White Paper

Taxpayer Search for Information: Implications for Rational Attention

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Taxes, especially income taxes, can be complex and confusing. Despite a general awareness of this fact, the consequences of complexity and misunderstanding are not well understood. Survey evidence suggests that many taxpayers do not understand basic tax concepts— and the compliance cost of taxes, including learning enough about them to comply, is large.

Modern technology has greatly expanded the accessibility of information that could help people through the maze of tax law. Anyone with access to the Internet may, in a few minutes, learn at least something about the most obscure details of the tax code. Taxpayers undoubtedly do use these resources to seek information: people Google “tax” more often than the names of public figures; the IRS website has received on average 4.6 million visits *per day* since 2004; and the IRS call line has received on average 125,000 calls per day since 1999. How tax knowledge matters hinges on (1) how and when people seek out tax-related information, and (2) whether they change their behavior once they acquire it.

This paper provides the first-ever attempt at understanding how, and why, taxpayers search for information about government policy, specifically tax policy. We establish that taxpayers seek information in order to both comply with their tax obligation and to respond behaviorally to tax incentives. Taking taxpayer learning seriously has important implications for understanding the impact of tax policy and tax policy changes, as well as for a full understanding of the nascent idea of tax salience.

In this project we collect data on information seeking with regard to one specific income tax-related topic: capital gains taxes. We select this topic because it is a perennially controversial policy issue, because data on the relevant taxed behavior—sales of capital assets—are available on a high-frequency basis, and because the American Taxpayer Relief Act of 2013 (ATRA) enacted a change in capital gains tax rates during our sample period.

We use information search data to shed light on competing theories of information and attention, and in particular different assumptions about the role of information in decision-making.We study information seeking around five different types of events: (1) time notches—dates when tax liability can change abruptly at certain dates, usually at year-ends; (2) macroeconomic changes; (3) policy changes or the mention of potential policy changes; (4) filing deadlines or approaching filing deadlines; and (5) tax-related news events. We examine four channels of search: (1) Google; (2) Wikipedia; (3) The IRS website; and (4) The IRS toll-free number.

We observe strong seasonality in the search for information about capital gains taxes through all channels. Taxpayer information search increases substantially during the period commonly called “tax season,” which runs from mid-January to mid-April of each year. An even more pronounced spike in information search occurs very close to the filing deadline in mid-April.

We also document through Google and Wikipedia the impact of several discrete events on taxpayer information search regarding capital gains taxes. Presidential debates in which candidates discuss their proposals for capital gains taxes, the passage on Jan. 2, 2013 of ATRA, the release of then presidential candidate Mitt Romney’s 2010 tax return in January of 2013, presidential elections, and policy changes all generate large and significant increases in taxpayer information search. In every case, these events cause a spike in taxpayer information search that fades within three or four days.

Next, we find through Google and Wikipedia that macroeconomic changes affect information searches for capital gains taxes. We observe significantly elevated information search on days with large trading volume in the stock market. We also explore a measure of information searches for personal investment advice generally, using Google searches. Daily searches for stock advice predict searches for capital gains tax on the same day, the previous day, and, in some situations, one day in the future. This is the first evidence we find, and in the literature, that some taxpayers investigate the tax consequences of an action while contemplating the action itself.

These patterns indicate that individuals search when different events make understanding tax policy more important (i.e., when they increase the return to information search). However, these results are also consistent with individuals making choices and *then* researching the tax implications of those choices for their wealth. In an effort to provide evidence that more strongly suggests a causal relationship, whereby events cause individuals to search for information in order to make more informed decisions, we examine information about capital losses. We document substantial elevation in information search related to capital losses at year-ends, especially in 2008 (when capital losses from the stock market crash would have made taxpayers more likely to rebalance their portfolios in order to take tax-efficient advantage of capital losses). Observing increases in information search just prior to the time notch is consistent with taxpayers seeking information on the tax system and using it to improve decision-making.

About the Authors:

Joel Slemrod is the Paul W. McCracken Collegiate Professor of Business Economics and Public Policy at Ross and Chair of the Department of Economics at the University of Michigan. He is a former senior staff economist at the President's Council of Economic Advisers and has been a consultant to the U.S. Department of Treasury, the Canadian Department of Finance, the South African Ministry of Finance, the World Bank, the OECD, and several corporations. Slemrod has written several books, including *Taxes in America:What Everyone Needs to Know*.

Jeffrey L. Hoopes joined the Fisher College of Business Department of Accounting and Management Information Systems in 2013. He completed his doctoral work in Business Administration (Accounting) at U-M. He holds a MAcc. degree with a tax emphasis from Brigham Young University, where he also earned his B.S. degree in accounting. Professor Hoopes is a certified public accountant (CPA) in the state of Colorado.

Professor Hoopes teaches introductory tax accounting at Fisher to undergraduate students. He has also taught introductory financial accounting at Utah Valley University. His primary research interests are in the areas of corporate taxation and financial accounting. He is especially interested in how firms respond to changes in tax policy, and how taxpayers learn about changes in tax policy.

Daniel Reck is a PhD candidate in economics at U-M. His research focuses on the application of behavioral economics to public policy, especially tax policy. He studies the importance of information, attention, and perception for the response to policy incentives and optimal policy design. Prior to coming to Michigan, Daniel studied economics, mathematics, and psychology at the University of Oklahoma.