Session 3. The Role of Incentives in Individual Compliance

Moderator:	***Saima Mehmood*** *IRS, Wage & Investment Division Research*
Impact of Filing Reminder Outreach on Voluntary Filing Compliance for Taxpayers with a Prior Filing Delinquency	***Stacy Orlett*** *IRS, SB/SE*
Charitable Contributions of Conservation Easements	***Adam Looney*** *The Brookings Institution*
Tax Preparers, Refund Anticipation Products, and EITC Compliance	***Maggie Jones*** *U.S. Census Bureau*
Discussant:	***Janet Holtzblatt*** *Congressional Budget Office*

Preemptive Correspondence Pilots

Impact of Filing Reminder Outreach on Voluntary Filing Compliance for Taxpayers with a Prior Filing Delinquency

June 21, 2017
IRS-TPC Research Conference

Internal Revenue Service

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Presentation Outline

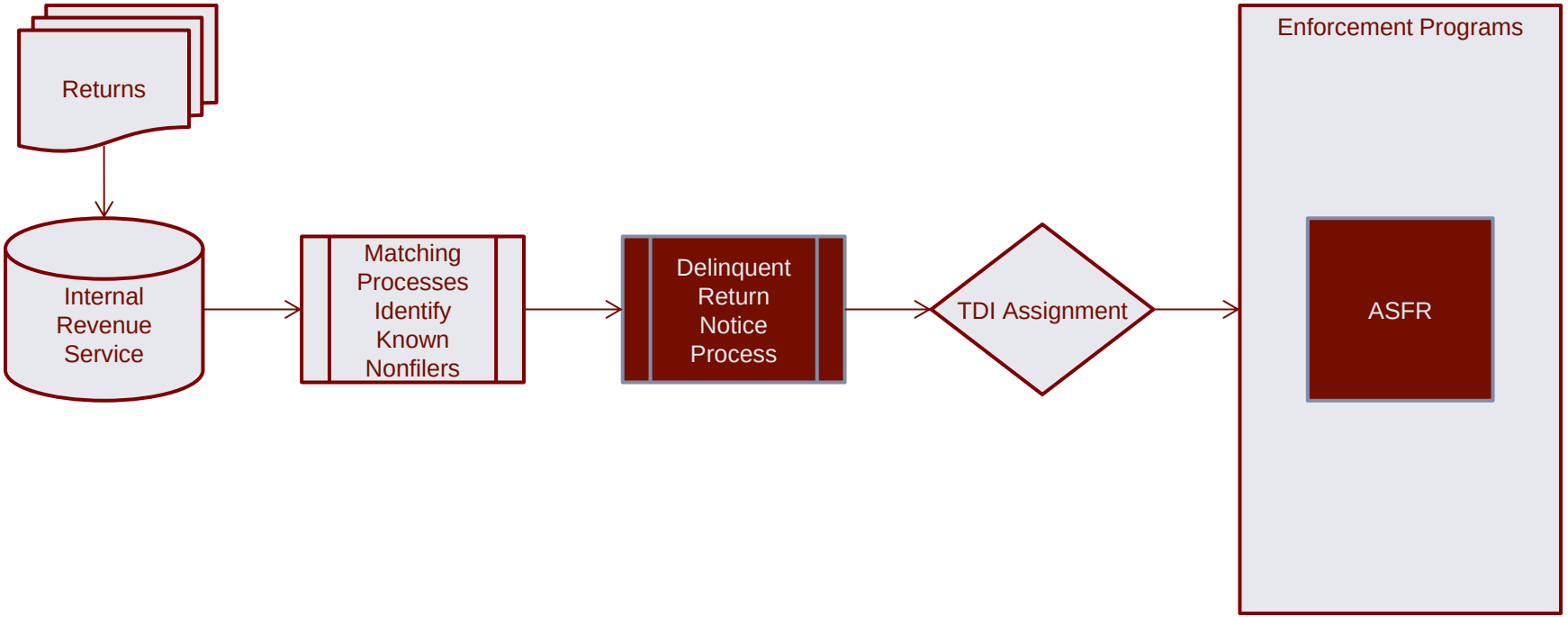
- Background
- Pilots
- Results
- Conclusions and Direction for Future Research

***Special thank you to John Guyton, Day Manoli, Brenda Schafer, Steven Ferris, Susan Haskell, Lisa Gilmore, and John Iuranich.*

Background

- Collaboration
  - Collection
    - Strategic Analysis and Modeling
    - Nonfiler Inventory and Analysis
  - Research, Applied Analytics, and Statistics
- Two individual populations with prior filing delinquencies
  - Automated Substitute for Return (ASFR)
  - Potential Nonfilers in a previous Tax Year
- Promote voluntary filing compliance
  - Taxpayers “at risk” for not filing through low cost outreach
  - Taxpayers were sent a reminder letter or at least one postcard
- Pilot conducted during Tax Year 2015 Filing Season

Return Delinquency Process



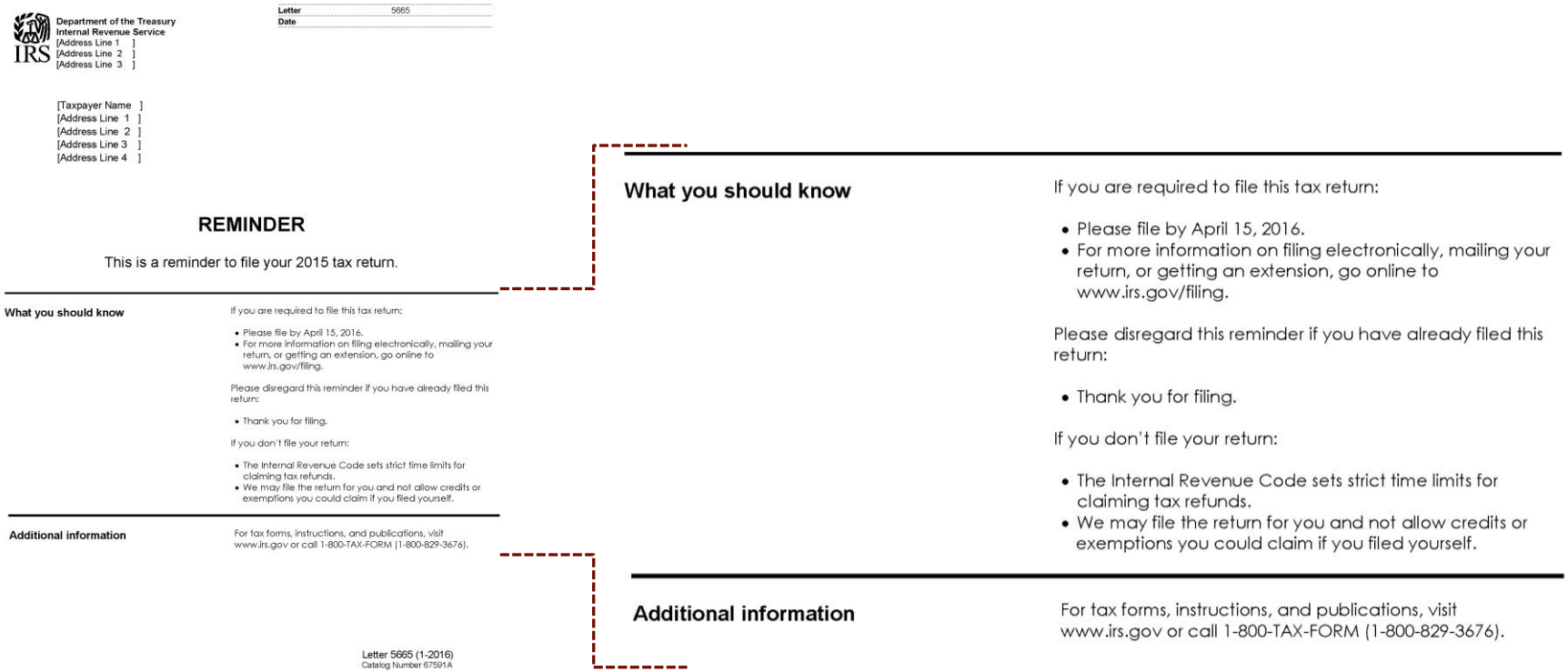
Overview of the Populations

Pilot	Pilot 1: ASFR Treated Cases	Pilot 2: Untreated Nonfiler Cases
Population	ASFR cases where a delinquent return was secured during Calendar Year 2015	Potential Tax Year 2013 Nonfilers
Division of Cases	Refund Hold vs non-Refund Hold	Primary Code B (PCB) designation
Population Size	~80,000 Taxpayers	~1.9 million Taxpayers
Population Proportions	Refund Hold, 33% / Non-Refund Hold, 67%	PCB, 16% / non-PCB, 84%

