Nonfiler Profiles, Fiscal Year 1993: A Focus on Repeaters

by Laura R. Rosage

To help improve compliance and increase tax collections, the Internal Revenue Service (IRS) has created a Nonfiler Database. This database, which will enhance the understanding of the causes of noncompliance and help focus operational initiatives, contains information on 6.5 million individual taxpayers who, in Fiscal Year (FY) 1993, filed 7.5 million returns after their due date or extended due date. Of these, 1.7 million taxpayers filed more than 2.5 million "delinquent" returns, returns that were filed at least 360 days after their due date. (The remainder were "late" returns, returns that were filed after the due date, but by less than 360 days.) Follow-ups on these 1.7 million FY 1993 delinquent individual taxpayers indicated that 53 percent of those who had failed to file a return for Tax Year (TY) 1991 or earlier years failed to timely file a return for TY 1993, and that 40 percent had still not filed a TY 1993 return more than a year after the return due date.

The data show that 15 percent of the 1.7 million FY 1993 delinquent taxpayers are "repeaters" and "in inventory" to be worked on by IRS enforcement personnel. Fourteen percent of these Repeaters in Inventory filed three or more delinquent returns in FY 1993 (for TY 1991 and previous years) and almost 36 percent of the delinquent returns they filed were three or more years late [1]. More than 50 percent of the delinquent returns filed by Repeaters in Inventory were filed with a tax balance due of more than $1,000. Nearly 68 percent of the repeaters' delinquent returns filed in FY 1993 were secured through IRS enforcement.

Background

The IRS profiles taxpayers to identify groups or "market segments" that have common characteristics or tax problems. These profiles are then used to develop operational programs that allow the IRS to maximize resources while minimizing burden. IRS recognizes that the same approach to tax administration may not be effective or even appropriate for all taxpayers. The characteristics highlighted in a profile of repeaters may suggest ways to target these taxpayers and change their noncompliant behavior. For example, an educational awareness program may not be the answer for a repeater whose delinquent return in FY 1993 was secured through IRS enforcement efforts, but may be a viable option for a delinquent repeater who filed voluntarily in the past. It should be noted, however, that developing an effective treatment for market segments may not be an easy process. There may likely be a need to conduct additional studies to gather further information that describes the cause(s) of noncompliance with the tax laws.

Starting in Fiscal Year 1992, additional nonfiler strategies were introduced to identify nonfilers and bring them back into the system. In order to study the effectiveness of the strategies, the Nonfiler Database was created for each fiscal year. This database is a file with selected information, by taxpayer, from the Individual Master File (IMF) for returns filed one day or more after the return due date or the extended due date. The returns on this file are classified into two segments: late-filed returns and delinquent returns. A late-filed return is any individual return received one day or more after April 15 (or the extended due date), but less than 360 days later. A delinquent return is any individual return filed 360 days or more after the return due date. The Fiscal Year 1993 Nonfiler Database contained information on nearly 6.5 million taxpayers who filed almost 7.5 million returns after their due date. Of these, there were 1.7 million taxpayers who filed more than 2.5 million delinquent returns for TY 1991 or earlier years (the remaining 4.8 million taxpayers filed 5.0 million "late" returns).

In August 1994, IRS reviewed the subsequent filing behavior of these 1.7 million individuals who filed tax returns for TY 1991 or earlier years in FY 1993 in order to see if they had filed a return for TY 1993. The data showed that 53 percent (914,817) of the FY 1993 delinquent taxpayers repeated their noncompliant behavior by failing to file a TY 1993 income tax return on time. In August 1995, IRS checked again to see if any of these repeaters had filed their 1993 income tax return by that date. About 76 percent of them (or 40 percent of the original 1.7 million delinquent taxpayers) still had not filed for TY 1993 [2].

The 915,000 repeaters were also matched against the Nonfiler Case Major File for TY 1993 to see if these taxpayers would be contacted through normal IRS enforcement operations. The Nonfiler Case Major File is created for each tax year and contains records for those taxpayers who, based primarily on "information reporting," were required to file an income tax return, but did not [3]. The cases on this file are prioritized by "select code" and placed in inventory to be worked [4]. A little more than 257,000 of the repeaters were in inventory as of August 1995.

Based on their subsequent behavior, the 1.7 million FY 1993 delinquent filers were classified by four types, or

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"market segments," for profiling. They are arranged below in order by degree of noncompliance, from least to greatest:

(1) **Non-repeaters**: those who filed their TY 1993 return timely

(2) **Delinquent repeaters**: those who filed their TY 1993 return delinquently

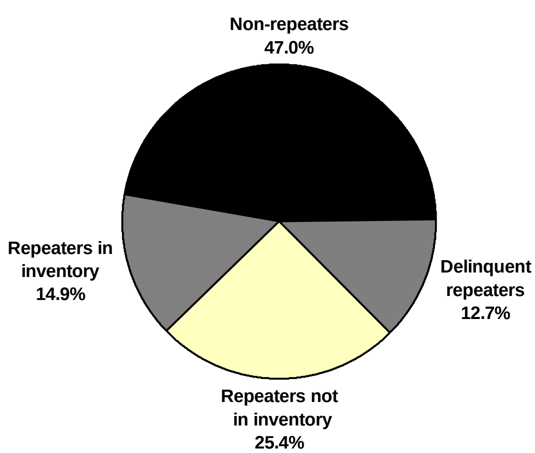
(3) **Repeaters not in inventory**: those who had not filed their TY 1993 income tax return as of August 1995, but were not selected to be worked operationally because of low potential tax yield

(4) **Repeaters in inventory**: those who had not filed their TY 1993 return as of August 1995, have been selected for the Nonfiler Case Major File, assigned a "select code," and are in inventory to be worked [5].

