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Companies Take More Aggressive Tax Positions When IRS Budgets Get Cut

FOR IMMEDIATE RELEASE

Lakewood Ranch, Fla. _ A new study published by the American Accounting Association finds that companies take IRS budgets into consideration when developing their year-to-year tax strategies and take more aggressive tax positions when IRS budgets are smaller.

"We wanted to explore what external factors affect a company's decisions regarding tax avoidance," says Danielle Stanley, coauthor of the study and an assistant professor of accounting at Coastal Carolina University. "Specifically, we wanted to see if companies were more comfortable with aggressive tax strategies when they think the IRS has fewer resources to engage in audits."

"Previous work looked at corporate tax decisions in light of historical audit rates, asking whether recent audit rates influenced tax strategy," says Hannah Smith Antinozzi, coauthor of the study and an assistant professor of accountancy at the University of Memphis. "We took a different approach and looked at corporate decisions in the context of publicly-available data on the IRS's forecast budget."

For the study, researchers looked at data from 10,992 companies between the years of 2011 and 2021. To assess changes in how aggressive each company was being with its tax positions, the researchers looked at changes in each company's effective tax rates and uncertain tax benefits. The researchers collected data on IRS budgets from the Treasury Department.

The research team then used statistical tools to account for confounding variables, allowing them to better identify any correlation between corporate tax positions and the projected IRS budget for the following year.

"We looked at IRS budget projections for the next year, because that is when the IRS could begin conducting audits on this year's tax filings," says Stanley.

"Our biggest finding was that companies appear to take IRS budgets into consideration and take more aggressive tax positions when budgets go down," says Stanley. "That's over and above any correlation to historical audit data."

"In other words, our findings suggest companies pay more attention to the IRS's projected budget than they do to recent audit rates when making decisions about how aggressive to be with their tax strategy," says Antinozzi.

"One takeaway message here is that cuts to IRS budgets seem to have the unintended consequence of encouraging aggressive tax behavior," says Antinozzi.

"And from a practical standpoint, our study suggests auditors should be aware that firms are more likely to make dicey tax decisions when IRS budgets are down," says Stanley. "That makes it particularly important for auditors to allocate their available resources in ways that will identify tax fraud."

The paper, "IRS Audit Detection Risk and Firm Tax Behavior: Can Tax Fraud be Deterred by Increasing IRS Budgets?", is published in the *Journal of Forensic Accounting Research*.

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