

## TAS Research Initiatives

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The National Taxpayer Advocate is a strong proponent for the role of theoretical, cognitive, and applied research in effective tax administration. TAS is currently conducting many new and continuing research initiatives. A primary focus of TAS Research initiatives is to better understand taxpayer compliance behavior and to evaluate IRS programs by balancing the goals of taxpayer compliance with minimizing taxpayer burden. The following discussion summarizes several research initiatives TAS will begin or continue to conduct for the remainder of fiscal years (FYs) 2018 and 2019.

### DISCUSSION

#### Impact of Taxpayers' Perceptions of IRS Service and Enforcement on Voluntary Compliance

TAS will confirm previous study findings and gain further understanding about how taxpayers' attitudes and trust in government affect their tax compliance. A prior TAS Research study indicates trust in government has a significant impact on the compliance of taxpayers who file Schedule C returns.<sup>1</sup> The current TAS study explores how trust in the IRS, as well as taxpayers' perceptions of legitimacy or coerciveness of the IRS powers to enforce compliance, affect taxpayers' accurate voluntary reporting of income and expenses.

The design of this study incorporates both treatment (test) and control groups to allow a comparison of groups receiving a treatment such as an audit to similar groups who were not audited. The treatment groups consist of taxpayers who either (1) were subject to audit of their Schedule C income tax return or (2) experienced IRS identity theft procedures, either because they were a victim of identity theft or because the IRS suspected them of submitting a fraudulent return. The control groups consist of taxpayers filing Schedule C income tax returns indicating noncompliance but not selected for audit and taxpayers whose primary income consisted of wages and who have not experienced IRS identity theft processing procedures. The Schedule C taxpayer group will be further stratified by the type of employee conducting the audit (*i.e.*, field, office, or campus) and whether the audit adjustments were positive, negative, or showed no change in tax.

Data collection was completed earlier in FY 2018, and a contractor is working with TAS Research analyzing the survey results. Preliminary findings from this study were published in 2017.<sup>2</sup> Data analysis will be completed in FY 2018.

It is expected that the research findings will inform the IRS about taxpayers' perceptions of IRS audits, including their trust in the IRS and their view of the legitimacy of IRS powers, and how these perceptions affect their subsequent reporting compliance. The study will also explore how an interaction with the IRS, based on known or suspected identity theft, impacts the taxpayers' views of the agency, as well as their subsequent reporting compliance. Given the IRS's limited resources for conducting audits, it is imperative that compliance interactions with the IRS encourage future voluntary compliance.

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1 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1–70 (Research Study: *Factors Influencing Voluntary Compliance by Small Businesses: Preliminary Survey Results*).

2 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 148–194 (Matthias Kasper, Sebastian Beer, Erich Kirchler and Brian Erard, Research Study: *Audits, Identity Theft Investigations, and Taxpayer Attitudes: Evidence from a National Survey*).

### Effect of Behavioral Messaging on Taxpayer Compliance

This multi-year study, begun in FY 2017 and continuing through FY 2018 and into FY 2019, will explore whether behavioral messaging can favorably influence compliance norms and trust in the IRS, resulting in improved taxpayer compliance. This research explores the extent to which the several different applied treatments impacted taxpayer compliance. The study will focus on whether different communication appeals can influence taxpayers' responsiveness to the IRS.

Building on prior research in behavioral economics and economic psychology, this original research design will examine the potential of different messages or appeals to promote delinquent taxpayers' payment morale. The draft proposal targets three groups of individuals: (1) taxpayers who receive the first delinquency notice (after the notice and demand) after failing to pay schedule C income tax, (2) taxpayers who have repeatedly ignored payment notifications and are receiving their final delinquency notice prior to being assigned to Taxpayer Delinquent Status, and (3) taxpayers whose liabilities have been assigned to the collection queue.

Many idiosyncratic factors drive noncompliance behavior at the individual level, but they can be categorized into three broad groups: (1) information constraints, (2) lack of tax morale, and (3) inability to pay. To test the role of information constraints, the message offered taxpayers will emphasize basic information. To test the importance of tax morale, and the potential to increase compliance from the redesigned notice, messages appealing to taxpayer's social norms (moral suasion) and stressing the negative consequences of noncompliance will be presented. Finally, to test to what extent inability to pay drives noncompliance, targeted messages that offer taxpayers the opportunity to commit to repaying their tax debt at a specific point in the future will be used. In some instances, the notices will also provide a phone number for the taxpayer to call to receive assistance.

