

Taxpayer Responses to Third-Party Income Reporting: Evidence from a Natural Experiment in the Taxicab Industry

Bibek Adhikari¹, James Alm², Brett Collins³, Michael Sebastiani⁴, and Eleanor Wilking⁵

DRAFT—NOT FOR CITATION⁶

ABSTRACT

This paper uses confidential tax returns data from sole-proprietor businesses to estimate behavioral responses to the introduction of Form 1099-K, a third-party income reporting law that requires credit card companies to report to the Internal Revenue Service the gross amount of all payment transactions that businesses receive through their electronic payment systems. We estimate the causal impact of Form 1099-K on business reporting by exploiting a natural experiment in which many cities in the U.S. passed their own ordinances mandating taxicab drivers install credit card readers in their vehicles, while other cities did not pass such ordinances. We find that taxpayers respond to third-party information reporting in offsetting ways. In particular, we find that firms from cities with mandatory credit card ordinances reported more *receipts* after the introduction of Form 1099-K compared to similar firms from cities without mandatory credit card ordinances, but they also reported an essentially offsetting increase in *expenses*. Overall, the net impact of third-party information reporting led to small and statistically insignificant changes in *taxable income*. These results are robust to a variety of alternative specifications and placebo tests.

¹ Department of Economics, Stevenson Hall 425, Campus Box 4200, Illinois State University, Normal, IL, 61790; Email: badhik1@ilstu.edu.

² Department of Economics, Tulane University, 6823 St. Charles Avenue, 208 Tilton Hall, New Orleans, LA, 70118.

³ Office of Research, Applied Analytics, and Statistics, Internal Revenue Service, Washington D.C. 20224.

⁴ Office of Research, Applied Analytics, and Statistics, Internal Revenue Service, Washington D.C. 20224.

⁵ New York University School of Law, 40 Washington Square South, New York, NY 10012.

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