

**Supporting Statement
Internal Revenue Service
Approval Request to Conduct Year One Test of Consumer Tipping Survey
OMB #1545-2261**

A. JUSTIFICATION

1. Circumstances Necessitating Collection of Information

The IRS is charged with collecting revenue legally owed to the federal government. One important category of income comes in the form of tips. Previous empirical research has shown income from tips to be significantly underreported¹, limiting the IRS's ability to collect the proper amount of tax revenue. The IRS believes a new study of consumer tipping practices is needed in order to better understand current tip reporting behavior so tax administrators and policy makers can make the tax system fairer and more efficient. Therefore, the IRS wishes to develop updated estimates of consumer tipping revenue across numerous services where tipping is prevalent.

The private nature of most transactions involving tipping makes it extremely difficult to collect reliable data that can be used to estimate total tip income. This difficulty is further compounded by the motivation of some individuals not to report tips received as taxable income. For these reasons, the IRS has concluded that surveying consumers about their tipping experiences is the most reliable way to collect quantitative data on tip income.

In support of this mission, IRS is seeking a standard clearance to conduct a minimum, one-year fielding of a nationwide consumer tipping survey. Unlike other surveys the IRS might conduct, the target population for this survey is not the set of U.S. tax filers with whom IRS already interacts. Instead, the potential target population includes all U.S. resident persons who use services that are commonly tipped. A precise estimate of the number of individuals in this population is unknown, but likely includes a majority of the U.S. adult population. Because this target population is broader than the set of all U.S. tax filers, it was necessary for IRS to explore other providers of appropriate survey sampling frames.

The sample that IRS intends to use for this study, Ipsos' non-probability online panel, was only selected after a pilot study was conducted which compared the results from this vendor to another panel source (GfK KnowledgePanel, a probability-based online panel) and an independent source of tipping data and determine which method will yield the most accurate results while reducing respondent burden and cost to the IRS. The findings from the pilot study demonstrated that there were no consistent differences in the results gathered from the panels when compared against each other or when compared against the 3rd party source of data. As such, the decision was made to use the non-probability panel due to the reduced cost per completed response, which will allow for a larger data collection and more precise estimates of tipping behavior for certain, low-incidence services.

¹ See IRS Publication 1530 (1990), Tip Income Study, "A Study of Tipping Practices in the Food Service Industry for 1984" and Robert B. Pearl and Kevin F. McCrohan, (1983), Estimates of Tip Income in Eating Places, 1982, IRS Research Bulletin, pp. 49-53.

Prior IRS research on consumer tipping behavior found tipping rates varied considerably by industry and by region. A 1982 study conducted by the University of Illinois for the IRS² found tipping rates to be roughly 14% of the total bill for restaurants, 12% for barber and beauty shops, 19% for bars, and 20% for taxis. On a regional basis, mean restaurant tipping rates ranged from a low of 12.5% in the West North Central to a high of 15% in the Northeast. The observed variation in tipping rates implies larger sample sizes may be required in order to produce accurate estimates of tipping rates for infrequent services. This factored into the decision to use the non-probability Ipsos panel, which will allow IRS to achieve a better balance of sample size and survey cost.

More details regarding the testing that was conducted on the pilot study can be found under section B.4, "Testing of Procedures." The full analysis is presented in the report "Comparison of Estimates of Tipping Behavior Produced Using Probability and Non-Probability Samples: Methodology and Results," which is attached as a supporting document.

The main goal for this survey effort is to generate preliminary estimates of tipped income in a variety of services for which no such estimates exist, in addition to providing information on other correlates of tipped income and behavior including, but not limited to, regional or seasonal fluctuations in tipped income.

As such, this survey effort requests a full-fielding of the previously tested pilot survey for the course of a full calendar year. This initiative flows from Goal 1 of the IRS Strategic Plan for FY 2014-2017: Deliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance.