TAS anticipates that this study will yield three crucial insights for tax administration. First, it offers a cost-effective opportunity to understand the drivers of noncompliance. Second, it will permit an examination of the effects of service provision (*e.g.*, phone assistance) on tax revenues. Third, by promoting an understanding of taxpayer behavior at different stages of the collection process, it will facilitate the design of more effective administrative policies and procedures.

### Effect of Educational Letters on Taxpayers Who Claim the Earned Income Tax Credit (EITC) Apparently in Error

TAS plans to build on its 2016 and 2017 studies that explored the effect of educational letters on taxpayers' subsequent compliance with the Earned Income Tax Credit (EITC).<sup>3</sup> These prior studies sent educational letters to taxpayers who appeared to have erroneously claimed the EITC on their tax year (TY) 2014 or TY 2015 returns. The letter explained the requirements for claiming EITC and identified the error the taxpayer appeared to have made. Both studies explored the extent to which the letter affected taxpayers' subsequent compliance.

In the 2017 study, TAS sent the same letter sent in 2016 to taxpayers who appeared to have erroneously claimed EITC on their TY 2015 returns, prior to filing their TY 2016 return, except the 2017 letter also

<sup>3</sup> National Taxpayer Advocate 2016 Annual Report to Congress vol. 2, 31–52 (Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently in Error and Were Sent an Educational Letter From the National Taxpayer Advocate*); National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 13–40 (Research Study: *Study of Subsequent Filing Behavior of Taxpayers Who Claimed Earned Income Tax Credits (EITC) Apparently In Error and Were Not Audited But Were Sent an Educational Letter From the Taxpayer Advocate Service, Part 2: Validation of Prior Findings and the Effect of an Extra Help Phone Number and a Reminder of Childless-Worker EITC*).

reminded taxpayers they could be eligible for the childless-worker EITC. In addition, TAS sent a separate letter to a group of taxpayers who appeared to have erroneously claimed EITC because the residency test was not met. The letter to this group was the same as the letter sent to other taxpayers who appeared to not have met the residency test, except that it included a toll-free number taxpayers could call to speak to a TAS employee about their eligibility for EITC.

The 2017 study had the following main findings:

- For taxpayers who appeared to not meet the residency requirement, the TAS letter with an extra help telephone number averted erroneous EITC claims more effectively than not sending a letter, sending a letter without the additional phone number, or auditing the taxpayer. Sending the TAS letter with the extra help phone number to all taxpayers whose 2015 returns appeared to be erroneous because the residency test was not met would have averted more than \$44 million in erroneous EITC claims;
- For taxpayers who appeared to not meet the relationship requirement, the TAS letter averted erroneous EITC claims more effectively than not sending a letter. Sending the TAS letter to all taxpayers whose 2015 returns appeared to be erroneous because the relationship test was not met would have averted nearly \$53 million (the estimate was \$47 million in the prior year) of erroneous EITC claims;
- For audited taxpayers who appeared to have claimed the same qualifying child as another taxpayer (*i.e.*, there were duplicate claims) who then claimed EITC in the subsequent year, the audits were the least effective in modifying their behavior; and
- The 2017 TAS letter sent to taxpayers who appeared not to have met the residency test on their TY 2015 returns included an extra help phone number (as opposed to the letter sent to all taxpayers reminding them of the childless-worker EITC) resulted in more taxpayers claiming the childless-worker EITC on their 2016 returns, compared to those taxpayers who received the last year's TAS letter without the notification that the taxpayer may still be entitled to the childless-worker EITC.

In 2019, TAS plans to again study taxpayers who appeared to erroneously claim the EITC in TY 2018. In addition to validating the results of the prior two studies, TAS plans the 2019 letters to offer a telephonic help line to taxpayers who did not meet the relationship test and to taxpayers who claimed an EITC dependent already claimed by another taxpayer. TAS wants to determine if the offer of additional personal assistance to taxpayers who appear to not meet the relationship test will show an even greater improvement in subsequent compliance with EITC rules. After its prior two studies did not show that the TAS educational letter significantly prevent taxpayers from claiming an EITC dependent already claimed by another taxpayer, TAS plans to test whether the offer of a help line will be more effective at preventing taxpayers from claiming dependents already claimed by another taxpayer. TAS also plans to test redesigned letters that are more visually appealing and present information in a manner more easily understood by taxpayers. The study will test the effect of redesigned letters on taxpayer behavior. Finally, the study will also include focus groups to provide qualitative information on the effectiveness of the content and layout of the messages included in the redesigned letters.

