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On the Administration of the First-Time Homebuyer Tax Credit

Before the Subcommittee on Oversight of the
House Committee on Ways and Means

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Chairman Lewis, Ranking Member Boustany and Members of the Subcommittee on Oversight, thank you for this opportunity to testify on the IRS' efforts to effectively administer the American Recovery and Reinvestment Act's expanded first-time homebuyer credit (FTHBC or credit).

The IRS moved aggressively to implement this important program as soon as it was enacted by Congress and signed by the President. There has been a strong response to the program. Indeed, between January 2009 and September 2009, I am proud that we have processed claims from more than 1.5 million individuals or families who have purchased homes.

In administering the FTHBC program, the IRS has undertaken significant outreach to ensure that taxpayers are aware of the benefit, developed new forms and instructions to allow taxpayers to file the claim, and instituted significant compliance programs to ensure that those claims are valid. As with any tax credit, the IRS must run a balanced

program aimed at delivering the benefits that the legislation provides, while ensuring that appropriate controls are in place to minimize errors and fraud.

BACKGROUND

The genesis of the FTHBC is the Housing and Economic Recovery Act of 2008 (HERA), which was signed into law in July 2008. Under the 2008 Act, taxpayers who purchased a principal residence after April 8, 2008, and before July 1, 2009, are allowed to claim a credit equal to 10 percent of the purchase price of the home, limited to \$7,500. This credit served as an interest-free loan to taxpayers that must be paid back over a 15-year period beginning two years after the credit is claimed.

With the February passage of the American Recovery and Reinvestment Act of 2009 (ARRA), the maximum credit was increased to \$8,000 and extended to include purchases completed on or after January 1, 2009, and before December 1, 2009. For homebuyers qualifying under the ARRA provision for 2009 purchases, unlike the credit provided for by the 2008 Act, there is no repayment requirement for qualifying purchases if they retain the residence for three years. Taxpayers seeking to claim this credit may do so on either their tax year 2008 or 2009 individual income tax returns.

The IRS was, therefore, faced with the administrative challenges of implementing two FTHBC provisions during 2009. In response, the IRS developed robust outreach and compliance strategies.

IRS' OUTREACH EFFORTS

Through a series of expansive outreach efforts, the IRS worked to make sure that taxpayers were aware of the expanded FTHBC.

Our efforts included numerous media interviews, press events, podcasts, public service announcements, IRS Nationwide Tax Forums, a national marketing campaign, expanded use of our website and working with business stakeholders and our partners in the tax community, to name but a few. These efforts led to virtually countless news articles in English and Spanish detailing the FTHBC. As part of this effort, the IRS worked to publicize the program's details through a special section on IRS.gov and created YouTube videos in English, Spanish and American Sign Language. Through these efforts we not only reached individuals who claimed the credit, but we also talked with return preparers who assisted individuals claiming the credit. Moreover, we intend to send notices to taxpayers who claimed the \$7,500 FTHBC but who may be entitled to the expanded \$8,000 ARRA credit to encourage them to file an amended return to claim the additional benefit.

We also worked with stakeholders to develop and implement a collaborative plan. For example, the IRS entered into a partnership with the Department of Housing and Urban

Development's Department of Single Family Housing Planning and Development to educate homebuilders, mortgage lenders, banks and other industry organizations as well as advocacy groups, on the FTHBC requirements for their clients. The IRS has plans to participate with HUD on a number of phone forums the agency coordinates to share information with the housing industry.

The IRS conducted extensive education and outreach activities with the return preparer and practitioner community as well. The IRS sought to ensure that preparers and practitioners understood the FTHBC eligibility requirements and endeavored to minimize inaccurate FTHBC claims. For example, we distributed written materials through our e-news for Tax Professionals e-mail service.

IRS' COMPLIANCE EFFORTS

The IRS recognizes that there is potential for both fraud and errors whenever a new refundable tax credit like the FTHBC is enacted. As we began implementing this credit in the days after the Recovery Act legislation was passed, we also identified different types of potential erroneous or fraudulent claims, and matched our compliance program to those abuses. We will vigorously pursue those who filed fraudulent claims for the credit, and have already opened up scores of criminal investigations. We have selected thousands of returns for those claiming the credit for civil examination.

Administering the FTHBC poses challenges similar to those the IRS confronts with other refundable credits -- namely, it has a number of eligibility rules and the Federal government lacks third-party data sources which can be used to verify taxpayers' eligibility for the credit.

