

# *Seeking Professional Advice: The Role of Preparers in Tax Compliance\**

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\*The views expressed here are solely those of the authors and do not reflect the opinions of the U.S. Department of the Treasury or the Office of Tax Analysis.

## QUESTION

- What role do professional tax preparers play in tax compliance among their clients?

# MOTIVATION

- IRS estimates the individual income tax gap to be  $\sim$  \$235 billion/year
- More than 60% of individual income tax payers use paid preparers
  - This does not include tax preparation software
  - This does not include filers using volunteer preparation assistance programs
- There are a lot less preparation services than tax filers, so targeting compliance efforts at them may be cost-effective

# SUMMARY OF RESULTS

- Relative to self-prepared returns, filers who use a paid preparer have audit adjustments that are 90% larger
- Preparers' large adjustments are driven by reporting of non-corporate business income and deductions
- Looking across tax payers, we find:
  - Stronger results for males
  - Larger preparer effects among high-income filers
  - Accountants and lawyers have the largest adjustments upon audit

# ESTIMATING THE EFFECT OF PREPARERS ON COMPLIANCE

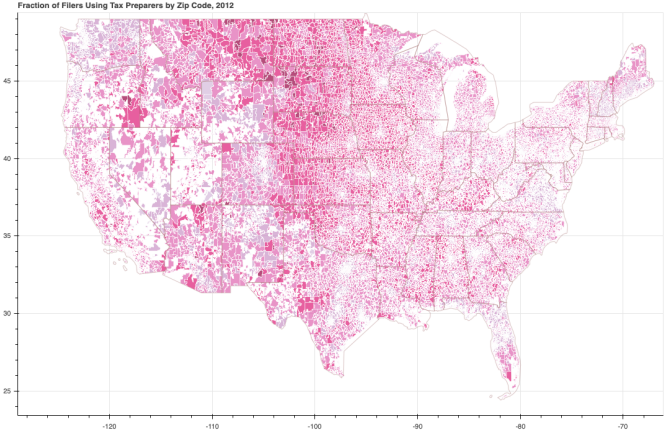
There are two main problems confounding causal identification of preparers' role in compliance rates:

- 1 Audits are non-random
- 2 The choice of tax preparer is endogenous, confounding causal inference

We address these by:

- 1 Using randomized audits of taxpayers
- 2 Finding a plausible instrument for whether a tax payer uses a preparer
  - Our excluded instrument is the fraction of filers in the taxpayers ZIP code who use a preparer
  - The idea is that there are peer effects - you are more likely to use a preparer if your neighbors do
  - Key assumption: the effects of the preparer-usage rate in a ZIP on compliance come through the filers' choice of using a tax preparer

# VARIATION IN PREPARER USAGE



- IRS' National Research Program (NRP)
  - IRS conducted random audits in tax years 2001, 2006-Present
  - About 44,000 filers in 2001, about 15,000 in each of subsequent waves
  - Stratified random sample, with population weights
  - Detailed audit adjustments information
  - We use NRP waves from 2006-2014
- Population files of individual income tax returns
  - Compute rate of preparer-use by zip code

# DESCRIPTIVE STATISTICS

	Filers Using a Paid Preparer	Filers Not Using a Paid Preparer	All Filers
Taxable Income			
Nonzero Mean (\$)	58,790	38,666	50,251
Taxes	79.00%	77.32%	78.28%
Nonzero Mean (\$)	12,503	6,607	10,010
Fraction w/ Sole Prop. Income	20.35%	12.57%	17.02%
Nonzero Mean (\$)	13,916	\$6,374	11,531
Fraction w/ Partner/S-Corp Income	17.84%	6.04%	12.79%
Nonzero Mean (\$)	32,338	\$7,067	27,228
Fraction claiming EITC	15.75%	12.91%	14.53%
Nonzero Mean (\$)	2,414	\$1,873	2,208
Fraction w/ Itemized Deductions	34.35%	25.78%	30.68%
Nonzero Mean (\$)	29,437	\$22,335	26,883
Fraction w/ Positive Audit Adjust.	51.13%	43.57%	47.89%
Nonzero Mean (\$)	1,667	982	1,374
Observations			
Unweighted	75,009	30,161	105,170
Weighted	628,986,050	470,779,048	1,099,765,098