Design

Treatment Group	Information Included	Mailing Date(s)	Pilot 1: Samples *ASFR Treated Taxpayers*		Pilot 2: Samples *TY13 Potential Nonfilers*	
			Refund Hold	Non-Refund Hold	PCB	Non-PCB
Control	• No Treatment		8,142	7,946	7,041	6,550
Letter	• IRS website • Toll free customer service number	March 1, 2016	8,142	7,946		
Postcard 1	• IRS website	March 1, 2016	8,142	7,946	7,041	6,549
		March 1, 2016 April 1, 2016			7,041	6,549
Postcard 2	• IRS website • Information to file prior year returns • Link to the Form 4506T that the taxpayer can submit to request tax documents for prior years	March 1, 2016			7,041	6,549
		March 1, 2016 April 1, 2016			7,041	6,549
Total Sample Size			**24,426**	**23,838**	**35,205**	**32,746**

Letter



Department of the Treasury
Internal Revenue Service
[Address Line 1]
[Address Line 2]
[Address Line 3]

Letter 5665
Date

[Taxpayer Name]
[Address Line 1]
[Address Line 2]
[Address Line 3]
[Address Line 4]

REMINDER

This is a reminder to file your 2015 tax return.

What you should know

If you are required to file this tax return:

- Please file by April 15, 2016.
- For more information on filing electronically, mailing your return, or getting an extension, go online to www.irs.gov/filing.

Please disregard this reminder if you have already filed this return:

- Thank you for filing.

If you don't file your return:

- The Internal Revenue Code sets strict time limits for claiming tax refunds.
- We may file the return for you and not allow credits or exemptions you could claim if you filed yourself.

Additional information

For tax forms, instructions, and publications, visit www.irs.gov or call 1-800-TAX-FORM (1-800-829-3676).

Letter 5665 (1-2016)
Catalog Number 67591A

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Additional information

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Postcards

Postcard 1: No 4506T Reference

If you have not already done so, remember to file your 2015 tax return by April 15, 2016.

- Did you know the average tax refund in 2014 was approximately $2,800?
- You could be eligible for valuable tax benefits, but you must file to receive them.
- For more information about filing, or getting an extension to file, go online to www.irs.gov/filing.

Postcard 2: 4506T Reference

If you have not already done so, remember to file your 2015 tax return by April 15, 2016.

- Did you know the average tax refund in 2014 was approximately $2,800?
- You could be eligible for valuable tax benefits, but you must file to receive them.
- For more information about filing, or getting an extension to file, go online to www.irs.gov/filing.

It's not too late to file returns for prior tax years.

- You can file late tax returns and claim tax refunds up to 3 calendar years after the April filing deadline. For example, you can claim a tax refund for 2012, if you file your tax return by April 15, 2016.
- To request transcripts of prior year W-2s and other tax documents, submit Form 4506T (from http://www.irs.gov/uac/About-Form-4506T).

Modeling Data

- Targeted Outcome/Dependent Variable
  - Timely filed Tax Year 2015 income tax return, or
  - Extension to file
- Available Taxpayer Control Variables:
  - Recent income tax filing information
  - Case Creation Nonfiler Identification Process data
  - Accounts receivable activity
  - Filing compliance
- Undeliverable Treatments
  - Identified taxpayers in the treatments groups that had their mailing returned as undeliverable
- Treatment Dummy
  - If treatment delivered, then the taxpayer received a “1” for applicable treatment
  - If undeliverable, then the taxpayer is assumed to be “untreated”

Two-Step Modeling Approach

- Data Issues resulting from mailing the correspondence
  - Undeliverable mail identified for taxpayers in treatment groups but not the control group
  - May be a relationship between the IRS having a “good address” and the likelihood that the taxpayer files
- Step 1: Likelihood of Undeliverable
  - Logistic Regression using cases identified for treatment
  - Create an Instrumental Variable
  - Calculate probability of being “undeliverable” for all cases – including control group
- Step 2: Likelihood of Timely Filing TY15 Return or Extension
  - Logistic Regression
  - Treatment Dummies, Instrumental Variable, and other controls
  - Measure the impact of the treatments on taxpayers timely filing TY15 returns or extensions

Pilot 1: Tax Year 2015 Filing Rates

Taxpayer Groups	Pilot 1: ASFR Treated Cases			
	Refund Hold		Non-Refund Hold	
	Number of Taxpayers	% Timely Filed TY15 or Extension	Number of Taxpayers	% Timely Filed TY15 or Extension
Untreated	8,982	77.7%	8,775	58.6%
Control Group	*8,142*	*78.4%*	*7,946*	*59.9%*
Undeliverable	*840*	*71.1%*	*829*	*46.0%*
Letter	7,752	81.4%	7,511	64.2%
Postcard 1 (one mailing)	7,692	79.6%	7,552	61.0%

Source: IRS. Compliance Data Warehouse. Individual Return Transaction File, Individual Master File Status and Transaction History, Individual Accounts Receivable Dollar Inventory, and Case Creation Nonfiler Identification Process. Data Extracted September 2016.

Pilot 2: Tax Year 2015 Filing Rates

Taxpayer Groups	Pilot 2: TY13 Potential Nonfilers			
	PCB		Non-PCB	
	Number of Taxpayers	% Timely Filed TY15 or Extension	Number of Taxpayers	% Timely Filed TY15 or Extension
Untreated	9,614	42.6%	8757	45.9%
Control Group	*7,041*	*46.5%*	*6,550*	*49.7%*
Undeliverable	*2,573*	*32.2%*	*2,207*	*34.9%*
Postcard 1 (one mailing)	6,404	49.0%	5,973	52.0%
Postcard 1 (two mailings)	6,429	49.3%	6,041	53.0%
Postcard 2 (one mailing)	6,396	49.2%	5,979	51.9%
Postcard 2 (two mailings)	6,362	49.5%	5,996	51.9%

Source: IRS. Compliance Data Warehouse. Individual Return Transaction File, Individual Master File Status and Transaction History, Individual Accounts Receivable Dollar Inventory, and Case Creation Nonfiler Identification Process. Data Extracted September 2016.

