

Increasing Voluntary Tax Compliance for Return Preparers



A pre-filing season letter sent to preparers improved tax compliance

Target a Priority Outcome

Paid tax preparers complete the majority of tax returns claiming refundable credits,^{1,2} and the IRS estimated a loss in 2021 of approximately \$26 billion in improper payments from these credits, specifically the Earned Income Tax Credit (EITC), Additional Child Tax Credit (ACTC), and American Opportunity Tax Credit (AOTC).³ The IRS Return Preparer Program (RPP) is an agency-wide effort to enforce compliance of tax return preparers. As part of their continuous efforts to increase voluntary tax compliance through RPP, the IRS aimed to improve the efficacy of the educational letters sent to paid preparers prior to the filing season.

Translate Evidence-Based Insights

Preparers may complete tax returns incorrectly due to a lack of awareness or understanding of due diligence requirements, or because they view the penalties for overclaiming as unlikely to occur or as too small to change their behavior. As part of their tiered strategy to improve the accuracy of claiming certain benefits, the IRS sends a letter, called the Letter 5025, to preparers prior to the filing season, if the returns they prepared for their clients during the previous season had likely errors in claiming benefits.^{4,5} The Office of Evaluation Sciences (OES) at the U.S. General Service Administration and the Wage and Investment (W&I) and Research, Applied Analytics and Statistics (RAAS) divisions of the IRS collaborated to design an updated Letter 5025. The redesigned letter builds off of insights from the behavioral sciences literature, which suggests that simplifying and clarifying the language, making salient the consequences of filing improperly, and communicating that the preparer's clients may also be notified of likely inaccuracies in their returns, may all serve as effective strategies in motivating voluntary tax compliance among preparers.^{6,7}

Embed Evaluation

The efficacy of sending the Letter 5025 and the content of the Letter 5025 were evaluated using a block-randomized controlled trial. Prior to randomization, the preparers were split into two groups based on whether or not they had previously been exposed to IRS education and outreach. We refer to those preparers who had *not* been exposed to IRS outreach in the prior three years as the *primary* preparer group, as they are the primary focus of our analysis. These preparers were only eligible for the pre-filing season 5025 letter (N=4,445 preparers). Primary preparers were randomly assigned to one of three groups: (a) sent the re-designed behavioral insights (BI) Letter 5025 (N=1,773), (b) sent the treatment-as-usual (TAU) Letter 5025 (N=1,782), or (c) sent no letter (control; N=890) (see Figure 1).

¹ Internal Revenue Service, Earned Income Tax Credit & Other Refundable Tax Credits: Preparer Compliance - Focused & Tiered, <https://www.eitc.irs.gov/tax-preparer-toolkit/preparer-compliance-focused-and-tiered/compliance>.

² Internal Revenue Service, Find a qualified tax professional using IRS website resources, <https://www.irs.gov/newsroom/find-a-qualified-tax-professional-using-irs-website-resources>.

³ U.S. Department of the Treasury, Department of the Treasury Agency Financial Report Fiscal Year 2020 (2020), 248, <https://home.treasury.gov/system/files/266/Treasury-FY-2020-AFR.pdf>.

⁴ Internal Revenue Service, *Preparer Compliance Focused and Tiered*, <https://www.eitc.irs.gov/tax-preparer-toolkit/preparer-compliance-focused-and-tiered/compliance>.

