United States General Accounting Office

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Report to the Honorable Dick Armey, Majority Leader, House of Representatives

March 2002

TAX DEDUCTIONS

Further Estimates of Taxpayers Who May Have Overpaid Federal Taxes by Not Itemizing

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United States General Accounting Office
Washington, DC 20548

March 29, 2002

The Honorable Dick Armey
Majority Leader
House of Representatives

Dear Mr. Armey:

When computing their federal taxes, taxpayers either claim a standard deduction or itemize deductions, and these deductions are subtracted from adjusted gross income in determining taxable income. Taxpayers generally claim the type of deduction that is larger, because this minimizes their taxable income. In recent years, approximately 70 percent of taxpayers have claimed the standard deduction, while the other 30 percent have itemized.

This is our second report in response to your request for an estimate of the number of taxpayers who may have overpaid their taxes by claiming the standard deduction instead of itemizing their deductions, as well as of the amount of taxes that they may have overpaid. In our first report,[1] we estimated that on about 510,000 returns for tax year 1998, taxpayers who claimed the standard deduction had deductible mortgage interest expense in excess of their standard deduction and overpaid their taxes by about $311 million.

In this report, our estimates include payments not only for mortgage interest but also for mortgage points, state and local income taxes, charitable contributions, and real estate and personal property tax for tax year 1998. We developed our estimate for mortgage interest payments, mortgage points, and state and local income taxes by matching a sample of tax year 1998 returns for individuals who did not claim itemized deductions with information in other Internal Revenue Service (IRS) databases. This information was supplied by lending institutions and employers and consisted, respectively, of the mortgage interest and points paid by each taxpayer and the wages paid to each taxpayer. Our estimates for charitable contributions and real estate and personal property taxes

[1] U.S. General Accounting Office, *Tax Deductions: Estimates of Taxpayers Who May Have Overpaid Federal Taxes by Not Itemizing*, GAO-01-529 (Washington, D.C.: Apr. 12, 2001).

are averages for various income classes based on Department of Labor data. We assigned (imputed) these class averages to each taxpayer in the same income class in our sample. In this report, we also present information on the proportion of returns prepared by a third party on which taxpayers may have overpaid their taxes.

When the data allowed, we identified and excluded from our sample the most common situations, such as returns with no tax liability, on which taxpayers could not have itemized deductions. We also attempted to identify and exclude the most common instances in which a payment, such as a mortgage interest payment, would not be deductible. However, we could not exclude all nonitemizable payments. To the extent that our estimates included some nonitemizable deductions, they may be overstated. Likewise, data were not available for us to identify and include all itemizable deductions. To the extent that we were not able to include all the deductions that nonitemizers could have claimed, our estimates may be understated. A more detailed discussion of our possible over- and underestimates of deductible payments is contained in an appendix.

Because our estimates are based on a random sample of tax returns, they are subject to sampling error, which indicates the extent to which random samples are likely to differ from the populations that they represent. Our estimates may also be subject to other types of error, called nonsampling error, which can occur, for example, when we impute values for missing data. Because we used imputed values for our estimates of charitable contributions and of real estate and personal property tax payments, and because these estimates may be affected by other sources of nonsampling error, these estimates are likely to have larger nonsampling errors and may be less reliable than our estimates of mortgage interest and state and local tax payments. The appendix contains more detail on our methodology and our assessment of the reliability of our estimates.

As agreed with your office, we did not attempt to determine the reasons why taxpayers claimed the standard deduction when they might have paid less tax had they itemized deductions.

Results in Brief

We estimate that on about 948,000 tax returns for tax year 1998, taxpayers did not itemize their deductions yet had payments for mortgage interest and points and for state and local income tax that exceeded the standard deduction for their tax filing status.[2] When we impute charitable contributions and real estate and personal property tax payments, the estimate of the total number of taxpayers whose potential itemized deductions exceeded the claimed standard deduction could be as high as 2.2 million tax returns.

