

# To File or Not to File:

## TAX COMPLIANCE AMONG UNDOCUMENTED IMMIGRANT WORKERS

By *Jacqueline Latnez*

Each year as April 15th approaches, most Americans organize their recently arrived wage and interest statements in anticipation of filing taxes. Come tax time, undocumented immigrant workers in America face the fundamental decision of whether or not to file a tax return. Tax compliance among the general working public is a complex issue. However, tax compliance among undocumented immigrant workers, in particular, is exceedingly complex. This article explores the tensions circling the immigration debate with respect to tax policy and examines whether undocumented immigrants are materially participating in the basic American obligation of “filing” taxes, which is not synonymous with “paying” taxes. Analysis of the issue requires a review of the three key players to the discussion which include the Internal Revenue Service (“IRS”), the Social Security Administration (“SSA”), and the Department of Homeland Security (“DHS”).



ing the needs of the population. One dire need is comprehensive immigration reform. Undocumented immigrants have limited options unrealistic quotas for legal entry, interminable processing times for adjustment of status petitions, and a systemic backlog that leaves many immigrants with little choice but to go “underground.” Employment opportunities exist in the United States for foreign-born workers but offer little opportunity, particularly for “low skilled” workers, to migrate legally.

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The United States population has reached 300 million, including an estimated 12 million undocumented immigrants, and it is vital for these three governmental agencies to work with Congress toward developing effective methodologies for address-

### The Internal Revenue Service

The IRS is intensely aware of the fact that undocumented immigrants in the United States are holding jobs. The IRS, in the business of revenue collection, facilitates revenue collection by allowing undocumented immigrants to use a Taxpayer Identification Number originally developed to permit nonresident aliens to file United States tax returns to report United States source income. The Individual Taxpayer Identification Number (“ITIN”) resolved the fact that nonresidents earning United States income from abroad did not possess and did not qualify for a Social Security Number (“SSN”), which is a requirement to file a personal income tax return. The ITIN program, first introduced in 1996, has since soared in popularity, primarily

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among undocumented workers. The Commissioner of the IRS has gone on record regarding tax compliance by undocumented workers, stating:

Our job is to make sure that everyone who earns income within our borders pays the proper amount of taxes, whether that income is legally obtained and whether the individual is working here legally. If someone is working without authorization in this country, he/she is not absolved of tax liability. Instead of an SSN to file a tax return, that person frequently uses an Individual Taxpayer Identification Number (ITIN).<sup>1</sup>

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The IRS *is* doing its job and has the unenviable responsibility of coaxing voluntary tax compliance by the working population in America, as well as compliance from those earning United States source income but who reside outside of the United States. Prior to the introduction of the ITIN program, the IRS experienced the administrative nightmare of receiving thousands of tax returns filed either with SSNs that did not exist, or that did not belong to the individual filing the tax return. When judged as a short-term solution, the ITIN program has been a resounding success.

### The Social Security Administration

The Social Security Administration holds an intriguing position in the analysis because it is keeper of the enigmatic Earnings Suspense File (“ESF”). The ESF is where employment taxes are placed when they cannot be traced to the person who earned the taxed wages. Employment taxes are sometimes referred to as Medicare and Social Security taxes. They were specifically enacted under the Federal Insurance Contributions Act (“FICA”) and additional acts under the Code that require employers to deduct these taxes directly from employee paychecks.<sup>2</sup> Employers are required to collect employment taxes and contribute their own equal portion.<sup>3</sup> These wage records are then transferred from IRS to the SSA.

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ity for executing the reporting function by providing SSA with W-2s and by filing Forms 941, 943 or Form 1040, Schedule H with the IRS. Self-employed taxpayers report their earnings and pay taxes to the IRS and have no direct reporting requirement with SSA. Thus, the data transfer occurs when the self-employed taxpayer makes estimated quarterly



tax payments, or files a tax return with the IRS. In any event, once SSA receives wage information, it conducts a reconciliation process and documents wage records by tracing the earnings to the SSN holder, duly updating the individual earnings record. The problem occurs when wage records are submitted for someone who does not exist in SSA records, or when, for example, \$15,000 in earnings from a fast food chain is attributed to a three-year-old’s SSN, or better yet, to the SSN of someone long deceased. These taxes cannot then be traced to the actual person earning the wages, so they are placed into the ESF, possibly indefinitely.