Pilot 1: Treatment Effects

Dependent Variable: Taxpayer Timely Filed TY15 or Filed for an Extension	Refund Hold			Non-Refund Hold		
Results Summary	• Postcard results in 1.3 percentage points increase in the propensity to file • Letter results were two times larger			• Postcard results in 1.1 percentage point increase in the propensity to file • Letter results were three times larger		
Model Results	**Parameter Estimate**	**Marginal Effect of Treatment**	**Marginal Effect of Intent to Treat**	**Parameter Estimate**	**Marginal Effect of Treatment**	**Marginal Effect of Intent to Treat**
Postcard Treatment	0.099* (0.040)	0.013	0.013	0.083* (0.035)	0.011	0.010
Letter Treatment	0.198* (0.041)	0.027	0.025	0.244* (0.035)	0.033	0.031
Probability: Undeliverable Mail	-2.519* (1.088)			-4.878* (0.754)		

Source: IRS. Compliance Data Warehouse. Individual Return Transaction File, Individual Master File Status and Transaction History, Individual Accounts Receivable Dollar Inventory, and Case Creation Nonfiler Identification Process. Data Extracted September 2016.
Note: Not all explanatory variables are shown.
Standard errors are reported in parentheses.
*, indicates significance at the 95% level

Pilot 2: Treatment Effects

Dependent Variable: Taxpayer Timely Filed TY15 or Filed for an Extension	Primary Code B			Non-Primary Code B		
Results Summary	• Multiple mailings may be needed for the lower priority cases • Two postcards have a larger impact			• Multiple mailings appear to have less of an impact • Postcard 1 appears to be more effective		
Model Results	**Parameter Estimate**	**Marginal Effect of Treatment**	**Marginal Effect of Intent to Treat**	**Parameter Estimate**	**Marginal Effect of Treatment**	**Marginal Effect of Intent to Treat**
Postcard 1 (one mailing)	0.0589 (0.041)	0.010	0.009	0.110* (0.042)	0.017	0.016
Postcard 1 (two mailings)	0.1447* (0.041)	0.024	0.021	0.140* (0.041)	0.022	0.020
Postcard 2 (one mailing)	0.1038* (0.041)	0.017	0.015	0.087* (0.042)	0.014	0.013
Postcard 2 (two mailings)	0.1293* (0.041)	0.021	0.019	0.084* (0.042)	0.013	0.012
Probability Undeliverable Mail	1.878* (0.422)			-2.086* (0.494)		

Source: IRS. Compliance Data Warehouse. Individual Return Transaction File, Individual Master File Status and Transaction History, Individual Accounts Receivable Dollar Inventory, and Case Creation Nonfiler Identification Process. Data Extracted September 2016.
Note: Not all explanatory variables are shown.
Standard errors are reported in parentheses.
*, indicates significance at the 95% level

Filing Prior Year Tax Returns

Taxpayer Groups[a]	Pilot 1: ASFR Treated Taxpayers		Pilot 2: TY13 Potential Nonfilers	
Results Summary	• Significant increase in filing a prior return for the non-Refund Hold ASFR group receiving a postcard		• Significant increase exists across all treatments • A slightly larger percentage point difference for the PCB group	
Groups Splits	**Refund Hold**	**Non-Refund Hold**	**PCB**	**Non-PCB**
Letter	-0.2	0.5		
Postcard 1 (one mailing)	-0.2	1.1*	2.4*	2.5*
Postcard 1 (two mailings)			2.3*	1.4*
Postcard 2 (one mailing)			2.4*	1.7*
Postcard 2 (two mailings)			2.3*	2.5*

Source: IRS. Compliance Data Warehouse. Individual Return Transaction File, Individual Master File Status and Transaction History, Individual Accounts Receivable Dollar Inventory, and Case Creation Nonfiler Identification Process. Data Extracted September 2016.
[a] Taxpayers with undeliverable treatments were moved to the Control group.
* Denotes a significant difference from the control group at the 95% level.

Conclusions

- Positive voluntary filing effects from preemptive contacts with taxpayers who had previous filing compliance issues
  - The impacts are modest, but impacts come at a very low cost
- Type of Treatment:
  - Our results suggest that a letter may be more effective than a postcard, at least for some taxpayers
  - Our results also support the notion that a simpler message may be more effective in increasing the taxpayer response, at least in terms of voluntary filing
    - Potential to extend the analysis of the impact of outreach on past compliance
- Frequency of Treatment:
  - When using postcards to nudge taxpayers, lower risk taxpayers may need multiple nudges in order for the treatment to be effective

Direction for Further Research

- Understand the differing results from letters vs. postcards
  - Is “opening” the letter a barrier or does just receiving the letter, even in unopened, have an impact on behavior?
- Understand the differing results from varying messages in postcards
  - Is a simpler message more effective?
  - Framing Effect - Does alluding to past potential noncompliance make the taxpayer more hesitant to file their current return?
- Does attempting to address past noncompliance act as an impediment to fostering future compliance?
  - If the tax authority does not have the resources to go back and enforce compliance, is it better for them to focus only on the taxpayer’s future filing behavior?
- Explore Network Effects

Thank You

BROOKINGS | QUALITY. INDEPENDENCE. IMPACT.

CHARITABLE CONTRIBUTIONS OF CONSERVATION EASEMENTS

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Conservation Easements are voluntary agreements that permanently limit the development or use of a property

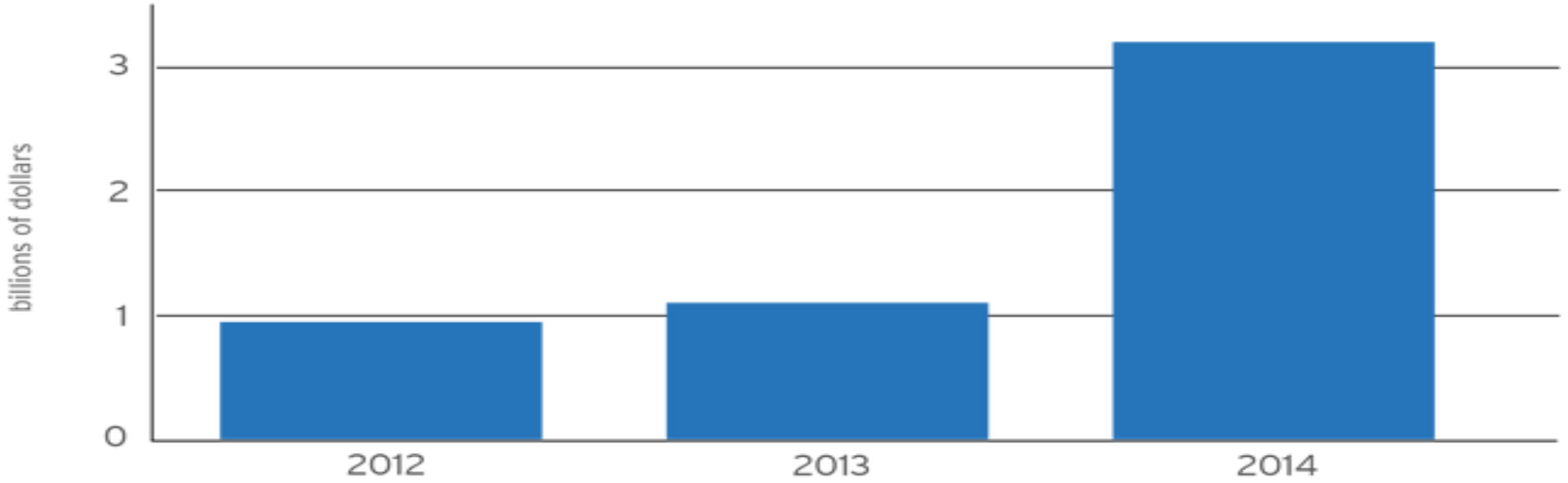
Qualified easement donations to charitable organizations may qualify for a charitable deduction

Tax break is popular and widely credited for encouraging conservation

ALSO A SOURCE OF LITIGATION AND ABUSE

- Recurrent item on the IRS's annual "Dirty Dozen" tax scams.
- Among most litigated tax issues according to the National Taxpayer Advocate
  - Certain easement transactions now "listed transactions"
  - Surprising given affects only 2,000 taxpayers each year
- Many anecdotes of abusive practices
  - golf courses, façade easements, backyards
- But little data or evidence on their use

Total deductions for conservation easement contributions by taxpayers



Source: U.S. Treasury, Office of Tax Analysis

BROOKINGS

How are they used?

