Harnessing Technology to Improve Tax Administration

Janet McCubbin, AARP Public Policy Institute

> Three observations about tax administration:

- > Too costly to audit more than a small fraction of taxpayers.
- > Collect substantial amounts of data electronically, in the normal course of business.
- > Many taxpayers want to comply, and would welcome help in doing so.

> How to manage in this environment?

- > Create a National Fiscal Database.
  - Persons
  - Property
  - Expenditure and income
    - – "One person's expenditure leads to another person's income thereby creating an ex-income audit trail."
- > Use it to verify taxpayer reports (modeling).
- > Or, use it to pre-populate taxpayer accounts.

> Questions:

- How comprehensive and accurate would the database – especially the ex-income data – be?
- How would taxpayers respond to pre-populated reports?
- How costly would it be to assemble and process the data?

- > The Taxpayer Relief Act of 1997 made it more cost-effective for IRS to levy certain Federal payments.
  - > Provided for a “continuous levy” that may remain in effect until the debt is paid.
  - > Maximum amount is 15% of payment.
  - > Most taxpayers affected are Social Security recipients.

Building a Better Filter

- Social Security recipients may be vulnerable.
  - About a third of Social Security recipients depend on Social Security for virtually all of their income.
- IRS initially excluded Social Security recipients with low Total Positive Income (TPI).
  - About 55 percent of delinquent Social Security recipients.
- GAO (2003) argued that many of these taxpayers could pay their tax debts.
- IRS dropped the TPI filter in 2005; FPLP cases referred to the Taxpayer Advocate grew from 500 in FY 2004 to over 4,000 in FY 2006.

Building a Better Filter

> Options:

> No filter

> TPI filter using last tax return

> Tax return + third party data income filter

> Collection standards applied to “best income” filter

> Other filters

> Which filter does the best job of separating those who can pay from those who cannot? How do we know?

Building a Better Filter

> Establish a benchmark for a "good" filter.
> Paper uses actual dispositions.

Case Status/Filter Result	Cannot Pay	Can Pay
Levy	28,420 (15%)	128,635 (67%)
Paid	785 (<1%)	14,435 (8%)
Installment Agreement	935 (<1%)	12,303 (6%)
Hardship waiver	952 (<1%)	4,851 (3%)

- Actual dispositions might not be the correct outcomes.
- Investigate the levy cases further.
  - “Accepting” a levy does not mean that hardship has not occurred.
  - Is IRS levying inappropriately, or is the filter exempting too many cases?
- Other data (e.g., experience with levying wages)?

- Compare taxpayers excluded by each filter.
  - What is the rationale and methodology behind alternative filters?
  - Are there substantial differences in the numbers and types of taxpayers screened out by each filter?
  - Can a fast, cheap, easily implemented filter perform nearly as well as a more complicated filter?
    - Looking for assets probably not productive.
- How do taxpayer circumstances change over time? Should cases be reevaluated? Annually?

> First research goal: determine whether the Free File program acts as a gateway to electronic filing.

- > Answer *seems* to be YES.
- > 80% of those using Free File for TY 2005 but not for 2006, nonetheless filed electronically for 2006.
- > 87% using Free File for 2005 and eligible to use Free File for 2006, filed electronically.
    - 40 percent via Free File
    - 11 percent via a paid preparer
    - 36 percent on their own
- > 73% of 2005 Free Filers filed electronically (including telefile) for 2004

- Second research goal: identify market segments with the greatest potential for increasing participation in Free File.
  - Young filers
  - Self-prepared, V-coded return filers
  - “Students”

> Young filers

  > Shackleford (2007) finds younger filers prefer to get forms and information on-line.

  > Chu and Kovalick (2007) find that Free Filers are likely to be young.

  > Most taxpayers *eligible* to free file are young.

  > Thus, young filers account for the largest number of eligible non-participants as well as the largest group of participants.

    - 41% of Free Filers & 24% of non-participants are < age 25.
    - 24% of Free Filers & 21% of non-participants are age 25-34.

  > Compare the characteristics of young participants and non-participants

> Self-prepared, V-coded filers

> Hypothesize that V-coded filers would be receptive to Free File and electronic filing, because they are already using a computer to prepare their return

> 8.5 million such filers eligible for Free File

- 2.8 million under age 25
- 1.5 million age 25 – 34
- 1.2 million aged 65 and older

> What else do we know about these filers? Why don't they Free File and what would make them do so?

A Lifetime of Electronic Filing

- "Students"
  - Aged 18 – 24
  - AGI under $17,000
  - No EITC claimed
  - 48% filing on paper (compared to 40% of all taxpayers)
- A diverse group of taxpayers, including many who are low-wage workers, not students
- How do you reach them?
  - Use Form 1098-T or other data to identify students
  - Determine market share of students vs. non-students