GAO Highlights

Highlights of GAO-24-106126, a report to the Chairman, Committee on Finance, U.S. Senate

April 2024

TAX ENFORCEMENT

IRS Audit Selection Processes for Returns Claiming Refundable Credits Could Better Address Equity

Why GAO Did This Study

Policymakers and the public expect IRS to administer the tax code fairly. Even though IRS does not collect information on the race and ethnicity of taxpayers, some audit selection criteria and methods could have different implications for taxpayers depending on their race or ethnicity. According to one academic study, audits of EITC returns accounted for 78 percent of the overall estimated racial disparity in audit rates.

GAO was asked to examine IRS's safeguards for ensuring audits do not target filers based on demographic characteristics. This report focuses on audits that address refundable credits, including EITC, and describes IRS policies to address equity in audits; describes relevant audit planning and selection processes; and assesses how IRS considers equity both in developing its audit workplans and in its automated audit selection processes.

GAO reviewed relevant academic literature, analyzed IRS audit tools and procedures, and interviewed IRS officials. GAO assessed IRS audit selection procedures against relevant agency goals and objectives, key practices for evidence-based policymaking, and standards for internal control.

What GAO Recommends

GAO is making six recommendations to IRS, including to calculate the no-change rate without default audits, improve its reviews of audit selection processes, and use additional performance measures in assessing its selection systems. IRS agreed to all of GAO's recommendations.

View GAO-24-106126. For more information, contact Jessica Lucas-Judy at 202-512-6806 or lucasjudyj@gao.gov.

What GAO Found

The Internal Revenue Service (IRS) and the Department of the Treasury have committed to tax administration equity, including equity in how IRS conducts audits, in multiple policies and various media. IRS also has begun to examine potential systemic biases in audit enforcement across several demographic characteristics, including age, gender, geography, race, and ethnicity.

IRS's Wage & Investment Division (W&I) audits returns claiming refundable tax credits, including the Earned Income Tax Credit (EITC) and the Premium Tax Credit. W&I uses a mix of manual and automatic processes to determine the number and types of audits it will conduct and relies on four objectives to develop its audit workplan. One of these objectives is the no-change rate—the percentage of returns that will yield no additional revenue after audit.

IRS seeks to achieve a low no-change rate because that indicates it is auditing noncompliant taxpayers. However, the calculation of the no-change rate includes default audits—audits closed as a "change" because taxpayers did not respond or provided insufficient responses to IRS's notices. IRS officials said their recent research found that Black taxpayers are more likely not to respond to IRS correspondence than taxpayers of other races. Default audits also may be more common among low-income and EITC taxpayers, because of challenges that make communicating successfully with IRS more difficult, such as being transitory or not having bank accounts. W&I uses past results to inform current audit planning, which could lead to W&I disproportionately selecting the types of returns that have historically resulted in filers' nonresponse rather than in confirmed noncompliance.

The primary system IRS uses to select specific returns for audit is the Dependent Database (DDB) program, an automated system that flags returns for potential risk of noncompliance. While IRS regularly reviews the program, the review process does not comprehensively consider data inputs and assumptions that could inform IRS about the demographic equity of the audit selection process, creating the potential for unintended bias in audit selection. For example, GAO found that some risk scores contained in the DDB program vary by sex, which could skew selection, and have not been updated since 2001.

The primary measure for assessing the performance of the DDB system is the no-change rate. IRS officials said they are piloting a new scoring model to better detect noncompliance in tax return filings, which would be used for audit selection. IRS used the amount of revenue gained through conducting the audits as a performance measure for the pilot, an indicator of the extent of noncompliance rather than just its presence. The agency may be missing opportunities to improve the likelihood that IRS is properly identifying returns at highest risk of noncompliance if it does not consider additional performance measures in reviewing its automated audit selection process.