

The Use of Third-Party Information Reporting for Tax Deductions: Evidence and Implications from Charitable Deductions in Denmark

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Introduction

- ▶ Wide use of information reporting for sources of income line items.
- ▶ Recently a number of Scandinavian countries have introduced information reporting and pre-filling for tax return *deduction* line items.
- ▶ We provide the first study of the use of third-party information reporting and pre-filling for a deduction line item: charitable tax deductions

Introduction

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- ▶ We provide the first study of the use of third-party information reporting and pre-filling for a deduction line item: charitable tax deductions
- ▶ Conventional wisdom suggests the reform should eliminate evasion opportunities:
 - ▶ Low audit rates make evasion a favourable gamble;
 - ▶ Information reporting effective at eliminating evasion opportunities;
 - ▶ Expect fewer deductions and increase in revenue.

Background: Denmark's Tax System

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- ▶ Wide use of information reporting and pre-filing for sources of income;
- ▶ Individual filing;
- ▶ No standard deduction;
- ▶ Flat charitable tax deduction subsidy rate:
 - ▶ Unrelated to marginal income tax rate;
 - ▶ Subsidy rate is one-third (subject to minor regional variation).

Figure: Taxpayers Claiming a Charitable Deduction

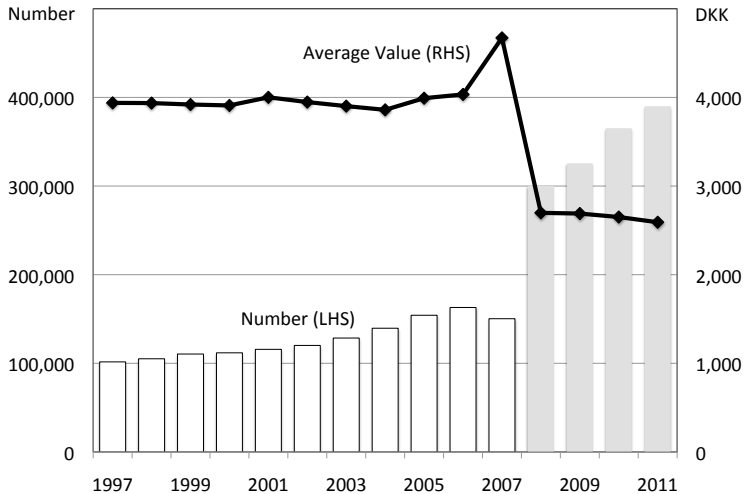
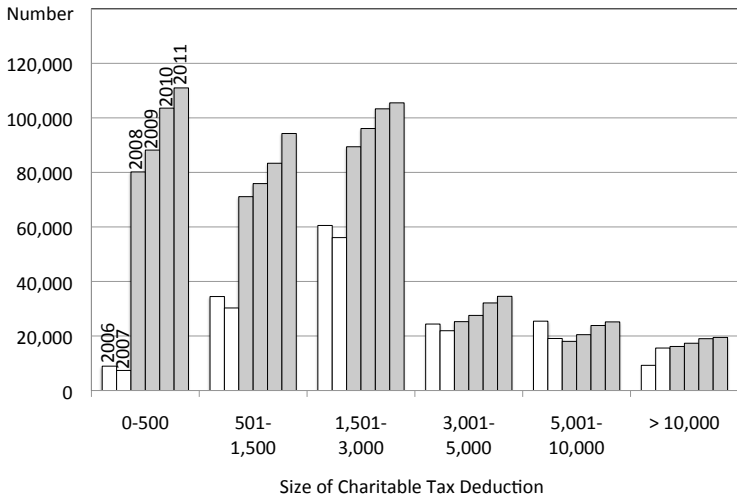


Figure: Taxpayers Claiming a Deduction: By Claim Size and Year



Number of Unclaimed Charitable Deductions

- ▶ Approximate estimate based on a time-series regression:

$$\triangleright \Delta \log (Number_t) = \underset{(0.031)}{0.026} + \underset{(0.003)}{0.003t} + \underset{(0.053)}{0.630}\delta_{2008} + \varepsilon_t$$

- ▶ $Number_t$ is the number of charitable deductions in year t ;
- ▶ t is a time trend;
- ▶ δ_{2008} is equal one in 2008 and zero otherwise;
- ▶ 0.63 log points \simeq 88 percent;
- ▶ $R^2 = 0.93$.

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- ▶ Average value of unclaimed deductions:
 - ▶ $\Delta (Average Value) = \frac{\Delta Number}{\Delta Value} \simeq \underset{(DKK63)}{DKK370}$

Evasion Under the Self-Reporting Regime

- ▶ We examine the Kleven *et. al.* (2011) audit sample for overreporting:
 - ▶ Approximately 20,000 taxpayers were selected at random for an unannounced audit in 2007 of their 2006 tax returns.

