

INCREASING VOLUNTARY TAX COMPLIANCE THROUGH OUTREACH TO CLIENTS OF RETURN PREPARERS



Letters sent to clients reduced likely errors in tax credit claims

Target a priority outcome

Paid tax preparers complete the majority of returns that claim these benefits, helping their clients to file over 84 million tax returns in 2019.^{1,2} Yet, the Internal Revenue Service (IRS) estimated that over \$22 billion was overpaid by the federal government in 2020 due to improper claiming of the Earned Income Tax Credit (EITC), Additional Child Tax Credit (ACTC), and American Opportunity Tax Credit (AOTC).³ Taxpayers who claim tax benefits in error, including those who use tax preparers, may face lengthy audits, large repayments that include interest, and bans from claiming benefits in the future.⁴ 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 collaborated with the Office of Evaluation Sciences (OES) to use behavioral science to design outreach to clients of tax preparers, with the goal of helping them to accurately claim the benefits to which they are entitled and avoid penalties for any erroneous claims, while also reducing the cost to the government of improper payments.

Translate evidence-based insights

The decision of whether and how to claim tax benefits can be complex and confusing. Tax preparers can help their clients simplify these decisions and more accurately claim tax benefits; however, clients may misunderstand their own

responsibilities when using a tax preparer, may not realize that tax preparers can and do make errors, and may not know how to select tax preparers who are more likely to complete accurate returns.

Education and outreach could help reduce barriers to accurately claiming tax benefits by helping clients understand their responsibilities and the filing options available to them. As part of their tiered strategy to improve the accuracy of claims, the IRS sends a letter (known as Letter 6138) prior to the upcoming tax season to a sample of clients whose previous year's return may have contained errors and who used a tax preparer who made likely errors on many of their clients' returns.⁵ The letter alerts the client to potential errors in their previous return and provides information on how to correct the return. It also highlights the consequences of completing an inaccurate return, and provides tips for choosing a better tax preparer in the future.

However, whether clients act on this information may depend on the framing and content of the information provided. OES collaborated with the Wage and Investment (W&I) and Research, Applied Analytics and Statistics (RAAS) divisions of the IRS to create a modified version of Letter 6138. The redesigned letter builds from the existing letter to further incorporate insights from the behavioral sciences literature, which suggest that additional simplification, clarification, and making salient the consequences of filing improperly can serve as effective strategies in motivating voluntary tax compliance. Modifications included: (1) a bold section at the top of the letter to emphasize the key takeaway: "We recommend you choose a different way to prepare your next tax return;" (2) a reminder of the client's responsibility for their own return; and (3) a simplified list of action steps, which also groups together similar tasks.

¹ Internal Revenue Service, *Earned Income Tax Credit & Other Refundable Tax Credits: Preparer Compliance - Focused & Tiered*, <https://www.irs.gov/efile/efile-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, *Consequences of not meeting your due diligence requirements*, <https://www.irs.gov/efile/efile-preparer-due-diligence/consequences-of-failing-to-meet-your-due-diligence>.

⁵ Throughout, we specify that the return "may contain" or "likely contains" errors, because whether a return contains an error is determined probabilistically by IRS algorithms; actual errors can only be determined via an audit, which was beyond the scope of this study.

We refer to this modified letter as the “Behavioral Insights” (BI) letter.

Importantly, sending letters to some clients may influence other clients who used the same tax preparer — what is known as a “spillover effect.” Clients sent letters may share information with these other clients, or their tax preparer may learn about the letter and may more carefully file returns for all of their clients.

Embed evaluation

OES and the IRS collaborated to answer three evaluation questions:

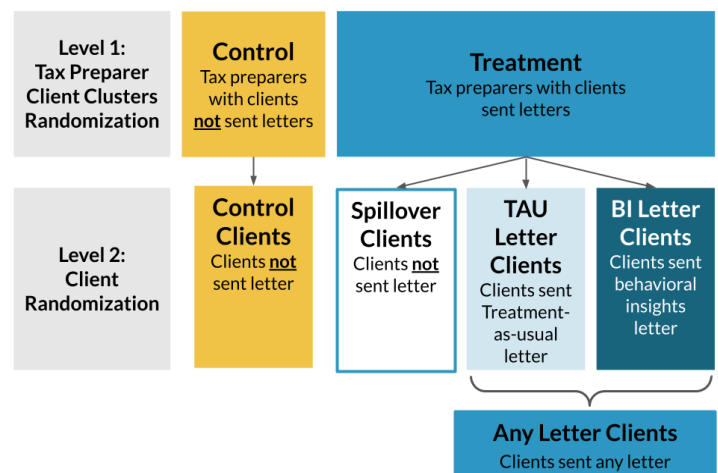
1. What is the effect of sending Letter 6138 on the returns of clients who are sent a letter?
2. Does sending a modified version of Letter 6138 that includes additional behavioral insights have different effects on the returns of clients than sending a treatment-as-usual letter?
3. What is the spillover effect of sending the letter on the returns of clients who are not sent a letter, but who used the same tax preparer as other clients who were sent letters?

These questions were answered using a multi-level clustered randomized design. The sample includes 86,446 clients (77,692 returns) who used one of 1,994 tax preparers identified as preparing returns that may have contained errors during the 2020 filing season.⁶ As shown in Figure 1, at the preparer level, groups of clients who used the same tax preparer (client clusters) were randomly assigned to a treatment group where some clients were sent letters (N=52,348) or a control group where no clients were sent letters (N=25,344). Next, at the client level, clients in the treatment client clusters were randomly assigned to be sent a letter (Letter group; N=20,849) or not sent a letter (the Spillover group; N=31,499). Finally, the version of the letter — the Behavioral Insights (BI) letter (N= 10,425) or Treatment-as-Usual (TAU) letter (N=10,424) — was randomly assigned among clients sent a letter.

⁶ If two individuals filed together, they were sent a single letter. Although we refer to the sample as clients, randomization and sample sizes are actually based on the number of returns associated with these clients.

Random assignment occurred within blocks among similar clients and similar client clusters. Random assignment of the version of the letter sent occurred among clients who used the same tax preparer.

Figure 1. Randomization procedure



Analyze using existing data

Centrally housed administrative data maintained by the IRS to meet the needs of research analysts, plus return-level data processed by W&I, were used to compare outcomes between the different randomly assigned groups.⁷ The data include baseline measures from tax year (TY) 2019 returns filed during the 2020 filing season and outcome measures from TY 2020 returns filed during the 2021 filing season (as of July 2021).

Our analysis includes four primary, pre-specified outcomes: 1. an indicator for whether a client changed their filing behavior by opting not to filing a tax return, using a different tax preparer, or submitting their own tax return; 2. whether the tax return contained one or more likely errors in claiming tax benefits; 3. the refund amount the client received; and 4. the total dollar amount of credits claimed that contained at least one likely error. In addition, because we were interested in whether there were changes to clients' filing

⁷ 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/projects/client-tax-compliance/>. Clustering standard errors by tax preparer is one omission from the analysis plan that is included in all analyses reported in this abstract.

methods among those who chose to file, we include a version of the client filing behavior outcome that was not pre-specified, defined as whether a client both filed a return and either used a different tax preparer or submitted their own return (i.e., self-filing).⁸

Results

Our results suggest that sending Letter 6138 increases the likelihood that clients change their tax filing behaviors, improves the likely accuracy of their returns, and reduces improper payments. Moreover, we find that including insights from behavioral science in the content of the letter matters for whether clients change their tax filing behaviors. Finally, spillover effects of the letter induce improvements in the accuracy of returns and reduce improper payments of those who were not themselves sent letters.

Evaluation question #1: What is the effect of sending the pre-filing season letter on the returns of clients who are sent a letter?

To measure the effects of sending any pre-filing season letter, our analysis compares outcomes among clients in the letter group to outcomes among clients in the control group. Among clients in the control group, 38.5% changed their filing behavior by opting not to file, using a different tax preparer, or self-filing, and 60.5% filed a return with likely errors. Clients in the control group had average refund amounts of \$4,525 and average dollar amount of benefits claimed with likely errors of \$3,132.

