

# **Office of Management and Budget Clearance Package**

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## ***Cash Economy Web-based Survey – Understanding Tax-Related Behaviors in the Cash Economy***

**Internal Revenue Service  
Small Business/Self-Employed Research and Analysis**

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## Cash Economy Web-Based Survey Understanding Tax- Related Behaviors in the Cash Economy

### I. Introduction

#### Background/Overview

Between April and September of 2008, the Internal Revenue Service (IRS) Communication, Liaison and Disclosure (CLD) organization, with assistance from IRS Small Business/Self-Employed (SB/SE) Research, conducted focus group interviews to determine how to influence tax-related behaviors of potentially non-compliant business owners, who receive income in cash, towards compliance.

In IRS testimony before the Committee on the Budget, United States Senate, February 15, 2006<sup>1</sup>, the following statements were provided:

- “The Cash Economy” is the largest source of the Tax Gap. Where taxable payments are reported to the IRS by third parties, the IRS generally collects well over 90 percent of the tax due. Where taxable payments are not reported to the IRS by third parties, compliance drops precipitously to a range from about 20 percent to about 68 percent, depending on the type of transaction. The term Cash Economy is defined to mean all taxable payments that are not reported to the IRS by third parties.”
- “These estimates suggest that the [Cash Economy] self-employed taxpayers who file returns but underreport their income (or self-employment taxes) represent the single largest component of the tax gap, accounting for more than a third of the gap and over \$100 billion per year.” “The IRS has no direct estimate of the portion of the tax gap attributable to the Cash Economy.”
- The statement recommended that “The IRS needs to conduct more and better research to identify the best approaches to reducing the Cash Economy Tax Gap and understanding the causes of noncompliance”.

Updating the figures for the above IRS testimony with the February, 2007 estimate for Tax Year 2001 Federal Tax Gap<sup>2</sup> yields the following:

- The annual gross tax gap is estimated at \$345 billion
- The annual net tax gap is estimated at \$290 billion
- The Cash Economy is estimated at \$118 billion

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<sup>1</sup> Nina E. Olson, “Written Statement of Nina E. Olson, National Taxpayer Advocate Before the Committee on the Budget, United States Senate,” February 15, 2006, <http://budget.senate.gov/republican/hearingarchive/testimonies/2006/NinaOlsenTestimony.pdf>.

<sup>2</sup> Tax Year 2001 Federal Tax Gap (Extended Version), Update February, 2007 [http://www.irs.gov/pub/irs-utl/tax\\_gap\\_update\\_070212.pdf](http://www.irs.gov/pub/irs-utl/tax_gap_update_070212.pdf)

In support of compliance activities, the IRS is trying to determine how tax-related behaviors of business owners and independent contractors dealing in cash (otherwise referred to as the “Cash Economy”) can be better understood and influenced toward increasing compliance. CLD, SB/SE Research and Cash Economy Stakeholders such as IRS Compliance and Taxpayer Advocate Services (TAS) have two specific goals for the research on better understanding the Cash Economy:

- To learn about Paid Tax Preparers' relationships with their “Cash Economy” clients. This will benefit IRS CLD in their efforts to develop communications and educational outreach strategies geared toward Paid Tax Preparers whose clients are small business owners and independent contractors who conduct their business in cash, as well as to the small business community through their related associations.
- To potentially enable the IRS to identify administrative and legislative tax law or procedural changes that might result in a significant improvement toward compliance by one of the largest contributors to the tax gap – that part of the small business and independent contractor communities in the Cash Economy that is currently underreporting income.

The IRS engaged its Federally-Funded Research and Development Center (FFRDC), the MITRE Corporation, to conduct the focus group sessions and document the results. Prior to the focus group sessions, conducted in Atlanta, Philadelphia, San Francisco, and New Orleans, the participants were asked to fill out a questionnaire that asked them to rate, on a scale of 1 to 5, how effective they believe sixteen specific proposed initiatives would be in helping to reduce non-compliance in the Cash Economy. For a copy of the previous focus group questionnaire see Appendix 1. The session then focused on allowing participants to discuss their perceived issues and solutions to non-compliance in the Cash Economy.

