

**Review: 4356
Statewide Single Audit
Year Ended June 30, 2010
Department of Revenue**

**FINDINGS/RECOMMENDATIONS – 1
Repeated – 1**

Not Accepted - 1

10-12. The auditors recommend the Department of Revenue review the process and procedures in place to identify earned income tax credit expenditures claimed under the TANF program and implement changes necessary to ensure only amounts eligible for claiming are reported to IDHS. (Repeated-2005)

Findings: IDOR has not established adequate procedures to determine whether earned income tax credits claimed under the TANF meet the federal allowability criteria.

During testwork, auditors noted IDOR's procedures for verifying the validity of taxpayer's earned income tax credit claims with federal tax returns are not completed prior to paying refunds to taxpayers or preparing the earned income tax credit claiming report for IDHS. Without this information, IDOR relies solely on limited data edits designed to verify the mathematical accuracy of the return and to identify individuals who may not meet the earned income tax credit criteria. The data verification procedures are not performed until the middle of the following year and have historically resulted in adjustments to amounts previously claimed.

Further, auditors noted that IDOR's limited data edits to identify individuals who may not meet the earned income tax credit criteria do not consider all information available to IDOR when they process the taxpayer's return and pay a refund. During testwork of earned income tax credits claimed under the TANF program, auditors identified:

- The population of earned income tax credits claimed under the TANF program during FY10 included 391 transactions (totaling \$31,139) that had been flagged by IDOR for having a W-2 form on file that was considered questionable and required further taxpayer correspondence or investigation to support the taxpayer's return. In discussing this issue with IDOR officials, they stated that IDOR only considers the validity of a taxpayer's W-2 in determining whether to claim State withholding credits, but not to determine whether the taxpayer had earned income during the tax year.
- The population of earned income tax credits claimed under the TANF program during the year ended June 30, 2010 included 3,591 transactions (totaling \$354,775) refunded to a taxpayer with an address outside of the State of Illinois

who was not serving in the military. IDOR's practice is to process returns showing out-of-State addresses as Illinois residents, unless the filer checks a box indicating that they are a part-year resident or non-resident. As a result, IDOR had not determined whether or not the earned income tax credits for these taxpayers were allowable under the TANF program. In discussing this issue with IDOR officials, they stated that IDOR does not use the taxpayer's address or compare to other State databases to determine that a TANF claim was a resident of the State.

In discussing these conditions with IDOR officials, they stated they disagree with the finding and believe their process is adequate.

Response: The Department of Revenue disagrees with the finding. The underlying issue is twofold:

- (1) The Department pays the refundable earned income credit before it is possible to verify that the federal Earned Income Credit (EIC) has been paid by the IRS.
- (2) The Department requests the draw-down of TANF match for the refundable portion of the tax refund before it is possible to verify that the federal Earned Income Credit has been paid.

Federal Health and Human Services (HHS) policy administrators in Washington D.C. validated the Department's process in 2006. The communication, which was approved by the Director of State TANF Policy, states: "The State has a reasonable verification process in place. Tax claims are checked against tax returns. Then reconciliation/validation of the tax claim occurs subsequent to actual payment of the refundable portion of the credit – the usual and customary method of reconciliation of tax issues."

The Department pays the Illinois EIC based on the information reported on the taxpayer's Illinois 1040 filing (as required by Illinois Statute, the Illinois EIC is 5% of the federal EIC), before the IRS has shared the federal EIC information, and works with the Illinois Department of Human Services to periodically draw-down federal funds to replenish the Refund fund. The Department does not receive the IRS report on federal EICs paid to Illinois taxpayers until October or November. Based on this report, when the IRS has made changes to what the taxpayer originally claimed, the Department bills the taxpayer and adjusts the draw-down accordingly. As a result, at the conclusion of the process, no TANF funds were utilized for ineligible EIC payments.

In addition, it should be noted that the two bullet points referenced by the auditor only identified "population of transactions" and the auditor did not perform procedures to verify if these transactions were invalid TANF EIC payments.

The Department does not believe it is reasonable to require taxpayers to wait for federal data to be available in order to receive the TANF portion of their refund; the Department believes that splitting a tax refund into two payments would be inefficient use of State resources and confusing to the taxpayer.

Auditors' Comment: As stated in the finding above, the verification procedures are not performed by IDOR until several months after IDHS has claimed the tax credits reported by IDOR. The State's current procedures allow unallowable costs to be claimed to the TANF program. Our finding and recommendation pertain solely to the timing of the claiming of TANF expenditures, not how IDOR chooses to process refunds or operate the Illinois Earned Income Tax Credit program.

Additionally, the populations of transactions identified in the finding are transactions which may not be eligible for claiming and should be evaluated by IDOR prior to claiming under the TANF Cluster.