

October 25, 2023

Distribution of IRS Audits by Income and Race

The Internal Revenue Service (IRS) enforces the federal tax code. Among the ways it does so is by conducting audits to verify the information on a taxpayer's return is accurate and the correct amount of tax has been paid. Some in Congress have expressed concern about who is audited and how that has changed over time.

Less than 1% of individual income tax returns are selected for audit each year. The audit rate has fallen for all income groups since 2010, but it has declined most for high-income taxpayers. While the IRS still audits a greater share of high-income filers than low-income ones, low earners who claim the Earned Income Tax Credit (EITC) face much higher audit rates than other taxpayers with similar incomes. Research also shows that the IRS is more likely to audit Black taxpayers than those of other races, even though the IRS does not collect information on taxpayer race.

Background on Audits

The IRS selects returns for audit using a variety of methods, including determining the likelihood that there may be an error on the return.

Audits generally take one of two forms: correspondence and field. The most common type of audit is a correspondence audit, where an IRS examiner requests information from a taxpayer by mail. Correspondence audits typically target one or several tax items rather than all the information provided on a return. In a field audit, an examiner typically meets a taxpayer at their home or place of business to review their records. Field audits typically examine more tax items in a filing than correspondence audits do. The IRS closed roughly 626,000 audits of individual income tax returns in FY2022, 85% of which were correspondence audits. The agency's National Research Program (NRP) also audits a small, semi-random selection of filers thoroughly to study the nature and frequency of tax nonpayment.

As of March 2023, the IRS had audited 0.41% of filed 2019 tax returns, a steep drop from the 0.89% of filers that were audited in 2010. This decline reflects a decrease in appropriations for enforcement at the IRS. Outlays for enforcement, measured in inflation-adjusted dollars, fell by 26% from FY2010 to FY2022.

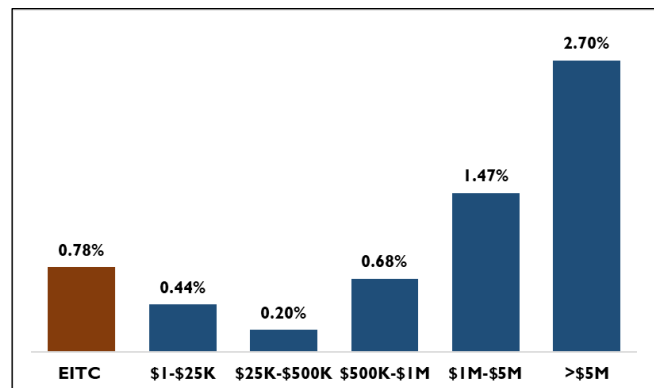
Congress made \$46 billion available to the IRS for enforcement activities—in addition to normal annual appropriations—through FY2031 as part of the \$80 billion for the IRS and related agencies in the law commonly referred to as the Inflation Reduction Act of 2022 (IRA; P.L. 117-169). Congress subsequently rescinded \$1.4 billion of these total IRA funds through the Fiscal

Responsibility Act of 2023 (P.L. 118-5). Negotiators also informally agreed to rescind \$10 billion from the IRS during both the FY2024 and FY2025 appropriations processes. Secretary of the Treasury Janet Yellen directed the IRS not to use the enforcement funds in the IRA to raise audit rates above historical levels for individual taxpayers with incomes below \$400,000 annually.

Distribution by Income

The IRS generally audits a larger share of high-income taxpayers than those with lower incomes, as illustrated in **Figure 1**. However, those who claim the Earned Income Tax Credit (EITC)—who typically have low incomes—are much more likely to face an audit than all but the highest-income taxpayers. While the average audit rate for all taxpayers that filed (an individual income tax return or any return) in tax year 2019 was 0.41%, the rate was 0.78% for EITC claimants.

Figure 1. Audit Rates by Positive Income, 2019 Returns



Source: Internal Revenue Service, *IRS Data Book*, Publication 55-B, March 2023, Table 17, <https://www.irs.gov/pub/irs-pdf/p55b.pdf>.

Notes: Audits of EITC returns are included in the audit rates of taxpayers with \$1-25K and \$25K-\$500K of income. These figures were published before the three-year statute of limitations on audits ended.

The IRS audited a smaller share of filers in 2019 than 2010 at every income level. According to the agency, it did so because of decreased funding (when controlling for inflation), staff attrition, and major disruptions such as a government shutdown and the COVID-19 pandemic.

The likelihood that high-income taxpayers will face an audit has fallen by more than the same decline in audit probability for lower-income taxpayers. While the audit rate for those earning over \$5 million fell by 86% for returns

from tax years 2010 to 2019, the rate for those earning below \$25,000 fell by 61%. The IRS says that resource constraints have compelled it to focus more of its resources on relatively simple, cost-effective audits, such as correspondence audits on EITC recipients.