The IRS has recently engaged the FFRDC to assist SB/SE Research to gather additional feedback from Paid Tax Preparers on the Cash Economy. The FFRDC will conduct a web-based survey to explore outreach and compliance strategies to reduce the component of the U.S. Tax Gap resulting from non-compliance in the Cash Economy – from the point of view of the Paid Tax Preparers. Paid Tax Preparers will be asked to complete a survey to get their opinion on potential ways to improve compliance in the Cash Economy.

Paid Tax Preparers play a very important role in tax administration. According to the IRS IMF Marketing Database, 73 percent of small business taxpayers who file a Form 1040 Schedule C use a paid preparer. Getting feedback from this large market segment will enable the IRS to:

Develop a rated list of ideas that a large number of Paid Tax Preparers had a stake in identifying – to reduce the Cash Economy

- Gain Insight to the “cognitive perspectives” of Cash Economy taxpayers as they relate to tax compliance
- Develop from the “rated list” ideas for developing:

- Administrative and legislative tax laws that are feasible and practical
- Marketing and educational strategies for taxpayer segments, partners and stakeholders that have the potential of shifting non-compliant behavior towards compliance.

## Objectives of Data Collection

The primary objective of this web-based survey project is to follow up on the information received during the focus group interviews, and gather additional ideas on how best to influence the tax-related behaviors of small business owners and independent contractors who receive income in cash, so they become more compliant. During a 2-day Cash Economy IRS stakeholder meeting, three specific objectives were identified for the web-based survey project:

- o Objective #1  
Determine how to better work with Paid Tax Preparers to increase compliance in the Cash Economy through education and outreach.
- o Objective #2  
Get suggestions, legislative or procedural, from Paid Tax Preparers for reducing the underreporting tax gap in the Cash Economy.
- o Objective #3  
Gather feedback from a larger set of stakeholders (Paid Tax Preparers) to rate the impact of several initiatives and potential solutions to improve compliance in the Cash Economy.

## II. Methodology

MITRE will be working with SB/SE Research and Cash Economy IRS stakeholders to develop a web-based survey to collect ideas from Paid Tax Preparers who have clients in the Cash Economy, on ways to improve compliance in the Cash Economy. This survey will be based on voluntary participation by a specific segment of tax preparers in the Cash Economy that CLD communicates with through its outreach and marketing activities. IRS CLD and SB/SE Research have identified a number of tax practitioner professional associations such as the American Institute of Certified Public Accountants (AICPA), the National Association of Enrolled Agents (NAEA), and the National Association of Tax Professionals (NATP) that would be targeted for participation in this Cash Economy survey through CLD outreach and communications activities.

The potential size and characteristics of the entire target survey population of Paid Tax Preparers who support taxpayers operating in the Cash Economy, is

not known. IRS cannot identify all Paid Tax Preparers and the full extent of the size of the population, since many are unlicensed and unregistered. The voluntary target population will consist of members of various tax professional organizations whose full membership size is not known and their membership may be duplicative. As the total size of the voluntary participant population for the web-based survey is unknown, it will not constitute a sampling survey. Therefore, no statistical inferences will be made about the total population of Paid Tax Preparers.

With regard to the low response rate, the IRS will assume that all data collected from this survey is **qualitative in nature**, and that no critical decisions will be made by SB/SE solely from the analysis of data from this survey. The results from this survey are simply one piece of a larger set of information needed to assess paid tax preparers behavior associated with the cash economy.

The survey will request the participants to rate certain initiatives and solicit additional ideas. These will provide inputs to outreach and education strategies and recommendations for additional legislative and procedural change initiatives. The results will indicate that the participant population included those Paid Tax Preparers who were aware of the survey and chose to participate, and they rated the selected initiatives as those they strongly disagree to strongly agree and recommended additional new initiatives. The web-based survey can be seen in Appendix 2. The Introduction page describing the purpose of the web-based survey and definitions for the survey can be seen in Appendix 3.