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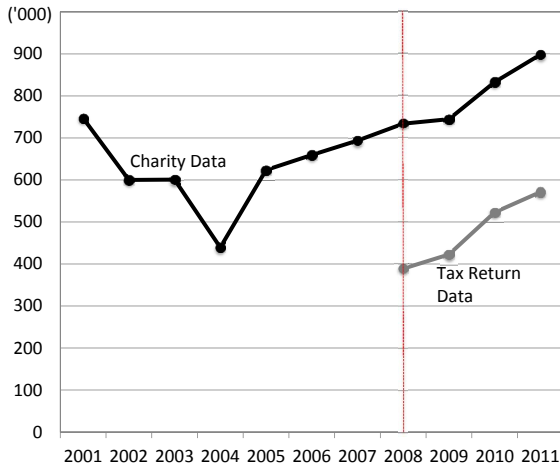
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 - ▶ Approximately 20,000 taxpayers were selected at random for an unannounced audit in 2007 of their 2006 tax returns.
 - ▶ For taxpayers in the audit sample reporting a charitable tax deduction:
 - ▶ 7 percent overclaimed: mean value DKK2,447;
 - ▶ 1 percent underclaimed: mean value DKK1,717;
 - ▶ Net evasion rate: 2.3 percent.
 - ▶ 2 percent had no pre-audit deduction but had a post-audit deduction

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 - ▶ 2 percent had no pre-audit deduction but had a post-audit deduction
- ▶ Why did the audits not detect the missing claims?
 - ▶ SKAT did not investigate items for which no deduction was reported;
 - ▶ Audits are not designed to detect underclaiming.

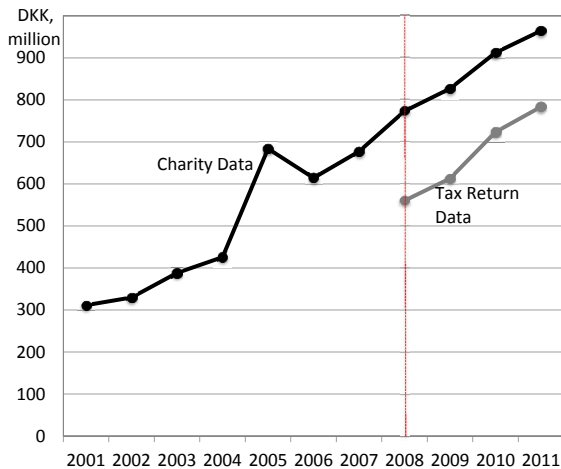
Did Information Reporting Increase Donations?

Figure: Number of Charitable Donors: 25 Largest Charities



Did Information Reporting Increase Donations?

Figure: Value of Charitable Donations: 25 Largest Charities



Effect of Information Reporting: Persistence of Missing Deductions

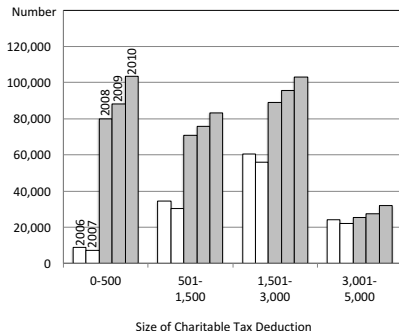
	Number ('000)
Total deductions claimed in 2008*	293
Did not claim a deduction 2006 or 2007	153
3 deductions 2009-2011	104
2 deductions 2009-2011	16
1 deduction 2009-2011	14
0 deductions 2009-2011	19

* By taxpayers who filed a return in each year 2006-11.

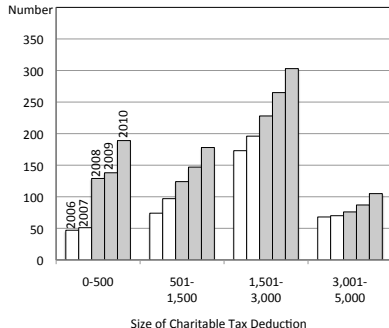
Drivers of Reporting Behaviour: Compliance Costs

Figure: Taxpayers Claiming a Deduction: By Claim Size and Year

(a) All Taxpayers



(b) Accountants



Drivers of Reporting Behaviour: Multiple Deductions

Dependent Variable: Reported a Charitable Deduction in 2007	
Other wage-earner (self-reported)	0.084*** [0.063, 0.104]
Childminders and fisherman deduction (self-reported)	0.082*** [0.051, 0.114]
Establishment account deposit (self-reported)	0.129*** [0.033, 0.225]
Unemployment insurance contributions (pre-populated)	0.021*** [0.015, 0.027]
Alimony (pre-populated)	-0.033*** [-0.047, -0.018]
Transport (pre-populated)	0.185*** [0.180, 0.190]

Note: Sample is taxpayers who claimed a deduction in each year under the information reporting regime.

