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

Raj Chetty, Harvard and NBER
John N. Friedman, Harvard and NBER
Peter Ganong, Harvard
Kara E. Leibl, Internal Revenue Service
Alan H. Plumley, Internal Revenue Service
Emmanuel Saez, UC Berkeley and NBER

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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

Max credit 2 QC = $4008 from $10020 - $13190 earned income

Max credit 1 QC = $2428 from $7140 - $13190 earned income

Max credit 0 QC = $364 from $4760 - $5950 earned income

Phase in rates:
0 QC 7.65%
1 QC 34%
2 QC 40%

Phase out rates:
0 QC 7.65%
1 QC 15.98%
2 QC 21.06%
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
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
National Research Program Tax Audit Data

Income Relative to First Kink of EITC Schedule

Percent of Filers

Reported Income
Detected Income

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
National Research Program Tax Audit Data

Reported Income
Detected Income

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.