8th Annual IRS/TPC Joint Research Conference on Tax Administration

Abstracts of Papers

Session 1: Factors That Contribute to Voluntary Compliance

Does Employer Withholding Affect Tax Compliance, and Why?

William Boning *(University of Michigan)*

This paper uses quasi-experimental variation in IRS administrative data to provide evidence that withholding income tax from employees' paychecks causes taxpayers to be more compliant, and investigates the mechanisms through which changing the timing and party responsible for income tax remittances, which are absent from standard evasion theory, alter behavior. In difference-in-difference results that leverage variation in withholding induced by an interaction between policies during the 2009 tax year, a $250 reduction in withholding leads to a 10 percent increase in late tax return filing and a 52 percent increase in incomplete payment of the tax owed. Taxpayers continue to owe these delinquent taxes and resulting interest and penalties for several months. A conceptual framework shows that withholding can alter tax remittance and reporting behavior among taxpayers who are myopic or credit-constrained. These predictions are compared to the empirical patterns of heterogeneity in the effect of changing withholding policy.

Accountants are not tax advisors: Using random audit data to test the effect of certified accountancy on SME's tax compliance in Denmark between 2008 and 2014

Johanne Søndergaard *(Danish Customs and Tax Administration)*

Recent policy changes have meant that the number of small and medium-sized enterprises (SME) in Denmark whose annual financial statements are not fully audited by a certified accountant has risen dramatically, from 12 in 2006 to 112,000 in 2016. Although certified accountants' primary role in Denmark is not tax advice, removing the oversight that certified accountants provide could arguably lead to an increase in tax noncompliance for Danish SMEs. On the other hand, there is theoretical and empirical evidence from the US and Australia to suggest that third-party agents do not aid in tax compliance and may even, in some instances, hinder it. What is the effect of the use of certified accountants on SME's tax and VAT noncompliance in Denmark?

Every two years, the IT and Development Agency of the Danish Ministry of Taxation conducts a random audit study of approximately 3,000 SMEs in Denmark. Using these data for limited companies and limited liability companies from 2008-2014, the paper finds that a full audit by a certified accountant is associated with a decrease in VAT noncompliance, but an increase in tax noncompliance. The results further show that although certified accountancy increases tax noncompliance, it is associated with a decrease in intentional noncompliance. These results lend support to the theory that accountants primarily work in the interests of their clients, in acting as ambiguity-exploiters, maneuvering for income maximization for their clients within the more ambiguous tax legislation, while within the confines of the more limiting VAT legislation they act as VAT-enforcers for their clients and the tax authority.

Compliance Spillovers Across Taxes: Results from a Field Experiment

Carlos Scartascini *and Andrea Lopez-Luzuriaga (Inter-American Development Bank)*

What happens with compliance in other taxes when the tax authority increases enforcement in another tax? The very little evidence so far is not conclusive. A few papers find a negative spillover, most likely because taxpayers assume that the tax authority can't be everywhere; a couple of papers find a positive spillover, most likely because taxpayers internalize the higher deterrence as a policy change across taxes. In this paper, we present a very simple analytical model that shows the conditions under which spillovers could be positive or negative in the context of uncorrelated taxes for the same individual (a property tax and a self-declaration sales tax). Basically, the sign of the spillover depends on how taxpayers update penalties and detection probabilities in one tax after watching the actions of the tax agency in another tax. We provide evidence from a randomized field experiment that shows that increasing the salience of fines and enforcement probabilities for those who don't comply with the payment of the property tax does not decrease how much the same individual declares on the gross-sales tax. The result has ample implications for researchers bringing interventions to the field and for governments' enforcement strategies. Given that most taxpayers are liable for more than one tax, researchers can't neglect the potential spillover of their intervention (as has been the norm so far). Tax authorities can't either. Instead, they should design the enforcement strategy that maximizes compliance across the portfolio of taxes. Importantly, this work indicates that penalties and detection may not be full substitutes when the portfolio is taken into consideration.

Session 2: Behavioral Responses to IRS Interventions

Using Behavioral Insights in Notice Design to Improve Taxpayer Responses and Achieve Compliance Outcomes

*Anne Herlache, **Jan Millard**, and Alicia Miller (IRS, RAAS) and Michelle Theel (IRS, S&E PMO)*

This paper introduces the Notice Redesign Initiative and highlights its use of behavioral insights (BI). Behavioral insights are drawn from a robust and rapidly growing body of research from the Behavioral Sciences (e.g., psychology, cognitive science, and behavioral economics). This research is centered on how individuals absorb, process, and react to information; that knowledge is then applied to design practical policies and interventions with human behavior in mind. The Notice Redesign Initiative aims to improve the effectiveness of collection notices and has incorporated behavioral insights into each of its pilots, including the two presented in this paper: the CP14 and LT16. Both notices are part of the IRS collection stream. The CP14 is the first and most common notice sent to taxpayers and notifies them that they have a balance due. The LT16 is one of the last notices to be sent and requests that taxpayers contact the Automated Collection System. Both the CP14 and LT16 pilots have addressed four major goals: 1) increasing payment compliance, 2) increasing the use of self-service tools, 3) reducing taxpayer burden, and 4) reducing costs to the IRS. In this paper, we highlight the pilot results as they pertain to those overarching goals.

