the authentication and verification errors are intentional or fraudulent and what portion may be unintentional due to complexity of the rules.

IRS does not have sufficient data to distinguish between unintentional taxpayer errors versus willful tax evasion or cheating.[5] Complexity is a large factor in EITC compliance affecting taxpayers' understanding of the EITC eligibility rules and how the credit is properly claimed.[6]

The Treasury report also does not distinguish what portion of authentication and verification errors are present on paid preparer returns versus self-prepared returns.

For example, IRS attempts to reduce the improper payment rate to date have generally focused on paid preparers. However, IRS data indicates that EITC filers have been migrating from assisted tax preparation to self-preparation at a higher rate than non-EITC filers.

To summarize Figures 1 and 2 below, the overall ratio between filers seeking assistance and those choosing to self-prepare remains constant—about 60 percent paid preparer, 40 percent self-prepared. In contrast, the filing trend for EITC filers indicates that EITC filers are migrating to self-preparation at a higher rate than those not claiming the EITC. What used to be an almost 70-30 ratio (paid preparer to self-prepared) is now a 60-40 ratio. Being a provider of both assisted tax preparation services and DIY self-preparation software, H&R Block is able to see this same trend in its data.

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[4] 2013 Treasury Financial Report, *supra* note 3, at 207.

[5] TIGTA, *Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2014*, at 5, available at http://www.treasury.gov/tigta/management/management_fy2014.pdf (Nov. 2013).

[6] Department of the Treasury, Agency Financial Report: Fiscal Year 2012, at 210 (Dec. 2012); and Robert Greenstein and John Wancheck, *Reducing Overpayments in the Earned Income Tax Credit*, Center on Budget and Policy Priorities, at 1, available at http://www.cbpp.org/files/4-30-13tax.pdf.

Figure 1: IRS Data Showing Trends in Return Preparation Method Overall[7]

Tax Season	2008	2009	2010	2011	2012
Paid-Preparer	86,515,114 (58%)	82,817,612 (60%)	81,040,615 (60%)	81,527,629 (59%)	82,192,985 (58%)
Self-Prepared	61,820,528 (42%)	55,149,802 (40%)	54,726,080 (40%)	56,659,609 (41%)	59,256,931 (42%)

Figure 2: IRS Data Showing Trends in EITC Return Preparation Method[8]

Tax Season	2008	2009	2010	2011	2012
Paid-Preparer	16,834,793 (72%)	16,635,464 (70%)	17,586,140 (67%)	17,176,689 (65%)	16,959,699 (62%)
Self-Prepared	6,618,802 (28%)	7,226,606 (30%)	8,712,391 (33%)	9,405,107 (35%)	10,264,882 (38%)

Understanding the sources of improper payments is critical to developing and implementing effective methods for reducing improper payment rates.

Authentication and verification errors due to complexity can be addressed by working with paid preparers and DIY software providers to provide additional education to taxpayers. H&R Block adopted rigorous due diligence standards for its preparers before the IRS implemented its regulations. H&R Block not only supports the IRS's efforts in this area but believes that minimum standards for, and oversight of, return preparers will help reduce improper payments. However, errors due to fraud, such as using stolen identities to file fraudulent returns, cannot be addressed through preparer education and outreach efforts.

As a result, H&R Block strongly encourages the Treasury Department and the IRS to release data on the sources of EITC improper payments.

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[7] I.R.S. Pub. 4822, *Taxpayer Filing Attribute Report*, available at http://www.irs.ustreas.gov/pub/irs-prior/p4822--2010.pdf and http://www.irs.ustreas.gov/pub/irs-utl/Pub_4822_Sept_2013.pdf.
[8] *Id.*

c. Require All EITC Filers to Answer the Same Questions

The EITC filer migration trend from assisted tax preparation becomes visible beginning in 2008, which is when the IRS implemented new regulations increasing the documentation requirements for paid preparer EITC due diligence standards. In order to ensure compliance with these regulations and avoid due diligence penalties, paid preparers must ask EITC clients intrusive, personal questions that taxpayers who use DIY software are not required to answer. For example, in order to meet the due diligence requirements, IRS requires paid preparers to ask individuals claiming the EITC about their non-taxable assistance (such as food stamps and housing assistance) or, if self-employed, their sources of business income.

The disparate implementation of anti-fraud measures by requiring only one group of EITC filers to answer certain questions and the concurrent migration to avoid such questions by other EITC filers suggests a loop hole in need of immediate attention. In other words, taxpayers may be migrating from assisted preparation to self-preparation in order to avoid the intrusive and personal questions paid preparers must ask them in order to comply with the preparer due diligence requirements.

To ensure fair administration of the EITC, H&R Block recommends that the IRS require all EITC filers to answer the same questions regardless of whether they use a paid preparer or self-prepare.

To accomplish this, H&R Block and the other major tax software developers recommended that IRS move questions which paid preparers ask taxpayers from Form 8867, *Paid Preparer's Earned Income Credit Checklist,* which is only filed with EITC paid preparer returns to the Schedule EIC, which is required of all taxpayers claiming the EITC.

The simplest way for IRS to implement uniformity is for the IRS to require such questions to be answered on a form that must be submitted to the IRS, such as the Schedule EIC, *Earned Income Credit*.

H&R Block believes that implementing uniform questions for all EITC filers will help reduce EITC improper payments related to complexity. As a result, it strongly encourages the IRS to implement the revised Schedule EIC for tax year 2014 returns filed in 2015.

H&R Block understands that expanding the Schedule EIC raises concerns about burden to the EITC filer who self-prepares his or her return and offers the following to address those concerns.

