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## The IRS Audits an Easy Target – The Poor

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# The IRS Audits an Easy Target — The Poor

In 2018, Natassia Smick and her husband filed their income tax return showing earnings of about \$33,000. [1] They expected a refund, \$2,000 of which is attributed to the Earned Income Tax Credit. [2] The Earned Income Tax Credit (EITC) is a tax credit “for working people with low and moderate incomes. It boosts the incomes of workers paid low wages while offsetting federal payroll and income taxes.” [3] The EITC aims to reduce poverty, and in 2018, the credit “lifted about 5.6 million people above the poverty line.” [4] Smick, like many other families, relied on her tax refund to help pay her credit card debt and other household expenses. [5] Instead of a refund, Smick received a letter from the IRS stating she was going to be audited. [6] After submitting bank statements, birth certificates, and proof that her child lives with her, the IRS would not review her documents for at least another six months. [7] Smick’s story is representative of many others and fits within a pattern where “[i]n the past decade, the IRS has audited low-income taxpayers who claimed the Earned Income Tax Credit (EITC)—with an average annual income under \$20,000—at a higher rate than people making \$500,000 to \$1 million dollars a year.” [8] The IRS has engaged in a practice of auditing low-income taxpayers because “it is cheaper and easier than auditing the rich.” [9] However, the harm of the audits is disproportionately affecting minority taxpayers. [10]

The Transactional Records Access Clearinghouse (TRAC) conducted a report examining the IRS audits in 2022 and found that low-income taxpayers remain the largest target of audits, with millionaires remaining at low risk of an audit. [11] The reports find the class with the “high[est] audit rates – five and a half times virtually everyone else – were low-income wage-earners taking the earned income tax credit.” [12] In contrast, audits of millionaire returns have decreased where “[t]en years ago, the IRS in fact audited 40,965 returns filed by millionaires. This had fallen to just 11,331 audits of millionaires in FY 2020.” [13]

The higher rate of audits on lower-income taxpayers has a disproportionate effect as “audit rates for Black Americans are three to five times higher than for other taxpayers, with audits focused on the tax credit [EITC] being a major driver of the disparity.” [14] Although close to half of the EITC tax filers “are white, an analysis by ProPublica found that the counties with the highest audit rates were ‘poor, rural, mostly African American and in the South.’” [15] The IRS “does not collect information on race and ethnicity on tax returns.” [16] However, the algorithms used by the IRS to monitor EITC fraud by targeting returns with errors “are more likely to identify Black taxpayers for audits.” [17] The increasing rate of audits on the poorest of Americans “serves to exacerbate America’s racial and class inequities.” [18] The frequency of audits is even less justifiable given that “these audits have done little to reduce alleged tax fraud . . . [t]he error rate on EITC claims remains high because the credit continues to be very complex.” [19] Even without considering the success rates of audits, “the IRS acknowledges the primary cause of the problem is not fraud: It is the law itself. It is too complex.” [20] To help mitigate these issues, policy proposals by advocates include: a call for simplification of the EITC and tax filing; increased funding for the IRS to conduct complex audits on high-income taxpayers; and additional funding for low-income taxpayer legal services. [21]

In response to these reports and under the Inflation Reduction Act, the IRS announced in September 2023 a “sweeping, historic effort to restore fairness in tax compliance by shifting more attention onto high-income earners, partnerships, large corporations and promoters abusing the nation's tax laws.” [22] The IRS outlined in its announcement a plan to prioritize high-income cases (i.e., income above one million) and complex partnership returns, focusing on sectors prone to wealth evasion such as digital assets, and protecting taxpayers from scams/fraud. [23] In regards to the auditing of EITC filers, the announcement claims that “the IRS will also ensure

audit rates do not increase for those earning less than \$400,000 a year as well as adding new fairness safeguards for those claiming the Earned Income Tax Credit.”[24] The IRS did not provide more details in this announcement nor subsequent announcements through January 2024.[25] Monitoring the IRS’ new initiatives is critical because it may “take several months after the next tax filing season for the I.R.S. to know if the changes have been successful.”[26] Funding will be vital to the IRS’ success, especially given that “[r]epeated funding cuts since 2010 hindered the ability of the IRS to go toe-to-toe with wealthy tax avoiders.”[27] It is crucial to ensure that Congress continues to support the IRS “through the appropriations process” and “avert a spending cliff when funds from the Inflation Reduction Act are exhausted.”[28]

[1] Paul Kiel and Jesse Eisinger, *Who’s More Likely to Be Audited: A Person Making \$20,000 — Or \$400,000?*, PROPUBLICA (Dec. 12, 2018, 5 AM), <https://www.propublica.org/article/earned-income-tax-credit-irs-audit-working-poor>.