We estimate that these taxpayers with unitemized mortgage interest, mortgage points, and state and local income taxes that exceeded the claimed standard deduction for their tax filing status are likely to have overpaid their taxes by about $473 million. When charitable contributions and real estate and personal property tax payments are included, the total overpayment of taxes could be as high as about $945 million. On the basis of this $945 million estimate, the average overpayment amount was an estimated $438. About 76 percent of these taxpayers may have overpaid by $500 or less, while the remaining 24 percent may have overpaid their taxes by more than $500. We also estimate that a third party prepared about 50 percent of the tax returns on which taxes may have been overpaid.

Background

The tax code allows taxpayers to subtract from gross income either a standard deduction or certain itemized deductions. The standard deduction is the sum of two components, the basic standard deduction and the additional standard deduction for taxpayers who are aged 65 years or older, blind, or both. Both the basic and additional standard deductions vary in amount, depending on filing status.[3] Basic and additional standard deduction amounts are set by Congress and are adjusted annually for inflation using the Consumer Price Index.

Itemized deductions are specified personal and other expenses that Congress has chosen to allow as deductions in arriving at taxable income. Deductible personal expenses include certain of the taxpayer's interest

[2]The five filing statuses are *single*, *married filing jointly*, *qualified widow(er) with dependent child*, *head of household*, and *married filing separately*. The standard deduction amounts vary by filing status. For tax year 1998, the basic standard deduction was $4,250 for filing single, $7,100 for married filing jointly or as a qualified widow(er), $6,250 for head of household, and $3,550 for married filing separately.

[3]For example, the basic standard deduction for single filers was $4,250 in 1998 with an additional standard deduction of $1,050 for filers who were aged 65 years or older, blind, or both, for a potential total standard deduction of $6,350. The basic standard deduction for married filing jointly was $7,100 with an additional standard deduction of $850 for each spouse who was aged 65 or older, blind, or both, for a potential total standard deduction of $10,500.

payments, such as mortgage interest and points, which are charges paid, or treated as paid, by a borrower to obtain a home mortgage; certain nonfederal taxes, such as state and local income taxes; gifts to charity; real estate taxes and personal property taxes; medical and dental expenses; and casualty and theft losses. Other deductible expenses include certain payments related to the production or collection of income and expenses related to the management of property held for the production of income.

Generally, a taxpayer is allowed to claim either itemized deductions or the standard deduction, whichever is greater. To minimize their tax liability, taxpayers can compare their total standard deduction (the sum of their basic standard deduction and any additional standard deductions) with their total itemized deductions. If their itemized deductions are less than their standard deduction, taxpayers can compute taxable income using the standard deduction. If their itemized deductions exceed the standard deduction, taxpayers can compute taxable income by itemizing.

Scope and Methodology

To estimate the number of taxpayers who may have overpaid their taxes by claiming the standard deduction instead of itemizing, and to estimate the amount of taxes that they may have overpaid, we used IRS's Statistics of Income (SOI) data for tax year 1998 (the most recent year for which data were available). The SOI data consist of a random sample of about 164,000 individual returns that is statistically representative of the 124.8 million individual returns filed. We attempted to identify and exclude taxpayers who could not have claimed itemized deductions, such as those with no tax liability, from our estimate of potential overpayers.

We matched the sampled returns with data from IRS's Information Returns Master File, which contains data for mortgage interest and points from form 1098 information returns that were received by IRS from taxpayers' lending institutions. We used this matched file to obtain mortgage interest payments and points for taxpayers in the SOI sample who did not itemize their deductions. We attempted to identify and exclude from our estimate of potentially deductible mortgage interest and points any of these payments that could not be claimed as itemized deductions.

Our estimate for state and local income taxes was based on our analysis of a subsample of the SOI sample returns for individuals who reported wage income and did not claim itemized deductions. For these wage earners, we collected the state and local income taxes reported on their form W-2 and applied these values to the total SOI sample of returns on which taxpayers reported wages but did not itemize their deductions.

