

To: Janis Bowdler, Counselor to the Secretary (Racial Equity) and Snider Page, Acting Chief, Office of Diversity, Equity, and Inclusion
Fr: Mayor Michael Nutter, Chair; and Felicia Wong, Vice-Chair, TACRE
Re: TACRE Data and Research Subcommittee Recommendations
Dt: July 3, 2023

Please find below three recommendations from the TACRE Data and Research Subcommittee. All TACRE members have had the opportunity to review and comment on these, and as such these are ready for your inclusion in any communications to Secretary Yellen.

Please let us know if you have any questions. Thank you for the opportunity to serve.

Recommendation #1: Addressing the Issue of Racial Disparities in Audits

Recent research has highlighted disparities in audit rates between Black and non-Black taxpayers (with particularly large disparities among those claiming the EITC) that are not easily explained by differences in tax circumstances. As a result, the Committee makes several recommendations.

We recommend that Treasury “develop its in-house analytical capacity in support of vulnerable taxpayers” (Jan 11, 2023 Briefing Memorandum to Members of TACRE) by prioritizing investments in tax equity analysis in the following offices: (i) Treasury’s Office of Tax Analysis (OTA); (ii) IRS Statistics of Income (SOI); and (iii) IRS’s Research, Applied Analytics and Statistics Division (RAAS). This will better enable the Administration to fairly enforce our tax laws.

In order to provide transparency, continual updates on the sources of these disparities, and whether current policy efforts are being successful in eliminating this disparity, the Committee recommends that the Secretary request an annual report from IRS providing updated numbers on racial disparities in audit rates in order to increase transparency. Such reports should include:

- An overall estimate of audit rates by racial and ethnic group (including all primary Census classification of race and Hispanic ethnicity) not limited to the EITC-eligible population.
- Estimates of the racial differences in audit rates within sub-groups which are affected by different pieces of salient tax law (such as EITC claimants and non-EITC claimants, Schedule C filers and non-Schedule C filers, etc...).
- A *publicly released* data set of audit rate disparities broken down by geographic unit, including state and (where population sizes allow) county and ZIP Code (“geographic audit report”) **to be provided within 90 days.**
- Whatever more disaggregated numbers the IRS Commissioner believes would clarify the sources of these disparities or the success of policy efforts to reduce them. For instance, if IRS believes that increased funding for VITA sites in under-resourced areas

would help reduce disparities through increased access to high-quality tax preparation support, then the report could provide statistics for filers in areas in which VITA funding is increasing.

- To the extent that clarifying the sources of the racial disparities in audits rates presents an unacceptable risk of public information release about the IRS audit process, the Commissioner should also brief the Secretary on the precise aspects of the audit algorithm that generate the racial disparities in audit rates among EITC filers reported in Elzayn et al.
- As the IRS reviews its algorithm in accordance with Commissioner Werfel’s letter of May 15, 2023, we recommend that the IRS assess how to focus enforcement efforts in ways that will contribute most to closing the tax gap, ie reducing the total dollars of taxes that are unpaid.

This annual report is similar to those already produced on audit rates and feasible with data currently available to IRS researchers. It is also consistent with the IRS’s Strategic Operating Plan: Objective 3, Initiative 3.7: Promote fairness in enforcement activities. Although IRS does not currently provide such statistics on racial disparities in audit rates, it does provide data on audit rates by income and EITC filing status. IRS similarly already provides information at disaggregated levels of geography in the County-to-County migration patterns tables. The IRS does not collect information on an individual tax filer’s race or ethnicity, but the above report would be feasible using either an imputation of race and ethnicity based on information that IRS does collect or via merging audit data with information on race and ethnicity from Census. The recent collaboration between Treasury, IRS, and Census which produced an analysis of the economic impact payments in Clark et al. could be used as a model.

IRS Commissioner Werfel stated in his May 15 letter: “I will stay laser-focused on this to ensure that we identify and implement changes prior to next tax filing season.” Therefore, the Committee recommends that the first such annual report be due to the Secretary **no later than March 2024**.

The Committee further recommends that the Secretary request that IRS Commissioner Werfel attend the September TACRE meeting and provide an update since his May 15 letter to members of the Senate Finance Committee, including a progress report on the geographic audit report, and an update on the Joint Statistical Research Program proposals received (see Recommendation #2).

Recommendation #2: Increase Independent Research into Racial Disparities in Tax Administration

IRS has not historically focused on issues of racial equity in its publication of data and analysis. Although we are encouraged by the Commissioner's recent focus on these issues, and we are hopeful that IRS will increase research and reporting on these issues going forward (pursuant in part to Recommendation #1), IRS reports alone will never substitute for the value of independent research into racial disparities in our tax system. Two recent independent research (i.e., without IRS sponsorship or current IRS staff as coauthors) papers studying racial disparities in audit rates (Elzayn et al. 2023) and tax expenditure usage (Cronin et al. 2023) both highlight the importance of such research.

The Committee recommends that the Secretary increase the volume of independent research on this important issue. Such steps should include (though not be limited to):

- Continue to prioritize research on racial disparities within the Office of Tax Analysis. Among the two papers mentioned above, two of seven coauthors of Elzayn et al. and all three coauthors of Cronin et al are OTA researchers. This work is outstanding and should be further encouraged.
- Prioritize research on these issues in the upcoming IRS Call for Proposals in the Joint Statistical Research Program (JSRP). IRS should additionally conduct outreach to scholars with expertise in this area to ensure that they are aware of this research opportunity and have an opportunity to apply. The call for proposals is June 1-30, 2023, and therefore **time is of the essence**.
- Where tax law permits, increase availability of Title 26 data at Census to permit broader study of racial disparities in tax administration using merged IRS and Census data (since race and ethnicity of individual tax filers can, in most cases, be directly observed with the Census secure data environment).

Recommendation #3: Equalize Reporting on Tax Non-Compliance Between Refundable Credits and Underpayment of Taxes

Under the current interpretation of the Payment Integrity Information Act (PIIA) of 2019, IRS must report more frequently and in more detail on tax non-compliance in the use of refundable tax credits than on other aspects of tax non-compliance (e.g., underpayment of taxes by Schedule C filers). Such imbalanced reporting draws attention away from underpayment of taxes by high-income filers and towards non-compliance of low-income filers, despite the former contributing substantially more to the tax gap than the latter.

Because more information is helpful to draw public attention to monitor IRS activities, we recommend that the Secretary increase reporting requirements for IRS on all sources of tax non-compliance to match those currently required by the PIIA for the EITC and other refundable tax credits. Alternatively, the Secretary could request that OMB remove the EITC and other refundable tax credits from the PIIA's reporting regime.