<sup>a</sup> 2006-2014 NRP waves



# COMPLIANCE RATES

## Panel A: Filers Using a Paid Preparer

	Nonzero Audit Adjustment	Underreported Income	Overreported Income
Taxable Income	\$6,553	\$8,040	-\$2,953
Non-zero fraction	69%	60%	9%
Sole Prop Income	\$9,544	\$11,612	-\$4,902
Non-zero fraction	81%	71%	10%
Capital Gains	\$4,475	<b>\$8,165</b>	-\$5,606
Non-zero fraction	<b>24%</b>	18%	7%
Partner/S-Corp Income	\$5,878	<b>\$10,191</b>	-\$8,992
Non-zero fraction	<b>51%</b>	39%	11%

## Panel B: Filers Not Using a Paid Preparer

	Nonzero Audit Adjustment	Underreported Income	Overreported Income
Taxable Income	\$4,076	\$5,431	-\$1,755
Non-zero fraction	59%	48%	11%
Sole Prop Income	\$7,683	\$9,390	-\$3,319
Non-zero fraction	86%	74%	12%
Capital Gains	\$1,668	<b>\$3,208</b>	-\$2,024
Non-zero fraction	<b>41%</b>	29%	12%
Partner/S-Corp Income	\$4,925	<b>\$7,513</b>	-\$3,514
Non-zero fraction	<b>67%</b>	51%	16%

<sup>a</sup> 2006-2014 NRP waves

# BASELINE RESULTS - 2SLS

Adjustment to :	Taxable Income		Total Tax	
	(1)	(2)	(3)	(4)
Paid Preparer Use	3,340.037*** (562.073)	3,050.329*** (1,101.412)	809.352*** (186.113)	794.753** (344.946)
Age	269.126*** (11.641)	275.411*** (13.882)	73.477*** (3.198)	75.076*** (4.037)
Age Squared	-2.675*** (0.117)	-2.731*** (0.134)	-0.732*** (0.031)	-0.750*** (0.038)
Primary Filer Male	923.588*** (103.766)	1,003.096*** (118.317)	292.649*** (30.481)	318.778*** (35.353)
Number of Kids	34.630 (69.744)	22.242 (81.959)	14.310 (22.938)	4.649 (27.099)
Mean AGI	0.012*** (0.003)	0.012*** (0.002)	0.004*** (0.001)	0.004*** (0.001)
ln(Population)	71.010 (52.859)	-14.835 (75.813)	34.476** (15.516)	19.558 (23.103)
Audit Rate	77,470.093*** (9,660.243)	43,250.186*** (16,041.849)	15,528.354*** (2,940.508)	85,18.589 (5,378.126)
Preparer HHI	-6,073.928*** (1,166.185)	-2,421.194 (2,188.959)	-1,446.911*** (327.246)	-849.165 (761.607)
Filing Status Controls	Yes	Yes	Yes	Yes
Year Controls	Yes	Yes	Yes	Yes
4-digit ZIP Code FEs	No	Yes	No	Yes
R-squared	0.005	0.028	0.004	0.004
N	1,080,102,255	1,080,102,255	1,080,102,255	1,080,102,255

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \* p<0.10, \*\* p<0.05, \*\*\* p<0.01

# FIRST STAGE RESULTS

Adjustment to:	Taxable Income		Total Tax	
	(1)	(2)	(3)	(4)
Fraction Use	0.969***	0.907***	0.969***	0.907***
Preparers	(0.025)	(0.047)	(0.025)	(0.047)
R-squared	0.065	0.176	0.065	0.176
N	1,080,102,255	1,080,102,255	1,080,102,255	1,080,102,255

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

## BY INCOME SOURCE

Adjustment to:	Paid Preparer Use	Filer Controls	Year Controls	N
Wages	-27.689 (157.853)	Yes	Yes	906,176,925
Sole Prop Income	-535.957 (3,025.773)	Yes	Yes	186,368,607
Capital Gains	1,545.882 (1410.203)	Yes	Yes	206,580,002
Partnership/S-Corp Income	12,823.402*** (3,044.319)	Yes	Yes	140,087,476
EITC	0.186 (71.228)	Yes	Yes	159,699,974
Itemized Deductions	-3,042.777*** (1,127.514)	Yes	Yes	337,097,607