2. Use of Data

The proposed consumer tipping survey is intended to improve the IRS' general understanding of current tipping practices across industries, to provide current preliminary estimates of aggregate unreported tip income across the population, and to prompt and inform discussion about IRS' administrative and statutory policies related to tip income. No enforcement actions will be taken as a result of the survey.

The consumer tipping survey is expected to provide useful information about current tipping practices for the IRS' National Tip Reporting Compliance Program. One key challenge of conducting audits where tip income is involved is in determining the correct amount of unreported tip income. Examiners do not use a one-size-fits-all method for doing so. Instead they are encouraged to gather information on a case-by-case basis through interviews, records, observations as well as on knowledge of industry practice. (See, for example, Internal Revenue Manual, IRM 4.23.7 for information on tip examinations, tip agreements, and tip examination processing procedures.) It is this latter piece about industry practice that can be informed by the consumer tipping survey. As noted above, the survey information the IRS has about industry practices of tipping was collected in the 1980s. Thus, the new consumer tipping survey data will provide an enhanced awareness of common tipping practices across industries that can help auditors make more informed decisions when implementing various methods for estimating unreported tip income. The estimates generated as a result of this survey are not expected to be incorporated directly into IRS audit methodology but instead to provide a general understanding of common tipping behavior.

² Pearl, R. B., & Sudman, S. (1983, June). *A survey approach to estimating the tipping practices of consumers* (Final Report to the Internal Revenue Service under Contract TIR 81-52); Pearl, R. B. (1985, July). *Tipping practices of American households: 1984* (Final Report to the Internal Revenue Service under Contract 82-21).

Second, the survey data will allow the IRS to produce preliminary estimates of aggregate unreported tip income, which in turn will contribute to IRS' estimation of the individual income tax underreporting tax gap and employment tax underreporting tax gap. It is understood that, by their nature, the tax gap estimates are subject to uncertainty and that some tax gap components are estimated more robustly than others. Developing new preliminary estimates of the magnitude of the tax noncompliance associated with tip income, particularly as it compares with other areas of tax noncompliance, will provide IRS with some initial insight as to how it can more effectively and efficiently allocate its resources. Results of the survey will not be used to initiate new enforcement actions. If the results of the study provide some initial indication that IRS might want to reconsider or reevaluate how it has allocated resources that may prompt IRS to explore the issue further, potentially conducting additional research on tip income noncompliance. No enforcement actions will be initiated directly as a result of the study.

We also expect that data gathered from the consumer tipping survey will prompt and inform discussions about whether various administrative or statutory policies related to tipping continue to be appropriate, such as the 8 percent threshold for allocating tips at large food and beverage establishments that became effective in 1983 (26 U.S.C. § 6053(c)(3)). This survey is the first step in determining whether additional rigorous data collection efforts should be conducted to evaluate such existing administrative and statutory policies.

Fors Marsh Group (FMG), who will administer the survey fielding, worked in close collaboration with a number of outside Subject Matter Experts throughout the course of this project. These experts were: Dr. Michael Lynn, a professor at Cornell who has published extensively on tipping related behaviors; Dr. James Alm, a professor at Tulane who specializes in public finance and tax compliance research; and Dr. John Vidmar, a project coordinator and significant contributor to previous iterations of the IRS Tipping Surveys conducted in the mid 1980's using the NPD panel.³ These SMEs consulted on numerous aspects of the project including the initial background research, the analysis reports, and questionnaire design.

3. Use of Improved Information Technology To Reduce Burden

The study will use a web survey to collect data.

The consumer tipping questionnaires include screening criteria and pull down-menus for transaction types to reduce respondent burden.

4. Efforts To Identify Duplication

This study will expand upon the pilot study conducted by the IRS in July, 2015. However, this is the only one being conducted to inform IRS staff about national tipping rates and gross tipped income by industry and geographic area. Furthermore, this survey effort will give the IRS an accurate snapshot of tipped behaviors during the course of an entire calendar year.