## Sample Design

The sample for the focus group interviews included Paid Tax Preparers, small business owners and independent contractors. As directed by the Cash Economy IRS stakeholders, the web-based survey will target Paid Tax Preparers only, who support clients who file Form 1040 with a Schedule C and operate in the Cash Economy. The web-based survey is not expected to be based on sampling a known tax practitioner population segment, but based on voluntary participation of a small practitioner segment that choose to participate based on IRS CLD outreach activities. Therefore, we will not make any statistical inferences on the entire Paid Tax Preparer population but provide profile information on how a certain percentage of respondents rated or answered the questions.

The target survey universe for the web-based survey will include Paid Tax Preparers who advise and assist small business owners and independent contractors in understanding and addressing their tax filing and reporting obligations, and whose clients file IRS Form 1040 and Schedule C(s). A communications campaign will be conducted to notify Paid Tax Preparers and IRS partners (belonging to some of the major tax professional organizations), who may deal with clients who operate in the Cash Economy, of the web-based survey. CLD will provide communication regarding the survey to partners to encourage preparers to take the survey. The communication will include the

objectives and purpose of the web-based survey, why they should participate, and how the data will be used and tabulated. It will also give the location of the web-based survey and provide a link. The web-based survey link will also be available through a hyperlink URL on the IRS.gov Tax Practitioners page and publicized to external partners, such as AICPA, NAEA, and NATP, for them to make available to their members.

### **Data Collection Date**

The web-based survey will be available to receive responses from November 24, 2008 until January 16, 2009, for approximately eight total weeks. The survey will end by January 16, 2009, or when 2500 surveys have been completed, whichever occurs first. It is important for the respondents to complete the survey within this targeted timeframe before the tax season starts and Paid Tax Preparers become too busy with tax preparation and taxpayer support. If the commencement of the survey is delayed by any longer than two weeks, then the overall timeframe for receiving responses will be reduced accordingly.

### **Data to be Collected**

The study will collect Cash Economy education, procedural and legislative initiatives ratings, data, and ideas from Paid Tax Preparers, who serve clients operating in the Cash Economy, on ways to increase compliance.

Data will be collected using an online web-based survey that will ask Paid Tax Preparers to answer a series of 14 questions to rate potential barriers to compliance, IRS initiatives to improve compliance, education and outreach, and to provide free form ideas for improvement. The questions for this web-based survey is shown in Appendix 2. Although the web-based survey maintains anonymity, certain demographic data such as Preparer location, type of tax practitioner, average number of returns filed, and years in practice will also be collected, to identify characteristics of the respondents. The survey will enable 'cookies' for respondents participating in the survey to ensure multiple responses to the survey are not conducted by the same participant. The goal is to collect responses from 2,500 survey participants.

### **How Data will be Used**

The survey data and findings will be used to develop tax education and outreach strategies, assess ratings and recommendations on policies, or legislative initiatives to educate, understand and influence taxpayers who operate in the Cash Economy. The data can be used to understand barriers for compliance in the Cash Economy and develop compliance improvement strategies.

### **How Data will be Analyzed**

IRS CLD, SB/SE Research, Cash Economy IRS stakeholders and the FFRDC will use the data collected via the web-based survey as a source for analysis of Cash Economy behavior and opportunities for improving education and compliance. The web-based survey data will be reviewed, analyzed and answers summarized. Potential correlations will be made in an effort to validate or identify initiatives for education, outreach, procedural and legislative changes that can improve tax compliance in the Cash Economy. The FFRDC will document the summary statistics and anecdotal analysis of the survey data and develop qualitative conclusions from the data. The survey data summary analysis will validate or identify new tax education strategies, policies, or legislative initiatives to address Cash Economy non-compliance and suggestions for improvement.

The following information will be provided within 30 days after the close of the web-based survey:

1. A summary of survey participation data – how many responses were received within the survey period and the demographics of the respondents.
2. A summary of Paid Tax Preparers ratings of education, procedural, and legislative initiatives, summary of inputs and average scores for questions and a histogram or sampling of answers to free form questions.

Within 60-90 days, the following additional data will be available:

3. Qualitative conclusions based on anecdotal analysis of the responses to survey questions that summarizes survey inputs.
4. The survey findings with summary of ratings and new ideas, which will provide inputs to allow CLD, SB/SE Research, and IRS Cash Economy stakeholders to develop tax education and outreach strategies as well as inputs for new procedural and legislative initiatives.