According to the Government Accountability Office (GAO), the IRS audited taxpayers who claimed the EITC more frequently than many other types of taxpayers because the EITC is often claimed improperly. From 2006 to 2008, the IRS estimated that 42%–49% of tax returns that included an EITC incorrectly claimed the credit.

The IRS may also view audits of EITC claims as more cost-effective than others. GAO estimated that the IRS collects roughly equal amounts of money per hour of auditing from EITC claimants and those with incomes between \$5 and \$10 million. Audits of EITC returns—almost all of which are correspondence audits—typically also require less time than those of high-income taxpayers, who are more likely to use sophisticated techniques that are difficult to detect. Further, since most audits of EITC returns are done before the credit is issued, such audits may be more successful in “protecting revenue.” Additionally, high-income taxpayers may be able to reduce the tax owed (abatement), lowering the amount collected. Audit practices that emphasize cost efficiency may raise federal revenues but could lead to unexpected disparate treatment among different types of taxpayers.

There may also be concerns with the higher audit rates of taxpayers who claim the EITC. Low-income filers are less likely to respond to IRS correspondence audits adequately or at all, meaning the IRS may incorrectly disallow the credit. These audits may also have longer-term implications. EITC claimants whom the IRS has audited appear to be less likely to claim the credit in subsequent years, even if the audit found them compliant. Further, other research has found that audits of high-income filers still result in more increased revenue per dollar spent than audits of lower earners, despite their higher up-front cost.

Distribution by Race

The likelihood a taxpayer will face an audit also varies by race. After imputing the race of taxpayers, Elzayn et al. (2023) used research data from NRP audits and found that the IRS audits Black filers 2.9 to 4.7 times more often than it does others, even though the IRS does not use race in its audit selection process. IRS Commissioner Danny Werfel said that the IRS independently investigated the same issue, and that “while there is a need for further research, our initial findings support the conclusion that Black taxpayers may be audited at higher rates than would be expected given their share of the population.” Studies to date have not publicly presented disaggregated results for non-Black taxpayers of different races.

Elzayn et al. used several hypothetical methods of selecting returns for audit to show that different audit selection models can select returns with different demographic profiles. For example, selecting EITC returns for audit based on the likelihood of a refundable credit overpayment flags filings by Black households at a higher rate than

selecting similar returns based on likely total tax underpayment.

According to Elzayn et al., approximately 14% of the disparity is attributable to the fact that black filers are more likely to claim the EITC. Of the remainder, 78% is attributable to higher audit rates among Black EITC claimants relative to other EITC claimants, while 8% result from higher audit rates among Black non-claimants than other non-claimants. This would imply that to reduce the race gap, the IRS should focus on reducing disparities in audits of EITC claimants. However, preliminary analysis by Hertz et al. (2023) suggests that auditing Black and non-Black EITC claimants at the same rate would have the same effect on reducing the audit race gap as auditing EITC and non-EITC claimants at the same rate.

Hertz et al. acknowledged other potential causes of the audit race gap, including that tax preparers who submit many improper claims for the EITC—and whose returns may be subject to additional scrutiny by the IRS—have disproportionately Black client bases. Additionally, tax benefits such as the child tax credit and the EITC use different eligibility criteria to determine the number of children a filer can claim for each credit. These differences in eligibility criteria—and the criteria themselves—may be particularly confusing in situations in which the child’s parents are unmarried, which is more common among Black households than others.

Hertz et al. also identified within the IRS’s audit selection system potential sources of “algorithmic bias,” meaning factors in the structure of the IRS’s technical systems that favor non-Black filers in ways that are neither explained by the selection objectives themselves nor the goals of the system. The IRS models the residency of children and their relationship to filers indirectly, and as the researchers found, imperfectly. Errors in this system appeared to raise the audit risk for Black EITC claimants relative to others. The IRS previously over-selected returns for audits in certain weeks, which contributed to the implicit racial bias. The authors stated that improved scheduling has largely resolved this issue.

Recent IRS Action

On September 18, 2023, Commissioner Werfel said the IRS will audit a smaller share of taxpayers who claim the EITC and other refundable tax credits, and will instead focus more resources on examining large partnerships and collecting owed taxes from high-income individuals. The Commissioner also said the IRS has implemented changes to how it measures children’s residency that “testing suggests will increase the expected return on investment for cases selected while simultaneously reducing disparities.” He added that the agency is piloting two alternative EITC case selection processes. Taken together, these changes aim to reduce the audit rates on lower-income taxpayers and shrink the gap in audit rates between taxpayers of different races.

Brendan McDermott, Analyst in Public Finance

IF12521

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.