

Taxpayer Response to the EITC: Evidence from IRS National Research Program

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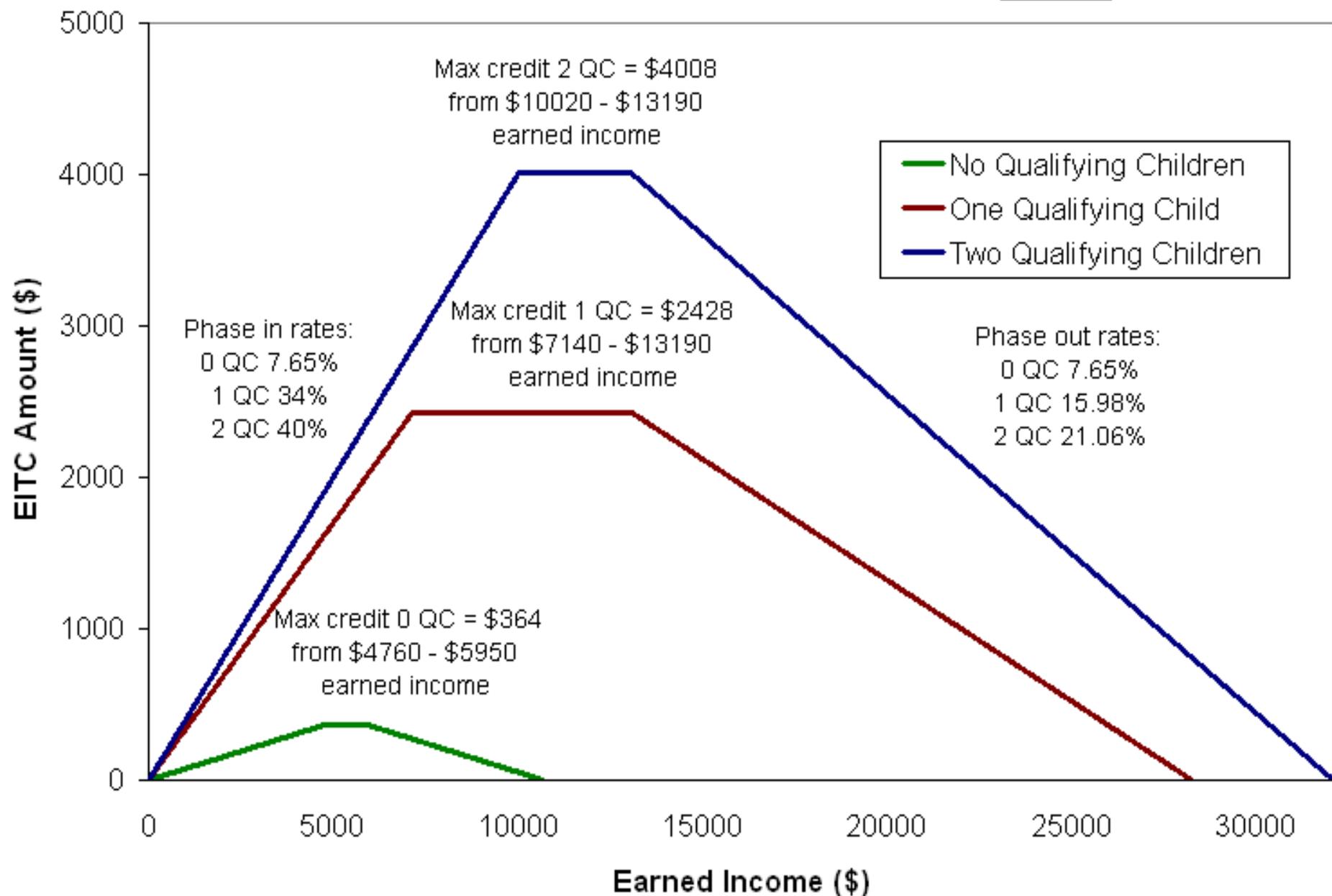
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Overview

- Large literature uses taxable income measures to estimate behavioral responses to taxation
- To what extent are responses to tax incentives driven by income manipulation (tax evasion) vs. “real” changes in earnings behavior?
- We report a set of tabulations using audit data to characterize differences between reporting behavior and “true” earnings behavior
- Analyze bunching in taxable income around first kink of EITC schedule
 - EITC generates strong incentives to misreport income and/or change true earnings to obtain a larger refund