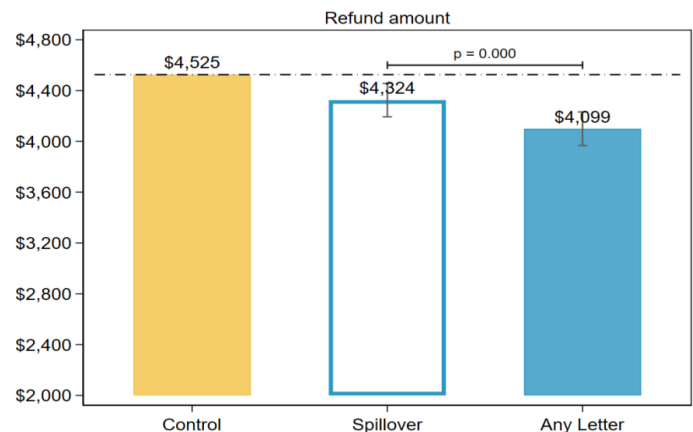
Sending the letter increased the probability that clients changed their filing method or did not file by 7.3 percentage points [$p = 0.00$, 95% CI [3.9, 10.6]]. The letter decreased the probability that clients had a likely tax benefit error by 7.3 percentage points [$p = 0.00$, 95% CI [-5.8, -8.9]]. Finally, the letter decreased average refund amounts by \$426 [$p = 0.00$, 95% CI [-\$294, -\$558]] and decreased total dollar amount of benefits claimed with likely errors by \$357 ($p = 0.00$, 95% CI [-\$271, -\$443]).⁹

⁸ We consider this outcome to be exploratory and did not adjust for it in our corrections for multiple hypotheses.

⁹ These results are statistically significant at significance level 0.004, which controls the Family-Wise Error Rate at 0.05 based on repeated simulations of randomization and

Exploratory analysis finds that only part of the effect on changing filing behavior is driven by not filing entirely: the letter causes a 4.6 percentage point increase in the likelihood of filing and choosing a different method ($p = 0.00$, 95% CI [1.5, 7.7]).¹⁰

Figure 2. Average refund amount for those in the Control group, those in the Spillover group, and those in the Any Letter group



Note: Gray bars show 95% confidence intervals. P indicates the p-value on the F-test of the difference in the coefficients on Spillover and Any Letter.

Evaluation question #2: Does sending a pre-filing season letter that includes additional behavioral insights have different effects on the returns of clients than sending a treatment-as-usual letter?

To measure the effects of the content of the letters, our analysis compares outcomes among clients sent the BI letter to outcomes among clients sent the TAU letter.¹¹

Clients sent the BI and TAU versions of letters do not have statistically significant differences in their likelihood of having one or more likely errors in claiming tax benefits ($p = 0.45$), their total refund

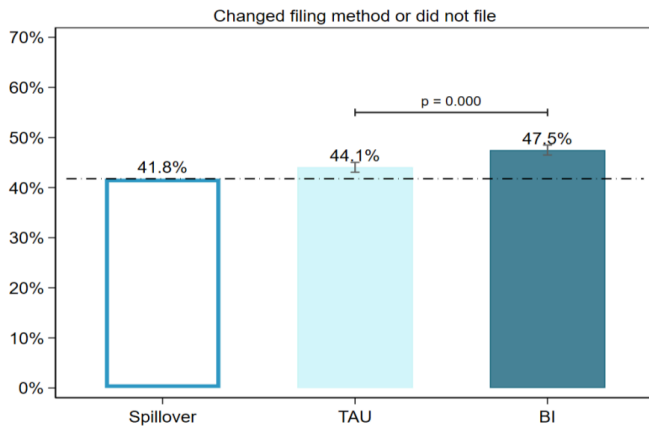
hypothesis testing.

¹⁰ This outcome was not pre-specified in our analysis plan and is not included in adjustments for multiple hypotheses.

¹¹ Comparisons of the impacts of the BI and TAU letters are conducted using a test of equality of the coefficients after regressing each outcome on indicators for assignment to each group relative to the spillover group. As such, confidence intervals are not presented. These results are statistically significant at $\alpha < 0.015$, which controls the Family-Wise Error Rate at 0.05 based on repeated simulations of randomization and hypothesis testing.

amount ($p = 0.41$), or their total dollar amount of tax credits claimed with one or more likely errors ($p = 0.82$). The likelihood that clients sent the TAU letter filed a return with likely errors was 53.4%, with these clients on average receiving \$4,119 refunds and claiming \$2,777 in benefits with likely errors. Similarly, the likelihood that clients sent the BI letter filed a return with likely errors was 52.9%, with these clients on average receiving \$4,080 refunds and claiming \$2,768 in benefits with likely errors.