Forty-seven percent of the FY 1993 delinquent taxpayers were Non-repeaters, and nearly 13 percent were Delinquent Repeaters. More than 25 percent were Repeaters not in Inventory, and the remaining 15 percent were Repeaters in Inventory who will be worked operationally (Figure A). While IRS places the most emphasis on Repeaters in Inventory because therein lies the highest potential tax yield, it is also important to look at Repeaters not in Inventory. These cases have low potential tax yield, but are great in number. Any operational solution which might cause these taxpayers to file timely and voluntarily would increase revenues and benefit IRS.

Figure A

Delinquent Taxpayers by Market Segment, Fiscal Year 1993



Characteristics of Repeaters

In FY 1993, there were 2.5 million delinquent returns filed by 1.7 million individuals. The number of delinquent returns filed by these 1,727,466 taxpayers shows that the majority of the Non-repeaters filed only one delinquent return. However, when broken down by the four types of taxpayers, the data show that less than 29 percent of the Non-repeaters and 31 percent of the Delinquent Repeaters filed more than one delinquent return in FY 1993, but more than one third (38 percent) of the Repeaters in Inventory filed 2 or more delinquent returns in FY 1993 (Figure B).

How many years late the delinquent returns were filed varied (Figure C). The largest portion, 43 percent, of the delinquent returns filed in FY 1993 were only one year late (at least one year, but less than two years late) [6]. Yet when broken down by market segment, 25 percent of the Non-repeaters and 26 percent of the Delinquent Repeaters filed returns that were two years late, while 26 percent of the Repeaters not in Inventory and 32 percent of the Repeaters in Inventory filed returns that were two years late. Further, only 28 percent of the Non-repeaters filed returns that were three or more years late, but nearly 36 percent of the Repeaters in Inventory, those IRS has identified as requiring enforcement contact, filed returns in FY 1993 that were three or more years late.

Type of Return

The delinquent returns filed in FY 1993 are classified into three groups: returns with refunds, those with a balance due, and "even" returns (in general, with neither a refund or balance due) [7]. These characteristics are important because delinquent filers who have tax liabilities represent delayed or lost revenues to the Federal Government. Refund returns are also important because people who are due refunds are not receiving their rightful amounts under the law, particularly in the case of citizens entitled to the earned income tax credit. The data show that almost 35 percent of the delinquent individual income tax returns processed in FY 1993 were refund returns, only 8 percent were "even" returns, and more than 57 percent had a balance due (Figure D). When looked at by market segment, the data further show that, while almost 44 percent of the delinquent returns filed by Non-repeaters were refund returns, only 29 percent of the returns filed by Delinquent Repeaters, 31 percent of the returns filed by Repeaters not in Inventory, and less than 20 percent of the returns filed by Repeaters in Inventory were refund returns. Conversely, while more than 71 percent of the returns filed by Repeaters in Inventory were balance due, less than 56 percent of the returns filed by Non-repeaters,

Figure B

Delinquent Individual Income Tax Returns: Number of Returns Filed Per Delinquent Taxpayer by Market Segment, Fiscal Year 1993

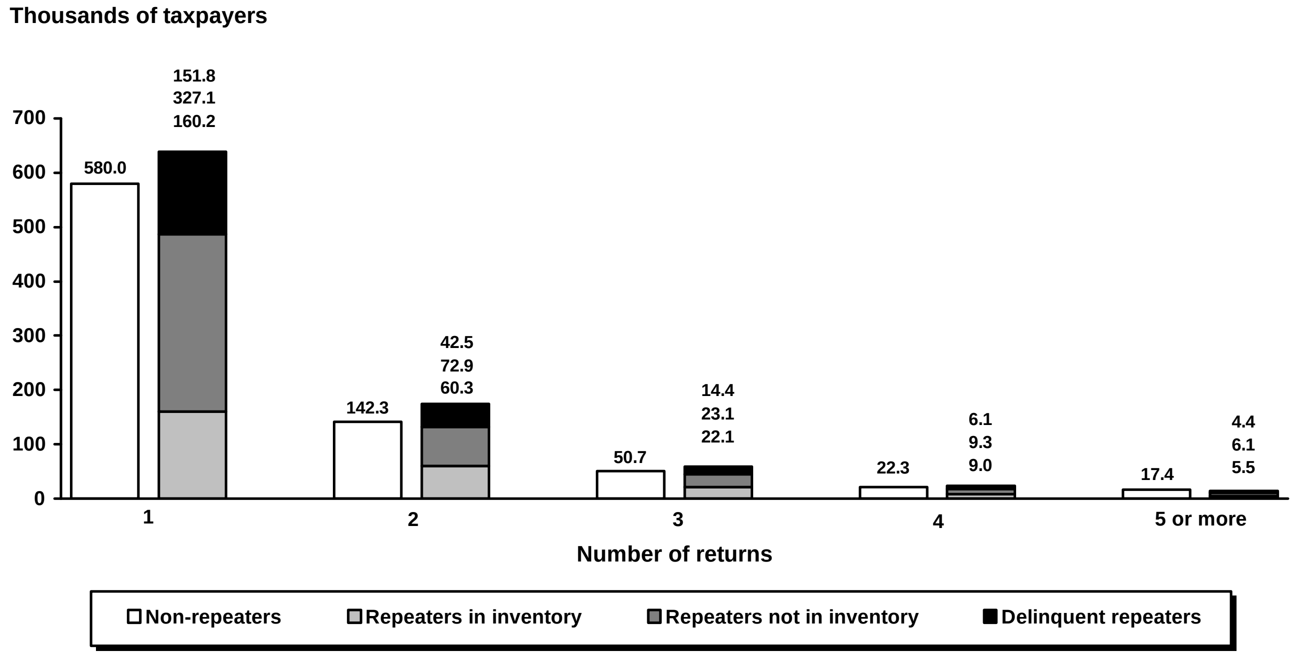


Figure C

Delinquent Individual Income Tax Returns: Number of Years Late by Market Segment, Fiscal Year 1993