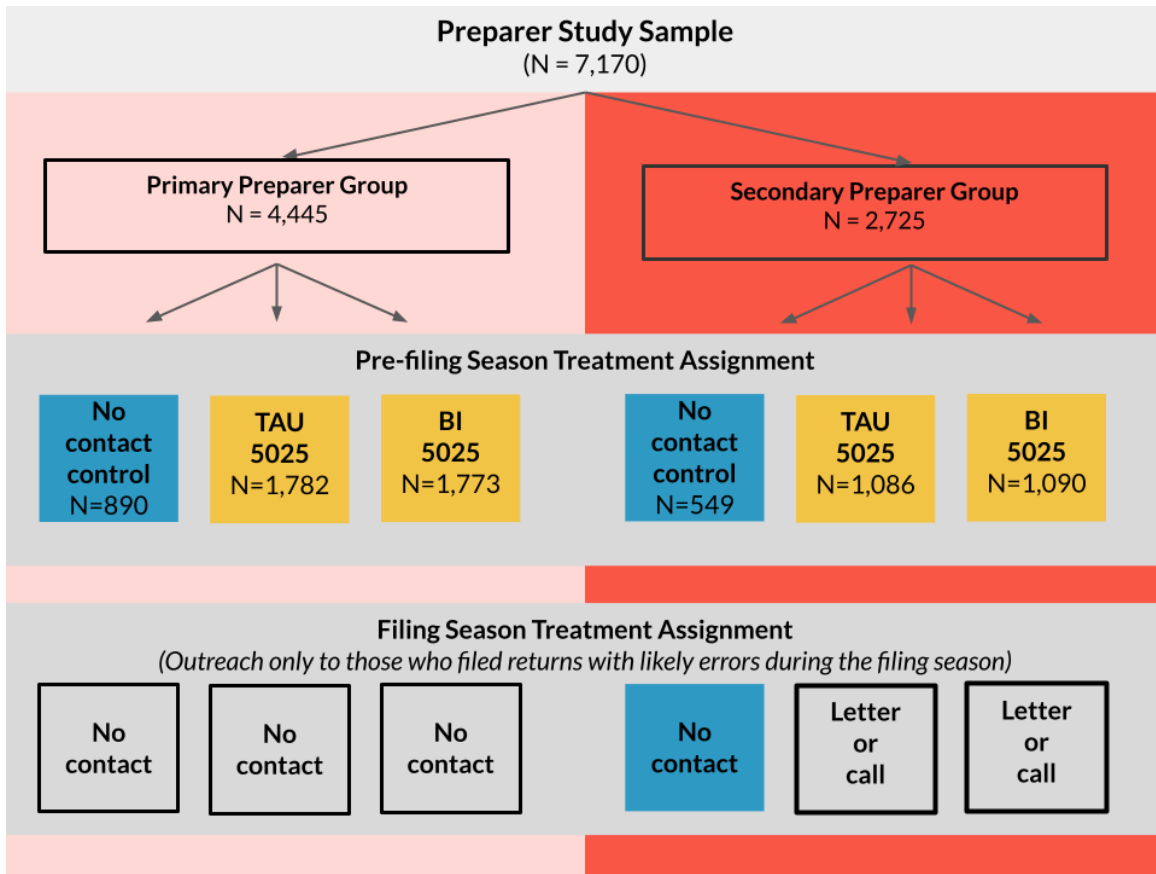
⁵ These benefits include the Earned Income Tax Credit (EITC), the Child Tax Credit, Additional Child Tax Credit, and Credit for Other Dependents (ACTC/CTC/ODC), the American Opportunity Tax Credit (AOTC), and Head of Household filing status (HOH).

⁶ Behavioral Insights Team. *Applying Behavioral Insights to Reduce Fraud, Error and Debt*. (2021).

⁷ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/60539/BIT_FraudErrorDebt_accessible.pdf

⁷ Lerner, J. S., & Tetlock, P. E. Accounting for the effects of accountability. (1999). *Psychological Bulletin*, 125(2), 255–275.

Figure 1: Randomization Procedure and Preparer Samples



Those preparers who *had* been exposed to other IRS treatments in the prior three years are referred to as the *secondary* preparer group (N=2,725 preparers). Secondary preparers were eligible for the pre-filing season 5025 letter, and were randomly assigned to the same three pre-filing season groups: (a) sent the re-designed behavioral insights (BI) Letter 5025 (N=1,090), (b) sent the treatment-as-usual (TAU) Letter 5025 (N=1,086), or (c) sent no 5025 letter (control; N=549). However, secondary preparers who were assigned to the BI or TAU group may also have received outreach (letters or phone calls) during the filing season, if they continued to submit returns that contained likely errors or did not meet due diligence requirements. Since the pre-filing season letter may influence their filing season behaviors, and thus the likelihood of receiving filing season outreach, we cannot separately estimate the impacts of the pre-filing season Letters 5025 and any filing season outreach. As a result, we consider the outreach as a bundled treatment.

The IRS mailed pre-filing season BI Letters 5025 and TAU Letters 5025 in December 2020. For both primary and secondary groups, preparers randomized to the no contact control group had no pre-filing season or filing season outreach.

Analyze Using Existing Data

Centrally housed administrative data maintained by the IRS, plus return-level data processed by W&I, are used to identify returns that have a high likelihood of errors. Since actual errors can only be determined via an audit, we measure the impacts of Letter 5025 by looking at whether returns are likely to contain errors, based on common sources of error.⁸ The primary outcomes analyzed are captured using the returns filed by preparers during the 2021 filing season, and include: (a) the percent of returns that contain one or more likely errors in

⁸Internal Revenue Service, *Preparer Compliance Focused and Tiered*, <https://www.eitc.irs.gov/tax-preparer-toolkit/preparer-compliance-focused-and-tiered/compliance>