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Official reports indicate that between the years 1937 and 2003, wage records numbering somewhere between 244 to 255 million<sup>4</sup> accounted for between \$421 billion to \$520 billion in earnings accumulated into the ESF.<sup>5</sup> James B. Lockhart III, Deputy Commissioner of Social Security, testified that generally about 2% of all wage items for a particular year remain in the ESF.<sup>6</sup> Deputy Commissioner Lockhart further confirmed that the ESF's growth over the years is indicative of the "increase in illegal immigration and subsequent illegal employment."<sup>7</sup> False or inaccurate social security numbers on wage statements add to the growth of the ESF, clearly increasing the IRS workload. Identity confirmation issues are also said to "burden individuals who must work with SSA and IRS to resolve disputes that may affect their social security benefits and tax obligations."<sup>8</sup>

Various officials have addressed whether these false or inaccurate SSNs can be attributed to undocumented workers. The Treasury Inspector General for Tax Administration ("TIGTA") estimated that "353,000 taxpayers could be identified as illegal aliens from IRS tax year 2000 data and that of these at least 265,000 had wage statements with invalid SSNs."<sup>9</sup> Additionally, a large percentage of inaccurate W-2s are reported by industries that have been known to rely on immigrant labor. Pursuant to an examination conducted by the Government Accountability

Office ("GAO"), of the percentage of inaccurate W-2s received from businesses, 17% were from restaurants, 10% from construction companies and 7% from farm operations.<sup>10</sup>

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The future of the Social Security ESF is uncertain. However, there are two important points to consider. First, undocumented immigrant workers cannot use ITINs to work. ITINs can be used only to file taxes and open an interest-bearing bank account. Therefore, in order to work, undocumented immigrants must provide employers false SSNs or work on a cash-only basis. Second, the only way undocumented immigrants can claim Social Security earnings, and thus Social Security benefits later in life, is through legalized status.

If the United States government grants undocumented immigrants the right to a valid SSN, undocumented workers will not need to use a false SSN, and will have the opportunity to establish their own legitimate earnings records.

However, without the possibility of immigration reform, or the potential for legalization of millions of undocumented workers in the United States, the ESF will presumably be allowed to grow ad infinitum. Meanwhile, undocumented workers are disproportionately taxed via regressive social security taxes.<sup>11</sup> These workers will continue contributing to the ESF and, except for the lucky few who win the immigration lottery, will never recover the 7.65% taken from each and every paycheck, every year.<sup>12</sup> Regardless of whether they ever file a tax return, an undocumented worker earning W-2 wages, without a valid SSN, will never recoup nearly 8% of their hard-earned dollars that vanish into the ESF mist.

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### The Department of Homeland Security

DHS may have the toughest job of all. They are the gatekeepers of an economically viable nation with employment opportunities for neighboring nationals brave enough to trek across deserts and rivers, and if the recently passed H.R. 6061 “Secure Fence Act of 2006” provisions come to fruition, scale walls. DHS Assistant Secretary Julie L. Myers stated during recent Congressional hearings:

Our agents and investigators are enforcing the immigration laws of this country on a daily basis. However, if we do not make greater strides in this area, immigrants will continue to risk their lives for the prospect of a well-paying job in this country, often by turning to smugglers who exploit and force them to live in the shadows once they arrive.<sup>13</sup>

Immigration into the United States is not a new phenomenon and Congressional testimony today is interesting to compare to historic debates on the issue.<sup>14</sup> Assistant Secretary Myers conceded that prior legislation, specifically the 1986 Immigration Reform and Control Act (“IRCA”), resulted in “explosive growth in an increasingly profitable false document industry catering to undocumented workers seeking employment.”<sup>15</sup> It is true that IRCA unfortunately ushered in the modern day problems with SSN misuse. A large majority of undocumented workers are here to work and will virtually do so by any means necessary. The biggest question facing DHS is whether there is any practical solution to the immigration debate. If there is, it is certainly not of the one-size-fits-all variety. DHS can also only work within the confines of Congressional action. The 109th Congress passed an enforcement-only bill that calls for the building of a 700-mile fence. DHS understands that enforcement alone will not quell

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the influx of immigrants who continue to seek better economic opportunity in the United States. Until comprehensive immigration reformed is realized, DHS will remain in the same indefinite quandary as the SSA & IRS.

So we return to our original question, voluntary tax compliance among undocumented workers. Looking at the situation in light of the preceding discussion, undocumented workers find themselves facing the following dilemma:

- 1 File taxes, with an ITIN, and hope for meaningful immigration reform. However, if they file taxes and Congress passes continued enforcement-only legislation—which could include mass deportations—they will be the easiest group to trace since, by way of the ITIN and the filing of federal and state tax returns, they are well within the ambit of governmental radar.
- 2 On the other hand, if future immigration reform allows for an essential worker policy and the possibility of legalization for those who can prove they have been in the United States for a prescribed time period, filing tax returns will be mandatory. There are those who, optimistically, have already filed taxes in hopes that such reform is imminent.



Meanwhile, regardless of whether or not undocumented workers file taxes, a guaranteed 7.65% of their W-2 earnings will remain out of their reach in an amorphous SSA Earnings Suspense File. For self-employed workers who optimistically file taxes, they are handing over 15.30% of Social Security taxes that they may realistically never, ever see again. For undocumented workers the question, “To File or Not to File,” takes on all the bitter cadence of the melancholy Dane’s beleaguered refrain. **BLB**

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## ENDNOTES: *Jaqueline Láinez*

<sup>1</sup> *Impacts of Border Security and Immigration on Ways and Means Programs Before the H. Comm. on Ways & Means*, 109th Cong. 109-76 (2006) (statement of The Honorable Mark W. Everson, Commissioner, Internal Revenue Service).

