

The Earned Income Tax Credit, Low-Income Workers, and the Legal Aid Community

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Abstract

The Earned Income Tax Credit (“EITC”) is the largest U.S. welfare program, with twenty-four million low-income Americans receiving \$60 billion of disbursements in 2009. Through the EITC, working Americans with little or no tax liability can receive up to nearly \$6,000 in refundable tax credits each year. Over the past two decades, policymakers have increasingly favored the EITC over direct-transfer welfare programs, citing its lower administrative expense (as recipients “self-certify” by filing taxes) and incentives for recipients to work. Despite its political appeal, the EITC suffers deep structural flaws. Largely because EITC claimants have little guidance in navigating the difficult filing process, they are subject to high rates of IRS audits and rescission of benefits with penalties and interest. This proliferation of EITC-related controversies has created an immense need for legal assistance, yet low-income tax law largely remains a peripheral concern within the legal aid community.

In this article, we suggest a comprehensive and achievable set of reforms that the IRS and legal services organizations can enact to improve the EITC’s efficacy and fairness. We first describe how the complexity of EITC eligibility criteria creates a tremendous burden for low-income Americans, as they frequently lack advice in tax filing and cannot afford legal representation in the event of a controversy with the IRS. We then outline measures that the IRS should implement to make the EITC more accessible and understandable to those qualifying for the credit, reducing the chance of an audit and loss of benefits. In particular, we focus on improving the tax filing process, making EITC audits more manageable for recipients, instituting less adversarial procedures for EITC-related Tax Court proceedings, and changing certain organizational structures within the IRS. Finally, we propose several practical ways that the legal aid community can enhance its support of EITC recipients confronting an IRS audit or Tax Court action. Most importantly, we argue that EITC assistance warrants greater Congressional funding and higher strategic and budgetary priority within legal aid organizations, given that the EITC is now far larger than the direct-transfer welfare programs on which legal aid lawyers have traditionally focused.

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I. INTRODUCTION

In 1997, College of William and Mary government professor Christopher Howard published *The Hidden Welfare State*.¹ Howard's book described a phenomenon of which many savvy observers were already aware: a prominent and growing proportion of American social policy was being implemented through the tax code, using tax expenditures, via mechanisms such as refundable tax credits.² Programs such as the Earned Income Tax Credit, the Targeted Jobs Tax Credit, and the Home Interest Mortgage deduction all served social welfare objectives, but did so stealthily, through tax provisions rather than cumbersome eligibility regimes associated with traditional welfare.

In this article, we explore one of the programs that Howard's study emphasized: the Earned Income Tax Credit. The EITC has, since the mid-1990s, been a prominent component of the American social welfare landscape. As we detail in Part II below, annual EITC expenditures dwarf the funds disbursed through traditional welfare programs such as the Temporary Assistance to Needy Families ("TANF") program. And, as a number of commentators have noted, the use of the tax system to administer the EITC has led to a number of pathologies not associated with traditional welfare. Writing in 1995, Professor Anne Alstott noted that "[t]he tax system's limitations render the EITC inherently inaccurate, unresponsive, and vulnerable to fraud and error in ways that traditional welfare programs are not."³ More recent commentators have focused on ways in which tax administration produces onerous and arguably unfair burdens for the low-income workers seeking to claim the benefits to which they are entitled under the program.⁴

Our article chronicles the burdens that the EITC imposes upon low-income claimants and examines the implications of these burdens. In particular, we focus on how the legal aid community should respond to the EITC's status as the nation's preeminent social welfare program. Two recognitions are crucial to our project. The first is that the EITC's tax-based regime is uniquely burdensome for low-income taxpayers. The program uses self-certification via the filing of a tax return, making taxpayers responsible for determining and verifying their eligibility. Having provided no *ex ante* assistance in determining eligibility, the program then employs a harsh, and arguably punitive, array of auditing and adjudicative techniques that challenge taxpayer eligibility *ex post*. Taxpayers unable to prove their eligibility to the IRS in a variety of correspondence-intensive and often adversarial processes are called upon to repay the benefit they received, with interest and penalties.⁵ This system is uniquely challenging to low-income taxpayers who may lack the skills required to navigate the tax return and audit processes.

The second key recognition upon which we build is the EITC's centrality in the American social welfare landscape. We argue that the legal aid community has allowed the "hidden welfare state" to remain hidden, moving too slowly to develop a robust

¹ CHRISTOPHER HOWARD, *THE HIDDEN WELFARE STATE* (1997).

² *Id.* at 3 (noting that tax expenditures devoted to social welfare projects cost approximately \$400 billion in 1995).

³ Anne L. Alstott, *The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform*, 108 HARV. L. REV. 533, 535 (1995).

⁴ See, e.g., Leslie Book, *The IRS's EITC Compliance Regime: Taxpayers Caught in the Net*, 81 OR. L. REV. 351 (2002); George K. Yin et al., *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11 AM. J. TAX POL. 225 (1994).

⁵ See Bryan T. Camp, *The Failure of Adversarial Process in the Administrative State*, 84 IND. L.J. 57, 105 (2009).

capacity to assist low-income taxpayers in navigating the vagaries of the EITC. While the legal aid community has not wholly neglected the EITC—programs such as the Legal Aid Society of Orange County’s development of the I-CAN! software are laudable initiatives⁶—it has not accorded the EITC the degree of attention one would expect for the nation’s largest welfare program. The result is a status quo in which low-income workers must navigate the complexities of the nation’s largest welfare program with a bare minimum of legal assistance.

In the pages that follow, we argue both that the EITC’s administration should be reformed to make it better suited to the needs of its low-income clientele, and that the legal aid community should respond to the centrality of the EITC in American welfare policy by devoting greater resources and energy to assisting EITC claimants. We proceed in four parts. Part II describes the rise of the EITC and details the various aspects of tax administration that render the EITC difficult for low-income taxpayers. Part III takes an internal approach to the problem, discussing and analyzing various structural reforms to the program and IRS administration that would serve to soften the program’s harsh edges. Part IV takes an external approach, discussing steps that Congress and the legal aid community can and should take in response to the EITC’s ever-growing prominence. Part V concludes.

II. ADMINISTERING WELFARE THROUGH THE TAX SYSTEM: BACKGROUND TO THE EITC

In this part, we discuss the difficulties that the EITC poses for low-income individuals who seek the credit. In particular, we focus on how the program’s tax-based administration presents unique legal challenges for low-income individuals that are different from those associated with traditional welfare. To do so, this part proceeds in three sections. First, we provide background to the EITC, focusing on the program’s history and structure. We emphasize the unique choice to use applicant self-certification via the submission of a tax return as the means for determining each claimant’s eligibility for the credit. Second, we discuss the costs and benefits of the EITC’s reliance on self-certification. We focus in particular on how self-certification imposes significant burdens on claimants, who are required to certify their compliance with complex eligibility guidelines and given minimal assistance in doing so. Third, we discuss the IRS’s audit, appeal, and Tax Court processes with a focus on how ill-fitted these processes are to the skills and life experiences of unrepresented, low-income EITC recipients. The account we provide in this section illustrates that the EITC’s use of tax administration—both through reliance on self-certification to make *ex ante* eligibility determinations and through reliance on audits and Tax Court to make *ex post* judgments of taxpayer compliance—imposes legal obstacles on low-income workers that merit the attention of the legal aid community.

A. History and Structure

The EITC was enacted in 1975 as a relatively modest wage-subsidy and payroll-tax offset for low-income workers, implemented largely to provide a degree of economic relief in the face of a significant recession.⁷ The credit was not initially viewed as a major piece of social policy. It was implemented as a temporary measure and renewed

⁶ See *infra* Part IV.A.

⁷ See Dennis J. Ventry, Jr., *The Collision of Tax and Welfare Politics: The Political History of the Earned Income Tax Credit*, in *MAKING WORK PAY: THE EARNED INCOME TAX CREDIT AND ITS IMPACT ON AMERICA’S FAMILIES* 15, 25 (Bruce D. Meyer & Douglas Holtz-Eakin, eds. 2001).

annually for several years in the mid-1970s before policymakers began to recognize its potential as a long-term fixture on the American social policy landscape.⁸ The credit had a number of features that made it politically and ideologically attractive to policymakers in an era when the orthodoxies of the welfare state were increasingly questioned by commentators such as NYU professor of politics and public policy Lawrence Mead.⁹ Most notable is the fact that, unlike the cash disbursements of traditional welfare, the EITC could be framed as tax relief that provided work incentives to families.¹⁰ That is, the EITC was successful in large part because politicians viewed it as “a work-oriented alternative to existing welfare programs.”¹¹

The welfare reform movement that began in the late 1970s fundamentally transformed expectations of the EITC. As Dennis Ventry explains: “the EITC would emerge from the welfare reform discussions at the end of the 1970s forever transformed. It would no longer constitute simply a modest work subsidy; rather it would represent an antipoverty device that could potentially raise the income of all working Americans above the poverty line.”¹² The EITC gained increasing political salience, benefiting from a major expansion in 1986.¹³ In 1996, when the Personal Responsibility and Work Reconciliation Act replaced the Aid to Families with Dependent Children (“AFDC”) with short-term state-administered welfare under the TANF program, the EITC took on an increasingly prominent role, emerging as the largest anti-poverty program in the United States.¹⁴

Since 1994, federal spending on the EITC has been consistently higher than spending on traditional federal welfare programs such as AFDC and its successor, TANF. By fiscal year 2009, EITC benefits paid out to low income tax filers accounted for over \$60 billion in federal spending, compared to under \$25 billion in federal spending on TANF.¹⁵ To illustrate the long-term magnitude of this shift, EITC disbursements in 1980 were approximately \$5 billion, whereas AFDC outlays were approximately \$18 billion. However, the winding path by which the EITC emerged as a major social welfare program has possibly obscured the program’s true significance from poverty lawyers. These lawyers have historically viewed welfare litigation as a significant aspect of their mission, but they have not widely adjusted their focus in recognition of the fact that a significant proportion of this nation’s welfare system is now administered through the tax code. And this failure to acknowledge the importance of the tax code to low-income workers is a mistake: as the following sub-sections illustrate, the EITC requires millions

⁸ *Id.* at 25-26.

⁹ See LAWRENCE M. MEAD, *THE NEW POLITICS OF POVERTY: THE NONWORKING POOR IN AMERICA* (1993) (criticizing American welfare state as giving rise to undeserving class of nonworking poor); LAWRENCE M. MEAD, *BEYOND ENTITLEMENT: THE SOCIAL OBLIGATIONS OF CITIZENSHIP* (1985) (arguing that welfare benefits should be conditioned on willingness to work). See generally BRENDON O’CONNOR, *A POLITICAL HISTORY OF THE AMERICAN WELFARE SYSTEM* 93-238 (2004) (describing conservative attacks on the liberal welfare state and the emergence of a “conservative” welfare system).

¹⁰ See Ventry, *supra* note 7, at 26 (discussing 1979 Joint Committee on Taxation report on the EITC).

¹¹ Dennis J. Ventry Jr., *Welfare by Any Other Name: Tax Transfers and the EITC*, 56 AM. U. L. REV. 1261, 1266 (2007).

¹² Ventry, *supra* note 7, at 26.

¹³ See *id.* at 32-34.

¹⁴ *Id.* at 34.

¹⁵ Urban Inst. & Brookings Inst., *Tax Facts*, TAX POLICY CENTER, <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=266> (last visited July 12, 2011).

of low-income Americans to engage the tax system each year, imposing significant burdens on them in the form of a daunting application process and an often-punitive, exceedingly complex auditing regime.

The challenges of applying for the EITC are a product of the fact that the credit is processed through the federal income tax system.¹⁶ Because the EITC operates as a refundable tax credit, in order to claim it, taxpayers file annual tax returns (even if they have no tax liability) and, in the process, use the credit to reduce their liability below zero.¹⁷ The amount that is claimed below zero is then paid to the taxpayer in the form of a tax refund.¹⁸ In this system, potential beneficiaries are responsible for both initially declaring their eligibility for the benefit and determining the size of the benefit to which they are entitled. Taxpayers claiming refundable tax credits, like the EITC, typically have their returns subjected to routine, mechanical scrutiny for mathematical error. The EITC's reliance on applicant *self-certification* is arguably the program's defining administrative feature, and is in stark contrast to the *universal pre-certification* regimes employed by traditional welfare programs.¹⁹

The EITC's method for calculating the refund claimed by an individual filer can be quite complex.²⁰ In general, the potential size of the EITC that can be claimed by an individual filer varies based on the taxpayer's income and the number of "qualifying children" that a claimant has.²¹ Specifically, the credit is calculated by multiplying the filer's earned income by a credit percentage tied to "qualifying children" who are claimed as dependents by the filer.²² The credit then eventually flattens and phases out after certain earning thresholds have been reached.²³ These general requirements are subject to exceptions and qualifications based on the nature of the income, the relationship with the children claimed, and the claimant's marital and employment statuses.²⁴

B. Self-Certification: Costs and Benefits

In this subpart we address both the advantages and disadvantages of employing the tax code to administer the EITC. There are four benefits that EITC advocates often claim as a result of this administrative form: first, high participation rates among eligible

¹⁶ See Alstott, *supra* note 3, at 535 (noting that "because the EITC is a *tax-based* transfer program, it faces significant institutional constraints that are not present in traditional welfare programs.") (emphasis added).

¹⁷ See Lily L. Batchelder et al., *Reforming Tax Incentives Into Uniform Refundable Tax Credits*, in POLICY BRIEF 3-4 (Brookings Inst., Ser. No. 156, Aug. 2006) (arguing that more than one-third of American households do not have income tax liability in any given year).

¹⁸ See *id.* (arguing that the optimal delivery mechanism for all socially valued incentives embedded in the tax code is the uniform refundable tax credit).

¹⁹ See Ventry, *supra* note 11, at 1274-75; Leslie Book, *Preventing the Hybrid from Backfiring: Delivery of Benefits to the Working Poor Through the Tax System*, 2006 WISC. L. REV. 1103, 1129 (noting that EITC recipients "are not made to go through the eligibility and verification gauntlet in the same manner as other benefits' recipients."); Lawrence Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867, 1869 (2005) (The EITC's self-certification "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.").

²⁰ See generally Book, *supra* note 4, at 361-63 (explaining that the tax credit is measured by multiplying the taxpayer's earned income up to a specific amount by a credit percentage).

²¹ See I.R.C. § 32(b) (2006) (prescribing method for calculation of EITC).

²² See Book, *supra* note 4, at 362.

²³ See I.R.C. § 32(b)(1)(A)-(B) (2006) (describing the phase-out formula).

²⁴ See Book, *supra* note 4, at 362.

individuals; second, reduced administrative costs; third, reduced stigma for program participants; and fourth, the political advantage of enshrining entitlement programs in the tax code, rather than in highly visible and politically controversial direct expenditures. However, these advantages are not unqualified, and the EITC entails significant disadvantages as well. As will be detailed below, these disadvantages involve significant burdens for the low-income workers who are expected to navigate the EITC's byzantine eligibility apparatus with a minimum of legal assistance.