Our estimates for charitable contributions and real estate and personal property taxes were based on the Department of Labor's calendar year 1998 consumer expenditure survey (CES), which contains data on these expenditures by income level and geographic location. For estimates of the charitable contributions and the personal property taxes of nonitemizers, we calculated the average value of these payments by income class in the CES sample and imputed these class averages to each nonitemizer in the same income class in the SOI sample. For estimates of real estate taxes, we calculated the average payment by geographic location as well as by income class and imputed this class average only to nonitemizers in the SOI sample who also had mortgage interest payments.

All sample results in this report have been weighted to reflect the entire population and are subject to sampling error. These sampling errors reflect the extent to which random samples of these sizes and structures are likely to differ from the populations that they represent. Each of the estimates is surrounded by a 95 percent confidence interval, indicating that we can be 95 percent confident that the interval contains the actual population value.

In addition to sampling error, our estimates may also be affected by other sources of error, such as errors in interpreting questions or providing information on the CES, errors in processing or recording data, and errors made when estimating missing data. These types of error are called nonsampling error. The estimates of charitable contributions and of real estate and personal property tax are likely to have larger nonsampling errors than our other estimates, because, unlike the estimates of mortgage interest and state and local tax payments, they are based on survey data and require procedures for estimating missing values. Because of these additional sources of nonsampling error, these estimates may be less reliable than the estimates of mortgage interest and state and local income tax payments by nonitemizers.

The appendix contains more detail on our findings and data limitations. We did our work from July 2001 to March 2002 in accordance with generally accepted government auditing standards.

We requested and received comments from IRS' director of the Office of Research, Analysis and Statistics of Income on a draft of this report. In addition, we discussed our methodology with academic and other tax policy experts. They stated that the methodology we used for developing our estimates was reasonable.

Itemized Deductions Exceeded the Standard Deduction for Some Taxpayers Who Did Not Itemize

For tax year 1998, taxpayers filed more than 124 million tax returns. On almost 86 million, or about 70 percent, of these returns, taxpayers claimed the standard deduction. On the remaining 38 million, or about 30 percent, taxpayers itemized their deductions. We estimate that on about 948,000 of the returns claiming the standard deduction, taxpayers could have reduced their taxes because of mortgage interest, mortgage points, and state and local income tax payments that exceeded the standard deduction. After imputing charitable contributions and real estate and personal property tax payments to taxpayers, we estimate that the number of returns on which payments for itemized deductions exceeded the standard deduction could be as high as 2.2 million returns. These estimates and their confidence intervals are reported in table 1.

Table 1: Estimated Number of Returns on Which Taxpayers May Have Overpaid Taxes because Itemizable Deductions May Have Exceeded the Standard Deduction, and Estimates of Amounts Overpaid, Tax Year 1998 (numbers in thousands)

Return category	Estimated returns	95% confidence interval	Estimated overpayments	95% confidence interval
Returns on which mortgage interest and points and state and local income tax exceeded the standard deduction[a]	948	607–1,411	$473,048	367,964–578,133
Returns on which mortgage interest and points and state and local income tax plus imputed charitable contributions, real estate and personal property taxes exceeded the standard deduction[b]	2,157	1,602–2,838	$945,182	792,542–1,097,822

[a]Estimate based on SOI and sampled tax return data.

[b]Estimate based on SOI and sampled tax return data as well as imputations from CES data.

Source: GAO analysis of SOI and other IRS data and Department of Labor CES data.

In addition, as shown in table 1, we estimated that taxpayers who could have reduced their taxes by itemizing mortgage interest and points and state and local income tax payments may have overpaid their 1998 taxes by about $473 million. We estimated that if charitable contributions and real estate and personal property tax payments are also imputed, taxpayers may have overpaid taxes by as much as $945 million (or about 0.1 percent of all 1998 individual income tax paid). On the basis of this $945 million estimate, the average estimated overpaid tax amount is $438. As shown in table 2, on about 76 percent of returns, taxpayers may have overpaid by $500 or less, while on the remaining 24 percent of returns, taxpayers may have overpaid their taxes by more than $500.