1) The majority of tax returns are now prepared using software and the majority of software packages provides guidance within the software and populates forms and schedules through interview screens. This means that the many taxpayers no longer look at actual IRS forms and instructions when preparing their tax returns. As result, the length or number of pages of a form alone should not determine burden. Figure 3 shows that almost 94% of all individual income returns are prepared using some sort of software, with 84% e-filing. Figure 4 shows that almost 98% of all EITC returns are prepared using software, with just over 91% e-filing.

2) Since all EITC filers are subject to the same eligibility requirements regardless of preparation and filing methods, EITC filers who utilize paid preparers are arguably subject to an increased burden because of these additional questions. Asking the same questions of all EITC filers would equalize burden.

Figure 3. IRS Data Showing Taxpayer Filing Trends [9]

All Taxpayers (including EITC)

	Paid Preparer	Self-Prepared	Total	
e-filed	74,992,044	43,827,647	118,819,691	84.00%
v-coded	6,325,374	7,575,052	13,900,426	9.83%
paper not v-coded	875,567	7,854,232	8,729,799	6.17%
			141,449,916	

Figure 4. IRS Data Showing Taxpayer Filing Trends[10]

EITC Filers

	Paid Preparer	Self-Prepared	Total	
e-filed	16,083,042	8,767,158	24,850,200	91.28%
v-coded	819,182	960,549	1,779,731	6.54%
paper not v-coded	57,475	537,175	594,650	2.18%
			27,224,581	

In sum, because the majority of EITC claims are prepared and filed using software, asking the same questions of all EITC filers should not increase burden.

[9] I.R.S. Pub. 4822, *Taxpayer Attribute Report*, available at http://www.irs.ustreas.gov/pub/irs-utl/Pub_4822_Sept_2013.pdf
[10] *Id.*

d. Prohibit more than three tax refunds to a single bank account or debit card

While the IRS processes tax returns and determines refund amounts, the Treasury Bureau of Fiscal Service (TFS)[11] is responsible for actually issuing the refunds, both paper checks and electronic transfers. H&R Block understands that Fiscal Service has the ability to detect suspicious payments, including multiple tax refunds electronically deposited into the same bank account or prepaid debit card account.

Because it is difficult for Treasury and IRS to recover improper payments, including tax refunds resulting from EITC claims, H&R Block recommends that TFS should prohibit disbursing more than three tax refunds to a single bank account or debit card.

However, there may be valid reasons for multiple refunds to a single account, such as dependents of filers that may not have an independent account. As a result, H&R Block recommends that TFS work with IRS to develop reasonable approaches where exceptions can be made.

II. ACA PREMIUM TAX CREDIT IMPROPER PAYMENT RATE

The Patient Protection and Affordable Care Act (ACA) created a new intersection between health care and taxes. H&R Block expects that many of our clients will be eligible for the ACA premium tax credit, or, alternatively, subject to the tax penalty for not having health insurance. As a result, we have been closely studying these provisions, including related forms, regulations and other guidance issued by both the IRS and the Department of Health and Human Services.

Because we prepare 1 in 6 returns—and 1 in 5 EITC returns—we, like the Members of this Committee and the Administration, are very concerned about the potential for fraud and abuse of the ACA premium tax credit. Our review of ACA legislative history informs us that the administration of this credit was modeled after the Health Coverage Tax Credit (HCTC).

The HCTC was enacted as part of the Trade Adjustment Assistance Act of 2002 and requires eligible individuals to submit their portion of health insurance premiums to the Treasury Department. The Treasury Department then combines the advance HCTC with the individual's payment and submits the total to the individual's insurance company. Individuals may also choose to claim the credit when they file their tax return instead of receiving the credit in advance.

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[11] Fiscal Service was formed from the consolidation of the Financial Management Service (FMS) and the Bureau of the Public Debt.

Regardless of how an individual chooses to claim the credit, an eligible individual must attach Form 8885, *Health Coverage Tax Credit*, to his or her tax return. This form includes a reconciliation of any advanced HCTC received. A copy of the health plan and proof of premium payments must also be attached to the form.

A cursory review of TIGTA and Government Accountability Office (GAO) reports regarding the HCTC seem to indicate that improper payments of the HCTC are very low. We suspect that is because of the anti-fraud measures, i.e., payments through Treasury and reconciliation with attachments to the return.

Similarly, H&R Block expects that the improper payment for the ACA premium tax credit may be low because the ACA included comparable anti-fraud measures through amendments to Internal Revenue Code sections 6055 and 6056. Specifically:

1) The ACA premium credit is only available for those purchasing insurance from the federal or state exchanges.
2) An insurance exchange is required to file an information report on new Form 1095-A, which an exchange will use to report premium tax credit information to the IRS and the individual.
3) Insurance companies are now required to file an information report on new Form 1095-B, which an insurance company will use to report health insurance information to the IRS and the individual.

We understand that, beginning next year, IRS will have immediate access to the information reports filed by the exchanges and insurance companies and expects to match that data at the time an individual files their tax return. This would be different from how IRS currently checks other information reports such as Forms W-2 and 1099. If the IRS is successful in cross-referencing data at the time a return is filed, we would expect low overpayments of the ACA premium tax credit.

However, as the IRS, like tax preparation companies, is focused on the current tax season, it has not yet released drafts of next year’s forms. We are very concerned about the complexity introduced by the reconciliation, or “true-up” process and are unsure how this will impact the taxpayer and look forward to partnering with the IRS on development of forms, instructions and other guidance. Understanding how the premium tax credit will be reported and reconciled will enable us to better understand the likelihood of improper payments for the ACA premium tax credit