### Study of the IRS Offer in Compromise Program for Business Taxpayers

The IRS conducted an offer in compromise (OIC) study over a decade ago that examined the frequency of taxpayers submitting multiple offers within a short period of time, the future compliance of taxpayers

with accepted offers, and a comparison of the dollars collected when an OIC was rejected versus dollars collected through other collection methods.<sup>4</sup>

In 2017, TAS Research completed a study evaluating the effectiveness of the IRS OIC program for individual taxpayers.<sup>5</sup> The study found that fewer than ten percent of individual taxpayers “churn,” defined as submitting multiple OICs within a six-month period. Furthermore, nearly half of the taxpayers who churn ultimately receive an accepted OIC, suggesting that individual taxpayers are not trying to game the system, but are legitimately seeking an acceptable offer. In addition, individual taxpayers with accepted OICs were significantly more likely (16 percent) to timely file their subsequent income tax returns for the next five years when compared to taxpayers whose OICs were not accepted.

TAS will begin work on a new study in 2018 that will follow a similar methodology as the 2017 TAS OIC study, but will focus on business taxpayers with tax delinquencies. Like the previous study, TAS will:

- Quantify the number of business taxpayers who have submitted multiple OICs in a short amount of time;
- Examine the subsequent filing and payment compliance for the next five years after the IRS accepts a business taxpayer’s OIC;
- Determine if subsequent compliance continues beyond the five years required as part of the accepted OIC agreement;
- Compare the amount the IRS could have collected on a rejected or returned OIC to the amount collected subsequently;<sup>6</sup> and
- Determine if the IRS realizes its estimation of the reasonable collection potential when it rejects an offer.

The 2018 TAS OIC study will quantify the dollars collected from business taxpayers with rejected or returned OICs and compare that to what the IRS could have collected if it had accepted the offers from these taxpayers. TAS will evaluate whether the IRS left money on the table when it rejected or returned a business taxpayer’s offer in favor of pursuing other collection methods such as refund offsets, voluntary payments, or levies. The study will also explore the future compliance of offers returned as unprocessable because of unfiled returns. TAS expects to complete the study in FY 2019.

### The Effectiveness of and Possible Improvements to Allowable Living Expense Standards

The IRS developed the allowable living expense (ALE) standards in 1995 to establish consistency in the application of expense allowances, such as food expenses, household expenses, medical expenses, housing expenses, and transportation expenses, in determining taxpayers’ available funds to meet their tax liabilities.<sup>7</sup> These ALE standards have come to play a large role in many types of collection cases.<sup>8</sup> Based on concerns identified by the National Taxpayer Advocate, the IRS entered into a joint agreement with

4 IRS, *Offer in Compromise Program: An Analysis of Various Aspects of the OIC Program* (Sept. 2004).

5 National Taxpayer Advocate 2017 Annual Report to Congress vol. 2, 41–60 (Research Study: *A Study of the IRS Offer in Compromise Program*).

6 Previously, the IRS worked with the taxpayer to secure any unfiled returns, so that the OIC could still be considered. However, in 2016, the IRS implemented new procedures, which require an offer to be returned as unprocessable if research shows the taxpayer has unfiled returns. Small Business/Self-Employed Division (SB/SE) Interim Guidance Memorandum (Apr. 13, 2016).

7 Internal Revenue Code (IRC) § 7122(d)(2)(A); SB/SE, *2015 Allowable Living Expenses Project* (Sept. 2015).

8 Internal Revenue Manual (IRM) 5.15.1, *Overview and Expectations* (Oct. 17, 2014).

TAS in 2007 to not decrease the allowance amount for any ALE category unless economic conditions changed significantly, such as a major sustained recession or depression.<sup>9</sup>

Despite the 2007 joint agreement, by 2014, the IRS believed that economic circumstances dictated lowering many ALEs.<sup>10</sup> While TAS does not question the IRS analyses of the data, which led to a decrease in the ALEs, TAS does not believe that decreases in expenditures necessarily equate to a price decrease in the cost of the expense. Rather, expenditures may show a decrease because consumers are no longer able to afford to purchase the item. For example, an elderly person may no longer be able to afford to purchase all his or her prescription drugs, even though a doctor has determined their necessity. Undoubtedly, many other examples exist where consumers are no longer purchasing needed items because of their personal economic circumstances. However, because of this situation, the monies being spent on ALE items will decrease creating a corresponding decrease in the amount of the expense allowed. Additionally, the IRS does not consider some basic expenses as necessary. For example, the IRS will not routinely allow expenses for home internet access even though many schools expect students to have home internet access and even though the IRS encourages taxpayers to interact with the IRS in an online environment.