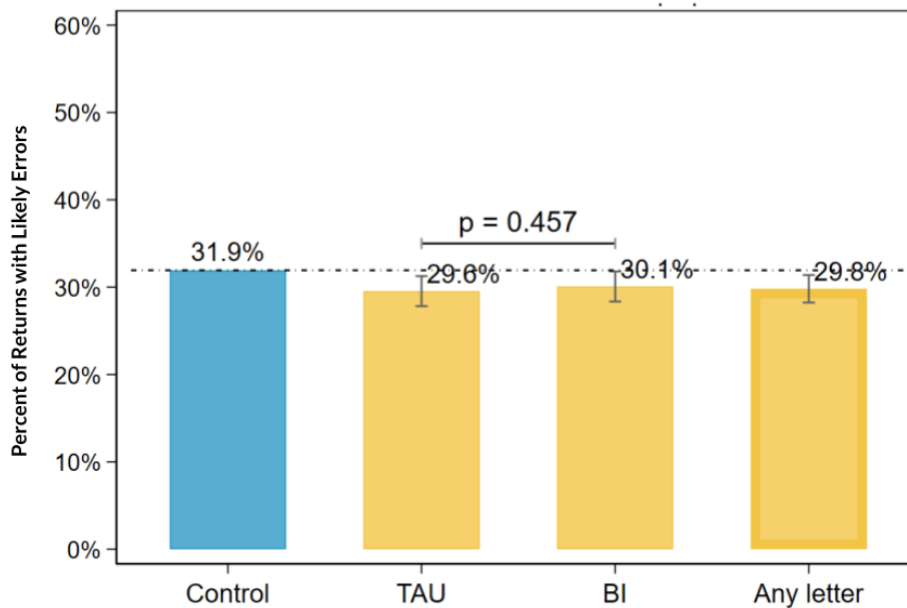
claiming benefits, out of all returns prepared by the preparer; (b) the total dollar amount of credits that may have been claimed erroneously; and (c) the total dollar amount of all refunds returned to the tax filer who used the preparer.^{9,10}

Results

Sending the 5025 Letter to preparers improved tax compliance outcomes for the primary preparer group, but had no effect among the secondary preparer group. Additionally, we observe no statistically discernible differences in tax compliance outcomes based on the content of the 5025 Letter for either subsample of preparers.

Among primary preparers, the Letter 5025 reduced the percent of returns that may contain errors in claiming benefits by 2.1 percentage points ($p < 0.01$, 95% CI [-3.7, -0.6]), compared to the control group's error rate of 31.9%. The letter also reduced the dollar amount of credits claimed with likely errors by \$13,104 ($p < 0.01$, 95% CI [-\$18,706, -\$7,502]), compared to the control group's average erroneous dollar amount of \$108,563. Finally, it reduced the average refund amount by \$36,351 ($p < 0.01$, 95% CI [-\$54,950, -\$17,753]), from a control group level of \$394,528.¹¹

Figure 2: Percent of Returns with Likely Errors among Primary Preparer Group



Among secondary preparers, the Letter 5025 reduced the proportion of returns that contain errors by 0.4 percentage points (compared to the control mean of 25.2%, $p = 0.56$, 95% CI [-1.8, 1.0]). The letters also reduced erroneous dollars by \$4,364 (compared to the control mean of \$155,017, $p = 0.28$, 95% CI [-12,338, 3,610]) and refund amount by \$4,625 (compared to the control mean of \$713,616, $p = 0.75$, 95% CI [-32,511, 23,262]). However, none of these estimates is statistically significant.

⁹ Unless noted otherwise, all of the analysis reported in this abstract was prespecified in an analysis plan, which can be found at <https://oes.gsa.gov>.