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \* p<0.10, \*\* p<0.05, \*\*\* p<0.01

# PAID VS VOLUNTEER PREPARERS

Adjustment to :	Taxable Income		Total Taxes	
	Paid Preparer	Volunteer	Paid Preparer	Volunteer
Preparer	3,340.037*** (562.073)	-4,799.740 (3,124.162)	809.352*** (186.113)	-898.569 (924.042)
Individual Controls	Yes	Yes	Yes	Yes
Zipcode Controls	Yes	Yes	Yes	Yes
Year Controls	Yes	Yes	Yes	Yes
R-squared	0.006	0.006	0.006	0.004
N	1,080,102,255	1,080,102,255	1,080,102,255	1,080,102,255

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

# VOLUNTEER PREPARERS, LOW INCOME SAMPLE

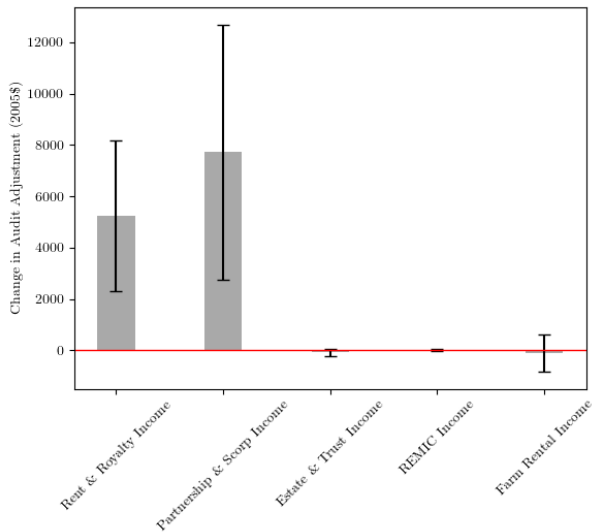
Adjustment to:	Taxable Income	Total Taxes
Volunteer Preparer	-3,018.861*** (1,021.921)	-632.279*** (198.101)
Individual Controls	Yes	Yes
Zipcode Controls	Yes	Yes
Year Controls	Yes	Yes
R-squared	0.024	0.022
N	744,001,499	744,001,499

<sup>a</sup> 2006-2014 NRP waves

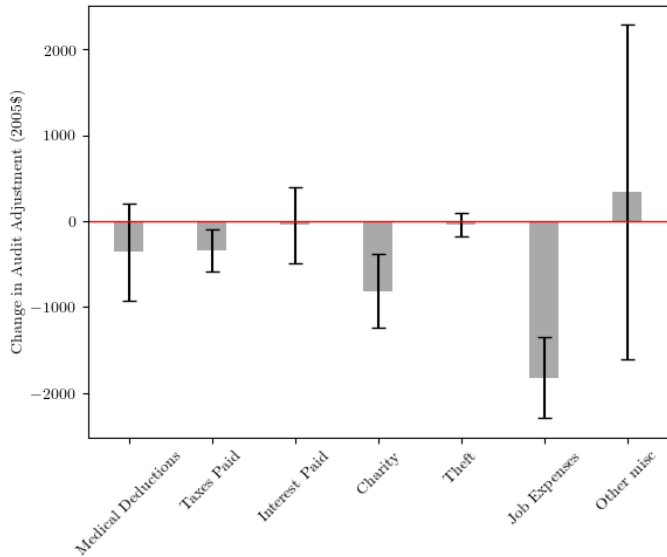
<sup>b</sup> S.E.'s clustered at the ZIP code level

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# NON-CORPORATE BUSINESS INCOME SOURCES