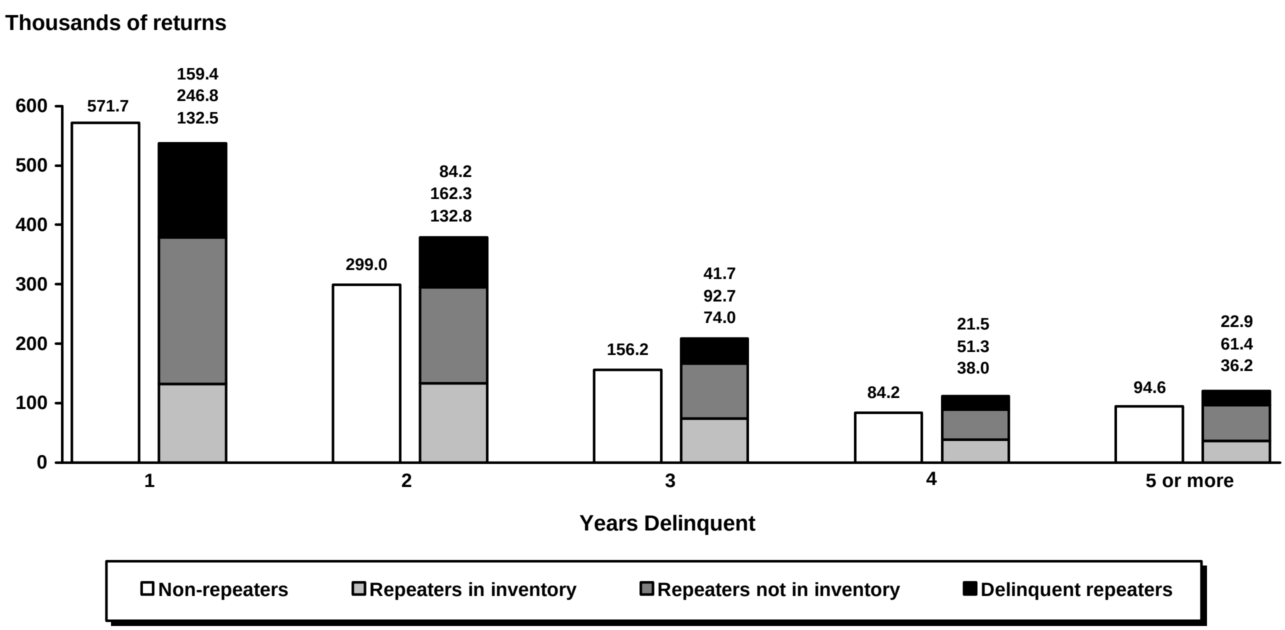
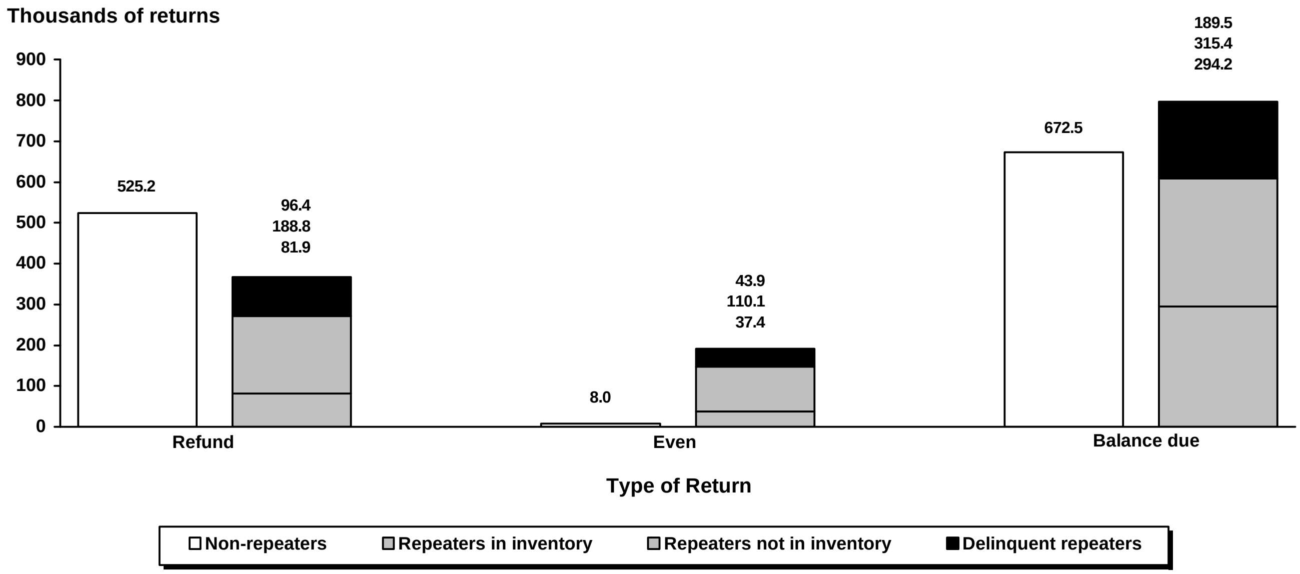


Figure D

Delinquent Individual Income Tax Returns: Type of Return by Market Segment, Fiscal Year 1993



58 percent of the returns filed by Delinquent Repeaters, and only 51 percent of the returns filed by Repeaters not in Inventory in FY 1993 were balance due returns.

A comparison of delinquent individual income tax returns can also be made by the size of the refund or balance due (Figure E). In general, the data show that refund returns were fewer in number and smaller in amounts as compared to balance due returns. Also, as would be expected, the difference between refund and balance due returns becomes larger as the degree of noncompliance increases. To illustrate, in FY 1993, 27 percent of the balance due returns filed by Non-repeaters fell in the under $500 size category and only 20 percent had a balance due of at least $500 but under $1,000. However, more than 53 percent of the balance due returns filed by Non-repeaters fell in the $1,000 or more category. In contrast, only 13 percent of the balance due returns filed by Repeaters in Inventory in FY 1993 fell in the under $500 segment and 16 percent had a balance due between $500 and $1,000. The remaining 71 percent of balance due returns filed by Repeaters in Inventory fell in the $1,000 or more category. In fact, 6 percent of these had balances due of $10,000 or more.