It is important to put the administration of the FTHBC in context of the overall tax filing process. The expanded credit available under the ARRA came in February – a time when the IRS processes tens of millions of tax returns filed during a peak month. In fact, during February 2009 alone, we received almost 44 million returns for processing. And the majority of the 1.5 million returns claiming the FTHBC, just over 1.1 million, were filed between January and May 2009. It was important that the IRS implement and administer the FTHBC in a way that did not disrupt the annual tax return filing process.

In response to HERA, the IRS developed Form 5405, First-Time Homebuyer Credit, for taxpayers to complete when calculating and claiming the first-time homebuyer credit.

Taxpayers are required to: (1) provide the address of the home qualifying for the credit; (2) the date the qualifying home was purchased; and (3) the amount of the credit they are claiming. The IRS updated this form just after the ARRA was passed in February 2009.

Taxpayers are required to attach this form to their individual income tax returns. The IRS considered requiring taxpayers to attach additional documentation, such as the HUD-1 Settlement Statement, to their tax returns. It is important to note that the statute did not grant the IRS the authority to disallow claims solely based on insufficient documentation

– an audit is required to disallow the claim. Additionally, requiring paper documentation up-front with the tax return would have caused all taxpayers claiming the credit to wait longer, in part because claims would need to be filed on paper. Therefore, within the mandate of the statute, the IRS took steps to implement a compliance plan through screening filters that would identify returns with potentially inappropriate claims.

In addition to developing a form which collects information pertinent to determining eligibility for the credit, the IRS took additional steps to ensure accuracy of the claims. Some of those steps include: (1) compliance checks to identify and select for audit the highest-risk FTHBC claims before refunding money; (2) post-refund audits of less problematic returns; and (3) criminal investigations of possibly fraudulent activities. As with any other compliance program, the IRS continuously refines the steps it takes to detect ineligible filers.

Soon after implementation, the IRS took steps to revise its return filters to identify egregious claims. It is important to note that these steps were being taken at the height of the IRS filing season, which is mid- to late February. As returns are being reviewed and additional issues identified, the IRS continues to revise its systems to allow it to identify erroneous claims. In early May, the IRS put in place additional filters that would continue to identify improper claims, such as indications of prior home ownership. Returns that were processed early in the filing season that were not subject to these additional filters have been run against the new filters and those returns will be reviewed for potential future examinations. Additionally, the IRS used a limited statutory authority

(known as “math error” authority) to prevent simple mistakes in three situations: claims in excess of the maximum allowable credit; claims in excess of the allowable amounts for those taxpayers with adjusted gross income exceeding income limitations; and claims without the required Form 5405 attached.

Through these efforts, the IRS has been able to identify and investigate many potentially fraudulent schemes and erroneous claims. For example, we have seen a number of taxpayers claiming the FTHBC indicating a future purchase date for the home on returns filed with the IRS. We are reviewing these claims and contacting taxpayers in order to correct their accounts. As another example, our return filters have identified a number of situations in which taxpayers claiming the FTHBC had indications of prior home ownership within the previous three years. It is important to note that just because these claims are being flagged as potentially erroneous, these taxpayers may actually be entitled to the FTHBC. Until the IRS follows up with the taxpayer, it is not possible to make a conclusive determination. We will vigorously pursue those who filed fraudulent claims for this credit, but we also will seek to respect the rights of taxpayers who claim a credit to which they are lawfully entitled.

The IRS has already identified over 160 potential schemes resulting in scores of criminal investigations. We have also selected more than 100,000 returns claiming the FTHBC for examination. We anticipate reviewing the audit results to refine our filters even further. The FTHBC has helped over a million American families purchase homes, and we cannot let fraudulent activity undermine a program that has benefited so many.

CONCLUSION

Mr. Chairman, the IRS administered the statute as written in a responsible way to meet the legislative intent of stimulating the economy quickly and providing first-time homebuyers with the credit promptly.

We appreciate and welcome the independent feedback that we have received from a number of our stakeholders, including the GAO and TIGTA. It has helped us to focus on continuing to improve the administration of this credit.

Mr. Chairman, thank you again for this opportunity to testify on the IRS' efforts to effectively administer the first-time homebuyer credit and help in the economic recovery efforts. I will be happy to respond to any questions.