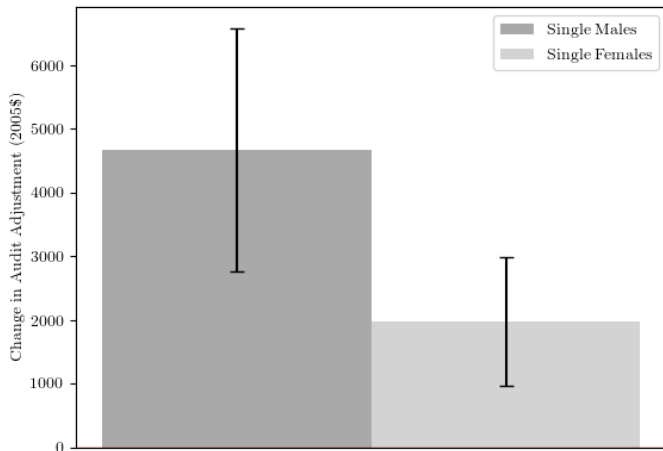


# ITEMIZED DEDUCTIONS





# PREPARERS EFFECT: SINGLE MALES VS. SINGLE FEMALES

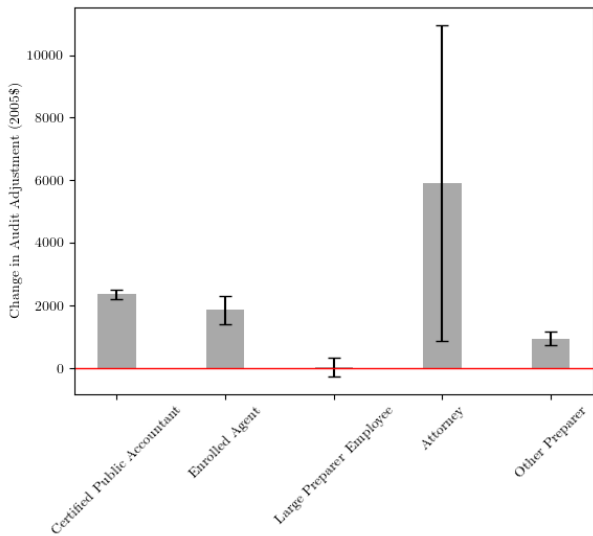


# PREPARER TYPES

- About 60% of returns are filed by paid preparers
- These preparers may have various credentials (or none).  
These include:
  - Certified Public Accountant
  - Enrolled Agent
  - Attorney

We next analyze whether different types of preparers have different effects on compliance.

# PREPARERS EFFECT: BY PREPARER CREDENTIAL



# SUMMARY

- Preparers increase tax non-compliance, as measured by audit adjustments for:
  - Taxable Income
  - Noncorporate business income
  - Itemized Deductions
- These effects are larger for:
  - Males
  - High-income filers
  - Among returns preparers by accountants and lawyers at small firms

## Additional Slides

## EMPIRICAL MODEL

Using 2SLS, we estimate:

$$\text{Audit Adjustment}_{i,z,t} = a + \phi \widehat{\{\text{Use Preparer}\}}_{i,z,t} + \gamma \mathbf{X}_{i,z,t} + \delta_t + \varepsilon_{i,z,t}$$

where the first stage is:

$$\text{Use Preparer}_{i,z,t} = \alpha + \rho \{\text{Frac Use Preparer}\}_{z,t} + \beta \mathbf{X}_{i,z,t} + \eta_t + u_{i,z,t}$$

and  $X_{i,z,t}$  includes:

- $AGI, AGI^2$
- Indicators for and amounts of: Sch C, D, E income, EITC claims
- Demographics controls: primary filer gender number of dependents, filing status, primary filer age, age<sup>2</sup>

# OLS RESULTS

Adjustments to:	Taxable Income	Total Tax
Paid Preparer Use	1,284.067*** (90.952)	353.024*** (28.481)
Age	275.651*** (11.449)	74.925*** (3.231)
Age Squared	-2.669*** (0.116)	-0.731*** (0.031)
Primary Filer Male	1,005.096*** (98.550)	310.740*** (28.571)
Number of Kids	102.562 (69.417)	29.387 (23.516)
Mean AGI	0.012*** (0.003)	0.004*** (0.001)
ln(Population)	41.017 (54.366)	27.819* (16.785)
Audit Rate	86,575.872*** (9,115.302)	17,549.410*** (2,745.982)
Preparer HHI	-6,321.653*** (1,163.346)	-1,501.894*** (328.621)
Filing Status Controls	Yes	Yes
Year Controls	Yes	Yes
N	1,080,102,255	1,080,102,255