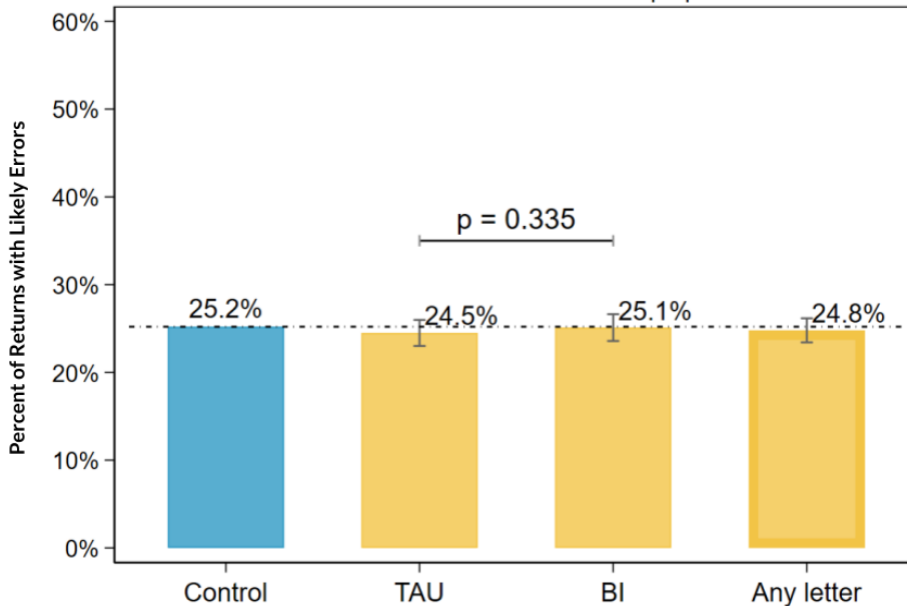
¹⁰ Note that we pre-specified one additional primary outcome not reported here. This outcome was a measure of the error rate up to the point when the preparer would have received filing season outreach, and was designed to allow for an analysis of the impact of the letter across all preparers, regardless of their filing season treatment. We are unable to present results on this outcome due to unforeseen data complexities.

¹¹ These results are statistically significant at the 0.02 level, which controls the Family-Wise Error Rate at 0.05 based on repeated simulations of randomization and hypothesis testing.

The results show that the BI letter does not have different effects on the behavior of preparers from the TAU letter. For the primary preparers, the BI letter reduced the percent of returns with likely errors by 1.9 percentage points ($p = 0.04$, 95% CI [-0.036, -0.001]), and the TAU letter reduced the percent of returns with likely errors by 2.4 percentage points ($p = 0.006$, 95% CI [-0.041, -0.007]), but the -0.5 percentage point difference between the letters' impacts is not statistically significant ($p = 0.46$). The BI letter reduced dollar amount of erroneous claims by \$13,192 ($p < 0.001$, 95% CI [-\$19,285, -\$7,100]), and the TAU letter reduced dollar amount of erroneous claims by \$13,092 ($p < 0.001$, 95% CI [-\$19,232, -\$6,953]), but the \$100 difference between the letters' impacts is not statistically significant ($p = 0.97$). The BI letter reduced refund amount by \$37,859 ($p < 0.001$, 95% CI [-\$58,716, -\$17,001]), and the TAU letter reduced refund amount by \$34,898 ($p < 0.001$, 95% CI [-\$55,294, -\$14,502]), but the \$2,960 difference between the letters' impact is not statistically significant ($p = 0.74$).

For the secondary preparers, impacts by letter type and differences in impacts between the letters are not statistically significant. The BI letter reduced the percent of returns with likely errors by 0.1 percentage points ($p = 0.9$, 95% CI [-0.016, 0.014]), while the TAU reduced the percent of returns with likely errors by 0.7 percentage points ($p = 0.35$, 95% CI [-0.022, 0.008]). The -0.6 percentage point difference between the letters' impact is not statistically significant ($p = 0.335$). The BI letter reduced dollar amount of erroneous claims by \$5,903 ($p = 0.18$, 95% CI [-\$14,490, \$2,685]), and the TAU letter reduced dollar amount of erroneous claims by \$2,469 ($p = 0.58$, 95% CI [-\$11,142, \$6,203]), and the \$3,433 difference in the letters' impact is not statistically significant ($p = 0.31$). The BI letter reduced refund amount by \$8,163 ($p = 0.6$, 95% CI [-\$38,637, \$22,309]), and the TAU letter reduced refund amount by \$1,019 ($p = 0.95$, 95% CI [-\$32,091, \$30,053]), and the \$7,144 difference in the letters' impact is not statistically significant ($p = 0.59$).

Figure 3: Percent of Returns with Likely Errors Among Secondary Preparer Group



Build Evidence

This evaluation demonstrates that IRS education and outreach efforts to preparers can effectively increase tax compliance, at least among preparers with relatively limited prior exposure to IRS education and outreach. We estimate that sending the Letter 5025 resulted in \$129 million in cost savings based on an average reduction of \$36,352 in refunds in filing season 2021 among 3,555 preparers sent letters in the primary preparer group. However, the fact that effects were not observed for secondary preparers suggests that the impacts of repeated outreach and education may fade over time. The evidence also suggests that the particular content of

the outreach may matter relatively less, since the re-designed behavioral insights and treatment-as-usual letters had similar effects on tax compliance. Nevertheless, since many of the results showed the BI letters to be relatively more effective (even if these results were not statistically significant), the IRS opted to use the BI letters for mailings for the 2022 filing season as a result of the findings from this evaluation.