First, the EITC boasts a higher participation rate than other social programs that provide support for low-income families.²⁵ One commentator has claimed that the EITC can boast participation rates as high as eighty-nine percent.²⁶ This is higher than comparable estimates for the Food Stamps Program, for instance, in which participation is currently estimated at seventy percent.²⁷ Scholars generally attribute this increased participation rate to the EITC's use of self-certification, which does away with time-consuming and potentially humiliating visits to welfare offices.²⁸ And, indeed, for many EITC proponents, the EITC's high levels of participation are among the program's most valuable features.²⁹ However, it should be noted that there is a lack of empirical work definitively connecting the EITC's pre-certification regime to its participation rate: it is possible, for instance, that the EITC enjoys high levels of participation because it targets low-income *workers*, who may be more likely to have the skills and initiative to apply for benefits than do those who are both destitute and unemployed.³⁰

Second, another putative advantage of self-certification is the EITC's relatively low administrative costs when compared to traditional welfare programs, which typically require that potential recipients be pre-certified prior to the disbursement of benefits.³¹ Pre-certification requires the programs' administering agencies to employ a large number of street-level intake workers in field offices around the country. Potential recipients typically must meet with these intake officials multiple times prior to certification, and then often have annual meetings for recertification.³² This stands in contrast with the self-certification process by which eligible individuals claim the EITC on their tax returns. The result is that the EITC is administered at a dramatically lower overall cost than traditional welfare programs. Scholars have estimated that the IRS is able to

²⁵ See, e.g., Jeffrey B. Liebman, *Who are the Ineligible EITC Recipients?*, 4 NAT. TAX J. 1165, 1183 n.34 (2000).

²⁶ Ventry, *supra* note 11, at 1265.

²⁷ See *id.*

²⁸ See, e.g., David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955, 1010 (2004) ("The EITC has a high participation rate but also a high overpayment rate. These facts are likely due to the lack of a precertification process.")

²⁹ See Zelenak, *supra* note 19, at 1915.

³⁰ However, TANF also includes work conditions, suggesting that the EITC's work condition alone cannot explain its high participation rates. See Noah D. Zatz, *What Welfare Requires from Work*, 54 UCLA L. REV. 373, 376 (2006) (describing TANF's work requirements).

³¹ See Alstott, *supra* note 3, at 534 (noting that advocates have argued that "because the EITC is part of the federal tax system, it is simpler and cheaper to administer than programs run by the welfare bureaucracy . . .").

³² See Janet Holtzblatt, *Choosing Between Refundable Tax Credits and Spending Programs*, 93 PROC. ANN. CONF. ON TAX'N 116, 119 (2000) ("Almost all food stamp applicants must visit a state office in person during regular business hours to apply for benefits. Further, all claimants must complete a lengthy application . . . and provide extensive documentation to support the claim. Over 40% of food stamp applicants make two or more trips to the state office to complete the initial application process.")

administer the EITC at a total cost that is 1-2% of benefits paid out.³³ This is substantially less than the rate for TANF, which is currently at ten percent of benefits paid, or the Food Stamps Program, which is estimated to devote roughly 20-25% of its budget to administration.³⁴

Third, the EITC's pre-certification regime may reduce the social stigma associated with traditional direct spending welfare programs, which require beneficiaries to engage in routine visits to welfare offices for face-to-face eligibility interviews.³⁵ However, there is a significant lack of empirical support for the proposition that the EITC is less stigmatizing than traditional welfare. Scholars have noted that tax-based welfare may also contain stigmatizing effects.³⁶ And recent outrage in conservative media circles about the fact that some taxpayers enjoy no (or negative) tax liability suggests that the tax system may be still susceptible to the stigmas associated with traditional welfare.³⁷

Finally, another claimed advantage of the EITC is that tax expenditures travel a different path through Congress than do direct outlays. Because the amount of federal dollars spent annually on the EITC depends on the amount of benefits claimed by filers, the program does not require large outlays in the appropriations process through Congress. Moreover, welfare benefits administered through the tax system are less visible and thus less politically controversial than are welfare benefits administered through traditional bureaucracies.³⁸

Unfortunately, there are also substantial costs to administering welfare through the tax system. The most prominent such cost is a massive non-compliance epidemic, as reliance on self-certification by applicants increases the potential for both deliberate fraud and inadvertent error. The IRS estimates that for tax year 2004, between \$9.6 billion and \$11.4 billion in erroneous EITC payments were made, approximately a quarter of the \$41.3 billion in EITC claims paid for that year.³⁹ A 2002 study of EITC payments in tax year 1999 found similarly high rates of noncompliance, estimating that the IRS made between \$8.5 billion and \$9.9 billion in erroneous payments (between twenty-seven percent and thirty-two percent of that year's total EITC payments).⁴⁰ The fact that as much as a third of the program's benefits are diverted to ineligible recipients suggests

³³ See, e.g., Zelenak, *supra* note 19, at 1884.

³⁴ *Id.* at 1881-1882.

³⁵ See Alstott, *supra* note 3, at 534 (noting that EITC advocates have argued that administering the program through the tax system "affords greater dignity and privacy to beneficiaries."); see also Nat'l Taxpayer Advocate, *Running Social Programs Through The Tax System*, 2 2009 ANN. REP. TO CONG. 75, 78, 87 (2009).

³⁶ See Weisbach & Nussim, *supra* note 28, at 1004 n.152 ("[S]tigma effects may arise under the tax system as well."); see also Timothy M. Smeeding et al., *The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility*, 53 NAT'L TAX J. 1187, 1189 (2000) ("There are several possible explanations . . . including . . . employees' unwillingness to inform the employer of EITC eligibility due to stigma effects . . .").

³⁷ See also, e.g., David Leonhardt, *Yes, 47% of Households Owe No Taxes. Look Closer*. N.Y. TIMES, Apr. 13, 2010, at B1 (describing how lack of tax liability of low-income Americans has "become a popular talking point on cable television and talk radio.").

³⁸ See Jacob S. Hacker, *THE DIVIDED WELFARE STATE* 42-44 (2002) (arguing that "private social benefits" administered through the tax code "are often characterized by both low visibility and low traceability.").

³⁹ Memorandum from Michael R. Phillips, Deputy Inspector Gen. for Audit, Dep't of the Treas., to Nancy A. Nakamura, Comm'r, Wage and Inv. Div., Internal Revenue Serv. 1 (Dec. 31, 2008).

⁴⁰ INTERNAL REVENUE SERV., DEP'T OF THE TREAS., *COMPLIANCE ESTIMATES FOR EARNED INCOME TAX CREDIT CLAIMED ON 1999 RETURNS* 3 (2002).

that claims regarding the program's relatively low administrative costs should be met with skepticism.

A related cost involves the imposition of a filing requirement on millions of taxpayers who would otherwise not be obligated to file a tax return. It is estimated that forty-seven percent of individual taxpayers do not have an obligation to file returns because they have either a zero or negative tax liability for the year.⁴¹ Also, many of the individuals who are forced to file tax returns to claim the benefits of the EITC lack the sophistication of wealthier taxpayers, and as a result, completing the return imposes a burden upon them.⁴² This burden is especially acute given the EITC's complex eligibility requirements, which may exceed the capabilities of many low-income workers. In 1997, the American Institute of Certified Public Accountants ("AICPA") described the credit's eligibility criteria as "nightmare of eligibility tests, requiring a maze of worksheets."⁴³ The Institute noted that application for the credit requires a claimant to consider:

nine eligibility requirements; the number of qualifying children—taking into account relationship, residency and age tests, the taxpayer's earned income—taxable and non-taxable; the taxpayer's adjusted gross income ("AGI"); the taxpayer's modified AGI; threshold amounts; phase out rates; and varying credit rates.⁴⁴

AICPA's statement concluded that:

While Congress and the IRS may expect that the AICPA and its members can comprehend the many pages of instructions and worksheets, it is unreasonable to expect those individuals entitled to the credit (who will almost certainly NOT be expert in tax matters) to deal with this complexity. Even our members, who tend to calculate the credit for taxpayers as part of their volunteer work, find this area to be extremely challenging. In fact, we have found that the EITC process can be a lot more demanding than completing the Schedule A – Itemized Deductions, which many of our members complete on a regular basis for their clients.

That taxpayer confusion over these eligibility criteria is a widespread phenomenon, as illustrated by the fact that, in 1999, about \$2.1 billion in erroneous EITC claims were made by taxpayers who should have employed a filing status of "married filing separately," which renders a taxpayer automatically ineligible for the credit.⁴⁵ The fact that such a large number of EITC claimants select a filing status that renders them automatically ineligible for the credit suggests widespread difficulty in navigating the credit's complex eligibility criteria, and further indicates that the above-discussed non-compliance epidemic is attributable, at least in part, to taxpayer confusion rather than deliberate fraud.

⁴¹ Roberton Williams, *Who Pays No Income Tax?*, 123 TAX NOTES 1583 (2009).

⁴² See Yin et al., *supra* note 4, at 263-64.

⁴³ American Institute of Certified Public Accountants, *Tax Simplification Recommendations*, 97 TNI 95-21 (1997).

⁴⁴ *Id.*

⁴⁵ See INTERNAL REVENUE SERV., *supra* note 40, app. at C-2.

Given these complexities, it is not surprising that many EITC claimants choose to have their returns prepared professionally.⁴⁶ In tax year 2003, seventy-one percent of all EITC returns were prepared by a third party, and a higher proportion of EITC filers use paid preparers than do middle- and upper-income taxpayers.⁴⁷ However, the fact that EITC filers rely so heavily on external preparation appears to expose them to incompetent or unscrupulous agents who, aware that the EITC can often result in a sizeable payout, promise large refunds as an incentive to use their services, and often issue predatory refund anticipation loans (“RALs”) to EITC claimants.⁴⁸ In low-income communities, for instance, return preparation services have arisen to facilitate EITC claimants’ purchases at various retail outlets and car dealers.⁴⁹ Such services have obvious incentives to deem any given taxpayer eligible for EITC, and, not surprisingly, paid preparers are associated with a troublingly high rate of erroneous EITC claims: so-called “brokered non-compliance.”⁵⁰ Moreover, these preparers are often fly-by-night in nature and, as such, are often no longer in business when their mistakes are discovered by IRS auditors.⁵¹ Taking a long-overdue step, the IRS published a rule in September 2010 that requires paid preparers to register and comply with a set of competency standards.⁵² It will be critical for the IRS to follow through with vigorous and uniform enforcement of this rule.

Currently, too few EITC claimants are taking advantage of the IRS’s Volunteer Income Tax Assistance (“VITA”) program, which consists of trained community volunteers who offer free tax help to low- and middle-income individuals—typically, those making under \$50,000 per year.⁵³ Even though the VITA staff members are not tax professionals, several features of the program still make it a superior option to paid preparation for most EITC claimants. First, VITA staff must undergo a rigorous training program and pass qualifying examinations in order to prepare returns for various individuals. For example, passing a basic exam allows a volunteer to prepare most individual and family returns, but passing a more advanced exam is required to prepare more complicated returns, such as those involving higher education credits or self-employment. Second, there is a dual-layer review process in VITA preparations, in which the initial preparer’s work is always checked by a more experienced volunteer before the return is filed. Finally, and most importantly, VITA is free, allowing the EITC

⁴⁶ See Stephen D. Holt, *Keeping it in Context: Earned Income Tax Credit Compliance and Treatment of the Working Poor*, 6 CONN. PUB. INT. L.J. 183, 199-200 (2007). Separately, and beyond the scope of this article, EITC claimants’ need for tax preparation may well pose a normative concern insofar as they are effectively paying a fee for their welfare entitlements.

⁴⁷ See *id.* at 199.

⁴⁸ See Janet Spragens & Nina Olson, *Tax Clinics: The New Face of Legal Services*, 88 TAX NOTES 1525, 1526 (2000); see also Holt, *supra* note 46, at 200.

⁴⁹ See Holt, *supra* note 46, at 201.

⁵⁰ See Danshera Cords, *Paid Tax Preparers, Used Car Dealers, Refund Anticipation Loans and the Earned Income Tax Credit: The Need to Regulate Tax Return Preparers and Provide More Free Alternatives*, 59 CASE W. RES. L. REV. 351, 368 (2009) (defining “brokered noncompliance” as “noncompliance facilitated by a paid preparer” and speculating that “[b]rokered noncompliance may be particularly serious among EITC recipients . . .”).

⁵¹ See Spragens & Olson, *supra* note 48, at 1526.

⁵² Furnishing Identifying Number of Tax Return Preparer, 75 Fed. Reg. 60309 (Sept. 30, 2010) (amending 26 C.F.R. Parts 1 and 602).

⁵³ *Free Tax Preparation for You by Volunteers*, INTERNAL REVENUE SERV., <http://www.irs.gov/individuals/article/0,,id=107626,00.html> (last visited Feb. 3, 2012).

claimants to keep more of their entitlement benefits. Paid preparation, by comparison, can cost EITC claimants hundreds of dollars.⁵⁴

For the purposes of this article, though, perhaps the most important drawback of the EITC's tax administration derives from the fact that when EITC claimants—who are responsible for certifying their own eligibility—erroneously claim to be eligible, they are required to engage the IRS's complex “deficiency process” encompassing correspondence audits, the IRS Office of Appeals, and United States Tax Courts.⁵⁵ Taxpayers who are unsuccessful in vindicating their claims through this daunting process are required to repay the benefit they have received, with interest, and often with penalties as well.⁵⁶ This susceptibility to legal penalties or loss of benefits, which will be discussed in the following section, is especially concerning in light of inadequate legal representation for EITC claimants. In sum, administering this anti-poverty regime through the tax system, despite its lower cost to the government, can come at significant personal expense to claimants, who are more susceptible to erroneous deprivation of their entitlements when compared to participants in other welfare programs.⁵⁷

C. A Legal Labyrinth: Navigating the EITC Audit and Appeal Processes

Here we chronicle the unique dilemmas that confront low-income workers who become enmeshed in the IRS's enforcement process. Such workers face a cumbersome and often harsh bureaucracy, which they are forced to navigate, usually without assistance. Failure to convince the IRS of the correctness of a tax return can result in the taxpayer's being compelled to repay the EITC benefit, with interest and penalties.⁵⁸

Two points are crucial in considering the audit and appeals process described below. First, as low-income workers, EITC claimants audited by the IRS are often not equipped—in terms of education, resources, or expertise—to demonstrate their compliance with the EITC's complex criteria. Second, the phenomenon described below, in which an EITC claimant is compelled to engage the IRS's audit and appeals process, is not a rarity. Indeed, the IRS has instituted a number of initiatives under which EITC claimants are *more likely* to be audited than middle- and upper-income taxpayers. Following a political firestorm over compliance in the mid-1990s, the proportion of IRS audits targeting EITC claimants began a dramatic increase.⁵⁹ By 2004, an EITC household was 1.76 times more likely to be audited than a household with an annual salary over \$100,000, and in 2005 a full forty-three percent of IRS audits of individual taxpayers involved an EITC claim.⁶⁰

⁵⁴ By way of example, the Cedar Rapids, Iowa VITA site reports that local commercial tax preparers charge an average of \$175 per return and an additional \$125 per hour for preparation. *Volunteer Income Tax Assistance*, CENTRAL CEDAR RAPIDS WEED AND SEED, <http://www.crweedandseed.com/Current%20Programs/VITA/VITA.html> (last visited Aug. 30, 2011).

⁵⁵ See I.R.C. §§ 6211-6216 (2006).

⁵⁶ See generally Bryan T. Camp, *The Failure of Adversarial Process in the Administrative State*, 84 IND. L.J. 57, 105 (2009) (citing the National Taxpayer Advocate finding that accumulation of interest and penalties often equal or exceed the original amount in dispute).