³ Pearl, R. B., & Vidmar, J. (1988, February). *Tipping Practice of American Households in Restaurants and other Eating Places: 1985-86* (Summary Report to the Internal Revenue Service un Contract TIR 86-279)

5. Methods to Minimize Burden on Small Businesses or Other Small Entities

The collection of information requirement will not have a significant economic impact on a substantial number of small entities.

6. Consequences of Less Frequent Collection on Federal Programs or Policy Activities

Not conducting this survey effort will mean the IRS will lack quantitative evidence concerning the amount of income that is not reported in various service industries that are commonly tipped. Furthermore, the IRS will lack reliable data on any regional differences or season fluctuations that might affect tipping behavior.

The practical consequences of this are at least twofold: first, IRS auditors will be hindered in their efforts to accurately and fairly determine the extent to which tip income has been underreported by taxpayers. Second, the IRS may not allocate its resources as efficiently or effectively as it would otherwise do based on recent and reliable estimates of tax noncompliance associated with tip income.

7. Special Circumstances Requiring Data Collection to be Inconsistent With Guidelines in 5 CFR 1320.5(d)92)

There are no special circumstances requiring data collection to be inconsistent with Guidelines in 5 CFR 1320.5(d)(2). The information collected will be voluntary.

8. Consultations With Individuals Outside of the Agency on Availability of Data, Frequency of Collection, Clarity of Instructions and Forms, and Data Elements

IRS is working with Fors Marsh Group (FMG) to administer the survey.

In response to the Federal Register notice dated April 12, 2019 (84 FR 15042), we received no comments during the comment period regarding the consumer tipping survey.

9. Explanation of Decision to Provide Any Payment or Gift to Respondents

The IRS is not providing payment or gift to survey respondents. However, the non-probability panel has a reward system set up with their panel members based on their response to any survey administered through the non-probability panel. This monetary incentive is equivalent to about \$1 for a 10-minute survey.

10. Assurance of Confidentiality of Responses

The security of the data used in this project and the privacy of survey respondents to the extent allowed by the law will be carefully safeguarded at all times. Security requirements are based on the Computer Security Act of 1987 and Office of Management and Budget Circular A-130, Appendices A & B. Physical security measures include a locked, secure office. Notes are stored in locked cabinets or shredded.

The IRS will apply and meet fair information and record-keeping practices to ensure privacy

protection of all respondents to the extent allowed by law. This includes criteria for disclosure - laid out in the Privacy Act of 1974, the Freedom of Information Act, and Section 6103 of the Internal Revenue Code - all of which provide for the protection of respondent information as well as its release to authorized recipients.

The survey data will not contain any respondent names, Social Security Numbers, or Taxpayer Identification Numbers. Participants will not be identified in any of the documents or files used for this project. FMG will limit and control the amount of information they collect to those items that are necessary to accomplish the research questions. FMG will carefully safeguard the security of data utilized as well as the privacy of the survey respondents to the extent allowed by law. FMG will apply the fair information and record-keeping practices to ensure protection of all survey respondents. The criterion for disclosure laid out in the Privacy Act, the Freedom of Information Act, and section 6103 of the Internal Revenue Code provides for the protection of information as well as its releases to authorized recipients.

The survey will be administered electronically; however there are no cookies involved. Survey participants will be provided a link/web address via a secure website. Transmission to/from the secure website for the survey will be encrypted.

The non-probability panel has a privacy policy for their members to explain when and how any personal information can be shared, either for client use or as required by law. The privacy policy can be viewed in full detail at the location below:

<http://www.i-say.com/Footerlinks/PrivacyPolicy/tabid/282/language/en-US/Default.aspx>.

11. Justification of Sensitive Questions

No sensitive personally identifiable information (PII) is collected.