New data sources:

- Form 8283
- IRS SOI Form 990 Microdata files
  - Plus pdf of returns (Guidestar.org)

Summary of evidence

- **Donations are concentrated** in transactions that seem unrelated to conservation benefits.
  - Deductions concentrated in certain transactions, acreage, geographic areas, and donee organizations.

- **A small handful of donee organizations** are responsible for a disproportionate share of donations.

- **Many organizations that receive donations of easements do not report them as gifts or revenues** on their public tax returns.

Table 1: Annual Statistics on Easements (2010-2012)

		(annual average)
Total Deductions	$	1,052,103,000
Number of Individual Easement Deductions		2,461
Average Deduction	$	427,500
Median Deduction	$	101,250
25th Percentile Deduction	$	43,750
75th Percentile Deduction	$	242,000
95th Percentile Deduction	$	1,340,000
Reported Acreage?		34%
Average Acreage Reported		245
Median Acreage		80
Mean Deduction/Acre	$	14,750
Median Deduction/Acre	$	1,600
Sample N (unweighted)		863

Note: Real 2016 dolars; Source: Office of Tax Analysis, Department of Treasury

Form 8283 sample

- Almost all report donee organization
- 34% of deductions reported acreage
  - Some did not include descriptions of property
  - Some easements are on properties where acreage is not relevant (e.g. historical buildings)
- Median deduction about $100,000
  - Median deduction only about $1,600 per acre
- Average is skewed by large transactions

Table 2: The Concentration of Contributions of Conservation Easements in a Small Number of Transactions and Acreage

CUMULATIVE DEDUCTIONS BY DONATION

Fraction of Total Donations	Fraction of Total Deductions
Top 2%	43%
Top 5%	55%
Top 10%	70%
Top 25%	86%
Top 50%	95%
Top 75%	99%

CUMULATIVE DEDUCTIONS BY ACREAGE

Fraction of Total Acres	Fraction of Total Deductions
Top 2%	26%
Top 5%	56%
Top 10%	69%
Top 25%	89%
Top 50%	96%
Top 75%	99%

Source: Office of Tax Analysis

Concentration by transaction and acreage

- **A small number of large donations and "expensive" acreage account for most of the tax expenditure**
- **Top 2% of transactions account for about 43%** of the total aggregate value of donations claimed by taxpayers
  - Top 10% account for about 70%
- **Properties that include the acreage:**
  - Top 2%: about 26%
  - Top 10%: about 69%
    - Valuation of easements in top range exceed $10,000 per acre and some rise over $100,000 per acre.

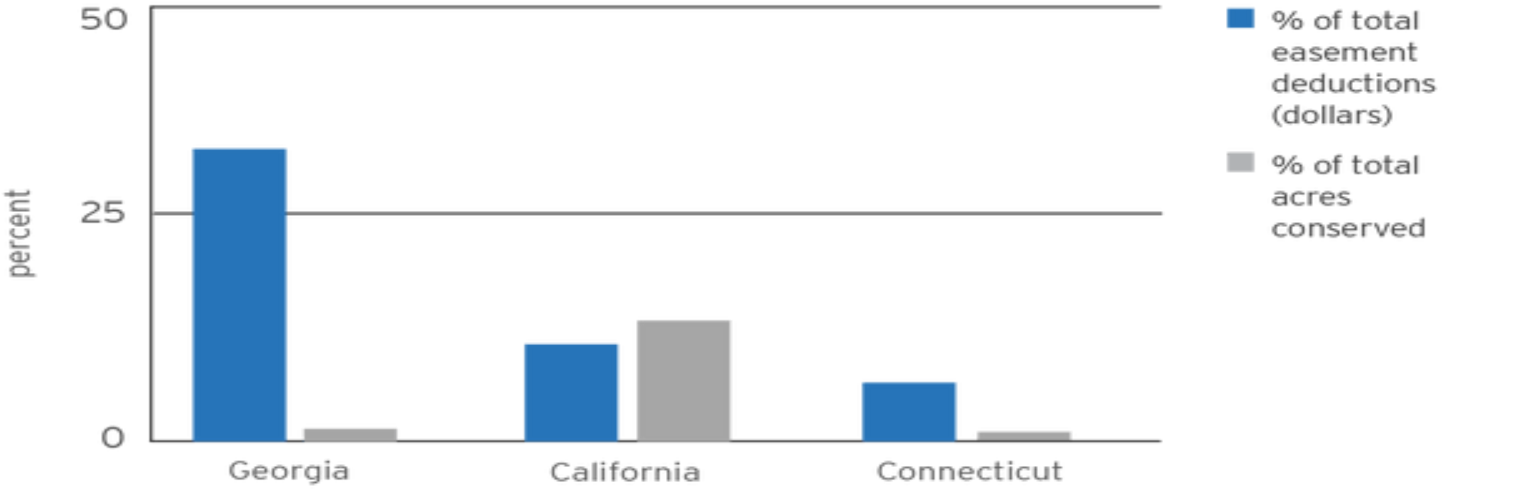
Table 3: Geographic Concentration of Easement Deductions by Residence of Taxpayers (2010-2012)

EASEMENT DEDUCTIONS (OTA)			LAND TRUST CENSUS (LTA)		
Rank	State	Percent of National Total	Share of Land Trusts	Shares of Acres under Easement	Total Acres Conserved
1	GA	36%	1.3%	2.5%	1.5%
2	CA	11%	11.6%	7.4%	14.3%
3	CT	7%	8.1%	0.4%	0.6%
4	NY	6%	5.7%	3.2%	6.1%
5	PA	6%	6.1%	2.1%	3.1%
6	VA	4%	2.1%	7.3%	7.0%
7	NC	3%	2.1%	1.7%	2.1%
8	MD	3%	3.3%	1.9%	1.2%
9	TX	2%	2.1%	3.4%	2.3%
10	SC	2%	1.4%	2.4%	1.5%
11	MA	2%	9.4%	0.9%	2.1%
12	FL	2%	1.9%	0.5%	1.1%
13	WI	2%	3.4%	0.8%	0.7%
14	CO	2%	2.2%	12.9%	7.6%
15	TN	1%	1.2%	0.7%	0.9%
16	DC	1%	0.2%	0.0%	0.0%
17	RI	1%	2.8%	0.1%	0.2%
18	AL	1%	0.5%	1.1%	1.0%
19	NV	1%	0.3%	0.0%	0.3%
20	VT	1%	2.1%	5.2%	3.8%
Total (Top 20 States)		94%	67.6%	54.7%	57.5%

Source: Office of Tax Analysis, Land Trust Alliance 2010.