EITC Parameters in TY 2001

Chart Area



National Research Program Audit Data

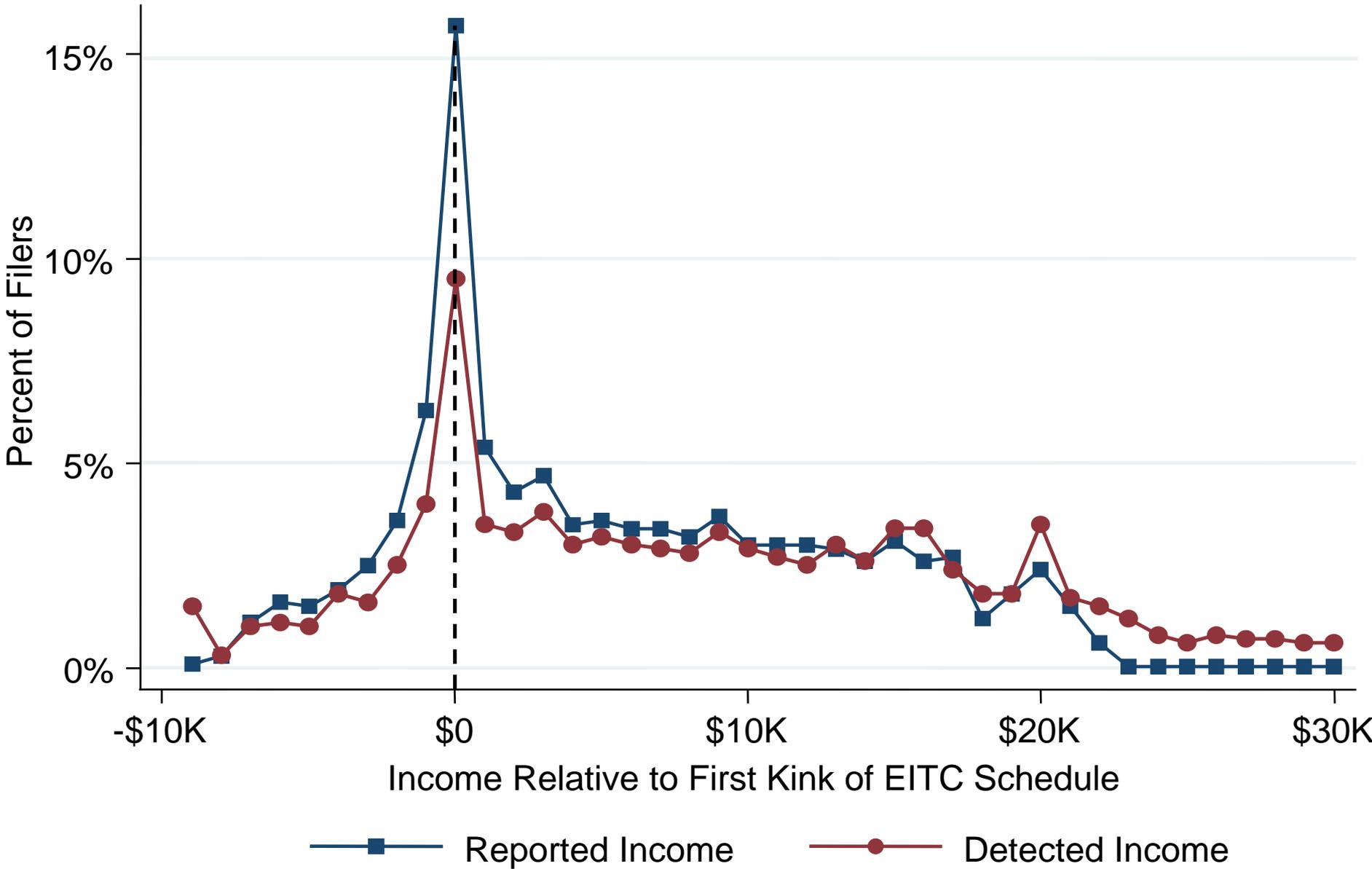
- NRP conducts audits on random samples of taxpayers
 - Provides taxpayer-reported and examiner-corrected (“detected”) amounts
 - Tax Year (TY) 2001 study sampled approximately 45,000 individual income tax returns
- Our sample: 5,400 EITC claimants with one or more qualifying children

Analysis

- We plot histograms (\$1000 bins) centered around first kink of EITC schedule for two groups
 - Self employed filers: individuals who report non-zero Schedule C income
 - Wage earners: individuals who report no Schedule C income
- Plot two income distributions
 - Reported income: income reported by taxpayers
 - Detected income: post-audit corrected income