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \* p<0.10, \*\* p<0.05, \*\*\* p<0.01

# ALTERNATIVE INSTRUMENTS: ADJUSTMENTS TO TAXABLE INCOME

IV	Workplace Preparer Use	Local efile use	Local VITA use	Local EITC claim rate
Paid Preparer Use	2,891.110*** (747.452)	3,267.270*** (771.173)	3,163.273 (2,044.877)	4,705.062** (1,895.300)
Age	245.770*** (14.930)	269.357*** (11.564)	269.687*** (15.046)	264.795*** (12.710)
Age Squared	-2.429*** (0.164)	-2.675*** (0.117)	-2.675*** (0.115)	-2.679*** (0.120)
Primary Filer Male	541.083*** (105.982)	926.472*** (107.439)	930.595*** (144.904)	869.472*** (125.250)
Number of Kids	-23.265 (67.727)	37.034 (71.048)	40.471 (95.055)	-10.472 (92.114)
Mean AGI	0.002* (0.001)	0.012*** (0.003)	0.012*** (0.003)	0.012*** (0.003)
ln(Population)	-17.074 (20.065)	69.948 (51.535)	68.431 (60.122)	90.923 (60.249)
Audit Rate	20,544.392*** (5,808.125)	77,792.372*** (9,980.812)	78,252.970*** (13,896.187)	71,424.468*** (12,564.567)
Preparer HHI	1,125.289*** (376.276)	-6,082.696*** (1,164.604)	-6,095.226*** (1,084.497)	-5,909.456*** (1,300.531)
Filing Status Controls	Yes	Yes	Yes	Yes
Year Controls	Yes	Yes	Yes	Yes
R-squared	0.003	0.005	0.005	0.001
N	833,848,218	1,080,102,255	1,080,102,255	1,080,102,255

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \* p<0.10, \*\* p<0.05, \*\*\* p<0.01



# NON-CORPORATE BUSINESS INCOME DETAIL

Adjustments to:	Rent & Royalty Income	Partnership & Scorp Income	Estate & rust Income	REMIC Income	Farm Rental Income
Paid Preparer Use	5,237.084*** (1,503.318)	7,728.975*** (2,533.300)	-91.880 (66.605)	13.369 (14.569)	-103.464 (368.790)
Age	100.782*** (23.939)	24.494 (38.319)	-1.043 (1.499)	0.048 (0.043)	0.133 (5.296)
Age Squared	-0.999*** (0.205)	-0.515 (0.322)	0.010 (0.013)	-0.001 (0.000)	0.021 (0.049)
Primary Filer Male	99.628 (209.083)	296.480 (441.124)	3.350 (9.732)	0.262 (0.311)	41.148 (45.035)
Number of Kids	-134.370 (109.171)	223.499 (169.250)	6.216 (5.526)	2.029 (2.009)	15.728* (9.389)
Mean AGI	-0.003*** (0.001)	0.005 (0.003)	0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
ln(Population)	285.671*** (79.897)	78.737 (114.197)	-2.890 (5.550)	0.324 (0.332)	-13.418 (15.415)
Audit Rate	88,115.011*** (16,903.266)	48,668.958** (19,782.341)	786.744 (638.618)	46.774 (48.197)	-2,583.600 (2,570.234)
Preparer HHI	-1787.750 (1,749.062)	-5,010.866 (3,375.611)	53.386 (105.844)	-2.477 (2.483)	233.795 (306.787)
Filing Status Controls	Yes	Yes	Yes	Yes	Yes
Year Controls	Yes	Yes	Yes	Yes	Yes
N	140,087,476	140,087,476	140,087,476	140,087,476	140,087,476