⁵⁷ See Book, *supra* note 4, at 352 (“The EITC is excessively complicated in its application and can have significant and sometimes unforeseen consequences on the lives of those who are the provision's beneficiaries, largely the working poor, of whom great numbers are racial minorities and women.”).

⁵⁸ See *supra* note 56.

⁵⁹ See Janet Holtzblatt & Janet McCubbin, *Issues Affecting Low-Income Filers*, in THE CRISIS IN TAX ADMINISTRATION 148, 159 (Henry J. Aaron & Joel Slemrod, eds., 2004).

⁶⁰ See *id.* (“[W]hile audit rates have generally fallen, the odds of being audited have increased for low-income filers relative to other filers. In 1988 the audit rate among 1040A nonbusiness filers with

In this section, we first discuss the high error rate associated with EITC claims. We then examine the correspondence audits and Tax Court adjudication to which EITC claimants are subjected when suspected of error. Finally, we examine the importance of representation during the audit process, as well as the inadequacy of current programs, such as the Low-Income Tax Clinic program that provides representation to low-income taxpayers.

1. *High Error and Audit Rate*

In the previous section's discussion of EITC noncompliance, we detailed the high error rate of EITC claims and the erroneous payments that result. Politicians have occasionally invoked these error rates as evidence that the EITC is broken and rife with fraud.⁶¹ In 1995, for instance, Senator William Roth proposed legislation to reduce the EITC, claiming that it was "probably the most abused program on the books."⁶² Accordingly, Congress's efforts to deter and detect taxpayer abuse have focused disproportionately on EITC recipients, notwithstanding the relatively low amount per EITC controversy.⁶³ Even though other methods for tax evasion—including corporate tax shelters, failure to pay corporate income taxes, and the misuse of pass-through entities to hide income—result in far more tax evasion than the EITC in absolute dollar terms, tax compliance efforts have centered so predominantly on low-income earners that by 2003 a taxpayer earning less than \$25,000 was more likely to be audited than a taxpayer earning more than \$100,000.⁶⁴ EITC claimants comprise over one-third of all individual IRS audits and are audited at triple the rate (2.1% in fiscal year 2008) of non-EITC taxpayers.⁶⁵

Congress has authorized substantial funding—approximately \$150 million annually—for auditing EITC compliance in recent years, and has enacted numerous enforcement measures specifically for the EITC as well.⁶⁶ If an EITC claim is found to be deliberately erroneous, the IRS can block subsequent EITC claims for ten years, and even if negligence (rather than outright fraud) is the underlying reason, claims can nonetheless be blocked for two years.⁶⁷ Furthermore, Congress has tightened the number of eligible children who can be claimed as qualifying dependents under the EITC, and has imposed particularized due diligence standards on EITC preparers.⁶⁸

2. *IRS Audit Process*

The high prevalence of error in the EITC and the heightened enforcement efforts that have resulted raise concerns as to the processes that the IRS uses to detect and adjudicate cases of suspected error. Unfortunately, the IRS's elaborate audit process does

positive income below \$25,000 was 1.03%, while the average audit rate among all filers was 1.57%. By 2000 the audit rate was 0.49% for all taxpayers, but it was 0.6% among 1040A nonbusiness filers with income under \$25,000 and 1.4% among EITC claimants." (footnote omitted); Holt, *supra* note 46, at 190-91.

⁶¹ See Book, *supra* note 19, at 1105-07.

⁶² Dana Milbank, *Republican Senator and Two of His Constituents Illustrate Debate on Tax Break for Working Poor*, WALL ST. J., Aug. 16, 1995, at A12.

⁶³ See Leslie Book, *The Poor and Tax Compliance: One Size Does Not Fit All*, 51 KAN. L. REV. 1145, 1152 (2003).

⁶⁴ *Id.* at 1158.

⁶⁵ Nat'l Taxpayer Advocate, *Beyond EITC: The Needs of Low Income Taxpayers Are Not Being Adequately Met*, 1 2009 ANN. REP. TO CONG. 110, 114 n.27 (2009).

⁶⁶ See Book, *supra* note 4, at 418.

⁶⁷ See Holt, *supra* note 46, at 194.

⁶⁸ See Book, *supra* note 63, at 1146.

not appear particularly well-suited to detect instances of noncompliance. In 2007, when IRS auditors denied the EITC and claimants requested reconsideration, forty-three percent of claimants ultimately received the EITC at an average amount of ninety-six percent of what they claimed on their original returns.⁶⁹ These statistics—which suggest that the IRS’s initial auditing process is only slightly more accurate than a coin toss—not only reveal serious structural flaws in IRS auditing, but also, as we will argue in the next section, underscore the need for effective representation for EITC claimants who face potential denial of benefits. As the National Taxpayer Advocate has argued, “[g]iven the significant barriers encountered by EIC taxpayers during the audit process, one must consider whether many audited taxpayers are truly ineligible for EI[T]C, or whether they were just unable to successfully navigate the IRS audit process.”⁷⁰

After an EITC claimant is targeted for an IRS audit, the information-gathering process is generally conducted on a “correspondence” basis through the mail, rather than in a “field,” face-to-face format.⁷¹ While correspondence audits are likely less intimidating to claimants than field audits, they pose significant disadvantages in terms of the ultimate outcomes—especially with respect to accuracy and fairness—of EITC determinations.⁷² For several important reasons, a mail-based audit system is ill suited for low-income taxpayers.

First, EITC claimants are much more likely than other taxpayers to be transient or homeless.⁷³ This creates multiple problems for correspondence audits.⁷⁴ Because they change domiciles frequently (and often do not provide forwarding information to the post office or the IRS), transient or homeless EITC claimants are simply less likely than other taxpayers to receive the items that IRS auditors mail to them.⁷⁵ Many of the working poor also spend intermittent periods of time in cars, motels, friends’ or relatives’ houses, or temporary shelters, making it very difficult for the IRS to conduct an effective correspondence audit of their tax returns.⁷⁶ Considering that such audits can last for months, a claimant’s transience can easily disrupt an audit that is already underway, particularly insofar as multiple addresses complicate the document-gathering process.⁷⁷ For instance, the process for proving a qualifying child’s residency—which is the most common EITC error—requires a number of forms, such as school and medical records, which must have fully consistent data or a satisfactory and detailed explanation of any inconsistencies for the IRS to grant approval.⁷⁸

On a related point, the abstruse classifications used in the EITC compound the difficulties that claimants face when responding to document requests. The National Taxpayer Advocate has consistently found that the EITC eligibility rules, especially those

⁶⁹ See Nat’l Taxpayer Advocate, *The IRS Correspondence Examination Process Does Not Maximize Voluntary Compliance*, 1 2009 ANN. REP. TO CONG. 158, 160 (2009).

⁷⁰ Nat’l Taxpayer Advocate, *IRS Earned Income Credit Audits—A Challenge to Taxpayers*, 2 2007 ANN. REP. TO CONG. 94, 108 (2007).

⁷¹ See Holt, *supra* note 46, at 191 (noting that “[m]ost EITC reviews are correspondence audits . . .”).

⁷² See *id.*

⁷³ See Book, *supra* note 4, at 393.

⁷⁴ See *id.* at 395.

⁷⁵ *Id.*

⁷⁶ See *id.* at 394-95.

⁷⁷ *Id.* at 395.

⁷⁸ *Id.*

for reporting family status for purposes of the EITC, are difficult for claimants to interpret correctly.⁷⁹ Again, the qualifying child issue illustrates this complexity: a taxpayer's child can be qualifying under the dependency exemption but not for the EITC, or vice versa. The lack of a uniform definition of qualifying child confuses claimants unfamiliar with the tax system, who often understandably assume that there is no reason why their children would somehow not be "qualifying" if they, as parents, could qualify themselves.⁸⁰

Beyond the substantive complexity of EITC rules and required documents, EITC claimants are often unsure which documents the IRS actually wants. One National Taxpayer Advocate study found, for instance, that roughly half of taxpayers subject to a correspondence audit contacted the IRS by phone or in person to clarify what forms they needed to send in.⁸¹ Additionally, more than half of audited EITC claimants reported difficulties in obtaining the requested documents, and nearly half of the same group did not understand why the documents were requested in the first place.⁸² Furthermore, the National Taxpayer Advocate's research shows that low-income taxpayers not only have inadequate access to computers, but also below-average computer literacy, thus complicating their ability to use the IRS's website (on which the agency relies heavily to convey information to taxpayers) as an additional means for answering questions about their obligations with respect to a correspondence audit.⁸³

EITC claimants are also far more likely than the average taxpayer to have English literacy problems, whether as a result of educational disadvantages or from speaking English as a second language.⁸⁴ Although there are no studies explicitly associating low literacy with poor EITC correspondence response rates, one could reasonably draw from the results of a 1990 Census report—which demonstrated that an individual's literacy skills were linked to the accuracy of Census returns—in surmising that a similar effect likely applies to the EITC.⁸⁵ These taxpayers face obvious difficulties in responding to an IRS correspondence audit. For instance, they often lack the ability to understand what documents are required to satisfy certain gaps in their tax filing.⁸⁶

Given that mail-based audits rely on a claimant's willingness to respond (and to clarify points of misunderstanding before doing so), they are particularly ineffective in cases where taxpayers are fearful of government interaction.⁸⁷ This problem is prevalent in cases involving recent immigrants, who are often concerned that by challenging the government over a tax controversy, they will entangle themselves in an immigration-related matter as well.⁸⁸ And even if these claimants were to contact the IRS in person or via telephone to clarify an audit question, the IRS has no budget for translators, creating another barrier to fair and effective audit resolution.⁸⁹

⁷⁹ See, e.g., Nat'l Taxpayer Advocate, *supra* note 65, at 114.

⁸⁰ See Book, *supra* note 4, at 399.

⁸¹ Nat'l Taxpayer Advocate, *supra* note 69, at 160.

⁸² Nat'l Taxpayer Advocate, *supra* note 70, at 95.

⁸³ See Nat'l Taxpayer Advocate, *supra* note 65, at 130.

⁸⁴ Book, *supra* note 4, at 394.

⁸⁵ See *id.* at 397.

⁸⁶ *Id.*

⁸⁷ See Spragens & Olson, *supra* note 48, at 1526.

⁸⁸ *Id.*

⁸⁹ *Id.*

Finally, there is a marked disparity in the burdens that an IRS audit imposes on low-income taxpayers when compared to their middle or upper-income counterparts. While the latter can often delegate the task to a lawyer or accountant, and are bothered only with respect to the costs associated with that assistance and any additional tax liability (likely to be a small percentage of their financial resources), low-income taxpayers must typically deal with the IRS on their own time and without professional expertise.⁹⁰ These burdens can be considerable. In 2007, for instance, more than half of EITC-audited taxpayers who reported submitting all of the IRS's originally requested documentation also received a request for additional documentation.⁹¹ Likewise, more than half of audited claimants reported that the IRS either took over a month to acknowledge receipt of their documentation or provided no acknowledgment at all. In her inaugural testimony to Congress in 2001 as the National Taxpayer Advocate, Nina Olson remarked that if the IRS "subjected middle class and more affluent taxpayers to the kind of intrusive inquiries we routinely subject a taxpayer to in an EI[T]C audit, the entire EI[T]C audit program would be shut down in response to taxpayer complaints."⁹²

No less problematic than the IRS's audit process is the use of U.S. Tax Court to resolve cases in which an EITC claimant fails an audit. EITC claimants have their disputes referred to Tax Court as a result of the culmination of the IRS's "deficiency procedure."⁹³ If, after auditing, the IRS determines that tax filers' true tax liability exceeds their self-reported tax liability, they are deemed to be "deficient." The IRS can then choose to then send the taxpayer a "Notice of Deficiency."⁹⁴ After receiving the notice, taxpayers who desire a formal hearing on their claim have ninety days to seek a hearing before a U.S. Tax Court.⁹⁵

The procedure that is followed in Tax Courts closely resembles the procedures used in federal district court bench trials.⁹⁶ Cases are tried before Special Trial Judges, using rules of procedure similar to the Federal Rules of Civil Procedure, and attorneys from the Office of the IRS Counsel represent the government. If the amount in dispute is less than \$50,000 for a given tax year, as is typically the case with EITC claimants, tax filers are able to invoke the small case procedures that are provided for in the Tax Court's Rules of Practice and Procedure.⁹⁷ These proceedings, which are often referred to as "S" cases, are specifically designed to accommodate pro se representation. To facilitate that goal, there are several changes to normal procedure. Those include not requiring the taxpayer to file a reply brief and trials "conducted as informally as possible consistent with orderly procedure."⁹⁸ Despite the procedures that are afforded to EITC claimants in "S" cases, the process is still inherently adversarial. In these adversarial proceedings,

⁹⁰ See Book, *supra* note 4, at 392-93.

⁹¹ Nat'l Taxpayer Advocate, *supra* note 70, at 95.

⁹² See Book, *supra* note 4, at 424.

⁹³ See I.R.C. §§ 6211-6216 (2006).

⁹⁴ See I.R.C. § 6213 (West 2011).

⁹⁵ *Id.*

⁹⁶ See MICHAEL I. SALTZMAN, *IRS PRACTICE AND PROCEDURE*, 1.06[1] (Rev. 2d ed. 2002) (discussing the mechanics of designating a case to be treated as a small tax case).

⁹⁷ See DAVID M. RICHARDSON, JEROME BORISON & STEVE JOHNSON, *CIVIL TAX PROCEDURE* 222 (2d ed. 2008).

⁹⁸ U.S. TAX CT. R. 174(b); see also U.S. TAX CT. R. 173(c) (noting that a reply is necessary only if the Court orders a reply), 174(c) (noting that neither briefs nor oral arguments are required unless by Court order).

there is strong burden of proof placed on the defendant and they are expected to zealously represent themselves.⁹⁹

While the “S Case” procedure is likely to ameliorate certain difficulties that low-income litigants face in a formal adversarial setting, there is still a fundamental incongruity between the Tax Court’s use of adversarial process and the EITC’s predominantly low-income, pro se clientele. As Barbara Bezdek noted in commenting on similarly informal adversarial processes used in Baltimore rent courts, “the rule-oriented court talk expected and privileged by judges in low-level courts bears little or no relation to people’s natural narratives. The rules of courtroom discourse are seldom explained to those witnesses expected to conform to them.”¹⁰⁰ Lucie White similarly notes that civil litigation “evoke[s] feelings of terror for many poor people,”¹⁰¹ who:

perceive litigation as an alien or even hostile cultural setting. The talk and ritual of litigation constitute a discourse and a culture that are foreign to most poor people. Poor people obviously do not speak in the same dialect that lawyers, judges, and elite businesspeople use. Furthermore, their courtroom speech is routinely interrupted by lawyers and judges who use threatening tones in ordering them when not to talk and what not to say. Their stories are interpreted by black-robed authorities on the basis of rules that are rarely explained and norms that they seldom share.¹⁰²

This dynamic is evident in reported Tax Court cases adjudicating EITC compliance, as when a Tax Court judge criticized a taxpayer who appeared to have difficulty speaking English with “vague and inconsistent assertions,”¹⁰³ or when a judge summarily dismissed the testimony of an EITC claimant’s low-income witnesses as conclusory, vague, and biased by the taxpayer’s interests.¹⁰⁴ In short, just as it is troubling to expect low-income taxpayers to navigate the complexities of the Internal Revenue Code without assistance, it is likewise troubling to subject them to correspondence-based audits and adversarial adjudication when they are suspected of noncompliance.