Reported vs. Audited Income Distributions for SE EITC Filers in 2001

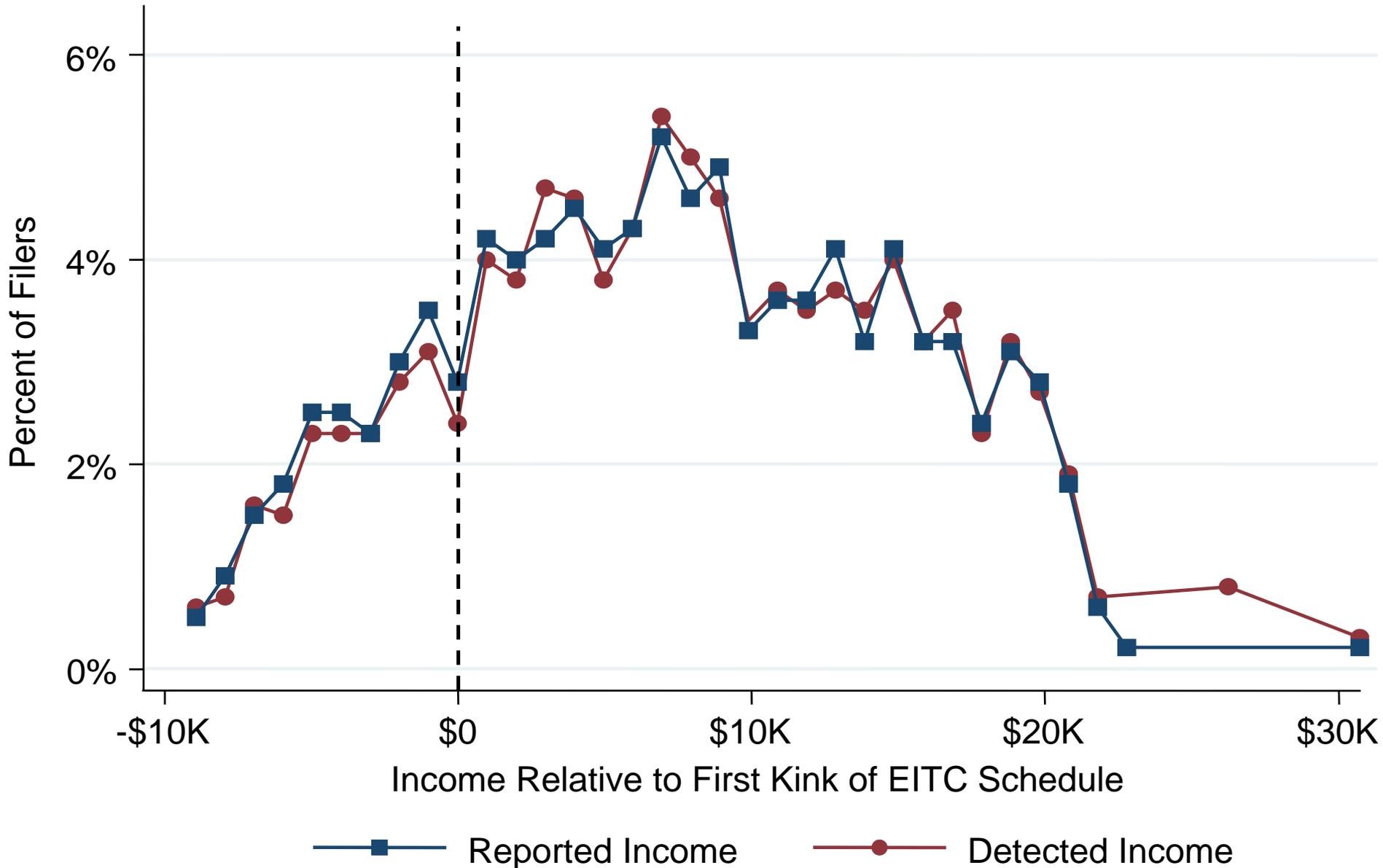
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Source: IRS TY01 NRP reporting compliance study of individual income tax returns for those reporting dependent children; amounts reflect only what was detected by the auditors, weighted to population levels.

Reported vs. Audited Income Distributions for EITC Wage Earners with Children

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Source: IRS TY01 NRP reporting compliance study of individual income tax returns for those reporting dependent children; amounts reflect only what was detected by the auditors, weighted to population levels.

Conclusions

- These tabulations reveal sharp bunching at first kink of EITC schedule in reported income for self-employed
 - Sharp bunching falls substantially in post-audit distribution
 - Considerable manipulation of self-emp. income to maximize refund
- Reported and detected income distributions for wage earners very similar
 - Little evidence that wage earnings are manipulated even in the presence of strong tax incentives to do so