Enforcement-secured vs. Voluntary

The distinction between returns that are filed as a direct result of IRS enforcement and those that are voluntarily filed without any IRS enforcement activity is very important in the analysis of delinquent returns [8]. The data show that, in general, the worse the degree of repeat noncompliant behavior, the more likely that prior delinquent returns were filed as a result of enforcement (Figure F). Nearly 60 percent of the Non-repeaters filed their delinquent returns voluntarily. However, only 53 percent of the Delinquent Repeaters and 32 percent of the Repeaters in Inventory filed their delinquent returns voluntarily.

As would be expected, the repeaters were more likely to voluntarily file their delinquent returns if they were due a refund. Conversely, enforcement efforts were often required for repeaters to file returns with a balance due. This difference is partially due to the large number of IRS-created "Substitute for Returns" (SFR), which are only resorted to for taxpayers that IRS believes to have an outstanding balance due return [9]. The data show that 74 percent of the Delinquent Repeaters with refund returns filed voluntarily, but only 34 percent with a balance due filed their returns without enforcement activity. More than 86 percent of the Repeaters not in Inventory who had refund returns filed voluntarily, but nearly 73 percent of those with balance due returns had to be contacted by IRS. Only 62 percent of the Repeaters in Inventory who had refund returns filed voluntarily, and of those with balance due returns, almost 73 percent required enforcement.

Personal Demographics

A distribution by filing status (i.e., the marital status categories recognized under the tax code) shows that across all types of repeaters, the delinquent individual

Figure E

Delinquent Individual Income Tax Returns: Type of Return and Size of Refund or Balance Due, Fiscal Year 1993

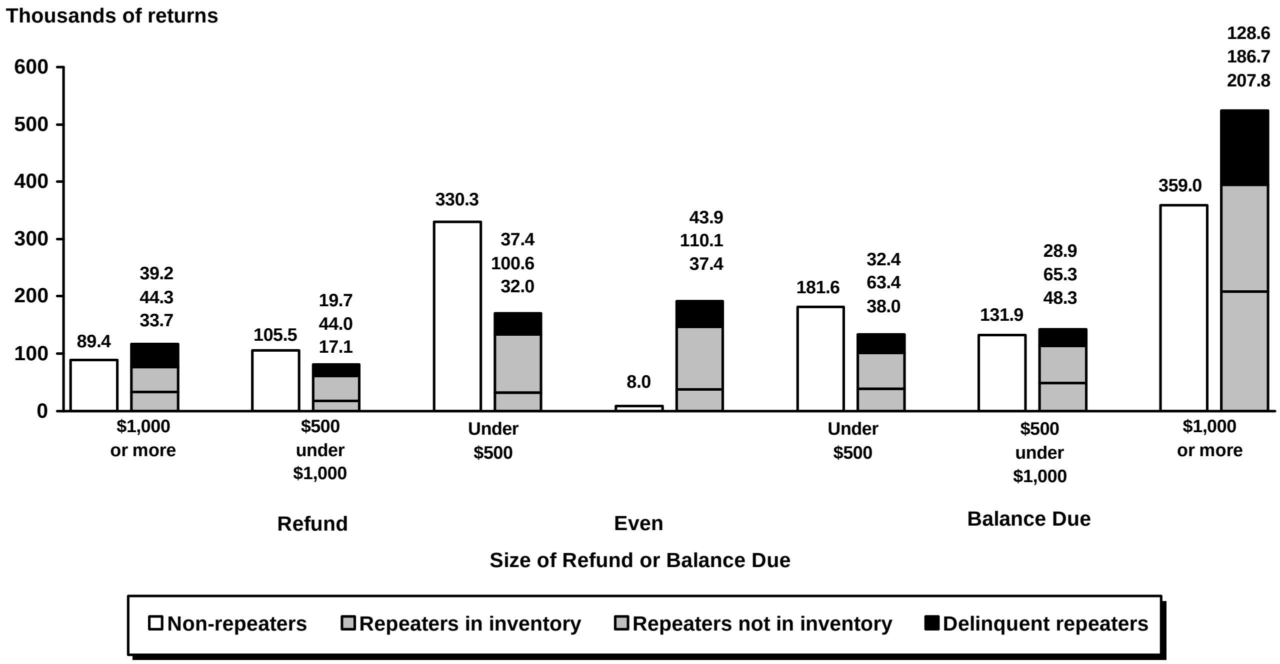
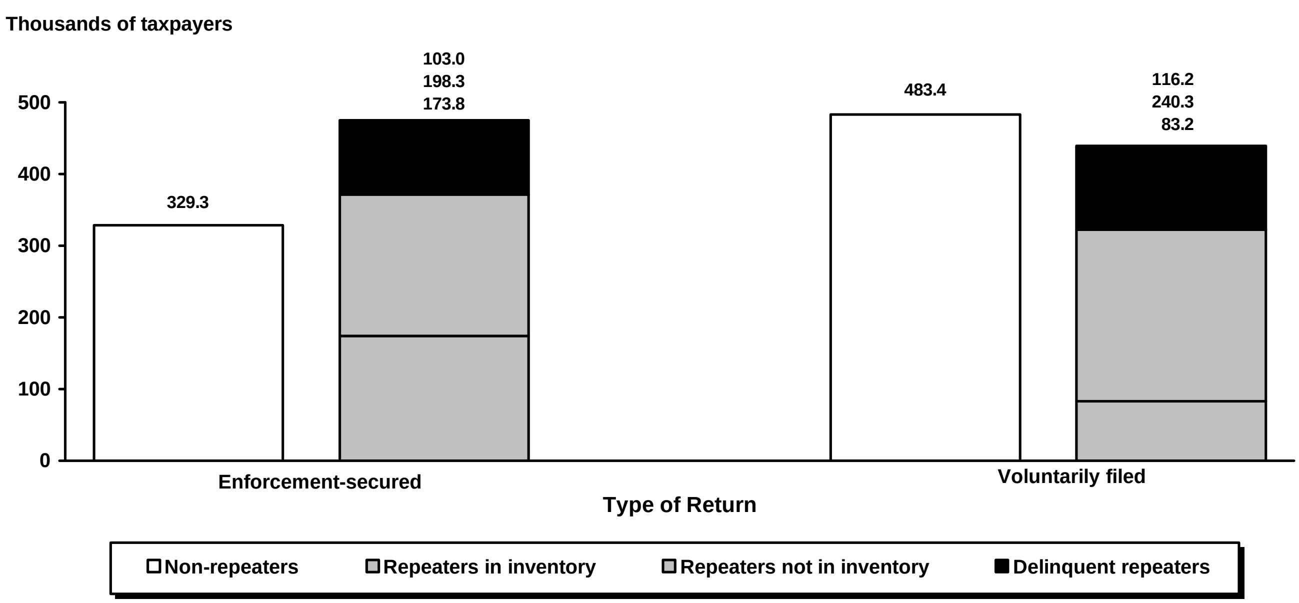