3. *Importance of Representation*

In general, legal services organizations have not assisted EITC claimants in navigating the legal complexities of an IRS audit—or, for that matter, in handling any subsequent proceeding or adjudication.¹⁰⁵ This is partly because the importance of tax law pertaining to low-income taxpayers is a relatively recent development, driven predominantly by the rapid growth of the EITC over the past few decades. Before the EITC, poor people had little to no interaction with the tax system, so there was no reason for legal services and pro bono lawyers to offer tax-related advocacy. But now, as the EITC has developed into the country’s largest vehicle for delivering welfare benefits, it

⁹⁹ See Camp, *supra* note 5, at 89.

¹⁰⁰ See Barbara Bezdek, *Silence in the Court: Participation and Subordination of Poor Tenants’ Voices in Legal Process*, 20 HOFSTRA L. REV. 533, 588 (1992).

¹⁰¹ Lucie E. White, *Mobilization on the Margins of the Lawsuit: Making Space for Clients to Speak*, 16 N.Y.U. REV. L. & SOC. CHANGE 535, 543 (1987).

¹⁰² *Id.* at 542-43 (footnotes omitted).

¹⁰³ See Diaz v. Comm’r, 87 T.C.M. (CCH) 1420 (2004).

¹⁰⁴ See Baker v. Comm’r, 91 T.C.M. (CCH) 949 (2006).

¹⁰⁵ See Spragens & Olson, *supra* note 48, at 1525.

has radically reshaped the legal challenges confronting poor Americans and created a need for tax representation for low-income taxpayers.

This need has been hard to meet for several reasons. First, tax law is widely perceived as a complex, isolated discipline that demands considerable specialization.¹⁰⁶ Given the resource constraints on many legal services organizations, it may be difficult to hire personnel with such expertise (or even to justify doing so, given that the salary could go toward a generalist who could handle a broader range of client matters).¹⁰⁷ Also, the tax bar—which practices in a realm traditionally viewed as “rich people’s law”—has generally not emphasized low-income issues or focused on pro bono services in a systematic way.¹⁰⁸

Largely because the EITC’s complexity makes it so difficult for claimants to manage the audit process themselves, the availability and quality of representation are often crucial factors in determining the outcome of an audit. In 2004, low-income taxpayers with representation were twice as likely as their non-represented counterparts to emerge from an IRS audit with no change in their claimed EITC, at rates of 41.5% and 23.1%, respectively.¹⁰⁹ Those with representation, moreover, retained 44.8% of the EITC on average, as opposed to only 25.3% for unrepresented taxpayers.¹¹⁰ The type of representation also matters. For instance in 2004, claimants represented by an attorney or CPA retained their EITC amount in full 45.8% of the time, while being disallowed their entire amount at a rate of 48.5%.¹¹¹ This stands in contrast to claimants represented by actuaries, law and accounting students, family members, and employees of the claimant’s organization, who retained their full EITC entitlement in just 35.4% of cases and lost the entire benefit 59.1% of the time.¹¹²

While these statistics show, perhaps unsurprisingly, that advocates with more relevant and advanced training have more success in representing EITC claimants, the more important question at present is whether EITC claimants are at least receiving *some* sort of representation. This is because the vast majority of claimants (98.2%) still do not have any representation during an IRS audit, and, as noted above, the outcome differential is much greater between represented and non-represented taxpayers than it is among types of represented taxpayers.¹¹³ Additionally, the largely all-or-nothing nature of an EITC audit heightens the stakes of having representation: only around five percent

¹⁰⁶ See Book, *supra* note 4, at 412 (“lawyers tend to view tax law as an isolated discipline, requiring great specialization due to the area’s complexity, both substantively and procedurally.”). See generally Paul L. Caron, *Tax Myopia, or Mamas Don’t Let Your Babies Grow Up to Be Tax Lawyers*, 13 VA. TAX. REV. 517 (1994) (discussing the popular misconceptions of tax law and tax attorneys).

¹⁰⁷ See, e.g., Algodones Associates, *The American Bar Association Legal Needs Study*, http://www.algodonesassociates.com/legal_services/assessing_needs/abalegal.htm (last modified Oct. 9, 1998) (documenting the many legal needs facing America’s poor without mentioning tax issues either as a concern or a priority).

¹⁰⁸ See Book, *supra* note 4, at 412 (noting that the tax bar has not been broadly involved in providing pro bono services); see also Spragens & Olson, *supra* note 48, at 1529.

¹⁰⁹ Nat’l Taxpayer Advocate, *EITC Examinations and the Impact of Taxpayer Representation*, 1 2007 ANN. REP. TO CONG. 222, 226 (2007).

¹¹⁰ *Id.*

¹¹¹ Nat’l Taxpayer Advocate, *supra* note 70, at 94, 110.

¹¹² *Id.*

¹¹³ *Id.* at 94 n.1, 97.

of cases result in a reduction of EITC benefits, as opposed to a total preservation or denial.¹¹⁴

Congress has taken some steps to fill the representation gap for EITC claimants. The IRS Restructuring and Reform Act (“RRA”) of 1998, in relevant part, established a \$6 million program within the IRS that provided matching grants up to \$100,000 to law and business school clinics and other 501(c)(3) organizations that provide free tax law assistance to low-income taxpayers.¹¹⁵ These groups, known as low-income taxpayer clinics (“LITCs”), can represent taxpayers in disputes with the IRS, provide outreach and education to taxpayers who speak English as a second language (“ESL”), or both.¹¹⁶ The IRS’s National Taxpayer Advocate office has administered the LITC program since 2003.¹¹⁷ Of the 162 LITCs operating in 2009, twenty clinics dealt with ESL issues only, while forty-five clinics focused on IRS controversies alone and ninety-seven clinics offered both services.¹¹⁸ In 2008, LITC-based advocates worked for 30,648 taxpayers on a total of 37,391 issues, opening 10,142 cases (of which 1,804 were submitted to the U.S. Tax Court).¹¹⁹ LITCs are the principal option for low-income taxpayers seeking representation during an IRS audit; in light of the above discussion of how important representation is in ensuring that audit outcomes are fair and accurate, LITCs clearly play an essential role in the EITC framework.

However, there are serious limitations on the efficacy of LITCs as currently structured and administered. Similar to legal services organizations more broadly, LITCs likewise suffer from a lack of financial resources in meeting demand for their assistance.¹²⁰ Compared with the amount of funding dedicated to compliance and enforcement of the EITC (roughly \$150 million annually), the roughly \$10 million annual outlay for LITCs is relatively small.¹²¹ Moreover, IRS employees who deal with EITC claimants cannot simply refer them to the nearest LITC for assistance, in light of government ethics rules prohibiting employees from recommending specific attorneys or accountants or from endorsing any “product, service, or enterprise.”¹²² The IRS deputy ethics official has interpreted these rules to mean that IRS employees can provide taxpayers with contact information for particular LITCs only if the taxpayer specifically asks, citing LITCs’ similarity to law firms insofar as they have a fiduciary responsibility to the taxpayer, provide legal advice, and represent taxpayers in court.¹²³ The National Taxpayer Advocate, Nina Olson, has disagreed with this assessment, arguing that LITCs’ congressional authorization, public-service orientation, and target population of low-

¹¹⁴ *Id.* at 108.

¹¹⁵ Spragens & Olson, *supra* note 48, at 1525.

¹¹⁶ Nat’l Taxpayer Advocate, *supra* note 65, at 117.

¹¹⁷ Nancy S. Abramowitz, *Thinking About Conflicting Gravitational Pulls: LITCs: The Academy and the IRS*, 56 AM. U.L. REV. 1127, 1129 (2007).

¹¹⁸ Nat’l Taxpayer Advocate, *supra* note 65, at 117.

¹¹⁹ *Id.*

¹²⁰ *See, e.g.*, Book, *supra* note 4, at 418.

¹²¹ *Low Income Taxpayer Clinic Grant Recipients Announced*, INTERNAL REVENUE SERV. (Apr. 21, 2009), <http://www.irs.gov/newsroom/article/0,,id=206743,00.html>.

¹²² *Hearing on the 2008 Tax Return Filing Season, IRS Operations, FY 2009 Budget Proposals, and The National Taxpayer Advocate’s 2007 Annual Report to Congress Before the Subcomm. On Oversight of the H. Comm. on Ways and Means*, 110th Cong. 29 (2008) (written statement of Nina E. Olson, Nat’l Taxpayer Advocate).

¹²³ *Id.*

income taxpayers distinguishes them sufficiently from law firms to warrant an exemption from referral restrictions.¹²⁴

III. IRS REFORMS TO PROTECT THE RIGHTS OF AMERICA'S WORKING POOR

In Part II of this article, we explored the development of the EITC into America's largest anti-poverty program and the shortcomings in the system that make it difficult for the working poor to both claim and protect the benefits that they are entitled to under the program. Essentially, the working poor are asked to certify their own eligibility for a welfare benefit without any assistance. If suspected of non-compliance, the working poor often must enter, without counsel, into a demanding adjudicative process with harsh, borderline-punitive consequences for recipients who fail to convince the IRS of their eligibility. Two potential avenues toward reform may alleviate these problems. The first has to do with the administration of the program itself. It is conceivable that the IRS could undertake administrative reforms aimed at rendering the process of *ex ante* EITC application and *ex post* EITC adjudication more humane. The second is ameliorative in nature and involves the legal services community. Assuming that the IRS does *not* undertake to comprehensively reform the mechanisms for certification, delivery, and audit of the EITC, Congress and the legal services community can recognize the centrality of the EITC for millions of low-income working families, and take steps to make legal aid for low-income taxpayers a greater priority. This part of the article addresses the former of these two options—IRS reforms aimed at rendering the EITC process more humane. In turn, in Part IV we will address the latter option and advocate specific steps that Congress and the legal services community can take in response to the recognition that the EITC is among the central pillars of American welfare policy.

Since a decision has been made to use the tax system to implement one of the nation's largest welfare programs, considerations of both efficient administration and fair treatment would seem to counsel that significant changes be made to the current structure of the IRS to make the benefit easier for potential EITC claimants to both initially claim and subsequently protect during audits and Tax Court proceedings. The case for such reforms is intuitive: even if one does not linger on the harsh consequences described in Part II of this article, there is simply no reason to believe that an IRS administrative apparatus that evolved to collect taxes from middle- and upper-income taxpayers would serve as a fair or efficient medium for administering a welfare program for low-income workers.

Accordingly, we will examine five areas where the IRS should implement changes to its structure, policies, and procedures to help ease the legal burdens that IRS processes and procedures place on EITC claimants. First, we will discuss the need to reexamine and reconsider the structure of the IRS. Second, we will explore the possibility of splitting the EITC into two distinct benefits. Third, we will analyze the possibility of reforming the EITC tax filing process, and the potential benefits of a "Ready File" system. Fourth, we will offer reforms to modify the auditing of EITC claimants. Fifth, we will present a proposal to employ less adversarial procedures for the Tax Court proceedings applied to EITC claimants that are deemed "deficient" following an audit. These reforms, if adopted either individually or in concert, would represent a substantial step toward helping to ease the burden that the EITC places on America's working poor.

¹²⁴ *Id.* at 33.

A. Evaluating and Reforming the Structure of the IRS

The decision to administer the EITC through the tax system has large implications for the overall mission of the Internal Revenue Service. In 2010, the Congressional Budget Office estimated that, between 2009 and 2013, the EITC will result in roughly \$250 billion in foregone revenue.¹²⁵ This means that administering social welfare programs will come to be a more significant part of the IRS mission, and changes should be made to the structure and nature of the IRS to reflect that reality.

Despite the fact that the IRS is now the agency charged with delivering America's largest welfare program, the IRS's core mission remains to collect revenue. Currently, the IRS collects ninety-six percent of all federal tax receipts.¹²⁶ Moreover, the IRS's primary institutional goal is addressing the "tax gap," which is the difference between the amount of taxes due and the amount of taxes actually collected.¹²⁷ This emphasis frustrates the goals of using the tax system for social policy in two ways. First, the most reliable current estimate of the magnitude of the annual gross underreporting gap comes from 2001, when it was calculated at \$345 billion.¹²⁸ Of this total, \$285 billion was from incorrect reporting on tax returns (as opposed to failure to file or pay).¹²⁹ The individual income underreporting gap was approximately \$197 billion of the \$285 billion total.¹³⁰ In contrast, the amount of incorrectly claimed credits, including the EITC, was only \$17 billion.¹³¹ This means that incorrectly claimed credits account for less than five percent of the total tax credits, which is a relatively minor fraction of the total.¹³² Second, the emphasis on closing the tax gap also motivates the IRS to attempt to crack down on non-compliance instead of promoting participation in programs. These two goals are often in conflict with each other, and the mission and culture of the IRS often leads to the collection and compliance activities of the IRS overshadowing the social policy objectives of programs such as the EITC.

As a result, the IRS should reevaluate its mission statement to acknowledge its dual roles of promoting tax compliance and delivering social programs. New Zealand is an illustrative example of how this can occur, as highlighted by the U.S. National Taxpayer Advocate.¹³³ In 2004, New Zealand passed a comprehensive social welfare program aimed at combining support to families with incentives to work that is administered through the country's tax system, Inland Revenue.¹³⁴ This reform "had three key objectives: making work pay, ensuring income adequacy, and supporting

¹²⁵ CONGRESSIONAL BUDGET OFFICE, PUB. NO. 4220, TRENDS IN FEDERAL TAX REVENUES AND RATES 12 (2010), available at http://www.cbo.gov/ftpdocs/119xx/doc11976/2010-12-02_IncomeTax_chartbook.pdf.

¹²⁶ See, e.g., INTERNAL REVENUE SERV., DEP'T OF THE TREAS., UPDATE ON REDUCING THE FEDERAL TAX GAP AND IMPROVING VOLUNTARY COMPLIANCE 2 (2009); Nat'l Taxpayer Advocate, *supra* note 35, at 92.

¹²⁷ See Nat'l Taxpayer Advocate, *supra* note 35, at 92.

¹²⁸ INTERNAL REVENUE SERV., *supra* note 126, at 4.

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.*

¹³² See Nat'l Taxpayer Advocate, *supra* note 35, at 82-83 (noting that "approximately 55 percent . . . of the individual underreporting gap . . . came from understated net business income, such as unreported receipts and overstated expenses for self-employed taxpayers . . . [compared to] only about nine percent . . . from overstated tax credits.").

¹³³ *Id.* at 87.

¹³⁴ See Taxation (Working for Families) Act 2004 (N.Z.), available at <http://www.legislation.govt.nz/act/public/2004/0052/latest/whole.html> (last visited Aug. 30, 2011).

people . . . into paid work.”¹³⁵ Since this changed the mission of Inland Revenue to create a greater emphasis on delivering benefits, instead of promoting compliance, a comprehensive “analytical redesign process” was undertaken.¹³⁶ This process helped to change the culture, structure, and emphasis of the agency to recognize the new dual mission. Although the reforms have only been in place a few years, initial econometric research has suggested that New Zealand’s reforms have resulted in increases in employment and hours worked due to the tax reforms.¹³⁷

In America, despite the fact that the EITC has existed since the mid-1970s and been a major part of our welfare system since mid-1990s, the IRS has yet to undergo a reform process that recognizes the importance of the social programs that Congress has chosen to deliver through the tax system.¹³⁸ Given the importance of the EITC to American welfare policy, this is a necessary step that should be considered to transform the IRS from an organization predominantly concerned with enforcement to an agency with the separate roles of revenue collection and social policy administration. Although these reforms may dramatically transform the IRS, the Federal Reserve can provide an example of an institution that has successfully adopted two theoretically conflicting missions.¹³⁹ Under the Federal Reserve Reform Act of 1977, it is the dual mission of the Federal Reserve to promote production and employment while curbing inflation.¹⁴⁰ Although the Federal Reserve’s dual role has come under attack recently by members of Congress who feel that the focus should be solely on keeping inflation low,¹⁴¹ these criticisms appear to highlight the fact that the Federal Reserve has internalized the importance of both parts of its mission.¹⁴²

¹³⁵ Joanne Hames, *Facilitating Fertility and Paid Work: Contemporary Family-Friendly Policy Initiatives and Their Social Impacts in Australasia*, 34 SOC. POL’Y J. N.Z. 25, 29 (2009).