Table 2: Distribution of Returns on Which Taxpayers May Have Overpaid Taxes because Itemizable Deductions May Have Exceeded the Standard Deduction, Tax Year 1998 (numbers in thousands)

	Returns		
Distribution of overpaid tax	Estimated number	Percentage of total	95% confidence interval
$1–$100	677	31	358–1,070
$101–$250	591	27	310–950
$251–$500	382	18	264–525
$501–$1,000	275	13	185–387
$1,001–$5,000	224	10	147–322
>$5,000	8	0	3–20
Total	**2,157**	**100**	**1,602–2,838**

Note: Totals may not sum because of rounding.

Source: GAO analysis of SOI and other IRS data and Department of Labor CES data.

We also estimated the number of returns with overpayments that were prepared by third parties. Most of these third-party preparers were paid preparers; less than 1 percent of the returns were prepared by IRS and other noncommercial preparers. On the basis of the data in table 3, we estimate that for about 50 percent of the taxpayers who might have overpaid their taxes, the tax returns were prepared by a third party.

Table 3: Distribution of Returns Prepared by a Third Party on Which Taxpayers May Have Overpaid Taxes because Itemizable Deductions May Have Exceeded the Standard Deduction, Tax Year 1998 (numbers in thousands)

Distribution of overpaid tax	Estimated returns	Estimated returns prepared by a third party	95% confidence interval
$1–$100	677	327	70–823
$101–$250	591	339	88–792
$251–$500	382	155	98–231
$501–$1,000	275	138	87–206
$1,001–$5,000	224	104	62–162
>$5,000	8	8	3–20
Total	**2,157**	**1,071**	**701–1,442**

Note: The confidence intervals for the estimated returns are shown in table 2. The upper ends of the confidence intervals for estimated returns prepared by a third party can exceed estimated returns because the latter also are estimates.

Source: GAO analysis of SOI and other IRS data and Department of Labor CES data.

As agreed with your office, we plan no further distribution of this report until 30 days from the date of this letter, unless you publicly announce its contents earlier. At that time, we will send copies to Representative William Thomas, chairman, and Representative Charles B. Rangel, ranking minority member, House Committee on Ways and Means; Senator Max Baucus, chairman, and Senator Charles E. Grassley, ranking member, Senate Finance Committee; Representative Amo Houghton, chairman, and Representative William J. Coyne, ranking minority member, Subcommittee on Oversight, House Committee on Ways and Means; and the Honorable Charles O. Rossotti, commissioner of internal revenue. We will make copies available to others on request.

If you have any questions regarding this report, please contact me at (202) 512-9110 or Ralph Block at (415) 904-2150. The major contributors to this report were John Mingus, Kevin Daly, and Anne Stevens.

Sincerely yours,

James R. White
Director, Tax Issues

Appendix: Methodology for Estimating the Number of Returns on Which Taxpayers Overpaid Taxes by Not Itemizing Deductions

Our estimates of the number of taxpayers who potentially overpaid their federal taxes by claiming the standard deduction instead of itemizing and of the amount of taxes they may have overpaid are based on estimates of nonitemizing taxpayers' payments for mortgage interest and points, state and local income taxes, charitable contributions, and real estate and personal property taxes for tax year 1998.[1] Data were not available for us to identify and include all itemizable deductions. To the extent that we were not able to include all the deductions that nonitemizers could have claimed, our estimates may be understated.

