

Tax Controversy Among the Low-Income Population

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Tax controversy is not unique to businesses, to high-income individuals, or even to those in the middle class. The low-income population has its share of controversy problems. People with lower incomes, too, are audited and receive letters from the IRS disputing the claims made on their returns. They, too, get into matters of dispute over complicated provisions dealing with a variety of exemptions, deductions, and credits.

In her role as the Executive Director of the American Tax Policy Institute, Professor Janet Spragens of American University has written about many of those issues, and I can do no better than to quote her liberally below. (For prior coverage, see Tax Notes, Oct. 5, 1998, p. 129.)

"It often comes as a surprise, even to tax professionals, to learn that low-income individuals have tax controversy problems at all, or that their returns are being audited to any significant extent. The reality is that returns in all income groups are audited by the Internal Revenue Service, and in fact tens of thousands of low-income taxpayer returns (if not more) are audited each year.

"The issues raised in these cases are so diverse that it's hard to provide a complete list of them; but they include the earned income tax credit, dependency exemptions, educational expense deductions, tip income, substantiation, innocent spouse issues, employee versus independent contractor issues, head of household and other filing status issues, start-up business expenses, alimony and child support, pension income, unemployment compensation, disability income, casualty losses, dependent care credits, construction worker commuting costs, home offices, business use of an automobile, section 1041 payments, self-employment taxes, employee business expenses, interest deductions, and hobby losses.

"The taxpayers are also an eclectic group. They include cab drivers, travel agents, construction workers, retirees, flight attendants, mail clerks, car salesmen, police officers, janitors, household workers, nurses, high school teachers, artists, waiters, immigrants, and many, many self-employed taxpayers with marginal businesses and terrible records.

"A recent client of the American University Tax Clinic was the owner of a barely profitable store whose income had been reconstructed by the IRS (and a large deficiency proposed) through the bank deposits method of proof. Another was a taxpayer whose sister-in-law had used his social security number on a bank account, which led to an IRS audit on unreported income. Another was an exotic dancer attempting to deduct some of his costumes. Still another was a prisoner who wrote to tell us that the IRS had disallowed the dependency exemptions he had claimed for his children (for a tax year before he went to prison).

"Several of our clients have been divorced women seeking innocent spouse relief for taxes attributable to joint returns filed during the marriage. We also get large numbers of nonfilers who have W-2s and 1099s floating around the system and who have received deficiency notices from the Service on a reconstructed tax return.

"Perhaps the most desperate clients who come to us are recent immigrants to this country for whom English is not a first language. These individuals are totally lost when it comes to dealing with the tax system. One aspect of the problem is that very few countries around the world have a voluntary filing system, and many of these people assume that the U.S. system operates similarly to their home country. Therefore, there are large numbers of nonfilers in this group of taxpayers. When these taxpayers do file, they frequently rely heavily on storefront tax preparers who, we have found, are often a significant source of erroneous information. They also frequently "borrow" or make up social security numbers, report husband and wife's income under one social security number, or make other errors on tax returns that are difficult to straighten out later.

"If the individual is an undocumented alien, the problems increase. These individuals are often fearful of answering correspondence from the Service out of concern that the information will be shared with the INS

and they will be deported. This fear, together with significant language barriers, make the Service's communication with them limited at best. Overworked exam and appeals officers sometimes just give up on these individuals and write the cases up as single nonfilers with no dependents or deductions other than the standard deduction. This frequently overstates the tax due.

"With the recent enactment of the child credit, tuition credits, collection due process procedures and separate liability provisions, as well as the recent proposals for additional change, such as for an elder care credit or marriage penalty relief, the return complexities and audit issues facing this segment of the taxpaying population can only grow. Already, unrepresented and low-income cases comprise a dis-proportionately large percentage of the Tax Court's and IRS Appeals' docket, and it is predictable that these cases will consume an increasingly large share of their resources over time."

Professor Spragens, I believe, has made a strong case that more attention ought to be paid to the needs of low-income taxpayers. Indirectly, she points to significant costs arising from the failure of Congress, the Treasury, and the White House to be able to come together to make an effort toward tax simplification.

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