¹³⁶ See Nat’l Taxpayer Advocate, *supra* note 35, at 87.

¹³⁷ John Fitzgerald, Tim Maloney, & Gail Pacheco, *The Impact of Recent Changes in Family Assistance on Partnering and Women’s Employment in New Zealand*, 42 N.Z. ECON. PAPERS 17, 48 (2008) (stating that their study “provide[s] some evidence of employment increases and more solid evidence of work hours increases for those working due to the Family Assistance policy change.”).

¹³⁸ See Nat’l Taxpayer Advocate, *supra* note 35, at 87. The National Taxpayer Advocate has also proposed changing the reporting structure of the IRS to adopt a more “programmatic approach.” *Id.* at 95. Although reforms of this nature might ultimately be necessary for the IRS to be able to successfully close the tax gap while still promoting legal participation in social programs that are administered through the tax system, evaluating the strength of these claims would ultimately require a more thorough study of the existing IRS organizational structure.

¹³⁹ See 12 U.S.C. § 225(a) (2006) (establishing that the monetary policy objectives of the Federal Reserve are to “maintain long run growth of the monetary and credit aggregates commensurate with the economy’s long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.”); Aaron Steelman, *The Federal Reserve’s ‘Dual Mandate’: The Evolution of an Idea*, FED. RES. BANK OF RICHMOND ECON. BRIEF 1 (Dec. 2011), available at http://www.richmondfed.org/publications/research/economic_brief/2011/pdf/eb_11-12.pdf (stating that the mandate to promote maximum employment while keeping inflation low can be conflicting).

¹⁴⁰ See *id.*

¹⁴¹ See Sewell Chan, *Republican Proposal Takes Aim at Fed’s Dual Role*, N.Y. TIMES, Nov. 16, 2010, at B3 (quoting Representative Mike Pence of Indiana, stating that: “[i]t is time to return the Federal Reserve to the singular mission of protecting the fundamental strength and integrity of the American dollar.”)

¹⁴² As Aaron Steelman of the Federal Reserve Bank of Richmond has recently pointed out, the idea that the Federal Reserve is responsible “for both securing the value of the nation’s currency as well as promoting employment” has been “prominent during most of its existence.” Steelman, *supra* note 139, at 5. Steelman also highlights how the Federal Reserve has largely remained faithful to balancing its two mandates even where public sentiment strongly favors one goal over the other (e.g., in times of high inflation or high unemployment). See *id.*

If the IRS were to recognize the importance of delivering social programs—specifically the EITC—to its mission, it could undertake a variety of experiments to address the myriad incongruities that, as Part II makes clear, currently bedevil the program’s administration.¹⁴³ The ultimate success or failure of the specific reforms discussed in sub-parts B-E may ultimately be reliant on thoroughgoing structural reforms that vest responsibility for EITC in an administrative structure focused on social policy.

B. Changing the Eligibility Structure of the Earned Income Tax Credit

In addition to reevaluating the mission of the IRS, the structure of the EITC should also be altered to allow for greater participation in the program. Currently, eligibility for the EITC reflects two basic considerations: income and family structure.¹⁴⁴ The result is that individuals hoping to apply for a refundable tax credit due to their low income must also provide information on how many months of the year they have custody over children, or other complicated information about their overall eligibility. This causes several distinct problems.¹⁴⁵ First, this requirement makes the application more burdensome and deters many applicants who are intimidated by the process. Second, the verification process is more difficult because confirming eligibility for the EITC requires examining income and family structure, which are two separate inquiries. Third, requiring applicants to provide information on both issues increases the likelihood that they will make a mistake, and thus increases the frequency of audits and denied claims.

To address these problems, the EITC could be broken into two separate tax credits: a “Worker Credit” and a “Family Credit.” This approach has been advocated by the National Taxpayer Advocate in its 2005 and 2008 annual reports to Congress,¹⁴⁶ and was reiterated by the National Taxpayer Advocate in testimony to the Senate in 2011.¹⁴⁷ This approach was also endorsed by the President’s Advisory Panel on Federal Tax Reform in 2005.¹⁴⁸ The United Kingdom has split its equivalent of the EITC into two separate, smaller tax credits that mirror this proposal: the “Working Tax Credit” and the “Child Tax Credit.”¹⁴⁹

The National Taxpayer Advocate has argued that such a divided credit would entail a number of advantages. First, breaking the EITC into two separate credits would simplify the process by which the working poor apply for tax benefits. As previously noted, potential claimants are required to provide information on both their income and family status. If the process is reformed so that potential applicants are able to claim a “Worker Credit” without also being forced to apply for the “Family Credit,” many

¹⁴³ See Book, *supra* note 4, at 382.

¹⁴⁴ See Nat’l Taxpayer Advocate, *supra* note 35, at 90.

¹⁴⁵ See generally *id.* at 90-91 (describing family status eligibility as a difficult fact and circumstances based assessment).

¹⁴⁶ Nat’l Taxpayer Advocate, *Tax Reform For Families: A Common Sense Approach*, 1 2005 ANN. REP. TO CONG. 397, 397-406 (2005); Nat’l Taxpayer Advocate, *Simplify the Family Status Provision*, 1 2008 ANN. REP. TO CONG. 363, 363-69 (2008).

¹⁴⁷ *Hearing on Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What’s Due Before the Committee on Finance of the United States Senate*, 112th Cong. 1 (2011) (written statement of Nina E. Olson, Nat’l Taxpayer Advocate).

¹⁴⁸ PRESIDENT’S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR AND PRO-GROWTH: PROPOSALS TO FIX AMERICA’S TAX SYSTEM (2005).

¹⁴⁹ See *Tax Credits*, HM REVENUE & CUSTOMS, <http://www.hmrc.gov.uk/taxcredits/index.htm> (last visited Aug. 30, 2011).

additional eligible workers may apply each year. This is because potential claimants often have confusing family structures and relationships, and are unsure how to document them on their tax return. On the other hand, workers often know much more precisely whether their earned income would meet the requirements of a “Worker Credit.” As a result, the reformed self-certification process would not scare off potential applicants by reframing their eligibility for the overall credit into two separate inquiries. Additionally, dividing the credit into two payments would have the benefit of lowering incentives to cheat or provide misinformation on the application, because applicants will be more aware of the fact that they can still be eligible for part of the benefit without meeting other eligibility requirements.

Second, a divided benefit would help improve the verification process for claimants’ eligibility. Assessing income eligibility for the program is undertaken in part through electronic verification of income data submitted on applicants’ W-2 forms. This electronic checking is identical to the verification that is done for individuals claiming a standard deduction who do not also claim the EITC. The more difficult eligibility verification, however, is determining family status. For example, to claim a qualifying child, a claimant must meet four tests: (1) a relationship test, (2) a residency test, (3) an age test, and (4) a support test.¹⁵⁰ Verifying any of these tests requires the IRS to collect additional data. The IRS, as a result, has great difficulty assessing these elements of eligibility for the credit (such as whether a child lived with the claimant or with another parent). Separating the EITC into two separate credits would disentangle the simple task of verifying eligibility based on income from the complex task of verifying eligibility based on family structure.

Finally, creating two separate credits in place of the EITC would also streamline the auditing process. During the auditing process, individuals are asked to provide information on various aspects of their eligibility for the credit.¹⁵¹ If, however, the IRS only has questions on one of the credits being claimed, the audit would be less intimidating and require less information. This has the advantage of both decreasing the total number of audits that need to be performed, and also increasing the number of eligible applicants that are able to keep their refund despite being audited. This is critical given the EITC audit process’s daunting requirements and alarmingly high error rate, which causes a significant number of taxpayers to lose their benefits during the auditing process simply because they have difficulty complying with the audit’s requirements.¹⁵² If there were fewer audits needed to administer two separate tax credits, and the audits that were to occur required less information, it is likely that fewer qualifying low-income families would lose the benefit of this program.

C. Changing the Application for the Earned Income Tax Credit

One of the primary reasons that the EITC has higher participation rates than other social welfare benefits is that most adult Americans file tax returns.¹⁵³ Given this reality, the burden of claiming the EITC is minimal compared with the burden of filing a separate application that is required for most other welfare benefits.¹⁵⁴ Additionally, the

¹⁵⁰ See I.R.C. § 32 (2006).

¹⁵¹ See Book, *supra* note 4, at 381.

¹⁵² Nat’l Taxpayer Advocate, *Earned Income Tax Credit Audit Reconsideration Study*, 2 2004 ANN. REP. TO CONG. (2004).

¹⁵³ *Id.* at 88.

¹⁵⁴ *Id.*

perceived burden is lower due to the EITC's self-certification process, under which potential claimants only have to interact with the government directly if they are subject to an audit. That said, despite the fact that most adults do file tax returns, it is estimated that in 2009 forty-seven percent of all individual taxpayers do not have an obligation to file tax returns because they have either a zero or negative tax liability.¹⁵⁵ As a result, by choosing to administer this welfare benefit for low-income workers through the tax system, the government is imposing the potentially significant burden on many EITC claimants of filing a tax return that they would otherwise not be required to file. Given that this is often a burden for EITC tax filers, the IRS should take steps to simplify the tax return that individuals with no tax obligation are required to complete.

As part of that goal, the IRS should take steps to develop a "Ready Return" modeled on the program that was developed in California in 2005.¹⁵⁶ A "Ready Return" program recognizes the reality that there is usually little need for a taxpayer to fill out information on her income or to complete complicated math. Income data from W-2 forms are submitted to the IRS by employers who withhold their employees' taxes. Currently, when a tax filer completes a tax return, the IRS checks the information provided by the filer against the information provided by the employer.¹⁵⁷ This system, however, can be beneficially inverted. Instead of asking tax filers to submit the information for the IRS to double check, "Ready Return" programs present tax filers with pre-populated forms that contain their individual income information that are submitted by their employers. Tax filers then simply confirm that the information submitted by their employers is accurate and comprehensive.¹⁵⁸

In California, the "Ready Return" is only available to individuals filing very simple tax returns who do not claim many deductions or sources of interest income.¹⁵⁹ Although this may prevent the "Ready Return" from serving as an overall fix for the tax return system, it should not prevent the development of a similar system to serve EITC claimants, who typically do not have complicated sources of income.¹⁶⁰ As a result, the IRS should be capable of developing a program where low-income tax filers can update their EITC applications each year by simply confirming the information that the government has on their income, living, and family situations. This reform would reduce the burden of self-certification, and, by lowering the EITC's error rate, reduce administrative costs spent on audits. It would also help supplement the IRS's ongoing efforts to promote free tax preparation assistance to low-income taxpayers through the VITA volunteer program, as discussed in Part II.

¹⁵⁵ Williams, *supra* note 41, at 1583.

¹⁵⁶ See Joseph Bankman, *Simple Filing for Average Citizens: the California Ready Return*, 107 TAX NOTES 1431 (2005).

¹⁵⁷ *Id.*

¹⁵⁸ See, e.g., Cal. Franchise Tax Bd., *Your California Tax Return May Be Ready And Waiting for You*, CA.GOV, https://www.ftb.ca.gov/ReadyReturn/?WT.mc_id=Individuals_Online_ReadyReturn (last visited July 12, 2011).

¹⁵⁹ *Id.*

¹⁶⁰ See *General Explanation of the Administration's Fiscal Year 2005 Revenue Proposals*, DEP'T OF THE TREAS., 88 (Feb. 2004), <http://www.treasury.gov/resource-center/tax-policy/Documents/bluebk04.pdf> (stating that most EITC claimants do not have income covered by the most complicated of the EITC's three income tests, which encompasses various kinds of investment income).

D. Reforming the Audit Process Used with Earned Income Tax Credit Claimants

Restructuring the way that the IRS conducts audits of tax returns where the EITC is claimed would help to make the EITC fairer.¹⁶¹ As previously discussed, after an EITC claimant is targeted for an IRS audit, the audit is typically conducted on a correspondence basis; moreover, EITC claimants are both more likely to be audited than high-income taxpayers, and more likely to have difficulties with the auditing process.¹⁶² The IRS should thus enhance the audit process of EITC claims by lowering hurdles that arise from communications issues, documentation requirements, and the audit process's reliance on correspondence.¹⁶³

First, steps should be taken to improve the communication between the IRS and the EITC claimant during the auditing process. An EITC correspondence audit typically starts with a letter informing an EITC claimant that he or she is being audited. In 2007, the National Taxpayer Advocate Service conducted a comprehensive survey of 754 different taxpayers who had been audited because of issues surrounding their 2004 tax year EITC claims.¹⁶⁴ In the survey, less than a third of the respondents felt that the initial notification letter that they had received was easy to understand, and only half felt that, after reviewing the letter, they knew what they were expected to do.¹⁶⁵ Given their confusion, over ninety percent of the respondents contacted the IRS about their audits to try to gain more information.¹⁶⁶ This illustrates that most EITC claimants are left overwhelmed and confused by the IRS's current communication process.

There are also several ways to clarify the means of correspondence. To make the standard form letter easier to understand, National Taxpayer Service studies could help determine what wording, structure, and information ought to be included in the letter.¹⁶⁷ The initial notification letter, and all subsequent communications, should also include the name of a single case officer who can be contacted with any questions that audited parties might have after receiving written communications that they find confusing. The case officer should, whenever possible, also take the affirmative step of phoning the claimant after a notification letter has been mailed. Finally, every notification letter and communication ought to include information on the benefits of obtaining representation during the auditing process.

Additionally, the current regulation forbidding the IRS from proactively referring taxpayers to LITCs¹⁶⁸ should be abolished, and case officers should be empowered to provide contact information for any nearby LITCs so that audited parties are aware of the

¹⁶¹ See, e.g., Book, *supra* note 63; Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. & POL'Y REV. 7 (2009).

¹⁶² See Holt, *supra* note 46, at 190-91 (defining "high-income" individuals as those earning \$100,000 and greater).

¹⁶³ See Nat'l Taxpayer Advocate, *supra* note 70, at 94 (noting that "barriers faced by taxpayers during EIC audits may be divided into three primary categories: communication, documentation, and process.").

¹⁶⁴ *Id.* at 100.

¹⁶⁵ *Id.* at 95.

¹⁶⁶ *Id.*

¹⁶⁷ See, e.g., Taxpayer Advocacy Panel, 2005 ANN. REP. 4, 32 (2005); Nat'l Taxpayer Advocate, *A Comprehensive Strategy for Addressing the Cash Economy*, 2 2007 ANN. REP. TO CONG. 27-30 (2007).