To make these estimates, we used IRS's Statistics of Income (SOI) data for tax year 1998. Our estimate for mortgage interest and mortgage points was based on SOI sample returns for individuals who did not claim itemized deductions. For these returns, we obtained tax year 1998 data on mortgage interest payments and points from IRS's Information Returns Master File. Our estimate for state and local income taxes was based on our analysis of a subsample of SOI sample returns for individuals who reported wage income and did not claim itemized deductions. For these wage earners, we collected the state and local income taxes reported on their form W-2. Our imputations of charitable contributions and real estate and personal property taxes were based on 1998 consumer expenditure survey data for the SOI sample of taxpayers who did not itemize their deductions. The sample results in our report have been weighted to reflect the entire population and are subject to sampling and other types of error.

In our report, we estimate federal income tax overpayments by taxpayers who do not itemize. We do not include the effect on state tax liabilities of itemizing at the federal level. For most states, itemizing on the federal tax return has no effect on state tax liabilities. However, in two states—Rhode Island and Vermont—where the state tax liability is a percentage of the federal tax liability, taxpayers who overpaid by not itemizing at the federal level would also overpay state taxes. In three states—Georgia, Virginia and Utah—and the District of Columbia, where taxpayers who itemize on their federal returns must also itemize on their state tax returns and not all federal itemizable deductions are deductible, taxpayers who overpaid by not itemizing at the federal level may have increased or decreased tax liabilities at the state level. In these jurisdictions, the effect on state tax

[1]We selected these five itemizable payments for our estimates in part because, among those who did itemize their deductions in tax year 1998, mortgage interest and deductible mortgage points, taxes paid, and charitable contributions were the largest itemized deductions, together accounting for 90 percent of all itemized deductions.

liabilities of itemizing on the federal return depends on the size of the state standard deduction, state tax rates, and the deductions allowed at the state level.

Exclusions from the SOI Sample

We attempted to identify and exclude from our sample the most common situations in which taxpayers could not have itemized their deductions. Except as noted, these are the same exclusions as in our first report. We excluded:

- Returns with no tax liability. Because these filers had no tax liability, there was no potential gain to them in itemizing deductions.
- Returns where the filing status was “married filing separately.” Taxpayers in this filing status are required to use the same type of deductions as their spouse (i.e., if one spouse claimed the standard deduction, the other must also). Some of these taxpayers may have been required to claim the standard deduction because their spouse did so. We did not have data on the filing status of the spouses, so we excluded these taxpayers from our analysis. In addition, we would not have been able to allocate the itemized deductions between the two returns.
- Returns of taxpayers that were in the phaseout range for itemizing deductions and who would not have lowered their taxes by itemizing. Certain itemized deductions are subject to being phased out, beginning at certain levels of adjusted gross income. For tax year 1998, the income levels are $124,500 for filing single, for married filing jointly, for qualified widow(er) with dependent child, and for head of household; and $62,250 for married filing separately. The itemized deductions subject to phaseout are home mortgage interest, including points; state and local income taxes; gifts to charities; real estate and personal property taxes; unreimbursed employee expenses; and some other itemizable expenses.

We excluded those taxpayers in the 1998 SOI sample who had claimed a standard deduction at the time the sample was drawn but who later itemized their deductions on an amended return. In our first report, we simply excluded all taxpayers in the 1998 SOI sample who later filed an amended return.

Mortgage Interest Payments

We matched data from IRS’s Information Returns Master File, which contains form 1098 data on mortgage interest and points, provided to IRS by mortgage lending institutions, to the SOI sampled returns to obtain mortgage interest payment amounts for taxpayers in the sample who did not itemize their deductions. We attempted to identify and exclude from our sample the most common situations in which mortgage interest or points could not be claimed as an itemized deduction. Again, except as noted, these are the same exclusions as in our first report. We excluded:

- Returns on which taxpayers reported their entire mortgage interest, on their Schedule C: Profit or Loss From Business; Schedule E: Supplemental Income and Loss; or Schedule F: Profit or Loss From Farming; or on some combination of Schedules C, E, and F. For those returns where the mortgage interest on the forms 1098 exceeded the amounts reported on the schedules C, E, and F, we assumed that the excess mortgage interest could be personal expenses. In our first report, we simply excluded returns with these types of business interest deductions and did not attempt to estimate the personal mortgage interest of these taxpayers.