Three states account for a majority of tax deductions for conservation easements

54 percent of tax deductions go to states that comprise only 26 percent of conserved land



Source: U.S. Treasury, Office of Tax Analysis and Land Trust Alliance 2010

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Geographic Concentration

- **Georgia, California and Connecticut** are the largest beneficiaries of deductions for contributions of easements.
- The **number** of land trusts, the **number** of acres under easement, and total **number** of acres conserved by land trusts (through any means) **unrelated to contribution amounts**.
- **States that are national leaders in the number of acres under easement or acres conserved receive only a de minimis share of the tax expenditure**
  - Maine, Montana, New Mexico, New Hampshire, Wyoming, Arizona, or Washington…

Table 4: Organizations Receiving Conservation Easements in IRS Public Use Microdata Sample 2011 and Form 990

Name of Organization	Avg. Annual Value of Conservation Easements Received (last 3 990s filed by 2015)	Number of Employees (2011)	Total Acreage of Easements (2011)
Foothills Land Conservancy	$125,374,000	4	19,638
Nature Conservancy	$79,353,000	3,725	2,888,283
The Trust For Public Land	$38,117,000	378	1,448
The Conservation Fund: A Nonprofit Corporation	$30,631,000	157	118,362
Rocky Mountain Elk Foundation Inc	$18,774,000	151	24
Peconic Land Trust Inc	$17,734,000	38	2,607
Natural Lands Trust Inc	$13,403,000	82	18,001
Wetlands America Trust Inc	$13,376,000	0	366,705
Triangle Land Conservancy Inc	$4,719,000	15	5,906
Little Traverse Conservancy Inc	$4,247,000	14	20,735
Puerto Rico Conservation Trust Fund	$1,317,000	132	74
Save The Redwoods League	$1,118,000	39	14,240
Upper Savannah Land Trust	$866,000	0	30,571
Sheriff's Meadow Foundation	$789,000	9	858
Iowa Natural Heritage Foundation	$748,000	40	14,874
Columbia Land Trust	$542,000	29	1,055
National Audobon Society Inc	$401,000	1,059	383,516
Open Space Conservancy Inc	$334,000	0	22,761
Mississippi Land Trust	$283,000	0	86,156
Society For Protection Of Nh Forests	$280,000	90	130,189
Legacy Land Conservancy	$47,000	7	2,596
Freshwater Land Trust	$8,000	8	1,862
Brandywine Conservancy Inc	not reported	156	34,180
The Trustees of Reservations	not reported	695	20,001
Aspen Valley Land Trust	not reported	3	34,379
Maine Coast Heritage Trust	not reported	70	16,725
Essex County Greenbelt Association	not reported	15	6,084
Western Pennsylvania Conservancy	not reported	255	32,507
New England Forestry Foundation Inc	not reported	10	1,144,653
The Scenic Hudson Land Trust Inc	not reported	0	12,263
Napa County Land Trust	not reported	15	21
Historic Landmarks Fdn of Indiana Inc	not reported	51	477
American Farmland Trust	not reported	75	44,188

Donee organizations

- **First 10 organizations** report about $346 million in donations of easements, on average, over the prior three years.
  - Total amount of conservation easements claimed by taxpayers in 2010 was $766 million and in 2011, $695 million
  - These organizations represent a large share of contributions of all easements
- **Substantial variation** between the total value of easement donations received— the tax expenditure—and the size and conservation effort provided by the entity.
  - Small organizations operate among nation's largest charities.
- **Information available on Form 990** is intended to be comprehensive and to allow the general public to understand which organizations are benefiting from public subsidies for charitable donations.

Table 5: Characteristics of Donee Organizations, 2010-2012

Rank (by Donations Received)	Avg. Annual gifts Received per Donee	Fraction of Aggregate Deductions	Cumulative Aggregate Deductions	# Reporting Gifts on 990	Avg. per Donation	Donations per Year
1-5	$61,462	29%	29%	2	$1,770	35
6-10	$20,799	10%	39%	1	$639	33
11-15	$10,115	5%	44%	1	$1,445	7
16-25	$4,434	4%	48%	2	$174	26
26-50	$1,156	3%	51%	na	$118	10
51-100	$974	5%	55%	na	$228	4

Source: Office of Tax Analysis; Note: Dollar amounts in $1,000 of 2016 dollars. Estimates from individual samples 2010-2012.

Donee characteristics from Form 8283

- Only 6 of the top 25 organizations report easements as gifts
  - Of the 21 public charities that receive the most gifts of donations of easements, 15 do not report those gifts

- Organizations that receive non-cash contributions avoid public oversight that the disclosure of Form 990 is intended to provide

- Allows organizations to sidestep an important legal test required to qualify as a public charity
  - Non-cash contributions are excluded from gifts reported on Schedule A
  - Given the size and concentration of certain non-cash contributions, this could affect whether certain organizations are qualified to be public charities or private foundations

Why are donations so concentrated?

- **Many large donations seem associated with large real estate development**
  - Recreational community surrounding a golf course/tennis club
  - Suburban residential development with multiple homes
    - The average deduction claimed for golf course easements currently under audit is about $19 million; can exceed $50 million.
    - A single such transaction can be 5 to 7 percent of annual total

- **Many high-value donations occur in high-cost areas**
  - Affluent suburbs: Westchester, Santa Monica, Atlanta.
  - Resort destinations: Jackson Hole, Nantucket, the Hamptons.

- **"Highest and best" private use** means development often increases the value of adjacent land or open space

New High Shoals Rd
Robinson Creek

Some Options

- Make promoted, syndicated easement transactions a “listed transaction”
- Use an allocated credit instead of a deduction
- Strengthen the definition of conservation purpose and standards for organizations

Increase Transparency

- Revise Schedule D reporting/Require Form 990 filing
- Revise Schedule B reporting
- Revise Schedule M reporting
- Require reporting of contributions of conservation easements at FMV in Form 990 and Form 990EZ core forms
- Revise Schedule A reporting and calculation of public support
- Improve Donor Reporting

Tax preparers, refund anticipation products, and EITC noncompliance

7th Annual IRS-TPC Joint Research Conference

June 21, 2017

Maggie R. Jones, U.S. Census Bureau

Research was performed under agreement TIRSE-14-M-00002 between the U.S. Census Bureau and the Internal Revenue Service.

United States Census Bureau
U.S. Department of Commerce
Economics and Statistics Administration
U.S. CENSUS BUREAU

Overview

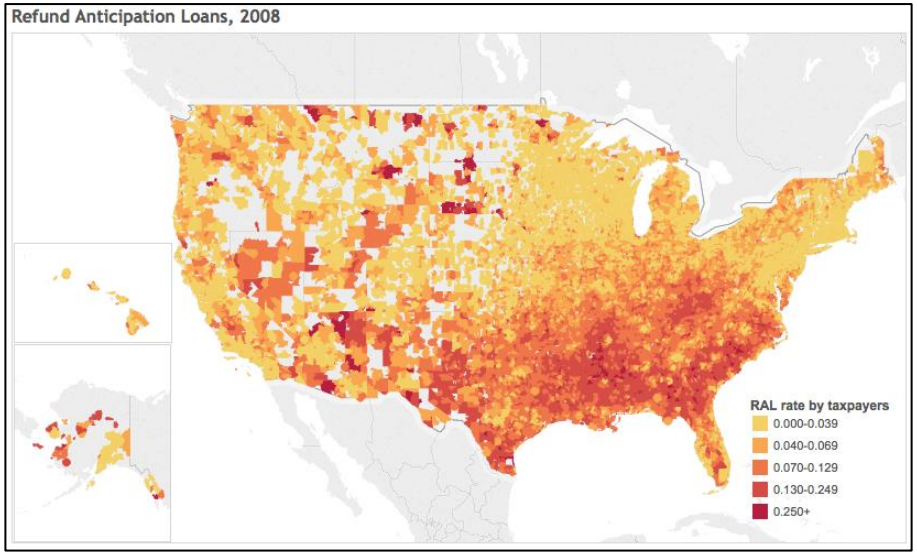
- Tax preparers offer expensive products to customers that speed up refund time and/or pay tax-prep fee
- Products are targeted to low-income taxpayers who often are
  - poor credit risks
  - non-banked
  - meet many eligibility requirements for large tax credits
- Tax refunds (made up mainly of EITC) constitute a large portion of U.S. safety net
  - substantial incorrect payment rate
  - some safety net moneys go to preparers rather than to recipients in need
  - burden and repercussions of audit fall on taxpayer