Although the Internal Revenue Manual clearly states that other expenses should be allowed as determined to be necessary for the taxpayer's necessary living expenses,<sup>11</sup> practitioners have raised concerns that IRS personnel are often unwilling to deviate from the ALEs, regardless of circumstances.<sup>12</sup> While TAS appreciates the consistency that ALEs have brought to the financial analysis of taxpayers with delinquent tax debts, the IRS must be willing to deviate from the ALEs.<sup>13</sup>

In FYs 2018 and 2019, TAS plans to conduct a study to review the IRS financial analysis of collection information statements for the following issues:

1. The incidence of taxpayers having expenses in a specific ALE category exceeding the ALE standard;
2. The incidence of taxpayers having expenses in one or more ALE categories, which exceed the ALE for the category and these excess expenses are disallowed even though the taxpayer's total expenses are less than the sum of all relevant ALE standards;
3. The incidence of the IRS not allowing an expense because it is outside of the current accepted ALEs; and
4. The incidence of the IRS not allowing an expense because it is outside of the accepted ALEs, but the taxpayer's total expenses are less than the sum of all relevant ALE standards.

Unfortunately, records of IRS financial analysis do not always contain sufficient detail to answer the research questions. Based on a prior review of financial statements, TAS expects to review about 1,500 cases to obtain sufficient information to complete this study. We believe the results of this study will provide important data to substantiate the need for the IRS to make changes in how it administers ALEs. An accurate and consistent financial analysis will likely create more durable installment agreements while

<sup>9</sup> SB/SE, *2015 Allowable Living Expenses Project iii* (Sept. 2015).

<sup>10</sup> *Id.*

<sup>11</sup> IRM 5.15.1.1(7), *Overview and Expectations* (Nov. 17, 2014).

<sup>12</sup> See, e.g., TAS, *2017 IRS Nationwide Tax Forums, TAS Focus Group Report: Preparers' Experiences with Installment Agreements* 9–10 (Oct. 2017).

<sup>13</sup> IRC § 7122(d)(2)(B). In addition, pursuant to the Taxpayer Bill of Rights (TBOR), the taxpayer has the *right to a fair and just tax system*. See TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights). The rights are now listed in the Code. See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

fostering taxpayer trust in the IRS to accommodate their individual necessities. Moreover, it will adhere to the taxpayer's *right to a fair and just tax system*, which says taxpayers can “expect the tax system to consider the facts and circumstances that might affect their underlying liabilities, ability to pay, or ability to provide information timely.”<sup>14</sup>

### Study of Math Error Cases Requiring Rework by the IRS

Internal Revenue Code (IRC) § 6213(b) provides the IRS authority to adjust returns and summarily assess tax to resolve mathematical or clerical mistakes on tax returns.<sup>15</sup> The statute permits the IRS to make such an additional assessment without issuing a statutory notice of deficiency. The taxpayer has 60 days to request an abatement of the additional tax. If the taxpayer makes a timely appeal but does not provide the documentation to abate the math error assessment, the IRS must follow normal deficiency assessment procedures and issue the taxpayer a statutory notice of deficiency. However, if the taxpayer does not appeal the additional assessment within 60 days, the assessment cannot be appealed to the U.S. Tax Court, which is the only prepayment judicial forum available to the taxpayer.<sup>16</sup>

The 2011 National Taxpayer Advocate's Annual Report to Congress included a study showing that a large proportion of math error adjustments related to an incorrect dependent taxpayer identification number were ultimately reversed. Over half of these math error adjustments were reversed, returning the originally claimed refund to the taxpayer. Worse, the IRS initially adjusted these taxpayers' accounts and issued a math error notice, even though its own systems contained the information to correct the taxpayer mistake in about 56 percent of the cases. The study determined that not only do some math errors inconvenience the taxpayer, the IRS spends millions of dollars correcting erroneous math error assessments and paying interest on delayed refund amounts.<sup>17</sup>

While the correction of mistakes affecting the true tax owed theoretically saves the IRS time and money, in practice many math errors are issued in situations where an error is easily corrected by the IRS using internal data, and in many cases the taxpayer has provided an accurate reporting of the tax. Determining situations where math error adjustments are likely to be subsequently abated will assist the IRS with making modifications to its math error programs to eliminate the issuance of math errors in situations where the cost of making the adjustment is not cost effective.

