Explainer: Why Racial Disparities in IRS Auditing Practices are an Urgent Matter of Family Economic Security

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A [Stanford University study] released earlier this year found that Black tax filers are audited at between three and five times the rate of non-Black tax filers. While previous research had found [regional biases] in IRS audit selection—with rural areas with larger numbers of Black, Indigenous, and Latinx/e families with lower incomes experiencing the highest audit rates—this was the first study to apply a new methodology to identify the race of tax filers and analyze disparities in auditing between Black and non-Black tax filers. The researchers convincingly showed that across all income groups, Black tax filers are audited at higher rates, with the largest disparities occurring among families claiming the Earned Income Tax Credit (EITC). Furthermore, the researchers found that the disparities are not explained by differences in income, family size, or household structure, or by differences in tax under-reporting. That is, Black families are not audited at higher rates because they owe more money to the IRS. Instead, it appears that decisions the IRS makes in which returns it selects for audits are driving the racial disparities.

In the months since the study was released, IRS Commissioner Daniel Werfel has confirmed the researchers' findings, and committed to taking a number of important steps before the next tax filing seasons to address racial disparities in auditing. Researchers and analysts concerned with racial equity in tax administration—[including the Treasury Advisory Committee on Racial Equity]—have called on the IRS to go even further. Given the highly technical nature of the problem and proposed solutions, it is perhaps not surprising that the problem has not attracted significant attention from individuals and organizations outside of the tax space. But racial disparities in auditing are an urgent matter of family economic security, and redressing the disparities and ensuring all families can file their taxes without fear of unjust surveillance or retribution is critical to advancing economic and racial justice.

The IRS administers the largest anti-poverty programs for families with children. The IRS [mission statement] emphasizes its role as an enforcement agency—helping taxpayers "meet their tax responsibilities and enforce the law with integrity and fairness to all." However, the IRS is in fact one of [the largest benefit administrators] in the United States. The Earned Income Tax Credit and the refundable portion of the Child Tax Credit [lift more children out of poverty] every year than any other government program. This was [even more true in 2021], when the temporary expansion of the Child Tax Credit lifted over 5 million people out of poverty and worked with other supports to cut child poverty almost in half. But even after the expiration of the CTC expansion, refundable credits remain the most significant economic security programs for children and families. And one of the most likely paths to a permanent child allowance in the future is through the tax system.

For families to claim the tax credits they are owed—and for those credits to accomplish their purpose of bolstering family economic security—families need to be able to trust the tax system. The tax system has a key advantage in delivering benefits to families with children: for families who already file taxes every year, accessing benefits can be relatively straightforward, and dignified. As Sarah Halpern-Meekin and colleagues found in a classic study of over 100 families, filing taxes to claim credits is not stigmatizing, and helps reinforce a positive identity as many families think of their refunds are something they have "earned." During the pandemic, the IRS made significant strides improving access to benefits through the tax system by standing up temporary portals for people who traditionally do not file taxes to be able to easily claim their Child Tax Credit and stimulus payments, and working with the third-party Code for America to create a user-friendly simplified filing tool. The IRS is piloting an exciting direct file tool for the 2024 tax filing season. For many families, receiving economic support through the tax system is a significant improvement over traditional delivery mechanisms for public benefits, which can create hurdles to access, including excessive paperwork and verification, punitive and intrusive surveillance, and other administrative barriers that together can make the programs feel "designed to keep you down." These barriers, as CSSP has found in recent research, lead many families to lose assistance, or decide the costs of participating outweigh the benefits. But the advantages of delivering assistance through the tax system are severely limited when the tax system adopts some of the harmful practices of public-benefit-administering systems, subjecting families claiming refundable credits to greater scrutiny and disproportionately sanctioning Black families through audits. (On the racial disparities in sanctioning families participating in TANF cash assistance, see this recent study).

For families to feel comfortable claiming the Child Tax Credit, Earned Income Tax Credit, and the other refundable credits they are owed, it is critical that the IRS fully address racial disparities in auditing so that families can be sure that the benefits of participation outweigh the costs. The changes that the IRS Commissioner has already announced to refocus IRS enforcement toward high-end tax evasion and address racial disparities in auditing before next tax filing season are important steps in the right direction. In addition, the IRS should commit to:

- Report annually on any racial disparities in auditing moving forward. As recommended by the Treasury Committee on Racial Equity, this annual reporting should, to the extent possible, further disaggregate the data by race and ethnicity to include audit rates for each of the primary Census classifications: White, Hispanic or Latino, Asian, Native Hawaiian or Other Pacific Islander, American Indian or Alaska Native, and Black or African American; report audit rate disparities by zip code; and share information about the case selection practices driving any racial disparities that are uncovered, and the steps being taken to address them.

- Treat families claiming refundable credits like other tax filers. Families claiming the EITC, CTC and other refundable credits should not be subject to extra scrutiny simply for claiming these credits. As the NYU Tax Law Center have reported, refundable credits account for a small share of underreported income, but the IRS has subjected returns claiming credits to more rigorous scrutiny in part out of the mistaken belief that they are statutorily required to do so as "improper payments" under the Payment Integrity Information Act of 2019. As Treasury Secretary Mnuchin concluded at the time, however, "refundable tax credit refunds that result in overclaims should not be reported under the improper payments framework." The IRS should prioritize the total amount of tax underreporting, not refundable-credit related errors, in its audit selection process, and OMB should issue new guidance making it clear that the IRS does not need to single out refundable credit related errors in its reporting.

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- Institutionalize increasing take-up of tax benefits as a core part of the IRS's mission. The IRS made enormous strides to reach families and ensure they received the tax credits they were owed during the pandemic, sending out letters to families who the agency believed were eligible for the expanded Child Tax Credit but had not received it, and standing up simplified filing software, as discussed above. To build on this progress, the IRS should devote resources to expanding access to critical refundable credits and providing direct services to help families file and claim the benefits they are owed—including by processing returns directly when feasible. So, for example, if the IRS audits a tax filer because the agency believes they have improperly claimed a child for the EITC, and it has information about who is eligible to claim that child, the agency should take affirmative steps to contact the person who is eligible to claim the EITC and help ensure they receive the credit.

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