Refund anticipation products I

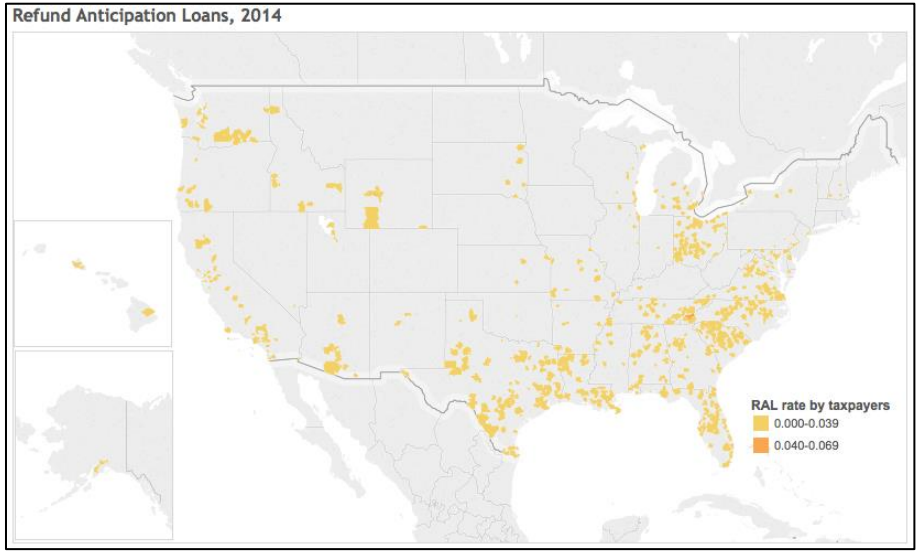
- Refund anticipation loans
  - a loan of the full refund, where the refund secures the loan
  - taxpayers pay substantial fees and interest (three-digit APR)
  - preparer arranges, but loan is made through consumer finance co.
- History of RALs
  - first available 1980s—provided “same-day” refund
  - arose in tandem with electronic filing
  - between 2000 and 2010, IRS provided debt indicator
    - made product very profitable due to low risk of default
    - cessation of debt indicator in August 2010 led to massive withdrawal of product offering beginning in the next tax season
    - all major players withdrawn by 2012

RAL rates per taxpayer count by zip

2008



2014



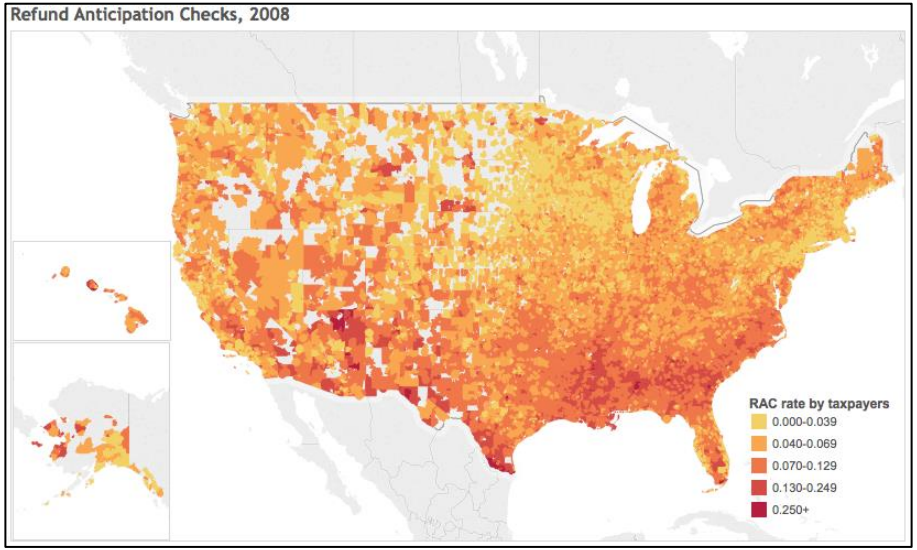
Source: IRS Form 1040 data. 2008 and 2014, aggregated to zipcode

Refund anticipation products II

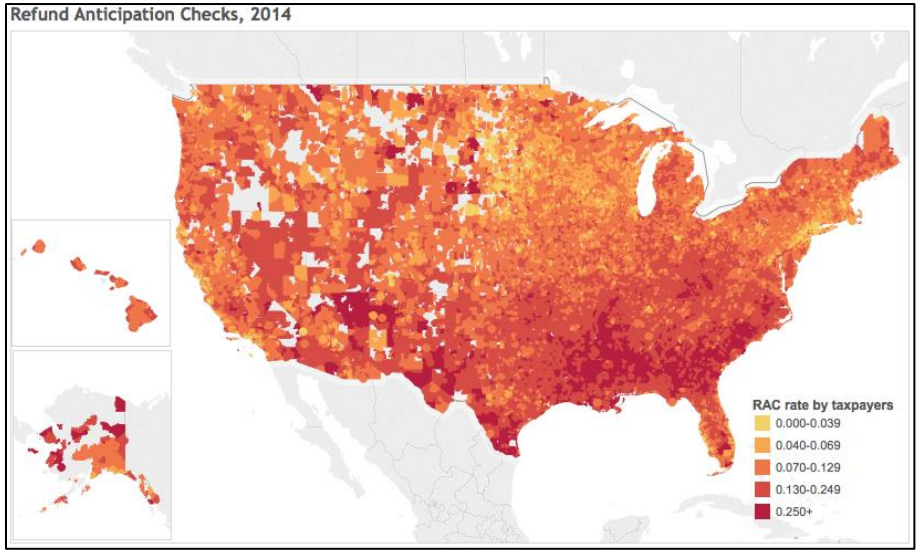
- Refund anticipation checks
  - preparer sets up a temp checking account, into which refund is deposited
  - prep and other fees taken from refund, balance to taxpayer in a check or prepaid debit card
  - product is essentially a lending of the prep fee, with APR often >100
- History of RACs
  - originally much cheaper than RALs, but recently price ↑
    - add-on fees, check cashing fees, debit card use fees
    - increasing prep fees
  - higher-cost RACs associated with higher refunds, esp. EITCs with children
  - overlapped with RAL provision; taxpayers could buy online

RAC rates per taxpayer count by zip

2008



2014



Source: IRS Form 1040 data. 2008 and 2014, aggregated to zipcode

Motivation and research questions

- Taxpayers have perverse incentives to claim EITC
  - price tag of incorrect payment in tens of billions of $ each year
  - between 22 and 25 percent of EITC receivers are paid erroneously
- Tax preparers have perverse incentives to make erroneous EITC filings
  - EITC filing requires further worksheets and higher prep cost
  - the higher the refund, the more lucrative the loan
  - higher-priced RACs associated with EITC filings and higher refunds
- Question: Is overpayment of EITC associated with paid preparer filings and refund anticipation products? (YES!)
- Question: Is the relationship between paid preparer/product use and incorrect payment of EITC causal? (MIXED)