In certain cases, we were unable to exclude mortgage interest that may not have been itemizable. To the extent that these cases included nonitemizable mortgage interest payments, our estimates may be overstated. Home mortgage interest payments that we identified as not being fully itemizable but could not exclude from our estimates are as follows:

- Interest payments on mortgage balances over $1 million when the mortgage(s) was used to acquire (i.e., buy, build, or improve) the residence(s). Although we could not exclude them, it is unlikely that our sample included many such large mortgages. Less than one percent of the returns that we projected to have overpaid taxes had associated mortgage interest payments of $50,000 or more, which would be the interest payment on a $1 million mortgage at an interest rate of 5 percent.

- Interest payments on home equity debt, where the mortgage totaled more than the lesser of $100,000 or the fair market value of the home, reduced by acquisition indebtedness.

- Interest payments on a third home. Taxpayers who meet this nondeductible category generally would have to have three non-income-producing homes. If any of the three homes were used for business purposes, including rental property, the mortgage interest payments would have been reported on the taxpayers' Schedule C, E, or F. If so, they were already excluded from our sample.

Our estimates may be affected by the accuracy of the form 1098 data that we used. We assumed that the data were accurate for both the amount of the mortgage interest payments and the taxpayer that made the interest payments. If there are any errors in the data, our estimates may be overstated to the extent that the mortgage interest amounts may be overstated. Conversely, our estimates may be understated to the extent that the mortgage interest amounts may be understated. Also, if the forms 1098 include the names and social security numbers of any taxpayers not legally entitled to claim a mortgage interest deduction, our estimates may be overstated.

State and Local Income Taxes

To estimate amounts of state and local income taxes, we obtained a subsample of 900 tax returns in the SOI sample from IRS and reviewed the form W-2s attached to the returns. We selected this subsample by identifying nonitemizing taxpayers with wages who lived in states with a state income tax. To ensure that our subsample was representative of the taxpayers in the SOI sample with wages, we stratified the SOI sample into categories based on the amount of wages and mortgage interest for a given taxpayer. We assigned weights to each taxpayer in the subsample, so that it could be used to project the number of nonitemizing taxpayers in the population whose state and local income tax would have exceeded their standard deduction. Our estimates of both the number of overpayers and the taxes overpaid may be understated, because we are not able to identify the state and local taxes paid by taxpayers that were not withheld from their wages.

Charitable Contributions, Real Estate, and Personal Property Taxes

Our estimates for charitable contributions and real estate and personal property taxes were based on our analysis of data from the Department of Labor's consumer expenditure survey (CES). The CES contains data on the expenditures of consumer units (roughly equivalent to households) by income level and geographic location that include charitable contributions and payments of real estate and personal property taxes.[2] The CES data that we used are from a random sample that represents all U.S. consumer units in calendar year 1998.

To estimate charitable contributions for nonitemizers, we calculated the average charitable contribution of households in the CES sample by

[2]The charitable contributions in the CES are contributions of cash, stocks, and bonds to religious, educational, and other charitable organizations. To the extent that nonitemizers made contributions of other types of property that are not included in the CES but that may be deductible on tax returns, our method may understate the number of taxpayers who overpaid their taxes.

income class and imputed this class average to each nonitemizer in the same income class in the SOI sample. A limitation of this "mean value imputation" method is that it does not fully reflect the distribution of charitable giving among all taxpayers. The method imputes some contribution to all nonitemizers and imputes the same contribution to each nonitemizer in an income class. According to the CES data, most households in most income classes make no contributions or make contributions that are less than the average contribution. To the extent that nonitemizers did not make any charitable contribution or made contributions that were less than the average, our method may overstate the number of taxpayers who overpaid their taxes.[3] Also, to the extent that nonitemizers made contributions greater than the average, the method may understate the number of taxpayers who overpaid their taxes.