<sup>2</sup> See IRC §§ 3101-28 (2000) (Federal Insurance Contributions Act, (“FICA”)); IRC §§ 3201-41 (Railroad Retirement Tax Act (“RRTA”)); IRC §§ 3301-11 (Federal Unemployment Tax Act (“FUTA”)); IRC §§ 3401-04 (regulating income tax withholding).

<sup>3</sup> Since 1990, the FICA tax rate has been 7.65%. This is the combined rate for Social Security and Medicare. The Social Security portion (OASDI) is 6.20% on earnings up to the applicable taxable maximum amount (\$94,200 for 2006 and \$97,500 for 2007). The Medicare portion (HI) is 1.45% on all earnings. Employees and employers each contribute 7.65%. Self-employed workers contribute the full 15.30%. See Social Security & Medicare Tax Rates, available at <http://www.socialsecurity.gov/OACT/ProgData/taxRates.html> (last visited Feb. 26, 2007).

<sup>4</sup> *Hearing Before the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Chairman McCrery).

<sup>5</sup> *Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 108th Cong. (2004) (statement of Asst. Inspector Gen. for Investigations O’Carroll, Soc. Sec. Admin., Baltimore, Md.).

<sup>6</sup> *Strengthening Employer Wage Reporting: Hearing Before Subcomm. on Soc. Sec. of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Deputy Comm’r of Soc. Sec. Lockhart III). “As of October 2005, approximately 8.8 million W-2s (3.7 % of the total) representing \$57.8 billion in wages remained in the suspense file for TY 2003. Since the beginning of the program in 1936 and through Tax Year (TY) 2003, the most recent year for which data is available, the suspense file contained about 255 million W-2s.”

<sup>7</sup> *Id.*

<sup>8</sup> U.S. GEN. ACCOUNTING OFFICE, TAX ADMINISTRATION: IRS NEEDS TO CONSIDER OPTIONS FOR REVISING REGULATIONS TO INCREASE THE ACCURACY OF SOCIAL SECURITY NUMBERS ON WAGE STATEMENTS 712 (2004).

<sup>9</sup> *Id.*

<sup>10</sup> Eduardo Porter, *Illegal Immigrants Are Bolstering Social Security With Billions*, N.Y. TIMES, Apr. 5, 2005, at 1.

<sup>11</sup> Regressive taxation refers to a tax imposed across the board without regard to income. FICA, or Social Security taxes, is one example because everyone is generally taxed at the 7.65% rate. Sales and valued added taxes (VAT) are another example, where everyone who purchases an item is generally held to the same sales tax rate without regard to their individual income level.

<sup>12</sup> See Rev. Rul. 77-140, 1970-1 C.B. 301 (noting that there are exceptions for certain temporary workers who are granted relief from FICA taxes). The IRS has taken the official position that the exception from FICA taxes that applies to temporary agricultural workers should not apply to undocumented immigrants working in the United States.

<sup>13</sup> *Hearing on Impacts of Border Security and Immigration on Ways and Means Programs Before H. Comm. on Ways and Means*, 109th Cong. 109-76 (2006) (statement of Asst. Sec’y, U.S. Immigration and Customs Enforcement, U.S. Dep’t Homeland Sec. Myers).

<sup>14</sup> See Immigration Act of 1924, ch. 190, 43 Stat. 153 (1924) (introducing permanent quotas based on national origin for legal entry, temporary quotas were first introduced in 1921). The 1924 Act was relatively friendly to neighboring Canada and Mexico, particularly the latter due to the U.S. need for agricultural workers and not so kind toward immigrants from Asia and Southern and Eastern Europe. *Id.* See also Ellison DuRant Smith, Addressing the 68th Congress, 1st Session (April 9, 1924) [“Shut the Door” speech] in GOV’T PRINTING OFFICE, 1924, vol. 65, at 5961-62 (seeming in large part to be based in eugenics and influenced by Madison Grant’s book, *The Passing of a Great Race*).

[Insert title of congressional hearing]: *Hearing on S. Con. Res. \_\_\_ Before the S. Comm. on \_\_\_*, 68th Congress \_\_\_ (1924) (statement of S. Ellison DuRant Smith). [Relied on Rule 13.3].

<sup>15</sup> See Porter *supra*, note 10. IRCA addressed illegal immigration by providing amnesty to undocumented immigrants who could prove they had migrated to the U.S. prior to January 1, 1982. IRCA also tackled the possibility of future immigrants entering the country and working without proper documentation by citing that employers would be required to comply with Form I-9 procedures, which required employers to confirm work authorization via Social Security Cards and work permits. The Act included provisions that subjected employers to the possibility of random audits to ensure their compliance. Immigration Reform and Control Act, Pub. L. No. 99-603, 100 Stat. 3359 (1986) (codified at 8 U.S.C. §1101 (1986)). (Simpson-Mazzoli Act).