Poor in US more likely to face tax audits

Shannon Jones
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New statistical evidence demonstrates that the net result of the so-called reform of the Internal Revenue Service (IRS) has been a further shift in the tax burden from the wealthy to the working class and sections of the middle class.

With the support of the Republican Congress and the Clinton administration the Internal Revenue Service Restructuring and Reform Act took effect in 1998. At the time proponents touted the measure in populist terms, declaring that it would end the harassment by federal tax collectors of workers and small businessmen. In fact the opposite has been the case.

The results of a study conducted by researchers at Syracuse University reported in the April 16 edition of the *New York Times* show that for the first time ever the IRS audited a higher rate of returns of low-income people than those of the rich. In 1999 the IRS audited returns of 1.36 percent of people making less than $25,000. That compares to an audit rate of 1.15 percent for those making more than $100,000. This is a remarkable turnaround, considering that in the late 1980s the audit rate for the upper income taxpayers was more than 11 percent.

Small, unincorporated businesses with less than $25,000 in annual sales were more likely to be audited than businesses with more than $100,000 in annual sales—a 2.7 percent audit rate for the small enterprises compared to a 2.4 percent rate for larger firms. At the same time only 1 in 66 corporations was audited in 1999, the lowest rate in 86 years.

In the increasingly unlikely event they are caught, wealthy tax evaders face little prospect of being penalized or having their assets seized. In fact, levies, fines and seizures have fallen dramatically. The number of levies of bank accounts and other assets carried out by the IRS to collect past due taxes dropped 86 percent over the past two years. Seizures of property have fallen 98 percent during the same period.

Corporations have interpreted the shift in IRS policy as a green light to avoid paying taxes. According to recently released figures, total taxes paid by US corporations fell by 2 percent last year, despite record profits.

The indulgent attitude shown by the IRS toward the wealthy has led to a proliferation of tax avoidance schemes by US corporations. According to a report published in the April 14 edition of *USA Today*, large investment houses and banks are marketing shady tax plans to businesses:

"This industry has boomed because promoters are selling these deals for contingency fees, which means there are no up-front costs to the companies. If the transactions go through, some promoters get as much as a 50 percent cut of the tax savings—if the companies get away with it. And many executives are taking the risk because the odds that the IRS will challenge a deal are slim."

In one example cited by *USA Today*, Compaq Computer Corp. bought 10 million shares of Royal Dutch Petroleum and sold them a few hours later for a loss of $1.9 million. However after taking a credit for paying $3.4 million in taxes to the Netherlands the company came out $1.5 million ahead on the deal.

As a result of such dodges there has been a widening of the gap between profits reported by companies to their stockholders and the amounts reported to the IRS. In 1999 the difference came to $122 billion. That figure represented twice the gap that existed in 1995.

The go-soft approach shown by the IRS toward corporate tax cheats is in marked contrast to its increasingly tough attitude toward the poor. The Clinton administration and Congress have mandated that the IRS take a harder line against so-called abuse of the earned income credit, a deduction available to lower paid workers. Bowing to claims by the Republican right that many poor people were illegally claiming the earned income credit, Clinton proposed the IRS increase audits of low-income families to fight the alleged fraud.

According to the *Times*, "the IRS is scrutinizing the earned income credit with such wariness that it is sometimes denying the credit to people who are legitimately owed it on nothing more than suspicion, according to several low-income taxpayer clinics run by law schools."

Few poor people have the resources, the *Times* noted, to fight the IRS and often give up when they are unjustly denied the credit. These cases are then added to the list of alleged instances of fraud and used by the extreme right to justify further cuts in aid to the poor.

Meanwhile the IRS has reduced the number of face to face audits it conducts of wealthy tax payers. These audits require highly trained investigators able to spot complex tax dodges. The number of these audits declined sharply last year, continuing a long-term trend toward more lenient treatment of the rich. In fact, budget cuts carried out by both Democratic and Republican administrations have reduced the size of the IRS staff by 31 percent since 1988.

It is increasingly common for the rich to understate the value of gifts in order to avoid paying taxes on property passed on to heirs. Recent legislation has made it even easier for wealthy individuals to avoid estate taxes.

Due to staff cutbacks the IRS has just 78 lawyers available to audit more than 3,300 gift tax returns filed by wealthy individuals. Of gifts valued at between $600,000 to $1 million, only 1 in 55 is even audited. Under these conditions many rich people do not even bother to report their taxable gifts at all.

The Taxpayer Relief Act of 1997 gives the IRS just three years to audit gift tax returns. Previously the agency could challenge such returns for an extended period of time, sometimes decades. This state of affairs has encouraged many wealthy people to deliberately undervalue assets in hopes of avoiding taxes.

A Southern California Law School professor said many wealthy business owners "will first kind of muck up much of their business" in order to justify declaring a much lower value before passing it on to heirs. He noted that rich people will often signal to appraisers whether they want a high or low estimate, depending on the purpose—tax avoidance or financial planning.

For the full text of the Syracuse University study see: http://www.trac.syr.edu/tracirs/index.html