Therefore, TAS is analyzing the different types of math errors issued by the IRS to determine which have the highest reversal rates. After this determination is made, TAS will calculate both the costs of the initial math error adjustment and its subsequent reversal. This study should help the IRS to refine its math error program and adapt its procedures to increase cost effectiveness, while reducing taxpayer burden.

### Eligible Taxpayer Population Not Using TAS Services

In 2018, TAS is studying the population of taxpayers who qualify for but do not use TAS services. TAS refers to these taxpayers as the “underserved taxpayers.” In addition to producing a new estimate of the underserved population of taxpayers, TAS seeks to better understand these taxpayers, including how best to reach and communicate with this audience.

14 See TBOR, [www.TaxpayerAdvocate.irs.gov/taxpayer-rights](http://www.TaxpayerAdvocate.irs.gov/taxpayer-rights).

15 See Area of Focus: *The IRS Has Expanded Its Math Error Authority Without Legislation and Without Seeking for Public Comments*, *supra*.

16 IRC § 6213(b)(1).

17 National Taxpayer Advocate 2011 Annual Report to Congress vol. 2, 113-144 (Research Study: *Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents*).

TAS previously conducted a marketing analysis of the underserved during 2001-2002 and 2007, followed by a 2012 online panel survey to estimate the underserved population.<sup>18</sup> However, the 2012 survey achieved significantly different results than the prior survey. With the current study, TAS will verify the accuracy of the prior survey and obtain greater detail about the composition of the TAS underserved population. In addition, TAS will build on previously used segmentations of the underserved population and will explore why underserved taxpayers have not sought TAS assistance.

A contractor will develop, administer, and summarize the findings of two surveys, each of which includes 1,000 U.S. taxpayers. One survey will focus on determining the size of the underserved population. The second survey will focus on determining the demographic characteristics of the underserved, including quantifying taxpayers in the previously defined categories of Surviving Spouses and Seniors, Unmarried Low Income, and Struggling Young Families. Additionally, the contractor will explore possible new categorizations of the TAS underserved population.

Finally, the contractor will also design and conduct two focus groups of underserved taxpayers. This qualitative study will gain more in-depth knowledge of the audience and explore why TAS assistance was not sought, which channels would best reach taxpayers, and how to increase the underserved population's use of TAS services.

## FOCUS FOR FISCAL YEAR 2019

In fiscal year 2019, TAS will:

- Confirm previous study findings and gain further understanding about how taxpayers' attitudes and trust in government affect their tax compliance. The current study explores how trust in the IRS, as well as taxpayers' perceptions of legitimacy or coerciveness of the IRS powers to enforce compliance, affect taxpayers' accurate voluntary reporting of income and expenses.
- Continue a multi-year study exploring whether outreach and education can favorably influence compliance norms and trust in the IRS, resulting in improved taxpayer compliance. This research will focus on whether different communication appeals can influence taxpayers' responsiveness to the IRS in the collection context.
- Validate the results of TAS's 2016 and 2017 studies that explored the effect of educational letters on taxpayers' subsequent compliance with the EITC. In 2019, TAS plans the educational letters to include a telephonic help line to taxpayers who did not meet the relationship test and to taxpayers who claimed an EITC dependent already claimed by another taxpayer. TAS wants to determine if this offer of additional personal assistance will further improve subsequent compliance with EITC rules.
- Evaluate dollars collected from business taxpayers with rejected or returned OICs. TAS will analyze the dollars the IRS could have collected if it accepted the offer versus what the IRS ultimately collected from the taxpayer. We will also examine the subsequent filing and payment compliance for the next five years after the IRS accepts a business taxpayer's OIC.
- Conduct a study to review the IRS financial analysis of collection information statements. The results of this study will provide important data to substantiate the need for the IRS to make changes in how it administers allowable living expenses.

18 Forrester Research, *Omnibus Mail Survey for the Taxpayer Advocate Service*, Q2/Q3 2012, 20 (Sept. 17, 2012).

- Conduct research to determine which types of math errors have the highest reversal rates. TAS will calculate both the costs of the initial math error adjustment and its subsequent reversal. This study should help the IRS to refine its math error program and adapt its procedures to increase cost effectiveness, while reducing taxpayer burden.
- Engage in research to identify the population of taxpayers who qualify for TAS assistance but do not use it. TAS will use this information to better reach underserved populations and to refine our communication methods going forward.