Figure F

Repeat Taxpayers: Type of Taxpayer by Method of Securing Delinquent Return and by Type of Return, Fiscal Year 1993



income tax returns in FY 1993 were largely filed by taxpayers claiming single status (Figure G) [10]. In general, a higher percentage of non-repeaters filed married filing jointly and head of household, where the larger percentage of repeaters filed returns claiming single and married filing separately filing status. In fact, repeaters as a whole filed three-and-a-half times as many returns claiming married filing separately status than did non-repeaters.

Delinquent returns filed in FY 1993 were also distributed by the age of the primary taxpayer (Figure H) [11]. (In the case of joint returns of husbands and wives, the age of the primary taxpayer was that of the taxpayer whose name was listed first on the tax return, usually the husband.) In general, non-repeaters were younger taxpayers than repeaters. More than 48 percent of the returns filed by non-repeaters were filed by taxpayers age 40 or under, but only 39 percent of the returns filed by repeaters were filed by taxpayers 40 or under. More than 45 percent of the delinquent returns filed by repeaters were filed by taxpayers in their prime earning years, between the ages of 41 and 61.

A Focus on Repeaters in Inventory

Additional data are available for profiling Repeaters in Inventory on the Nonfiler Case Major File. The Nonfiler Case Major File contains data, such as total wages, interest, dividends, pensions and annuities, unemployment compensation, non-employee compensation, and mortgage interest, from information returns that were filed for Tax Year 1993, the year for which these repeaters have not filed. The data show that almost 68 percent of the total income as reported on information returns earned by Repeaters in Inventory was wage income. This percentage, when calculated for the entire population for which the IRS received Tax Year 1993 information returns, was slightly higher at a little more than 70 percent (Figure I). In addition, interest and dividend income was 8 percent of the total income amount for the population, but only 2 percent of the income of Repeaters in Inventory. The data also show that although non-employee compensation was nearly 14 percent of the total income reported for the entire population, it was significantly larger for Repeaters in Inventory at 21 percent of the total income reported. Also, while the amount of withholding was at 11 percent of the total income amount reported for the entire population, it was less than 9 percent of the total income reported for Repeaters in Inventory.

Based on the availability of this type of income information for taxpayers who have not filed, IRS has created some market segments for these taxpayers through the assignment of select codes [12]. For Tax Year 1993 there

FigureG

Delinquent Individual Income Tax Returns: Filing Status by Market Segment, Fiscal Year 1993

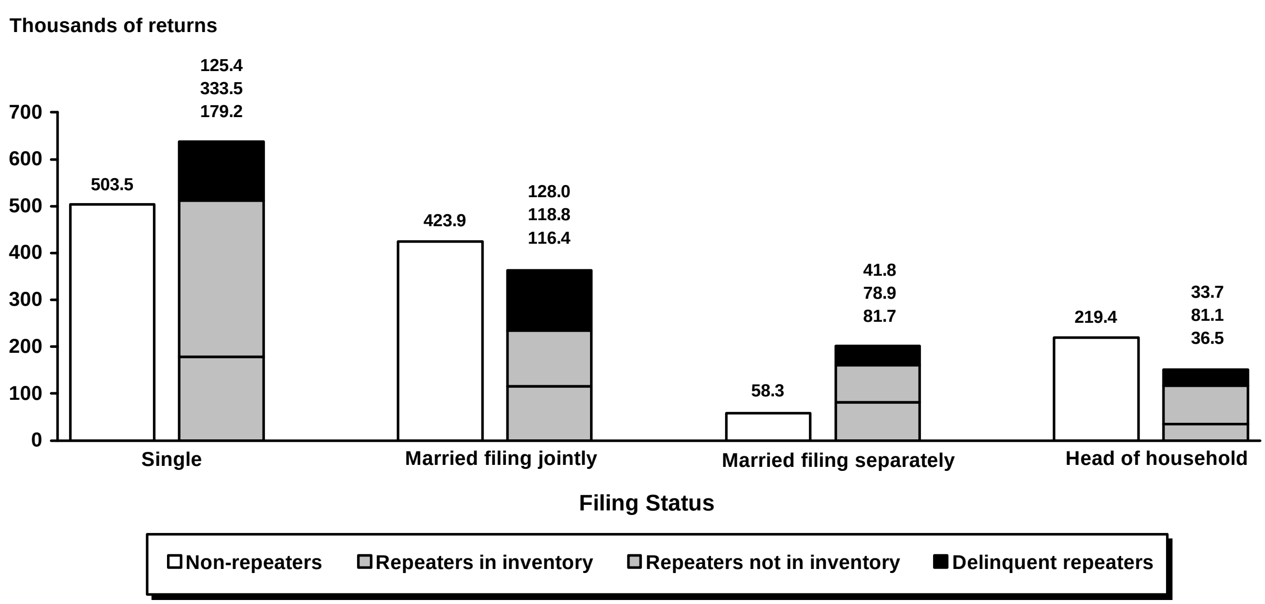


Figure H

Delinquent Individual Income Tax Returns: Age of Primary Taxpayer by Market Segment, Fiscal Year 1993