¹⁶⁸ See *supra* notes 122-123 and accompanying text.

assistance that is available.¹⁶⁹ Similarly, once an audited claimant has retained the services of an LITC, the LITC officials should not be barred from communicating with the claimant about his or her current tax year issues, as is now the case. In addressing past year controversies, LITC officers are frequently undoing errors committed by third-party tax preparers.¹⁷⁰ Perversely, then, this rule encourages a situation where, after the LITC solves the past year's problem, claimants often return to their familiar tax preparers and undergo the same type of audit the following year.

In addition to improving communication during the auditing process, measures should also be adopted to clarify the documentation required to resolve the audit. The National Taxpayer Advocate's survey indicates that fifty-nine percent of the respondents identified difficulty obtaining the necessary documentation, and only fifty-five percent of respondents indicated that they even understood "how the documents would answer the IRS's questions about the EITC claim."¹⁷¹ For example, EITC claimants are often asked to provide documentation that their child was enrolled in a local school to prove that their child meets the residency requirement for a qualifying child under EITC's guidelines. Frequently, EITC respondents then submit documentation proving that their child was in school for the previous school year, forgetting that to prove this fact for the previous tax year, they need to provide documentation that their child was enrolled in both the spring and fall semesters (spanning two school years).¹⁷² As a result, the initial notification letter should be modified to provide a simple and explicit checklist of the documentation that is required for the audit. The listed documentation should give specific, concrete examples of all documentations required to complete the correspondence audit.

Even if the audited EITC claimants understand what is being requested, they often have difficulty obtaining the proper documentation. In 2004, the IRS piloted the use of affidavits from reliable third parties when an EITC claimant was unable to find appropriate documentation for the child residency requirement.¹⁷³ Under this pilot program, if an EITC claimant was audited and unable to find appropriate documentation for that requirement, he or she could submit a form completed by a school administrator, social worker from another agency, clergy member, or other reliable third party. The IRS agent conducting the audit was then able to follow up with the third party and quickly confirm information about the claimant's family status and living situation. Although this system is certainly prone to error, and there is the possibility that the affidavit could be fabricated, the National Taxpayer Advocate Service's 2009 Annual Report to Congress indicated that "the affidavit is the most effective and accurate means of proving eligibility and the taxpayers prefer the affidavit to providing documents, records, or letters."¹⁷⁴ Given that the pilot program appears to have been a success, the IRS's 2004

¹⁶⁹ It should be noted that the IRS is currently barred from referring taxpayers to LITCs by law. The Taxpayer Assistance Act of 2010 is currently before the House Ways and Means Committee, and among other changes, would allow the IRS to begin referring taxpayers to LITCs. *See generally Congress Introduces Bill to Help Taxpayers Cope with IRS*, ACCOUNTING TODAY FOR THE WEB CPA (Apr. 13, 2010) (discussing the Taxpayer Assistance Act of 2010, which will allow IRS employees to refer taxpayers to LITCs), <http://www.webcpa.com/news/Congress-Introduces-Bill-Help-Taxpayers-Cope-IRS-53885-1.html>.

¹⁷⁰ Email from Tamara Borland, Dir., Iowa Legal Aid's Low Income Tax Clinic, to Joshua Boehm (Aug. 8, 2011, 18:51 CST) (on file with authors).

¹⁷¹ *See* Nat'l Taxpayer Advocate, *supra* note 70, at 106.

¹⁷² *Id.* at 97.

¹⁷³ INTERNAL REVENUE SERV., DEP'T OF THE TREAS., REP. ON FISCAL YEAR 2005 TESTS, at iii (2007).

¹⁷⁴ Nat'l Taxpayer Advocate, *supra* note 35, at 97-98.

pilot program should be expanded and adopted as the norm during correspondence audits of EITC claimants.

Third, the IRS should take steps to reform the audit process so that EITC claimants are not under the impression that they are subject to the correspondence audit process alone. In the National Taxpayer Advocate's 2007 survey, over seventy percent of respondents would have preferred a system other than correspondence to resolve their audit,¹⁷⁵ despite the fact that those audited have a right to request that they instead be subject to a "face to face" audit instead of simply being subject to the correspondence process.¹⁷⁶ This right is difficult for those audited to assert, however, because they are not typically notified of this right in initial communications and do not know how to assert the right. As a result, the initial notification letter should also be modified so that it informs audited tax filers about their right to a "face to face" audit, and includes a checklist of the steps that must be taken to assert that right.¹⁷⁷ This reform, along with the others suggested, may increase the overall costs of the auditing process. But since a decision has been made to use the tax system to administer one of the primary social welfare programs for the working poor, these rights should not be denied simply because individuals are unable to understand what is being asked of them in the process, what documentation is required to resolve the audit, and what rights they have during the audit. This is especially critical given the National Taxpayer Advocate's admission that a "lack of representation during an audit puts EITC taxpayers at an inherent disadvantage over those taxpayers who are represented."¹⁷⁸

E. Moving Toward A Non-Adversarial Alternative To Tax Court

Given the above discussion of the difficulties low-income taxpayers encounter in engaging the Tax Court's adversarial adjudicative processes, a system that would be both more normatively fair and produce less incongruous results should be adopted.¹⁷⁹ An excellent model exists in another welfare context: Social Security Disability Insurance ("SSDI") adjudication. SSDI proceedings, which are "inquisitorial" rather than "adversarial" in nature, are distinct in a number of ways that may prove beneficial if transposed to the EITC context. First, the SSDI adjudication is presided over by an Administrative Law Judge ("ALJ").¹⁸⁰ The ALJ plays the roles of advocate for the government, advocate for unrepresented defendants, and adjudicator who makes a decision in the case.¹⁸¹ Second, the cases are far less formal. They are typically conducted in a small conference room with only the ALJ, the defendant, and representatives or witnesses for the defendant present.¹⁸² As a result, the proceedings are

¹⁷⁵ Nat'l Taxpayer Advocate, *supra* note 70, at 95.

¹⁷⁶ *See id.* at 116.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at 97.

¹⁷⁹ *See generally* Jonathan P. Schneller, *The Administration of Tax Expenditures: The Case of the Earned Income Tax Credit*, 90 N.C. L. REV. (forthcoming 2012) (arguing that the adversarial procedures of the U.S. Tax Court are ill-suited to EITC controversies, due to claimants' resource constraints, and advocating instead for a more inquisitorial, administrative model of adjudication).

¹⁸⁰ RONALD A. CASS, COLIN S. DIVER & JACK M. BEERMANN, *ADMINISTRATIVE LAW: CASES AND MATERIALS* 598 (5th ed. 2006).

¹⁸¹ *See* Fred Davis & James Reynolds, *Profile of a Social Security Disability Case*, 42 MO. L. REV. 541, 549-50 (1977); *see also* Jon C. Dubin, *Torquemada Meets Kafka: The Misapplication of the Issue Exhaustion Doctrine to Inquisitorial Administrative Proceedings*, 97 COLUM. L. REV. 1289, 1325 (1997).

¹⁸² *See* CASS, DIVER & BEERMANN, *supra* note 180, at 598.

less intimidating to low-income workers who are fearful of the government and formal proceedings.¹⁸³

Moving to a model similar to the one used in SSDI adjudications for EITC claimants who are deemed “delinquent” after IRS audits would have several distinct advantages. First, it would help to alleviate the inequities that are suffered because EITC claimants have limited access to counsel for the Tax Court proceedings. Moreover, it would help to ensure that in at least one stage in the process, there is a government advocate helping EITC claimants to present their side of the story. It would also create potential efficiencies because the proceedings would require a single government employee, instead of the judges, attorneys, and court staff who are currently used for “S” cases in Tax Court. And finally, the SSDI approach would allow for a flexible adjudicative inquiry in which ALJs could have follow-up meetings and take it upon themselves to consult with social workers, school officials, or clergy members who understand the circumstances of the EITC claimant. To be sure, ensuring the neutrality of the ALJ proceedings will also depend greatly on how burdens of proof are allocated; careful consideration must be given to what testimony and facts the ALJ must elicit before denying benefits.¹⁸⁴ Properly designed, the features of an ALJ system are far better suited to the needs and capabilities of low-income litigants, and their application in the EITC context should be considered accordingly.

IV. THE NEED FOR INCREASED INVOLVEMENT FROM CONGRESS AND THE LEGAL AID COMMUNITY

While the IRS-centered reforms proposed in the previous section have varying levels of political feasibility, the legal aid community may be better placed to enact timely and meaningful changes that benefit EITC claimants, given its core mission to assist the poorest Americans. To that end, this part discusses discrete initiatives available to the legal aid community that can address current pathologies in the EITC. As will be discussed below, the legal aid community is already achieving substantial gains in promoting awareness and developing easier methods for potential EITC claimants to file federal tax returns. Yet it must still take additional steps to offer representation during the auditing process and Tax Court proceedings, where, as noted above, there remains a great unmet need for legal assistance.

To be sure, legal aid organizations are in the midst of an extraordinarily difficult fiscal situation,¹⁸⁵ and are already forced to turn away as many clients as they are able to help.¹⁸⁶ Congress has greatly erred in its decision to cut Legal Services Corporation (“LSC”) funding from \$420 million in 2010 to \$348 million in 2012. As LSC President James Sandman has pointed out, this sharp reduction in resources comes at “a time when low-income families are increasingly seeking legal assistance” in matters implicating fundamental needs, including “domestic violence, foreclosure, veterans’ benefits, and

¹⁸³ See Book, *supra* note 4, at 401-02.

¹⁸⁴ Authors’ correspondence with Tamara Borland, *supra* note 170.

¹⁸⁵ See *Staff Reductions Hit Legal Aid Programs*, LEGAL SERVS. CORP. (Jan. 2012), available at <http://www.lsc.gov/media/press-releases/staff-reductions-hit-legal-aid-programs> (noting that 13.3% of attorneys will be cut from LSC-funded programs in 2012 and that Congressional appropriations for the LSC has decreased from \$420 million in 2010 to \$348 million in 2012).

¹⁸⁶ See *Documenting the Justice Gap in America*, LEGAL SERVS. CORP. 11 (Sept. 2009), available at <http://www.lsc.gov/justicegap.pdf>.

other matters.”¹⁸⁷ While Congress surely faces tough budgetary choices of its own, we question the wisdom, cost-effectiveness, and morality of weakening such a critical part of the social safety net—precisely when the poorest Americans need it most—to garner savings representing a tiny fraction of the federal budget.

Accordingly, we understand that the observations and recommendations we make in this section may be difficult to effectuate at this particular time. But, even in a tight budgetary context, the importance and scale of the EITC representation shortfall should nonetheless command a greater amount of attention from Congress and the legal aid community. In this section, we explore four steps that the legal aid community can take to meet the needs of EITC claimants. First, we examine limited assistance programs that are currently available to EITC claimants. In this discussion, we address the advances that have been made in the last decade, as well as potential steps that can be taken to improve self-help resources for EITC claimants. Second, we explore the failure of the modern civil *Gideon* movement to include representation in tax proceedings. Third, we analyze the need to increase the resources and enhance the services of LITCs. We conclude by arguing that Congress should appropriate new budgetary funds to the LSC for assisting in tax cases, notwithstanding austerity pressures, and that LSC grantees should consider ways to reallocate existing resources to tax cases as soon as practicable. The dual recognitions that (1) the EITC has largely displaced traditional welfare in American anti-poverty policy; and (2) the EITC imposes legal burdens arguably more daunting than those associated with traditional welfare, compel a renewed focus on the program by Congress and the legal aid community.

A. Limited Assistance Programs and the EITC

One innovative solution for meeting the needs of potential EITC tax filers is the adoption of limited assistance programs.¹⁸⁸ Limited assistance programs are efforts to provide self-represented litigants with the necessary information and resources to be able to effectively resolve their legal disputes without an attorney or other trained professional.¹⁸⁹ Examples of limited assistance programs include offering simplified forms, providing pamphlets in a wide range of languages, establishing hotlines with legal information, or even selling “unbundled” legal services.¹⁹⁰

These programs have been increasingly used to fill a wide range of needs across the legal services landscape, and offer several potential benefits over more labor-intensive options. First, limited assistance programs free up the time of legal aid lawyers and pro-bono attorneys to work on cases that require high levels of professional training.¹⁹¹ Second, limited assistance programs can have impressive returns to scale

¹⁸⁷ See *Staff Reductions Hit Legal Aid Programs*, *supra* note 185. It should be noted that another important form of funding for legal aid organizations, interest on lawyers’ trust accounts, has also diminished in recent years due to low interest rates. See Karen Sloan, *Perfect Storm Hits Legal Aid* (Jan. 3, 2011), available at <http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202476843961&slreturn=1>.

¹⁸⁸ Jeanne Charn, *Legal Services for All: Is the Profession Ready?*, 42 LOY. L.A. L. REV. 1021, 1040 (2009) (using the Legal Aid Society of Orange County I-Can! program as an example of “one of the most innovative providers of legal services in the country.”).

¹⁸⁹ See, e.g., John M. Greacen, *Framing the Issue for the Summit on the Future of Self-Represented Litigation*, in SUMMIT ON THE FUTURE OF SELF-LITIGATION 21 (2005) (discussing examples of the LSC moving towards facilitating self-representation).

¹⁹⁰ *Id.*

¹⁹¹ See Charn, *supra* note 188, at 1058 (“Like the solo and small-firm bar, salaried legal aid lawyers should focus on matters that require their extensive professional training and expertise, and leave to lay

because the variable costs are low relative to the fixed costs of initially starting the programs.¹⁹² Third, the programs may gain political support more easily due to their emphasis on individualism. Fourth, commentators hypothesize that, by playing a larger role in making their own case, clients learn lessons that they are able to use in the future both to avoid conflicts and to help resolve them with less assistance.¹⁹³ As a result of these benefits, LSC data currently suggest that three-fourths of all completed legal aid matters involve “advice, referral, or limited assistance.”¹⁹⁴ Although the EITC’s complexities often create a need for representation and assistance, limited assistance programs can still play a pivotal role in ameliorating the EITC’s administrative shortcomings.

One of the most prominent examples of a limited assistance program designed to help EITC claimants is the Legal Aid Society of Orange County’s (“LASOC”) development of its “EIC Partner” website (www.eicpartner.com).¹⁹⁵ The EIC Partner website promotes the use of free internet filing software that helps potential claimants file for the EITC. In the 2007 tax year, this service helped over 25,000 individual tax filers, and resulted in nearly \$12 million in EITC benefits being paid out.¹⁹⁶ These usage rates continue to improve, and as a result, the LSC recently reported that tax filers from 49 states used the I-CAN! software and were able to claim \$110 million in total refunds.¹⁹⁷ This website and its associated organization serve three key functions.

First, the EIC Partner website provides information for potential EITC filers on how to use I-CAN!. This software provides online forms and information that allow users from anywhere in the country to file for the EITC while completing their federal tax returns.¹⁹⁸ Since the software is free and contains detailed information on common problems confronting low-income taxpayers, it is, for many EITC claimants, a preferable alternative to fee-based preparation software or professional help. Although the I-CAN! software was once only available without charge to EITC-eligible individuals, it is now available to any tax filer, unless the filer also owns a small business or is subject to a few minor exceptions.¹⁹⁹ The software is also able to e-file state tax returns for residents of

advocates, and self-help and limited-assistance centers all matters that these service resources can handle appropriately.”)

¹⁹² See Richard Zorza, *The Future of Self-Represented Litigation: Report from the March 2005 Summit*, NATIONAL CENTER FOR STATE COURTS 5 (2005), available at <http://lawworks1.com/publicfiles/PDFs/FutureOfProSe.pdf>.