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

# ITEMIZED DEDUCTIONS DETAIL

Adjustments to:	Medical Deductions	Taxes Paid	Interest Paid	Charity	Theft	Job Expenses
Paid Preparer Use	-357.277 (289.651)	-340.078*** (123.008)	-44.448 (225.112)	-813.823*** (220.446)	-40.833 (68.429)	-1,823.002 (241.16)
Age	-13.450 (16.672)	-8.077** (4.009)	-7.876 (5.238)	-22.692** (9.264)	-0.092 (1.683)	7.176 (7.082)
Age Squared	0.084 (0.171)	0.102*** (0.035)	0.076* (0.046)	0.221** (0.094)	0.005 (0.011)	0.148* (0.059)
Primary Filer Male	-100.285 (154.514)	-36.340 (30.723)	51.493 (47.668)	-41.341 (39.251)	12.094 (13.565)	-8.795 (60.31)
Number of Kids	17.796 (20.973)	-6.898 (11.601)	7.498 (23.499)	-3.890 (17.725)	0.629 (4.127)	71.724* (19.79)
Mean AGI	0.001 (0.000)	0.000 (0.000)	-0.001*** (0.000)	-0.000 (0.000)	0.000 (0.000)	0.001 (0.001)
ln(Population)	-16.650 (24.256)	-32.396*** (9.903)	-19.409 (14.872)	-63.770*** (13.375)	3.957 (3.881)	-63.155* (18.62)
Audit Rate	-2,090.339 (5,794.182)	-2,914.102 (1,902.403)	-2,330.635 (4,321.407)	-2,6147.134*** (3,903.545)	-2,228.852** (901.120)	-28,075.54 (4,339.7)
Preparer HHI	682.975 (523.335)	1,030.207*** (278.257)	-88.518 (498.197)	1,627.804*** (353.531)	103.774 (135.389)	1,558.01 (659.15)
Filing Status Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year Controls	Yes	Yes	Yes	Yes	Yes	Yes
N	337m	337m	337m	337m	337m	337m

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

# SINGLE MALES VS SINGLE FEMALES

Adjustments to:	Taxable Income	Total Tax
Paid Preparer Use by Men	4,672.790*** (975.874)	1,314.673*** (274.881)
Paid Preparer Use by Women	1,979.881*** (514.627)	553.437*** (127.676)
Individual Controls	Yes	Yes
Zipcode Controls	Yes	Yes
Year Controls	Yes	Yes
N	522,311,249	522,311,249 ]

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \* p<0.10, \*\* p<0.05, \*\*\* p<0.01

Figure

# HETEROGENEITY BY INCOME

Adjustments to:	Taxable Income	Total Tax
Paid Preparer Use*(AGI < \$15k)	399.456 (559.067)	158.758 (185.875)
Paid Preparer Use*( AGI \$15k-\$35k)	2,413.241*** (558.985)	514.972*** (183.732)
Paid Preparer Use*(AGI \$35k-\$70k)	5,399.500*** (578.361)	1,193.982*** (189.611)
Paid Preparer Use*(AGI \$70k- \$150k)	8902.115*** (621.995)	2,259.295*** (202.931)
Paid Preparer Use*(AGI > \$150k)	19,341.113*** (969.029)	5,717.285*** (305.180)
Filer Controls	Yes	Yes
Year Controls	Yes	Yes
N	1,080,102,255	1,080,102,255

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \* p<0.10, \*\* p<0.05, \*\*\* p<0.01

# HETEROGENEITY BY PREPARER CREDENTIAL

Adjustments to:	Taxable Income	Total Taxes
CPA	2,347.875*** (182.017)	699.315*** (60.427)
Enrolled Agent	1,848.760*** (231.745)	495.415*** (66.347)
Large Preparer Firm	27.034 (151.372)	7.823 (48.849)
Attorney	5,912.436** (2,579.013)	1,817.655** (881.915)
Other Preparer	930.638*** (110.084)	240.651*** (33.458)
Filer Controls	Yes	Yes
Year Controls	Yes	Yes
N	1,080,102,255	1,080,102,255

<sup>a</sup> 2006-2014 NRP waves

<sup>b</sup> S.E.'s clustered at the ZIP code level

<sup>c</sup> \*  $p < 0.10$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$