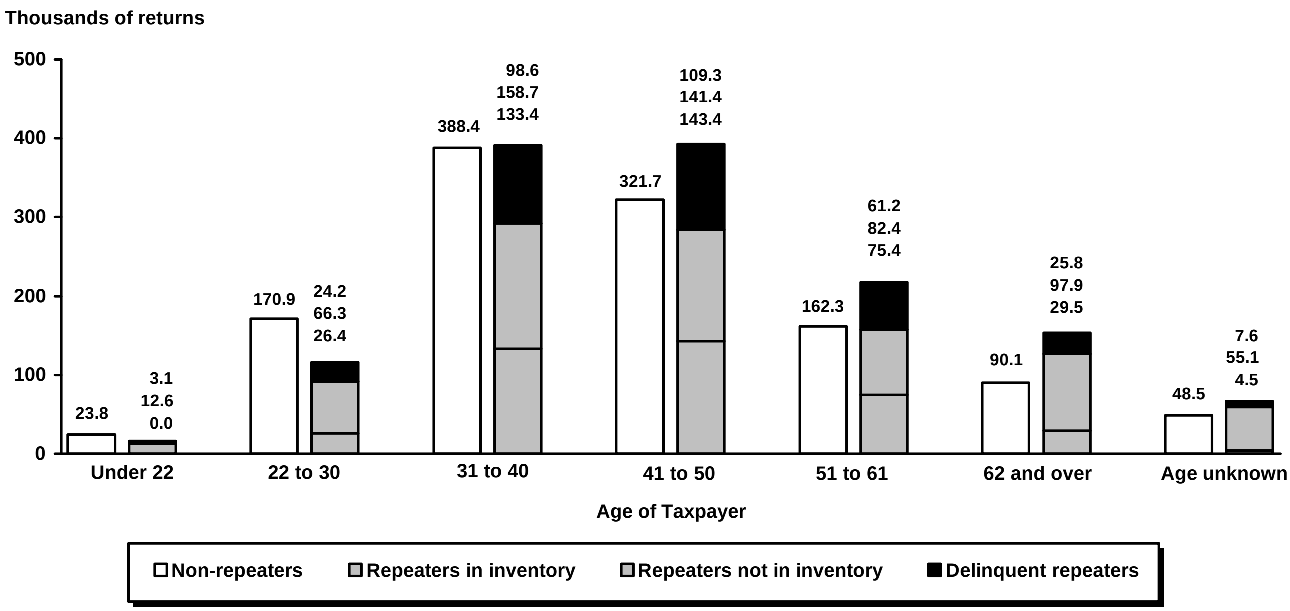
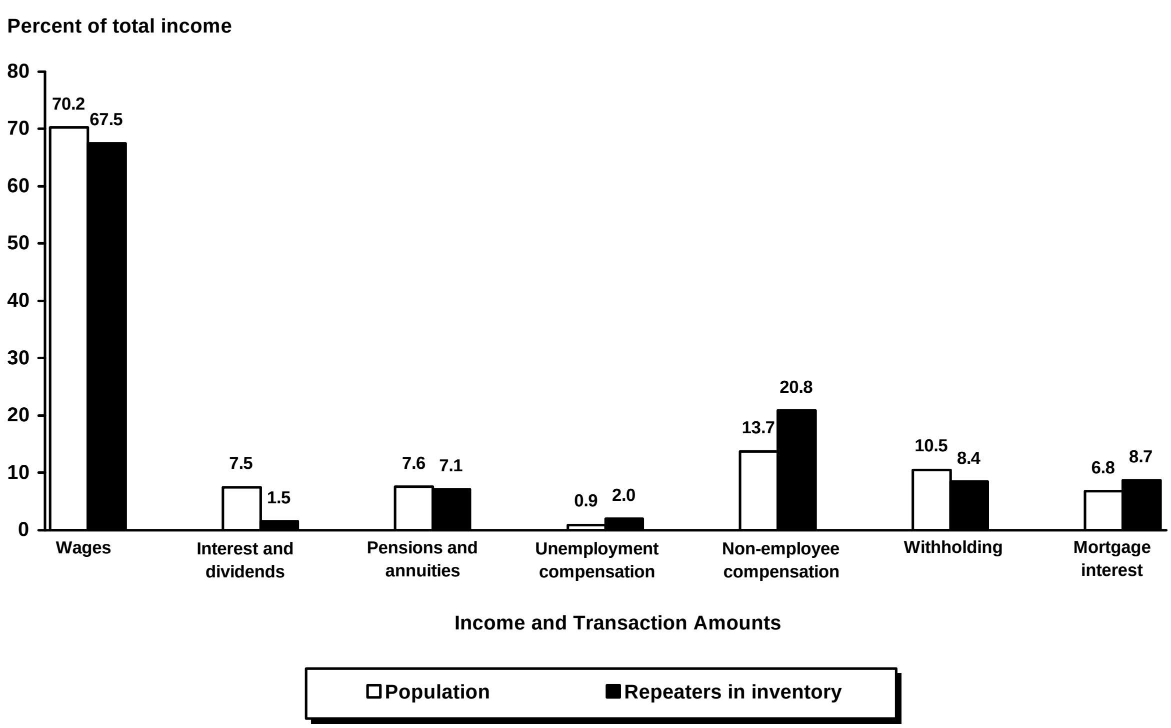


Figure I

Repeaters with Select Codes: Income and Transaction Amounts as a Percent of Total Income Reported on Information Returns, Tax Year 1993



were 25 individual select codes, which for the purposes of this article can be arranged into five major groups that generally maintain the select code hierarchy (Figure J). The hierarchy is designed to prioritize cases in inventory to maximize tax revenues and target the largest possible number of taxpayers with the available resources.