Figure 3. Percent of clients who changed their filing method by using a different preparer or did not file, among those in the Spillover group, those who were sent the treatment-as-usual letter, and those who were sent the behavioral insights letter



Note: Gray bars show 95% confidence intervals. P indicates the p-value on an F-test of the difference in the coefficients on BI and TAU.

However, when we look at how clients choose to file returns, we do see significant differences. Among clients sent the TAU letters, 44.1% changed their filing method or did not file, while clients sent the BI letter were 3.4 percentage points ($p < 0.01$) more likely to change their filing method or not file. When we disaggregate this outcome, we find that this result is driven by clients choosing to change preparers, rather than by opting out of filing. The rate of not filing was 17% among clients sent the BI letter and among clients sent the TAU letter ($p=0.58$), but 30.5% of clients sent the BI letter filed but chose a different preparer or filed on their own, compared to only 26.8% of clients sent the TAU

letter ($p < 0.01$).¹² This suggests that changes to the content of the Letter 6138 can be effective in encouraging clients to seek out new methods of filing.

Evaluation question #3: What is the spillover effect of sending the pre-filing season letter on the returns of clients who are not sent a letter, but who used the same tax preparer as other clients who were sent letters?

To measure the spillover effects of sending the letters (both versions), our analysis compares outcomes among clients in the spillover group to clients in the control group. Clients in both groups were not sent letters, but clients in the spillover group used the same tax preparers in the prior filing season as other clients who were sent letters.

Results suggest spillover effects of the letter reduced the likelihood of errors in claiming certain benefits and measures of improper payment amounts, but did not change whether or how clients filed their tax return. Among clients in the spillover group, 41.8% changed their filing method or did not file, an increase of 3.3 percentage points over the control group ($p = 0.06$, [-0.1, 6.6]), which is not statistically significant at conventional levels. Still, 57.3% of clients in the spillover group filed returns claiming tax benefits that may contain errors, a statistically significant decrease of 3.2 percentage points over the control group ($p < 0.01$, 95% CI [-1.7, -4.6]).¹³ Additionally, clients in the spillover group had average refund amounts of \$4,324 and average benefits claimed with likely errors of \$2,973, statistically significant decreases when compared to control clients of \$200 ($p < 0.01$, 95% CI [-\$69, -\$332]) and \$159 ($p < 0.01$, 95% CI [-\$75, -\$242]), respectively.

Build evidence

The results demonstrate that education and outreach to clients can reduce improper payments from likely errors in claiming benefits, and change

¹² Not filing and filing but changing filing method are both exploratory outcomes that were not adjusted for in our corrections for multiple hypotheses.

¹³ These results are statistically significant at significance level 0.004, which controls the Family-Wise Error Rate at 0.05 based on repeated simulations of randomization and hypothesis testing.

clients filing behaviors. Moreover, the results demonstrate that further incorporating behavioral science to modify the content of the letter can change the filing behavior of clients beyond the effects caused by sending a standard letter. Finally, the results show that it may be more cost-effective to send letters to only a subset of clients of tax preparers, as clients who are not sent letters experience spillover effects from letters sent to others who have used the same tax preparer the prior year.

Based on the reductions in the average refund amount caused by sending letters, along with the number of clients exposed to the letters directly or indirectly, we can calculate the monetary value of the revenue protected under this program. We find that sending letters reduced refunds by \$426 on average for the 20,849 clients sent letters, for a savings of approximately \$8.9 million. Additionally, we find that spillover effects of the letters reduced refunds by \$200 on average for the 31,499 clients not sent letters but who used tax preparers the prior year whose clients were sent letters, for an added savings of approximately \$6.3 million. This gives a total savings of approximately \$15.2 million.

Future research could examine the extent to which certain client segments respond differently to being sent letters or letters with different content. This research could help inform ways that education and outreach can better balance improving tax compliance, reducing burdens associated with tax filing, and maintaining access to tax benefits to which taxpayers, including those who use tax preparers, are entitled. Building on the spillover findings, future research could also try to identify the optimal proportion of clients who should be sent letters that would maximize the reduction in improper payments while minimizing the cost of outreach.