¹⁹³ See Michael Milleman et al., *Rethinking the Full Service Legal Representation Mode: A Maryland Experiment*, 30 CLEARINGHOUSE REV. 1178, 1179 (1997) (“By playing a larger role in resolving the problem, the client also may fully exercise her right to make basic case judgments and learn to avoid future legal problems.”).

¹⁹⁴ See Charn, *supra* note 188, at 1032.

¹⁹⁵ See *id.* at 1040. See also Legal Aid Society of Orange County, *I-CAN! E-File*, I-CAN! E-FILE, <http://www.icanefile.com> (last visited July 12, 2011).

¹⁹⁶ Legal Aid Society of Orange County, *Quick Summary Jan. 14th, 2008 – April 15th 2008*, I-CAN! E-FILE, available at <http://www.eicpartner.com/UserFiles/I-CAN%20E-File%20and%20800%20Number%20Summary.pdf>.

¹⁹⁷ See *I-Can! E-File Hits New High in Tax Refunds to Low-Income Americans*, LEGAL SERVICES CORPORATION (March 1, 2011), available at <http://www.lsc.gov/media/press-releases/i-can-e-file-hits-new-high-tax-refunds-low-income-americans> (last visited Jan. 9, 2012).

¹⁹⁸ See Charn, *supra* note 188, at 1040.

¹⁹⁹ *Id.*; see also Legal Aid Society of Orange County, *I-CAN! E-File*, I-CAN! E-FILE, <http://www.icanefile.org/index.asp?caller=> (last visited Jan. 9, 2012) (“You can generally use I-Can! E-File

California, Montana, Michigan, Pennsylvania, and New York.²⁰⁰ In the 2007 and 2008 tax years, EIC Partner conducted an online survey that users were asked to complete after using the program to complete their tax returns. In that survey, fifty-nine percent of respondents indicated that the software was “very easy to use” and fifty-eight percent of respondents indicated that they were “very satisfied” overall with the I-CAN Software.²⁰¹ The survey data did indicate one of the limitations of the service: seventy-two percent of respondents indicated that they used the internet daily, and another fifteen percent of respondents indicated that they used the internet weekly.²⁰² As a result, although this service is quite valuable to many low-income tax filers, its scalability is effectively restricted to the subset of filers with computer proficiency, access, or both. Although this does not undermine the potential benefits of the service, it does indicate a limitation in meeting the needs of all EITC tax filers.

Second, in addition to the EIC Partner website, the LASOC runs a hotline that potential EITC claimants can call for information. The hotline is a toll-free number that greets callers with an automated message on the EITC, information explaining how to apply, and information regarding access to the I-CAN! software.²⁰³ At the end of the automated message, callers are prompted to enter their five-digit zip code. After doing so, the callers are notified of free tax service centers in their area.²⁰⁴ As part of this service, the LASOC actively encourages any organization that is able or willing to provide advice on the EITC to register with the hotline so that its contact information is listed after a caller enters a zip code in its area.²⁰⁵ In 2008, over 4,400 individuals took advantage of the hotline.²⁰⁶

Third, the EIC Partner website provides resources for partner organizations seeking to assist EITC claimants. To this end, EIC Partner develops best practices that it disseminates to organizations that wish to help potential EITC filers claim the benefit.²⁰⁷ Additionally, partner organizations are given a unique URL to put on their webpage. Any time the URL is used for a filer to access the I-CAN! filing software, the organization that directed the tax filer there is given information for tracking its success in helping individuals claim the EITC.²⁰⁸ An excellent example of a partnering

unless you (or your spouse, if filing together) are in the military, are a church employee, are a non-resident alien, sold real estate or you or your employer have a non-US address.”).

²⁰⁰ See Legal Aid Society of Orange County, *Frequently Asked Questions*, I-CAN! E-FILE, <http://www.icanefile.org/faq.asp?caller=#13> (last visited Jan. 9, 2012).

²⁰¹ Legal Aid Society of Orange County, *User Survey Data 2007/2008 Tax Year*, I-CAN! E-FILE, available at <http://www.icanefile.org/programs/Survey%20Data%20April%2015.pdf> (last visited Jan. 9, 2012).

²⁰² *Id.*

²⁰³ Legal Aid Society of Orange County, *Nationwide 800 Number*, I-CAN! E-FILE, available at [http://www.eicpartner.com/UserFiles/File/i-can!%20e-file%20800%20number%20flyer\(3\).pdf](http://www.eicpartner.com/UserFiles/File/i-can!%20e-file%20800%20number%20flyer(3).pdf) (last visited Jan. 9, 2012).

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ Legal Aid Society of Orange County, *supra* note 196.

²⁰⁷ Legal Aid Society of Orange County, *Becoming a Partner Site*, I-CAN! E-FILE, available at <http://www.eicpartner.com/UserFiles/File/i-can!%20e-file%20partner%20sites%20flyer%282%29.pdf> (last visited July 11, 2011).

²⁰⁸ *Id.*

organization is the Montana Legal Services Association,²⁰⁹ which has created a website based on the EIC Partner's information and software (www.montanafreefile.org). By the 2008 tax season, Montana Free File helped refund over \$3.25 million to I-CAN! E-File users in the state of Montana.²¹⁰ Of that total, sixty-one percent was from the EITC.²¹¹ This illustrates the success that legal services organizations can have in helping individuals access social benefits that they are due through the tax system.

All three of these activities demonstrate how limited assistance programs can be developed to help potential EITC claimants obtain the welfare benefits that they are entitled to without resorting to expensive private tax preparers. The success of I-CAN! shows that more resources and effort should be devoted to developing and spreading awareness of the EITC assistance that the program makes available.

Although the LASOC's development of the EIC Partner program and I-CAN! software is a laudable example of "a culture of bottom-up creativity and innovation" in the development of legal services,²¹² there are still limits to the organization's ability to provide legal services to EITC claimants. LASOC's technical assistance is restricted to questions that users have on how to use the I-CAN! software, how to check their E-File status, how to enter tax information into the software, and how to amend a rejected return.²¹³ All other inquiries about one's tax situation are directed to the IRS.²¹⁴ Accordingly, the organization's assistance operates exclusively at the filing stage of an EITC claim, and does not extend to EITC claimants who are having their tax returns audited.²¹⁵ Since, as previously noted, EITC claimants are far more likely to be audited than ordinary taxpayers and benefit dramatically from representation,²¹⁶ this is a critical gap in the information and services provided by the "EIC Partner" organization.

As a result, funds should be allocated to help develop information for those EITC filers who are subjected to an audit. First, the EIC hotline should be expanded (or a new hotline created) so that EITC claimants subject to an audit can gain access to information on the audit process and the location of the nearest legal aid resource. Second, the website should provide clear information on the audit and Tax Court process. For example, the site could provide examples of the types of documents to submit during correspondence audits to satisfy common IRS requests. Similarly, the EIC Partner organization could begin development of audit best practices to complement the filing best practices currently provided to partner organizations. Although not an exhaustive list, all of these steps would be relatively straightforward mechanisms to improve the coverage of taxpayer self-help and extend the limited assistance made possible by the EIC Partner website into the domain of EITC audits and Tax Court adjudication.

As helpful as such programs can be, they are necessarily limited to individuals with the literacy and initiative to attain self-help via navigation of such resources. As one

²⁰⁹ See Montana Legal Services Association, *2007-2008 Montana Legal Services Association Guide to Annual Implementation and Outreach: I-CAN! E-File*, I-CAN! E-FILE (Sept. 18, 2007), available at [http://www.eicpartner.com/UserFiles/2007-2008%20I-CAN%20Binder\(2\).pdf](http://www.eicpartner.com/UserFiles/2007-2008%20I-CAN%20Binder(2).pdf).

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² See Charn, *supra* note 188, at 1040-41.

²¹³ Legal Aid Society of Orange County, *How We Can Help*, I-CAN! E-FILE, <http://www.icanefile.org/help.asp?caller=> (last visited Jan. 9, 2011).

²¹⁴ *Id.*

²¹⁵ See *id.*

²¹⁶ Nat'l Taxpayer Advocate, *supra* note 65, at 119.

commentator pointed out when discussing the limits of self-help in the tax system, “[s]lightly more than 20% of the population lacks the skills necessary to read a food label, fill out a form, or read a simple story to a child.”²¹⁷ A single mother with full-time work and child-rearing responsibilities but lacking Internet access may not be well-positioned to avail herself of limited assistance resources such as the I-CAN! program. The IRS’s VITA program, as discussed earlier, is well-placed to remedy this gap.²¹⁸ VITA’s trained volunteers not only serve a critical role in areas where programs such as EIC Partner and I-CAN! are not yet implemented, but can also assist where EITC claimants have access to such technology but are unable or unwilling to use it. Many legal services organizations recognize the importance of VITA in meeting this demand and make concerted efforts to publicize VITA site locations to their clientele; it is critical that they continue to do so.²¹⁹

B. Expanding and Improving Low Income Tax Clinics

Low Income Tax Clinics (“LITCs”) can and must play a much greater role with respect to representing EITC claimants who have been targeted for audits.²²⁰ Viewed in light of the significant need for and dramatic impact of representation, the federal LITC budget of \$9.5 million per year is woefully inadequate,²²¹ both when seen in light of need for legal services and in light of the estimated \$300 million a year that eligible EITC claimants are denied due to the lack of representation.²²² LITCs handled roughly 37,000 taxpayer controversies in 2008; assuming an LITC funding amount of \$20 million (a figure which assumes the full budget was disbursed along with matching spending by educational institutions), the average cost per controversy can be estimated at \$540.²²³ While it is unrealistic, at least in the immediate term, to expect Congress to expand the LITC program budget in order to provide representation to every claimant, each additional audit representation will, on average, diminish the amount of erroneous deprivation (\$623) by more than the cost of that representation (\$540). Additional expenditures on audit representation will not necessarily pay for themselves; in fact, if such representation is effective, it will actually cost the government more because claimants will be recouping a greater percentage of their EITC entitlements. Rather, this comparison illustrates that dedicating more funding to EITC representation would be a cost-effective use of administrative resources. Moreover, LITC funding might reduce the cost of the IRS audit process, because represented and advised parties can be expected to

²¹⁷ Bankman, *supra* note 156, at 1431.

²¹⁸ For background information on the VITA program, see *supra* note 54 and accompanying text.

²¹⁹ Authors’ correspondence with Tamara Borland, *supra* note 170.

²²⁰ The basic structure and function of LITCs are discussed in Part II.C.3.

²²¹ Nat’l Taxpayer Advocate, *supra* note 65, at 117.

²²² In a 2007 study, the Taxpayer Advocate Service found that represented and unrepresented taxpayers have nearly identical claim amounts before auditing—a difference of \$36—but the average amount disallowed after audit is \$587 higher for non-represented taxpayers, yielding an overall disparity of \$623 between taxpayers with representation and those without. Assuming that non-represented taxpayers would have retained a similarly higher amount of EITC funding post-audit had they been represented, the aggregate deprivation of benefits due to lack of representation can be estimated at over \$300 million. Nat’l Taxpayer Advocate, *supra* note 70, at 97, 112. This figure is derived by multiplying the number of EIC audits (517,617) by the overall disparity (\$623).

²²³ This figure is derived by dividing the estimated total EITC budget (\$20 million) by the number of issues LITCs handle each year (37,000). It should be noted that of these issues, 10,142 cases were opened, of which 1,804 were submitted to the U.S. Tax Court. It is likely that such cases required a greater expenditure than the average cited here. Nat’l Taxpayer Advocate, *supra* note 65, at 117.

focus more on salient issues, provide necessary documentation in response to initial IRS requests, and handle hearings in an efficient manner.²²⁴

Furthermore, the cost of representation must be viewed in the broader context of the policy choices Congress made in enacting the EITC. By putting essentially no resources into pre-certification, unlike other welfare programs such as TANF, Congress effectively opted for low administrative costs at the expense of error rates, while shifting the costs of compliance from the state to the low-income taxpayer.²²⁵ While Congress has devoted significant resources to EITC compliance and enforcement (roughly \$150 million annually), when viewed against a backdrop of \$10 billion in EITC disbursements to non-qualifying recipients for the 1999 tax year,²²⁶ it seems incongruous that only \$10 million has been dedicated to help ensure that *qualified* audited recipients retain their full benefits by providing representation.

C. Deepening Legal Aid Programs' Involvement with Tax Matters

The LSC and its local grantees should consider recognizing the EITC's pervasiveness and undertaking initiatives to assist EITC claimants. The LSC's latitude to assist EITC claimants is somewhat restricted by its guidelines, which limit eligibility for LSC assistance to individuals with incomes equivalent to 125% of the federal poverty guidelines.²²⁷ However, a significant number of EITC recipients fall within the LSC's eligibility threshold, as the EITC's eligibility criteria encompass individuals at well below the guideline.²²⁸

There are two paths for the LSC and grantee organizations to deepen their support for EITC recipients. First, current LSC grantees could expand the range of resources they devote to EITC assistance. To illustrate, recent data suggest that two of the largest legal aid programs in the country, in New York and Los Angeles, dedicate around one-fifth of their hours toward government benefits retention cases.²²⁹ These include cases where individuals have been deprived of benefits under Social Security, food stamps, TANF, Supplemental Security Income, and other federal and state-specific welfare programs.²³⁰ These are undoubtedly important issues, and tax problems of EITC claimants are just one of the many legal problems that low-income individuals face each year. After all, there are an estimated "45 million to 75 million low- and moderate-

²²⁴ See *supra* Part II.C.2 for a detailed discussion of the confusion that IRS audits typically present to EITC claimants.

²²⁵ See Book, *supra* note 19, at 1106; David A. Super, *Privatization, Policy Paralysis, and the Poor*, 96 CAL. L. REV. 393, 434 (2008) (noting that in "cash assistance, food stamps, and Medicaid, the government traditionally has borne the costs of helping claimants complete applications" but in the case of the EITC, the government has left much of the "payment for administration to claimants . . .").

²²⁶ Nat'l Taxpayer Advocate, *supra* note 70, at 98.

²²⁷ See 45 C.F.R. §1611.3(c) (2005).

²²⁸ See I.R.C. § 32(b)(2)-(3) (West 2011) (setting forth EITC income eligibility criteria); Income Level for Individuals Eligible for Assistance, 74 Fed. Reg. 5620 (Jan. 30, 2009) (outlining LSC assistance income thresholds).

²²⁹ See *Funding Sources*, LEGAL AID FOUNDATION OF LOS ANGELES, <http://www.lafla.org/funding.php> (last visited Dec. 24, 2011); *Annual Report 2009-10*, LEGAL SERVS. N.Y.C. 53, available at http://www.legalservicesnyc.org/storage/lsny/PDFs/ls-nyc_annrep_09-10-12-lo.pdf (last visited Dec. 24, 2011) (note that the category "income maintenance" represents government benefits).