12. Estimated Burden of Information Collection

IRS will attempt to obtain 18,000 complete surveys with at least one tipped service transaction. Burden hours were calculated using a 13% completion rate estimate. The expected completion rate for the non-probability sample is 13%. This is based on the completion rate for the 2012 survey concerning the previous Presidential election. The IRS Office of Research estimates that the total burden hours for this project come to 11,144 hours. Estimated time to complete survey and required number of completes are based on incidence rate estimates of tipped survey responses from the pilot study, completed during July, 2015. Incidence rates used for burden calculations were based on the non-probability sample respondents. The non-probability panel showed a 33% incidence rate during the pilot study fielding but a 30% incidence rate is planned for the full survey fielding to ensure an even distribution of completes throughout the entire year and allow for any seasonal variations that might occur. As such, 60,000 participants will need to complete the screening survey in order to acquire 18,000 surveys with at least one tipped transaction.

The burden hour estimates breakdown as follows:

| Non-Probability Sample | | | |
|--|---------------------------|---------------------------|---------------------|
| Category of Respondent/Activity | No. of Respondents | Participation Time | Burden Hours |
| Read Invitation Email | 461,540 | 0.5 minute | 3,846 hours |
| Read Reminder Email* | 431,540 | 0.25 minute | 1,798 hours |
| Complete Survey | 60,000 | 5.5 minutes** | 5,500 hours |
| | | TOTAL BURDEN HOURS | 11,144 hours |

* The estimate for the Reminder emails is based on the assumption that 50% of the needed respondents will complete the survey online in time to not receive the Reminder email.

** Participant time is based on mean completion time for non-probability panel members during pilot survey fielding.

13. Estimated Total Annual Costs Burden to Respondents

There is no monetary cost to respondents for participating in these data gathering efforts. Therefore, there are no costs to respondents affected by this collection.

14. Estimated Annualized Cost to the Federal Government

The cost to the government over the three-year period is estimated to be \$410,550.63 for fielding with the non-probability panel. This cost would be a portion of the total contract cost, which includes analysis and reporting.

15. Reason for Change in Burden

There is no change to the paperwork burden previously approved by OMB. IRS is making this submission for renewal purposes.

16. Plans for Tabulation, Statistical Analysis and Publication

The contractor FMG will administer surveys using an online, non-probability panel. The survey administration will include an initial invitation email with a link to the survey as well as reminder emails, as necessary. The survey will field in a continuous manner throughout the year with sample invitations released at least three times a week.

Response rates for non-probability samples cannot be calculated since the probability is unknown. To obtain a representative transaction-average tipping rate by industry, FMG will weight the sample of tipping transactions. This will involve generating transaction-level weights as a function of the number of individuals in a respondent's particular demographic-geographic strata in the population, taken from the Census or ACS, and the respondent's predicted number of tipped transactions, obtained from the survey data.

FMG will provide a final, detailed technical report to IRS researchers within five months of conclusion of the survey effort. This document will include descriptions of final dispositions of the sample and outcomes rates; document the construction of questionnaire; outline sample characteristics, including the population of interest and sample description; describe data collection techniques, and procedures related to sampling and weighting.

As part of a final report that will be delivered eight and a half months after completion of the survey fielding, FMG will conduct a number of analyses to generate summary estimates of tipping behavior on a number of criteria that have been identified as important and relevant to the IRS. To mitigate the effect of sampling-induced error that results from the limited number of observations available per transaction type, we will utilize a modeling and post-stratification approach. This will involve first pooling data across transaction types and using that data to predict the tip rate for an individual transaction, where the tip rate is a function of a limited number of characteristics such as the individual's level of education, urban/rural status, the industry of the establishment where the tip took place, etc. Using information on the characteristics of individuals engaging in transactions of a certain type (particular industry, geography, etc.) and the fitted model, predictions for the mean tipping and stiffing rate of all transactions of a given type can be obtained.

17. Reasons Why Displaying the OMB Expiration Date is Inappropriate

IRS believes that displaying the OMB expiration date is inappropriate because it could cause confusion by leading taxpayers to believe that the survey sunsets as of the expiration date. Taxpayers are not likely to be aware that the IRS intends to request renewal of the OMB approval and obtain a new expiration date before the old one expires.

18. Exceptions to the Certification Statement

There are no exceptions to the certification statement.