### **Who is Conducting the Research?**

SB/SE Research and IRS CLD, working closely with the IRS FFRDC and Cash Economy stakeholders, will be conducting this research and analyzing the data and findings.

### **Location – Region/City and Facilities**

The Cash Economy web-based survey is a national survey soliciting Paid Tax Preparers around the country irrespective of their location or region. Since the survey will be a web-based one, it will be facilities independent. The survey will be hosted on a secure server at a MITRE FFRDC facility in McLean, VA. All data will be collected securely, and not shared by MITRE with anyone other than IRS SB/SE Research and the sponsors for this survey, including CLD, TAS, and Exam.





## **Test Structure/Design**

The survey design will consist of a series of questions with multiple choices on rating education and legislative / procedural initiatives, and open-ended questions soliciting new ideas. The survey is designed to elicit ideas from Paid Tax Preparers about ways to increase compliance from small businesses and independent contractors who file Form 1040 along with a Schedule C, and operate in the Cash Economy. The survey will be reviewed and tested by the twenty-seven member IRS Advisory Council (IRSAC) as well as four Paid Tax Preparers, selected by CLD, for feasibility and suitability and to ensure it adheres to IRS standards. The survey will also be made available to test groups in web format as a mock-up so they can test it and ensure it can be completed within the planned timeframe. The IRS Advisory Council (IRSAC) will also review the plan and design of the survey.

## **Efforts to not Duplicate Research**

A literature survey on the Cash Economy was performed prior to the focus group interviews to ensure that this specific kind of focus group research study targeting Paid Tax Preparers has not previously been conducted by IRS. The web-based survey will simply follow up on the focus group interviews. Subsequently, additional research was conducted to ensure there has been no duplicative work done related to web-based survey of Cash Economy related Paid Tax Preparers. The IRS conducted a 2-day meeting with the Cash Economy stakeholders to review any existing literature and surveys conducted in the Cash Economy. It was decided by the stakeholders that, in agreement with the Survey Group and the Advisory Council, this research is not duplicative and is important to be conducted to understand the behavior of businesses in the Cash Economy.

## **III. Participant Criteria**

Participants, who will be solicited for this survey, include Paid Tax Preparers who have clients who file Form 1040 Schedule C and conduct business in the Cash Economy. These participants, with interest in the Cash Economy, will be solicited for voluntary participation in the survey based on CLD marketing and communications. Since this is a voluntary survey by Paid Tax Preparers who self report their eligibility, there will be no way to prevent participants who do not meet the participant criteria from responding to the survey. However, the link to the survey will only be advertised to Paid Tax Preparers and available from a link on the IRS.gov Practitioners Page and will not be accessible via Internet search engines. Basic demographic data will be collected from participants, and they will be asked questions related to whether they meet the participant criteria of Paid Tax Preparers working in the Cash Economy. Finally, the use of 'cookies' for each respondent will ensure that no more than one response per participant is included.

#### IV. Privacy, Security, Disclosure and Anonymity

The IRS will ensure compliance with the Taxpayer Bill of Rights II. All participants will be treated fairly, IRS will maintain anonymity without attribution of practitioner response, and protect their data from inappropriate usage. Participants will be instructed not to provide any private or taxpayer data, any identifying information, nor will any specific tax situation question be asked. The survey data will be protected on survey deployment server, its integrity maintained during data capture, analysis, and usage, as well as sharing and transmission to the IRS SB/SE Research sponsor.

#### V. Burden Hours

Participants in the web-based survey will be required to respond to the specific questions on the survey. They will not be required to provide any information prior to the survey, nor will they be contacted to request additional information after the survey.

The desired response for the survey is 2,500 Paid Tax Preparer participants. It is estimated that the survey will take no longer than 8 minutes for a participant to complete. Therefore, the total burden involved in the survey will be 333.33 hours (2,500 participants X 8 minutes per survey equals 20,000 minutes; 20,000 minutes divided by 60 minutes/hour = 333.33 hours).

<b>Estimated Burden Hours</b>	
333.33 hours	For participants to complete the web-based survey
<b>333.33 hours</b>	<b>Total estimated burden</b>

#### VI. Research Cost

The IRS funding allocated for this project is \$150,000.