The first group includes select codes which are highest in the hierarchy and are assigned to taxpayers based on their personal characteristics. This group comprises taxpayers who are held to a higher standard, such as IRS employees or other Federal Government employees; people who illegally protest Federal taxes; and those who already owe the IRS and are currently paying the balance from a prior year through an installment agreement.

The second group entails select codes which are based primarily on high income levels estimated from information returns. Included are taxpayers whose income information indicates a total income of $100,000 or more and those whose balance due, based on income estimated from information returns, is estimated to be $500 or more. This is by far the largest segment of the Repeaters in Inventory. These cases are high in IRS's enforcement priority because of the substantial potential tax yield.

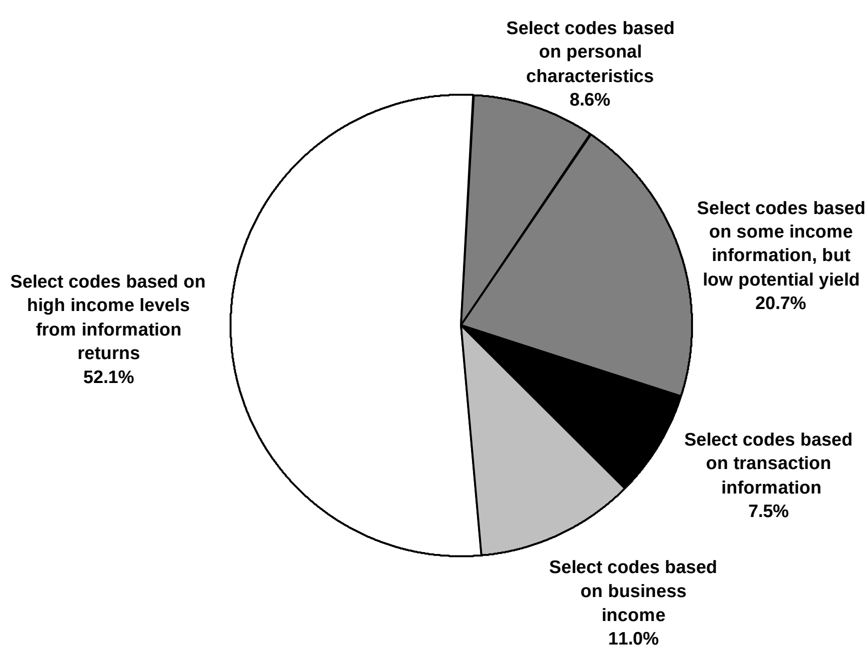
The select codes in the third group are also based upon income estimated from information returns, but the income is business type income. Included are taxpayers who have received information documents indicating income from partnerships or S Corporations, which is at least 30 percent of their total income estimated from information returns, and taxpayers who have received information returns indicating the receipt of a payment of $600 or more in the course of trade or business.

The fourth group is made up of select codes that are not based on information return income amounts, but on other available transaction data. Taxpayers who have stopped filing, but in the immediately prior tax year: a) had $200 or more in self-employment tax, b) filed a Schedule D, *Capital Gains and Losses*, and had total positive income of at least $20,000, or c) had a total positive income of $40,000 or more, fall into this group. Also included are taxpayers who have an expired extension or a credit balance from estimated credits, taxpayers who have sold stock or real estate, or have made large cash transactions, and taxpayers who have paid more than $10,000 in mortgage interest or have a dependent under the age of 14 who has unearned income of at least $5,000.

The last group of select codes are lowest in priority and are assigned to cases where there is some income information, but a low potential tax yield. Included are taxpayers who are not U.S. citizens and have a green card or U.S.

Figure J

Repeaters in Inventory by Select Code Group, Tax Year 1993



citizens who have applied for a passport and have a potential tax assessment of $50 or more. Also here are taxpayers for which IRS has information indicating some income, but the potential refund or balance due is minimal.

As one can see, the IRS has substantial information on Repeaters in Inventory. However, the profiles of the other segments of the repeater population are also important. In profiling market segments, solutions to noncompliance problems may become more evident.

Summary

More than half of the FY 1993 delinquent taxpayers repeated their noncompliant behavior and failed to file a TY 1993 income tax return timely. As of August 1995, 40 percent of the delinquent taxpayers still had not filed a return for TY 1993. The IRS has identified more than 257,000 of these taxpayers for enforcement contact. These taxpayers were in their prime earning years and more likely to file their delinquent returns with more than $1,000 balance due. More than two-thirds of the delinquent returns filed by these taxpayers were filed due to enforcement efforts, and, compared to the entire population, they were far more likely to have non-employee compensation.

Such taxpayer profiles allow IRS to identify group patterns of noncompliance and to measure trends [13]. One goal of the Internal Revenue Service is to tailor approaches to these groups to bring them "back into the system." The decision not to file on time can cause economic losses to both the nonfiler and the U.S. Government. Unclaimed refunds, for example, are cases in which people harm themselves. However, a major financial problem is unpaid tax liabilities, which represent a drain on the resources of the U.S. Government and, ultimately, are subsidized by society as a whole. Taxpayers who repeat their noncompliant behavior by filing late or failing to file required income tax returns are a substantial economic burden. Not only do their unpaid tax liabilities represent a loss of money to the government, but they also repeatedly consume IRS resources each time they require personal contact before they comply with the law. By developing profiles of repeat nonfiler market segments, the IRS can improve its system of nonfiler detection and establish programs to increase filing compliance.