Strategies to Address Noncompliance in Refundable Tax Credits: Evidence on Taxpayer Responses to EITC Correspondence Audits and Experimental Outreach

*John Guyton, Kara Leibel, Mark Payne, and Brenda Schafer (IRS, RAAS), **Day Manoli** (University of Texas-Austin), and Ankur Patel (U.S. Treasury)*

Each year, the United States Internal Revenue Service sends notices to selected taxpayers who claim Earned Income Tax credit (EITC) benefits to request documentation to verify those claims. Using administrative tax data, this paper estimates the impacts of these correspondence audits on taxpayer behavior by comparing randomly-selected audited and non-audited taxpayers. The results indicate, in the years following an audit, there are decreases in the likelihoods of claiming EITC benefits and filing returns, and taxpayers with self-employment income at the time of audit increase wage employment, while taxpayers with wage income at the time of audit decrease labor force participation.

Federal Tax Liens and Letters: Effectiveness of the Notice of Federal Tax Liens and Alternative IRS Letters on Individual Tax Debt Resolution

*Ishani Roy, **Brett Collins**, Alex Turk, and Alan Plumley (IRS, RAAS) and Terry Ashley and Jeff Wilson (IRS, TAS)*

When taxpayers fail to pay federal tax assessments, a lien is established to give the government certain rights to collect the delinquent amounts. Typically, only the Internal Revenue Service (IRS) and the taxpayer are aware of the lien. A notice of federal tax lien (NFTL) can be filed to make the lien public information. The NFTL is an important collection tool in resolving delinquent tax accounts. However, U.S. legislation, IRS policy, and IRS budgetary challenges can alter the degree to which this collection tool is used. Concerns exist about the potential for NFTLs to make it harder for taxpayers to pay their debts to the IRS. Given the potential costs and benefits of NFTLs to the IRS, it is important to assess how well NFTLs accomplish their goals, and whether alternative treatment tools might better serve taxpayers and the IRS.

Our paper extends prior research on this population using a randomized field experiment of filing the NFTL versus other less intrusive treatments for individual taxpayers. The field experiment follows approximately 13,000 individual taxpayers owing money to the IRS who were transferred from the IRS ACS to the Field Collection Queue in the spring of 2016. These taxpayers were randomly assigned to one of five groups (including a control) and we tracked how their balance changed over the next year. Consistent with previous research, we find significant impacts for NFTLs, which are substantially larger than softer nudges in motivating taxpayers to resolve these debts. The estimated treatment effects of the NFTL are consistently larger during the year following the treatment and treatment effects appear to be more persistent than nudges through correspondence, perhaps three to five times more than the alternative treatments. However, we also find that it is important in general to use lower costs treatment prior to filing the NFTL.

Session 3: Complexity and Global Tax Administration

Taxing Hidden Wealth: The Consequences of U.S. Enforcement Initiatives on Evasive Foreign Accounts

Niels Johannesen (University of Copenhagen), Patrick Langetieg (IRS, RAAS), ***Daniel Reck*** *(London School of Economics), and Max Risch and Joel Slemrod (University of Michigan)*

In 2008, the IRS initiated efforts to curb the use of offshore accounts to evade taxes. This paper uses administrative microdata to examine the impact of the enforcement efforts on taxpayers' reporting of offshore accounts and income. Enforcement caused approximately 60,000 individuals to disclose offshore accounts with a combined value of around $120 billion. Most disclosures happened outside offshore voluntary disclosure programs by individuals who never admitted prior noncompliance. The disclosed accounts were concentrated in countries whose institutions facilitate tax evasion. The enforcement-driven disclosures increased annual reported capital income by $2.5-$4 billion corresponding to $0.7-$1.0 billion in additional tax revenue.

Global Tax Administration Initiatives Addressing Tax Evasion and Avoidance

Thomas Neubig *(Tax Sage Network)*

This paper analyzes recent global initiatives addressing tax avoidance and evasion using a tax-systems perspective and identifying tax administration research questions. National tax systems and tax administrations need to improve their ability to both attract activity as well as to ensure the intended domestic taxation of domestic economic activity. Effective use of tax systems instruments can protect countries' tax sovereignty in a world of increasing globalization. Countries can no longer design their national tax systems without considering other countries' systems as well as multinational arrangements and organizations.

Two major global initiatives involving multilateral cooperation are the Base Erosion and Profit Shifting (BEPS) Inclusive Framework and the Global Forum on Transparency and Exchange of Information for Tax Purposes. Both initiatives have more than 100 countries actively participating with peer-reviews of their implementation. New information reporting began in 2017, and has already had some desirable economic and behavioral effects. Effective cross-border exchange of information will reduce the ability of investors to hide capital income and wealth from their country's tax administration, thus reducing the tax rate sensitivity of such flows. Other multilateral initiatives are also improving national tax administration capabilities.