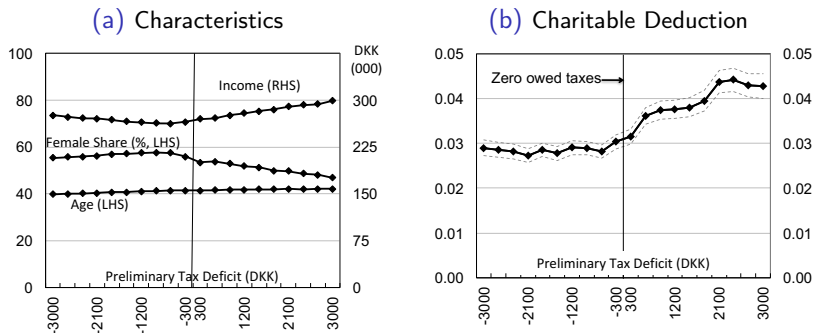
Drivers of Reporting Behaviour: Active/Passive Choice

Dependent variable: Reported a Charitable Deduction in 2007				
	(1)	(2)	(3)	(4)
Pension saving above default	0.019*** (0.003)			0.031*** (0.005)
Capital pension account		0.012*** (0.005)		0.007 (0.005)
Changed withholding			0.085*** (0.003)	0.065*** (0.004)
Number of observations	145,119	69,097	213,579	57,656

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Drivers of Reporting Behaviour: Loss Aversion

Figure: Taxpayers by Size of Preliminary Deficit in 2007

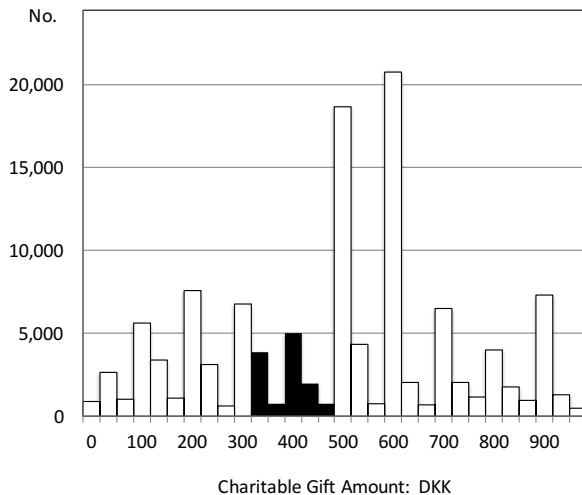


Drivers of Reporting Behaviour: Notched Subsidy Scheme

Taxpayer	Charity			Tax Deductible Amount
	1	2	3	
A	400	0	0	0
B	0	700	0	200
C	500	500	0	500
D	500	500	400	500

Drivers of Reporting Behaviour: Notched Subsidy Scheme

Figure: Dominated Giving Choices: 2011



Drivers of Reporting Behaviour: Notched Subsidy Scheme

Persistence of Dominated Choices				
	2008	2009	2010	2011
2008	100	35	32	25
2009		100	33	26
2010			100	33
Percent of Total	2.2	2.5	2.9	3.2

Relationship with the Literature

- ▶ Our findings contrast with Fack and Landais (2016):
 - ▶ 1983 reform in France requiring people to include receipts with tax return to claim a charitable deduction;
 - ▶ Coincided with a 75 percent fall in deductions claimed;
 - ▶ F&L assume increased compliance cost had no effect on claiming behaviour.

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- ▶ Cost of itemizing deductions in the United States:
 - ▶ Pitt and Slemrod (1989): approximately US\$105 (2015 dollars);
 - ▶ Benzarti (2015): approximately US\$644.

Conclusions

- ▶ Tax deductions perceived to be an important source of lost revenue.
- ▶ We find underreporting to be more important than overreporting:
 - ▶ About half of all eligible charitable deductions unclaimed;
 - ▶ Average value of unclaimed deductions about DKK370;
 - ▶ Repeated failure to claim eligible deductions.

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 - ▶ Repeated failure to claim eligible deductions.
- ▶ Audits not suited to detection of missing tax deductions:
 - ▶ Reliance on audits overstates the importance of evasion.
- ▶ Drivers of reporting behaviour:
 - ▶ Compliance cost: accountants & multiple deductions;
 - ▶ Loss aversion: owed taxes;
 - ▶ Active/passive choice;
 - ▶ Information frictions: notched subsidy scheme.