Data Sources and Limitations

The data presented in this article are from the Statistics of Income Nonfiler Database and are based on the population of 1,727,466 taxpayers who were responsible for the 2,563,312 returns received during Fiscal Year 1993 that were filed 1 year or more late. This population includes 743,312 "substitutes for returns" (SFR's), for which there was little information beyond tax and balance due. Based on the subsequent filing behavior of the FY 1993 nonfilers for Tax Year 1993, additional information has been added from the Individual Master File and from the Nonfiler Case Major File.

While the data provide an accurate picture of those nonfilers who eventually filed one or more delinquent returns either voluntarily or through enforcement in FY 1993, and later repeated their noncompliant behavior, they do not provide any insight into those nonfilers who have not filed a delinquent return. As a result, there is a segment of the nonfiler population for which this profile has no information.

Explanation of Selected Terms

Delinquent return. - Any individual return filed 360 days or more after the return due date.

Individual Master File (IMF). - This data file, compiled and maintained at the IRS National Computing Center in Martinsburg, West Virginia, contains tax accounts for all individual taxpayers. Identifying information, such as name, address, and social security number, as well as tax information, e.g., "adjusted gross income" or tax balance due, is recorded in each taxpayer's account. The file is updated periodically with changes to each account.

Information Returns Master File (IRMF). - This file contains data from Forms W-2, *Wage and Tax Statement;* Forms 1099-INT, *Interest Income*; Forms 1099-MISC, *Miscellaneous Income*; and any other "information returns" issued to taxpayers by employers or other payers for a given calendar year. IRS uses this information to verify income and deductions reported on income tax returns. This file contains over 1 billion information returns per year.

Late filed return. - Any individual return received one day or more after April 15 (or the extended due date), but less than 360 days.

Nonfiler Case Major File. - This file, created for each tax year, contains identifying information and income data from the IRMF on taxpayers who meet certain income criteria and IRS has determined are required to file an income tax return but have not for that tax year. This case file becomes inventory for IRS enforcement functions to work.

Notes and References

[1] Unless stated otherwise, the data on size of refund, balance due, etc., in this article are taken from the delinquent returns processed in FY 1993. Because the returns were delinquent, they are for Tax Year 1991 and earlier.

[2] It should be noted that some of the apparent repeaters may not be required to file a Tax Year 1993 income tax return because their income has dropped below the filing level threshold or they are now deceased.

[3] Information reporting is the process by which employers and other financial entities report wages and other monies paid out to taxpayers and withheld from taxpayers on Form W-2, *Wage and Tax Statement*; Form 1099-MISC, *Miscellaneous Income*; etc. These reports are sent to the payee for his or her records and for use in tax return preparation, as well as to the Internal Revenue Service for determining filing requirements and comparing with what is subsequently reported by the taxpayer on his or her return.

[4] For each tax year, select codes are assigned to nonfiler cases on the Nonfiler Case Major File. The select codes are developed based on taxpayer characteristics, income types and amounts, and transaction information available from information returns. For example, one specific select code indicates the taxpayer is currently a Federal government employee or retiree with an estimated tax balance due of $100 or more; and another indicates that the taxpayer has a total income reported on information returns of $100,000 or more. Select codes are arranged in a hierarchy designed to maximize revenue and target the largest number of delinquent taxpayers. If a taxpayer could fall into more than one select code based on the available information, he or she is assigned the select code which ranks highest in the established hierarchy.

[5] Because of limited resources, the Internal Revenue Service is unable to work all nonfiler cases identified. Programs have been developed, based on information from the previous year's return, if filed, and current information returns, to select those nonfiler cases that will provide the maximum revenue. The selected cases are placed on the Nonfiler Case Major File, assigned a "select code" (see footnote 4), and arranged in field inventory based on the select code hierarchy, to be worked by IRS enforcement.

[6] The database includes returns that are at least one year or more late. Returns that are more than one year late, but less than two years late are counted as being delinquent one year; returns that are two years late, but less than three years late are counted as being delinquent two years, and so on.

[7] A refund return includes those for which the taxpayer elects to credit an overpayment for one tax year to the estimated tax due for the next tax year, as well as an overpayment refunded directly to the taxpayer. Balance due represents the tax due at the time of filing and is therefore calculated before any remittance submitted with the return is credited. An "even" return occurs when there is no tax liability and no prepayment credits, or in the rare instances when the tax liabilities exactly match the prepayments.

[8] For this article, enforcement-secured returns are defined as those for which the IRS sends a "demand notice" or investigates because of information available that indicates a filing requirement should have been met.

[9] When a taxpayer does not file a return, the IRS issues a series of reminder and delinquency notices. If the taxpayer continues to be delinquent, the IRS may choose to file a "substitute for return" (SFR) for the taxpayer. Using single filing status, the standard deduction, and income information available from Form W-2, *Wage and Tax Statement*, and other information returns, IRS computes the tax liability and penalties for the taxpayer. A bill is then issued for the outstanding amount. Mainly because only the standard deduction is included in the calculation, the tax amount due may be higher than if the taxpayer had filed a return. In Fiscal Year 1993, the number of SFR assessments was 743,213; this does not include the actual number of returns the taxpayer filed after an SFR assessment notification.

[10] The percentage of returns claiming single status is higher than might be expected because the calculation includes SFR returns (see footnote 9). SFR's are always generated with a filing status of single.

[11] IRS receives age information for all taxpayers from the Social Security Administration for use in tax administration.

[12] See footnote 4.

[13] See also Rosage, Laura R., "Nonfiler Profiles, Fiscal Year 1993," *Statistics of Income Bulletin*, Spring 1995, Volume 14, Number 4; and Daronco, Karla M., "Nonfiler Profiles, Processing Year 1991," *Statistics of Income Bulletin*, Summer 1993, Volume 13, Number 1.