Details on perverse incentives

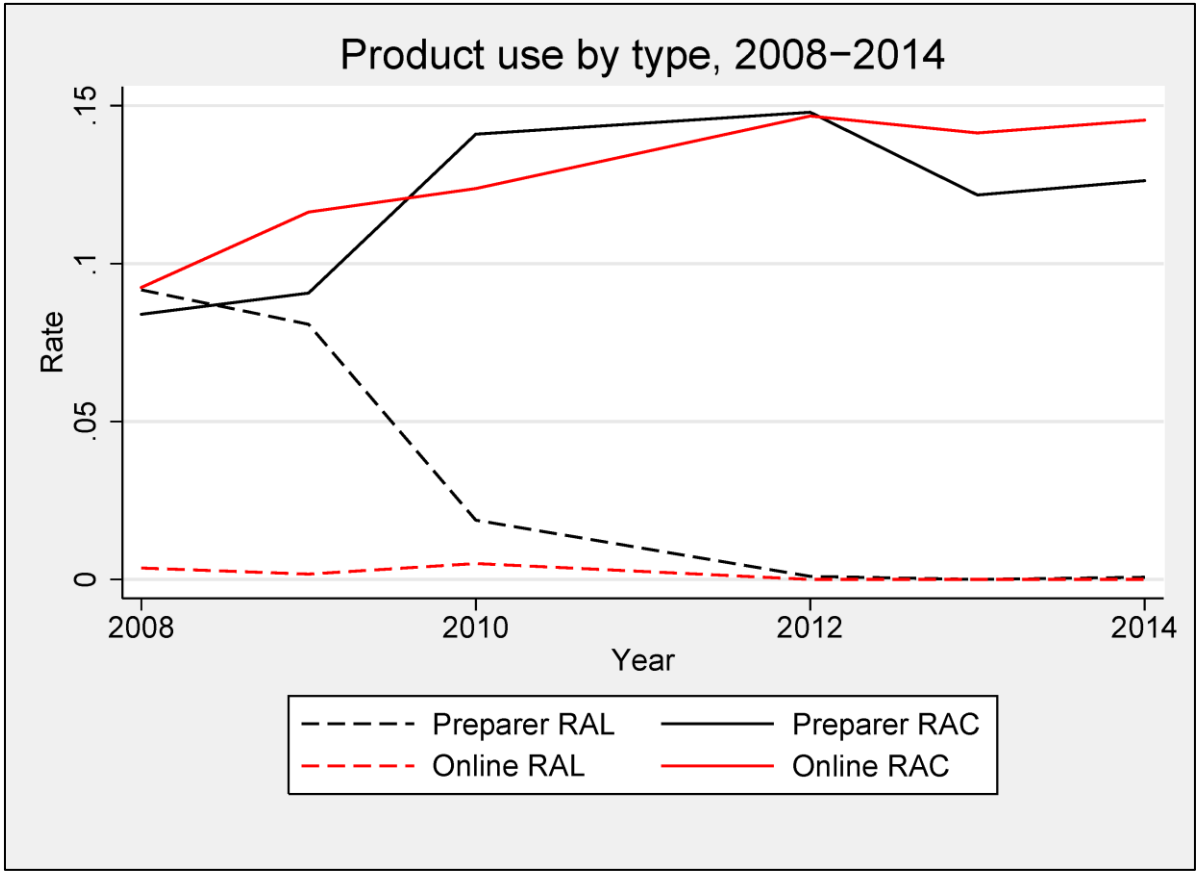
- A filer buying a product may
  - want immediate cash to pay off more pressing bills (Barr & Dokko, 2008; Theodos, 2010)
  - lack access to any other forms of credit (Elliehausen, 2005)
  - believe that going to a preparer may help avoid an audit (Book, 2009)
- Preparers
  - are encouraged to sell products through bonuses and job performance review
  - often are not licensed in any way
  - often face no repercussions for erroneous filings
- No price data on products, but according to mystery shoppers (NCLC)
  - final price often much higher than quoted
  - highest RAC/prep total price for returns with EITC-qual child ($330 to $540, 20 percent of average HH EITC)
  - low-ball total estimate of $848 mil in 2014

IRS data, 2008-2010 and 2012 to 2014

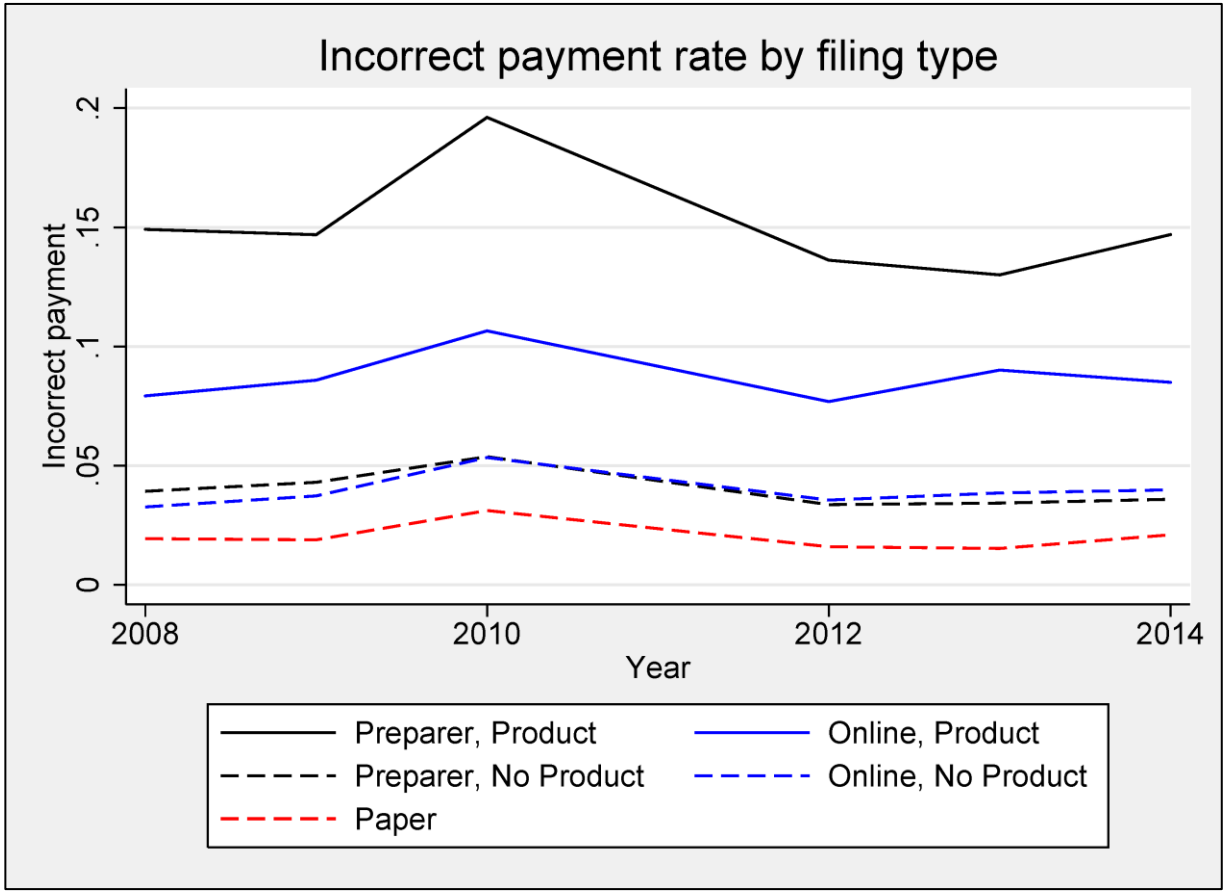
- Files related to EITC receipt, for use in EITC take-up rates
  - Form 1040 individual income tax files
  - Form W-2 return records
  - EITC recipient files
  - each file arrives with SSNs, the vast majority of which are swapped for a unique, in-house identifier (99.6%)
- Records of tax filers who purchased a RAL or a RAC (coded separately)
- Combined data allow for identifying preparer filings, online filings, and paper filings
- Only preparer filings and online filings allow for product purchase

CPS ASEC data, 2009-2011 and 2013-2015

- Unique, in-house identifier placed by using probabilistic matching to a master reference file (match rate is about 90% for each year)
- Tax records and survey files linked together
- Eligibility and ineligibility determination based on combined survey and tax record values
- Sample selection bias-corrected using inverse-probability weights
  - calculate probability that a CPS ASEC person is found in 1040 data (equivalent to calculating probability of identifier placement)
  - reweight the CPS ASEC persons weights and replicate weights using inverse
  - resulting data compares favorably with Statistics of Income numbers and distribution of demographic characteristics of tax filers matched to 2010 decennial



Source: Linked CPS ASEC-Form 1040 data, 2008–2010, 2012–2014.



