THE COMPLIANCE COSTS OF IRS POST-FILING PROCESSES

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ABSTRACT

Better measuring the costs of tax administration will allow for a better understanding of factors influencing the federal tax system and its outputs. As discussed in Slemrod and Yitzhaki (2002), the public's cost of providing information is the largest component of tax administration costs, considerably exceeding the direct budgetary costs of the Internal Revenue Service. The public's compliance costs are typically related to the filing of a tax return. However, there are instances where additional information is provided to the IRS after a tax return has been filed, at which point additional costs are incurred. Because it is impractical to measure these costs directly, they must be estimated. This work addresses the estimation of these post-filing compliance costs.

1   LITERATURE

Prior compliance cost research has focused on the pre-filing and filing compliance costs incurred by individuals (Contos et al. 2010), business entities (Contos et al. 2009) and tax-exempt entities (Blumenthal and Kalambokidis 2006). A previous effort (Connors et al. 2007) compared discrete event simulation and econometric microsimulation as potential modeling frameworks for IRS post-filing processes. This effort extends that research by determining post-filing compliance costs, describing the associated data collection, modeling, and estimation efforts.

2   THE DATA SET

Individual taxpayers with post-filing issues were categorized into four groups: taxpayers who (1) filed an amended tax return, (2) had accounts receivable with the IRS and made an attempt to reach an agreement as to how the account could reach full paid status, (3) were audited by the IRS and attempted to comply with the requests of the audit, (4) appealed an IRS decision, or any combination thereof. We sampled tax year 2008, 2009 and 2010 individual taxpayers who concluded a post-filing case during calendar year 2011. This approach proxies for a single tax year where the majority of post-filing cases have had sufficient time to complete. The sample was stratified based on the original tax return complexity and preparation method, as well as on seven levels of post-filing case conclusion. The final design yielded 22 strata. The survey collected data on the time and money spent by taxpayers to resolve issues with an already-filed tax return. Survey data was then linked to IRS administrative data to create the estimation data set.

3   MODELING APPROACH

To model the conditional distribution of post-filing compliance costs, we employed a log-linear regression specification in which the natural log of post-filing compliance costs is linearly related to a set of explanatory variables. Given that post-filing compliance cost data are available from survey respondents, it was important that the dependent variables in the model be based on IRS administrative data which are available for multiple years. The modeling approach used for this study is similar to one proposed in Con-

tos et al. (2009), a study of small business compliance costs. For this study, we controlled for the substitution of time and money by creating a single measure of post-filing compliance costs. More specifically, taxpayer-level information was used to assign each taxpayer their own monetization rate. Total monetized compliance cost is equal to the sum of monetized time and out-of-pocket costs. The model controls for (1) at-filing characteristics (such as original tax return complexity and preparation method, third-party designee), (2) post-filing characteristics (third-party representation, IRS administrative costs, post-filing results and post-filing case type), and (3) collection-related resolutions. A draft model and associated preliminary results are presented.

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