[2] *Id.*

[3] *Policy Basics: The Earned Income Tax Credit*, CTR. ON BUDGET & POL’Y PRIORITIES (Apr. 28, 2023), <https://www.cbpp.org/research/policy-basics-the-earned-income-tax-credit>.

[4] *Id.*

[5] Kiel & Eisinger, *supra* note 1.

[6] *Id.*

[7] *Id.*

[8] Kenna Titus, *The Wealthy Get Tax Loopholes. The Poor Get Audited*, NAT’L WOMEN’S L. CTR. (Aug. 3, 2022), <https://nwlc.org/the-wealthy-get-tax-loopholes-the-poor-get-audited/>.

[9] *Id.*

[10] *Id.* See also Dorothy A. Brown, *The IRS Is Targeting the Poorest Americans*, THE ATLANTIC, (July 27, 2021), <https://www.theatlantic.com/ideas/archive/2021/07/how-race-plays-tax-policing/619570/>.

[11] *IRS Audits Few Millionaires But Targeted Many Low-Income Families in FY 2022*, TRAC (Jan. 4, 2023), <https://trac.syr.edu/reports/706/>.

[12] *Id.*

[13] *Id.*

[14] Alan Rappeport, *I.R.S. Changes Audit Practice That Discriminated against Black Taxpayers*, N.Y. TIMES (Sept. 18, 2023), <https://www.nytimes.com/2023/09/18/us/politics/irs-audits-black-taxpayers.html>.

[15] Dorothy A. Brown, *The IRS Is Targeting the Poorest Americans*, THE ATLANTIC, (July 27, 2021), <https://www.theatlantic.com/ideas/archive/2021/07/how-race-plays-tax-policing/619570/>.

[16] Lily Batchelder and Greg Leiserson, *Disparities in the Benefits of Tax Expenditures by Race and Ethnicity*, U.S DEPT. TREASURY (Jan. 20, 2023), <https://home.treasury.gov/news/featured-stories/disparities-in-the-benefits-of-tax-expenditures-by-race-and-ethnicity>.

[17] Jacob Bogage, *IRS Audits Black Taxpayers More Often than Other Groups, Agency Confirms*, WASHINGTON POST (May 16, 2023, 2:10 PM), <https://www.washingtonpost.com/business/2023/05/15/tax-audits-black-americans/>.

[18] Brown, *supra* note 15.

[19] *Id.*

[20] Kiel & Eisinger, *supra* note 1.

[21] Titus, *supra* note 8. See also Brown, *supra* note 15.

[22] *IRS announces sweeping effort to restore fairness to tax system with Inflation Reduction Act funding; new compliance efforts focused on increasing scrutiny on high-income, partnerships, corporations and promoters abusing tax rules on the books*, IRS (Sept. 8, 2023), <https://www.irs.gov/newsroom/irs-announces-sweeping-effort-to-restore-fairness-to-tax-system-with-inflation-reduction-act-funding-new-compliance-efforts>.

[23] *Id.*

[24] *Id.*

[25] *News release and fact sheet archive*, IRS, <https://www.irs.gov/newsroom/news-release-and-fact-sheet-archive> (last visited Jan. 29, 2024).

[26] Rappeport, *supra* note 14.

[27] Jean Ross, *Rebuilding the IRS Improves Customer Service and Reduces the Tax Gap*, CTR. FOR AM. PROGRESS (Jan. 30, 2024), <https://www.americanprogress.org/article/rebuilding-the-irs-improves-customer-service-and-reduces-the-tax-gap/>.

[28] *Id.*