An Examination of Partnership Tax Return Complexity

Larry May and Lisa Rupert (IRS, RAAS), and ***Erin Towery*** *(University of Georgia)*

Despite the growing number of business entities organized as partnerships, little is known about partnerships due to the lack of publicly available tax microdata on partnerships. This study uses confidential partnership tax return data to investigate the evolution of partnership tax return complexity over time. We report multiple findings. First, while the number of C corporations has decreased over time, the number of partnerships continues to increase. Much of this growth is attributable to an increase in the number of limited liability companies (LLCs) in the real estate, rental, leasing, finance and insurance industries. Second, of the partnerships that report total assets, almost 70 percent report assets of $10 million or less, suggesting that a large majority of partnerships fall within the purview of the Small Business/Self-Employed (SBSE) division of the IRS. Approximately half of partnerships have only two owners, although 2 percent of partnerships have at least 100 owners, suggesting wide variation in ownership structure complexity. Third, 77.3% of partnerships have no flow-through entities as owners. However, 0.7% of partnerships have 9 or more ownership tiers and the number of partnerships with 9 or more tiers has increased over time, consistent with an increase in partnership complexity over time. Finally, approximately 43% of partnerships report $0 ordinary income/loss. Our findings are helpful to both the IRS and policymakers, especially in light of recent rules requiring tax adjustments to be assessed at the partnership level rather than the partner level and the recent Tax Cuts and Jobs Act (TJCA) provision allowing flow-through entities a 20 percent deduction of their flow-through income. Our evidence on the scope of partnership tax return complexity also provides some of the first insight into the costs of partnership tax compliance.

Session 4: Future Directions in Tax Administration

Who is Minding the Nanny Tax?

Brian Erard *(B. Erard & Associates)*

Households are responsible for filing and remitting various federal and state employment taxes, commonly subsumed under the moniker "the Nanny Tax", when they pay more than $2,100 for the services of a domestic employee over the course of a year, including a nanny, housekeeper, home health aide, cook, butler, chauffeur, or groundskeeper. This study provides evidence of pervasive noncompliance with Nanny Tax obligations. Improving compliance with the Nanny Tax is important, not only because it is a significant source of federal and state revenue leakage, but also because it has important implications for a particularly vulnerable class of workers. The Nanny Tax gap in part is attributable to a knowledge gap; many household employers appear to be unaware of their Nanny Tax responsibilities. The state and federal Nanny Tax filing and reporting burden and insufficient enforcement also contribute to the size of the gap. Proposals are provided to address these issues so that household employers will have sufficient knowledge and incentive to begin minding the Nanny Tax.

Can IRS Move Paper Filers to Free Assisted Tax Preparation?

Brenda Schafer and ***Rizwan Javaid*** *(IRS, RAAS), Jacob Goldin and Adam Isen (Department of the Treasury), and Tatiana Homonoff (New York University)*

Over 89 percent of tax returns are prepared with software and filed electronically. While the Internal Revenue Service (IRS) still accepts paper returns, software-prepared returns reduce the potential for errors and refunds for electronically-filed returns are received several weeks sooner than for paper-filed returns. Despite these benefits, there are still approximately six million Americans who prepare and submit their individual tax returns on paper. We conducted an experiment to test whether we could move paper filers to a free assisted preparation method. This paper presents preliminary results from that experiment.

During Tax Season 2017, information about free assisted tax preparation opportunities was sent to a randomly-selected sample of taxpayers who filed paper-prepared paper returns for Tax Year 2015 (TY2015) and who appeared to qualify for free assisted tax preparation. The experiment design included five test groups, each consisting of approximately 80,000 individuals, with approximately 12 percent of the sample stratified to include taxpayers who were apparently eligible for the Earned Income Tax Credit (EITC), but didn't claim it. The control group consisted of the remaining study population. The taxpayers in the five test groups received a postcard with information on one or a combination of the following: Volunteer Income Tax Assistance (VITA) program, VITA site addresses closest to the taxpayer, Free File program, and the MyFreeTaxes program. Taxpayers in the control group received no postcard. The effect of the postcards was then measured on the TY2016 return tax preparation and filing method. Preliminary results indicate that the postcard outreach was modestly successful in increasing assisted tax preparation, and that the varied messaging on postcards was instrumental in influencing certain subgroups of taxpayers.

Creating a Fully Synthetic Individual Income Tax Return Data File and Validation Server

Leonard E. Burman*, Surachai Khitatrakun and James R. Nunns (Tax Policy Center), and Sarah Armstrong and Alex Engler (University of Chicago)*

Administrative tax data contain a wealth of information that is potentially valuable for research and analysis. However, the legal and ethical imperative to protect taxpayer privacy has restricted access to a small number of government analysts and select researchers. We propose to develop in consultation with the experts at the Statistics of Income division of the IRS a fully synthetic tax database – that is, a file that preserves many of the statistical characteristics of the restricted data without containing any identifiable tax return information. Working with the IRS, we also hope to develop a procedure for researchers to submit their statistical programs, which have been tested on the synthetic data, to run on IRS computers subject to a review to guarantee that output satisfies disclosure avoidance protocols. This paper discusses the current methodology used to produce public use datasets, surveys the literature on synthetic data and privacy protection, and outlines our proposed plan to produce a synthetic file and discusses special challenges.