²³⁰ See, e.g., *Government Benefits*, LEGAL AID FOUNDATION OF LOS ANGELES, <http://www.lafla.org/service.php?sect=govern&sub=main> (last visited July 12, 2011); *How We Help People*, LEGAL SERVICES NEW YORK CITY, http://www.legalservicesnyc.org/index.php?option=com_content&task=view&id=23&Itemid=52#Help%20protect%20and%20secure%20income (last visited July 12, 2011).

income people who have legal problems for which interested and competent lawyers might be a benefit.”²³¹

Yet it remains critical to recognize the importance of the “hidden” welfare state in contemporary anti-poverty policies. Consider, for instance, that the government benefits litigation budget for New York City’s Legal Services NYC (\$8.9 million in 2009-10) is not significantly less than the entire federal outlay for EITC representation (\$9 million as matching funds for LITCs).²³² Given that LITCs can currently represent so few audited EITC claimants—less than two percent, as noted above—legal aid groups might consider allocating some portion of their government benefits litigation funding to help close this yawning representation gap. While again acknowledging that the feasibility and impact of any such shift would likely be modest at present, given stark budget cutbacks at LSC grantees, it is nonetheless important to highlight the severe underrepresentation of EITC claimants (even in relation to other underserved clients).

As we suggested earlier, lawmakers ought to recognize that even in times of fiscal austerity, providing legal help to the poorest Americans facing EITC challenges—involving benefits that finance basic needs—should remain a high budgetary priority. A more promising path, accordingly, would be for Congress to allocate new funding to the LSC and local legal aid societies for assistance of EITC claimants. While LSC grantees choose their own priorities, the LSC could seek a special competitive grant to assist EITC claimants with filing. Such funding could enable legal aid societies to serve as a backstop to the automated and self-help measures that they are currently funding and spearheading. There are clear opportunities for legal aid societies to expand and integrate their self-help and limited-assistance tax initiatives, like I-CAN!, with their core competencies in providing direct legal advice. Frequently, LSC grantees encounter clients who are simultaneously trying to resolve prior year controversies while also completing returns for the current year.²³³ At present, there is a strict division of funding and responsibilities between legal aid organizations and VITA programs, which complicates the resolution of such cases: legal aid attorneys must deal only with the past year problems while referring the client to a VITA site to complete the current year’s taxes.²³⁴ To increase efficiency and reduce the risk of error and miscommunication, legal aid attorneys should have the resources and mandate to deal with all of the client’s tax issues in such circumstances.

To be sure, any Congressional funding increase for pre-filing EITC assistance at legal aid societies would likely engender political criticism because such reform imbues the EITC with greater administrative costs, thus reducing its supposed advantage over other welfare programs like TANF and food stamps. Ultimately, though, such funding would likely generate sufficient benefits to outweigh those costs. Deeper legal aid involvement with complicated pre-filing EITC cases could augment the salutary effect of I-CAN!, VITA, and self-help by further cutting into the billions of dollars that EITC claimants spend annually on private tax preparation assistance.²³⁵ If EITC claimants

²³¹ James L. Baillie, *The Role of the Private Bar in a Model System for the Delivery of Legal Services*, 26 *HAMLIN J. PUB. L. & POL’Y* 195, 198 (2005).

²³² *Annual Report 2009-10*, *supra* note 229, at 53. *Low Income Taxpayer Clinic Grant Recipients Announced*, INTERNAL REVENUE SERV. (Feb. 17, 2012), available at <http://www.irs.gov/newsroom/article/0,,id=254537,00.html>.

²³³ Authors’ correspondence with Tamara Borland, *supra* note 170.

²³⁴ *Id.*

²³⁵ Cords, *supra* note 50, at 376-77.

knew that government-funded advice were available, they would presumably be less inclined to seek assistance from private preparers with high rates of non-compliance. Thus, it could be expected that legal aid involvement in pre-tax filing would both ensure that claimants retain a greater portion of the credit to which they are entitled, and reduce erroneous filings encouraged by unscrupulous private preparers.

LSC competitive grants could also be targeted at representation in the audit and Tax Court settings. As noted, some LITCs are already run by legal aid groups—as of 2011, roughly one in five were²³⁶—such close coordination between general legal services and low-income tax representation is laudable and should be encouraged. And certain state legal aid groups, such as Legal Services of New Jersey, already provide some tax services in-house.²³⁷ However, the involvement of legal aid groups in poverty-level tax work is generally very low and must be expanded.²³⁸ One potential barrier may be, as Book suggests, that “lawyers tend to view tax law as an isolated discipline, requiring great specialization due to the area’s complexity, both substantively and procedurally.”²³⁹ But as statistics show, the problems that most frequently trigger EITC audits tend to fall within common niches—such as proof of a qualifying child under EITC criteria—thus diminishing the breadth of material to learn.²⁴⁰ Moreover, a number of LSC grantees have recently started or expanded foreclosure representation practices in response to burgeoning demand for such services as a result of the recent housing crisis. This illustrates the ability of legal aid groups to adapt quickly to meet client needs, and to do so in a relatively complicated area of the law.

Even if the legal aid groups were to expand deeper into tax representation, individual legal aid offices would be required to spend at least 12.5% of their basic field grants to recruit and assist private attorneys to represent low income taxpayer clients, usually on a pro bono basis.²⁴¹ More than ten percent of the cases closed in 2007 were assisted by pro bono attorneys.²⁴² LSC grantees are under no obligation to allocate private attorney-related funding toward any specific field, but if they targeted low-income tax representations with some of those resources, it would help increase the visibility of EITC representation in the professional tax community, and especially in the eyes of private firms looking for pro bono opportunities. Firms can give special bonuses to associate hires with tax clinic experience, allow associates to participate directly in government-sponsored representation programs, or handle pro bono cases independently.²⁴³

D. The Civil *Gideon* Movement and the EITC

Although the Supreme Court found a constitutionally guaranteed right to counsel in criminal cases in the landmark 1963 decision *Gideon v. Wainwright*, the Court denied

²³⁶ See INTERNAL REVENUE SERV., LOW INCOME TAXPAYER CLINIC LIST (2011), available at <http://www.irs.gov/pub/irs-pdf/p4134.pdf> (last visited Feb. 19, 2012); see also *Tax Legal Assistance Project*, LEGAL SERVICES NEW JERSEY LAW, available at <http://www.lsnjlaw.org/aboutlsnj.cfm#tax> (last visited July 12, 2011) (example of one such coordination).

²³⁷ *Id.*

²³⁸ Book, *supra* note 4, at 412.

²³⁹ *Id.*

²⁴⁰ *Id.* at 395.

²⁴¹ *Budget Request Fiscal Year 2010*, LEGAL SERVS. CORP. 14, available at <http://www.lsc.gov/sites/default/files/LSC/pdfs/br2010.pdf> (last visited Aug. 30, 2011).

²⁴² *Id.*

²⁴³ Spragens & Olson, *supra* note 48, at 1529.

a constitutional right to counsel in civil cases in the 1981 decision *Lassiter v. Department of Social Services*.²⁴⁴ As a result, right to counsel in civil cases is a patchwork system with access for the indigent dependent on the available legal services and statutes in individual states.²⁴⁵ Currently, there are only three main categories of cases where most state statutes or court rules provide a right to counsel in civil matters: family law matters, involuntary commitment, and medical treatment.²⁴⁶ In fact, although individual states provide a right to counsel in a number of other specific situations (guaranteed counsel for military members, cases involving mental health records, and juvenile immigrant status actions, for example), not a single state has a statute or judicial opinion that provides a right to counsel in tax cases.²⁴⁷ This fact is not surprising in light of the “civil *Gideon*” movement’s core focus on courts.

Given this emphasis on non-tax matters, the EITC audit process and Tax Court has not been an element of the current “civil *Gideon*” movement.²⁴⁸ The fact that representation during tax cases is largely left out of the civil *Gideon* movement is especially critical since many commentators have argued that the movement is better positioned to make gains since the *Lassiter* decision in 1981.²⁴⁹ One major development in the last decade is the American Bar Association’s 2006 resolution that endorsed providing “counsel as a matter of right at public expense to low income persons in . . . adversarial proceedings where basic human needs are at stake, such as those involving shelter, sustenance, safety, health or child custody”²⁵⁰ As a result of this development, groups representing the American Bar Association are now able to file amicus briefs in cases that are seeking the right to counsel.²⁵¹ Also, pilot legislation has been passed in California²⁵² and proposed in New York to expand the right to counsel.²⁵³

In addition to these statutory and ABA initiatives, there is also progress in state court systems toward a guaranteed right to counsel in certain situations. In 2007, an Alaska trial court held that the state constitution created a right to counsel for a parent in a custody action when the other parent has private counsel; in 2009, a Washington Court of Appeals held that children have a due process right to counsel in truancy

²⁴⁴ See *Lassiter v. Dep’t. of Soc. Servs.*, 452 U.S. 18 (1981). See also *Gideon v. Wainwright*, 372 U.S. 335 (1963).

²⁴⁵ See Clare Pastore, *A Civil Right to Counsel: Closer to Reality?*, 42 LOY. L.A. L. REV. 1065 (2009).

²⁴⁶ Laura K. Abel & Max Rettig, *State Statutes Providing for a Right to Counsel in Civil Cases*, 40 CLEARINGHOUSE REV. 245 (2006).

²⁴⁷ *Id.* at 247.

²⁴⁸ See, e.g., NATIONAL COALITION FOR A CIVIL RIGHT TO COUNSEL, <http://www.civilrighttocounsel.org/> (last visited April 7, 2012). The organization does not make reference to providing tax cases and audits as one of the goals of the organization.

²⁴⁹ See Pastore, *supra* note 245, at 1066.

²⁵⁰ AMERICAN BAR ASSOCIATION HOUSE OF DELEGATES, RESOLUTION 112A (2006), available at http://www.americanbar.org/content/dam/aba/administrative/legal_aid_indigent_defendants/ls_sclaid_06A112A.authcheckdam.pdf.

²⁵¹ See Pastore, *supra* note 245, at 1070.

²⁵² Kevin G. Baker & Julia R. Wilson, *Stepping Across the Threshold: Assembly Bill 590 Boosts Legislative Strategies for Expanding Access to Civil Counsel*, 43 CLEARINGHOUSE REV. 551 (2010).

²⁵³ See Pastore, *supra* note 245, at 1068.

proceedings.²⁵⁴ However, these court-driven gains in civil representation, like their statutory and ABA analogues, wholly omit tax assistance from their ambit.

Addressing the need for civil *Gideon* in the context of the EITC is more complicated than simply asserting that the right to representation during the IRS audit process and U.S. Tax Court proceedings should be guaranteed and funded through government revenue. As previously noted, the recent successes in expanding civil *Gideon* have not been achieved by constitutional arguments or expansion of federal programs.²⁵⁵ Instead, as one commentator has pointed out, the gains of the movement have primarily occurred when state legislatures believe that the proposal will have a net positive impact on the state's budget, or when arguments about fundamental fairness are advanced by advocacy groups in a way that is persuasive to either the judiciary or public.²⁵⁶

In the case of EITC claimants subject to audits, it may be possible to advance both rationales for extension of civil *Gideon* rights. A fiscal case for free tax representation could be made if it can be documented, and demonstrated to legislatures, that providing counsel during the EITC auditing process and U.S. Tax Court proceedings will help to keep potential claimants from resorting to state-provided social services. In addition to reducing reliance on state services, EITC recipients would presumably spend the bulk of their received funds on goods and services in their home state, boosting local economies as well as state sales tax receipts. Although it has been extensively documented that EITC claimants with representation are more likely to preserve the benefit of the refund, whether those that are unsuccessful during the audit process are more likely to need expansive state benefits has not been studied.²⁵⁷

As to the fundamental fairness rationale for the EITC, it is critical to note that a failed EITC audit can have drastic consequences for an EITC claimant. The Tax Court case of *Baker v. Commissioner* illustrates the predicament of a taxpayer who has received the credit and is later deemed ineligible.²⁵⁸ Daniel Aaron Baker, whose income in the year he claimed the credit was \$15,349 and who bore significant childcare expenses for his four-year-old daughter, was required to repay an assessment of \$3,556 because he failed to establish that his daughter resided with him over the course of the relevant tax year.²⁵⁹ The entry of a \$3,556 assessment against an individual with an annual income of \$15,349 (who also had significant child care expenses) presumably had a disastrous financial impact. Such dire ramifications—which one cannot assume are atypical—go to the heart of the ABA's statement that “counsel as a matter of right at public expense” must be provided “to low income persons in . . . adversarial proceedings where basic human needs are at stake, such as those involving shelter, sustenance, safety, health or child custody”²⁶⁰

²⁵⁴ See *id.* at 1069; *Gordnier v. Jonsson*, No. 3AN-06-887 CI (Alaska Super. Aug. 14, 2007); *Bellevue School District v. E.S.*, 199 P.3d 1010, 1017 (Wash. 2009).

²⁵⁵ See, e.g., Laura K. Abel, *Keeping Families Together, Saving Money, and Other Motivations Behind New Civil Right to Counsel Laws*, 42 LOY. L.A. L. REV. 1087, 1110 (2009).

²⁵⁶ *Id.*

²⁵⁷ See Nat'l Taxpayer Advocate, *supra* note 70, at 108-16.

²⁵⁸ See *Baker v. Comm'r*, 91 T.C.M. (CCH) 949 (2006).

²⁵⁹ *Id.*

²⁶⁰ AMERICAN BAR ASSOCIATION HOUSE OF DELEGATES, *supra* note 250.

In cases where legislatures have been persuaded by concerns of fundamental fairness, it has often been with the assistance of advocacy groups.²⁶¹ Although some of these groups (such as parental advocacy organizations) have been distinct from the legal aid movement, the most common group of advocates has been lawyers associated with the legal aid movement.²⁶² This includes “civil right to counsel advocates, civil legal aid attorneys, and bar associations.”²⁶³ For EITC claimants, this fact offers some hope. Since there are over 500,000 audits of EITC claimants each year,²⁶⁴ there would be a great deal to gain for attorneys if legislatures were convinced that EITC claimants should have a government-funded right to counsel during auditing process and Tax Court proceedings. As a result, the civil *Gideon* movement, and lawyers advocating for increased representation, should take up the entirely reasonable argument that it is normatively unjust to force low income individuals to self-certify that they are eligible to America’s largest welfare program through an exceedingly complex tax return, only to be forced to defend themselves without assistance when they make a mistake, and often lose the benefit for lack of representation.

V. CONCLUSION

The EITC’s administrative vacuum makes it more onerous for low-income taxpayers to navigate than traditional welfare programs. In this article, we have discussed and analyzed a number of reforms—both internal reforms to the IRS and external initiatives for the legal aid community—that could help soften the program’s harsh edge. While some of these reforms may require increased Congressional funding at a time when budgets are being slashed across the board, such funding generally pales in comparison to the \$10 billion in erroneous payments made under the EITC each year. If the program’s tax-based administration can justify the diversion of such significant resources to non-compliant taxpayers, surely it is appropriate to devote far more modest sums to assist qualifying taxpayers in claiming the benefit to which they are entitled.

The proposals in this article should be considered individually. Each stands to provide unique benefits, and may well have unique costs as well. What is important is not so much that any one of these proposals be adopted, but to recognize that the EITC’s tax-based administration raises a number of normative concerns in regard to the program’s treatment of low-income taxpayers, and to begin a discussion about *how* those normative concerns might be addressed. Those concerned with providing legal aid to low-income Americans must see the “hidden welfare state” for what it is—a prominent, and often problematic reality for millions of low-income Americans—and take action accordingly.

²⁶¹ See Abel, *supra* note 255, at 1112.

²⁶² *Id.*

²⁶³ *Id.*

²⁶⁴ See Nat’l Taxpayer Advocate, *supra* note 70, at 97 (noting that there were 517,617 EITC audits in 2006, which represented 40.3% of the total IRS audits of individuals).