Source: Linked CPS ASEC-Form 1040 data, 2008–2010, 2012–2014.

Econometric model

- Triple-difference approaches to examine the impact of the removal of debt indicator on probability of incorrect payment (*y*)

$$y_{its} = \alpha + \beta_1 \text{prepXproductXyear}_{2009} + \ldots + \beta_5 \text{prepXproductXyear}_{2014} + \gamma_1 \text{onlineXproductXyear}_{2009} + \ldots + \gamma_5 \text{onlineXproductXyear}_{2014} + \delta \text{prepXproduct} + \varphi \text{onlineXproduct} + \theta \text{prep} + \rho \text{online} + \tau_1 \text{year}_{2009} + \ldots + \tau_5 \text{year}_{2014} + \sigma_s + X_{its}'\beta + \epsilon_{its}$$

- Base group is paper filers, for whom product=0 at all times
- Comparison of this group with online filers and those using a preparer give picture of incorrect payment induced by preparer and product use
- Triple interaction with year=2010 estimates the impact of the debt indicator removal on the supply side
- Mechanism: Preparers forced to sell RACs vs RALs; sold higher-priced RACs based on higher refunds via EITC

	(1) Baseline	(2) With covariates	(3) Online as comparison	(4) Low income
Preparer	0.019***	0.018***	0.006*	0.026***
	(0.003)	(0.003)	(0.003)	(0.004)
Online	0.012***	0.012***		0.019***
	(0.002)	(0.002)		(0.004)
Preparer X Product	0.119***	0.078***	0.047***	0.079***
	(0.011)	(0.009)	(0.012)	(0.009)
Online X Product	0.049***	0.030***		0.035***
	(0.009)	(0.009)		(0.011)
Preparer X Product X 2010	0.028**	0.033**	0.026	0.022***
	(0.010)	(0.010)	(0.016)	(0.010)
Online X Product X 2010	0.002	0.007		0.003
	(0.010)	(0.010)		(0.012)
Preparer X 2010	0.002	0.001	-0.005	0.005
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Product			0.030***	
			(0.009)	
Product X 2010			0.007	
			(0.010)	
Test of $\beta_2=\gamma_2$: Prob > F	2.45; 0.124	2.57; 0.115		1.04; 0.313
Obs.	336,166	336,166	308,723	207,622

* p<0.05, ** p<0.01), *** p<0.001. Source: Linked CPS ASEC-Form 1040 data, 2008–2010, 2012–2014.

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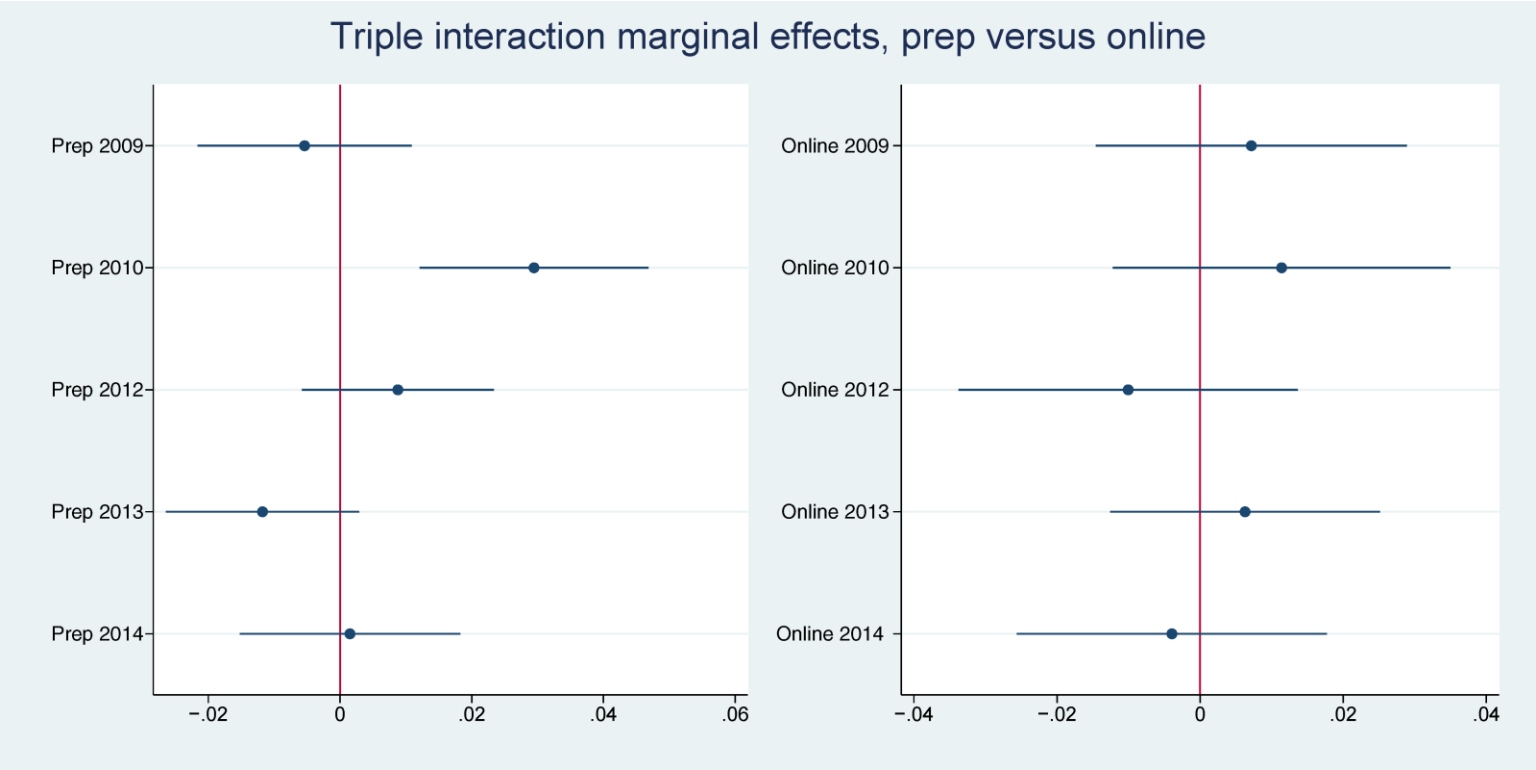
Marginal effects



Source: Linked CPS ASEC-Form 1040 data, 2008–2010, 2012–2014.

Conclusion

- Preparer use and product use are each separately associated with incorrect payment of EITC
  - Filers using a preparer and buying a product have the highest rates of incorrect payment, followed by filers who file online and use a product
  - Prepared and online filers who don't buy a product do not differ in incorrect payment, but both rates are slightly higher than for paper filers
- Suggestive evidence exists of a "preparer effect," with incorrect payment increasing in 2010 for those using a preparer and buying a product
  - Added another 3 percentage points, approximately, to the incorrect payment rate in that year
  - The triple interaction for online filers + product in 2010 was not statistically different from prepared filings

Thank you!

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