However, we believe that our estimates of charitable contributions are likely to produce reasonably accurate estimates of overpaid taxes despite this limitation. The average contribution does not exceed the standard deduction for any filing status. (The contribution amounts range from $135 for those with less than $5,000 income to $1,348 for those with more than $70,000 income.) Only when these imputed contributions are added to other deductions can the total exceed the standard deduction. Our analysis of itemizers shows that taxpayers with the deductions that we did not impute, the mortgage interest and state and local tax payments, are more likely to make some charitable contribution. Furthermore, the amount of their contribution does not vary consistently with the amount of these other deductions. To the extent that charitable contributions are related to other deductions in the same way for nonitemizers, imputing the same average contribution to each taxpayer is likely to produce a reasonably accurate estimate of the effect on overpayment of taxes resulting from this additional deduction.

For our real estate tax estimates, in addition to separating households in the CES sample into income classes, we separated the households into two classes depending on whether or not they lived in a metropolitan

[3]The CES data do not allow us to identify the charitable contributions made by nonitemizers. In 1986, when taxpayers who did not itemize could fully deduct their charitable contributions, about 45 percent of nonitemizers made some charitable contribution, compared with about 63 percent of all taxpayers. The nonitemizers gave an average of $474, while the average for all contributors was $1,036. To the extent that these relative giving practices still applied in 1998, nonitemizers would be, like most households in the CES, less likely to make contributions and more likely to contribute less than the average amount.

statistical area. We calculated the average real estate tax for these combined income and location classes and imputed this class average to each nonitemizer in the same income and location class in the SOI sample who also had paid mortgage interest. A limitation of this method is that, to the extent that nonitemizers without mortgage interest owned real estate and paid real estate taxes on this property, our estimates of both the number of overpayers and the amount overpaid may be understated.

For estimates of personal property tax payments, we also used the CES sample to calculate average personal property tax by income class and imputed this class average to nonitemizers in the same income class in the SOI sample. This method has the same limitations as the method for estimating charitable contributions. However, for the reasons that we described regarding charitable contributions, we believe that this method produces reasonably accurate estimates of the effect of this additional deduction on overpayment of taxes.

The estimates of charitable contributions and of personal and real estate taxes are less reliable than the estimates of the other deductions, because they are likely to have larger nonsampling errors. Unlike the mortgage interest and the state and local income tax estimates, which are based on tax return information, these estimates are based on the CES data and on a procedure for imputing missing data to nonitemizers. Our use of survey data and our imputation of missing data provide additional sources of nonsampling error that are not present with the other estimates.

To assess the importance of nonsampling error from our use of survey data, we reviewed studies of the reliability of the CES data. In the studies, the CES estimates were judged more reliable to the extent that they agreed with estimates from other sources. The CES estimates of property taxes were found in general agreement with estimates from another source. However, we found no study that compared CES estimates of charitable contributions with estimates from other sources. The studies indicated that the CES might underreport income, particularly at the lower end of the income distribution. To the extent that this is true, imputations based on the CES data may overstate the number of taxpayers in lower income categories who overpaid their taxes.

To assess the importance of nonsampling error from our use of imputations, we used an alternative method to impute missing data. As described above, a limitation of the imputation method used in our report is that in imputing the same average value by income class to all nonitemizers, it does not reflect the fact that many households in the CES reported making no charitable contributions or personal property tax payments. To test the effect of this limitation on our estimates, we randomly imputed zero values for charitable contributions and personal property tax payments to nonitemizers in the same proportion by income class as the proportion of households in the CES that reported making no contributions or payments. We imputed to the remaining nonitemizers the average charitable contribution and personal property tax payment of only those households that reported making such contributions and payments. We found that using this alternative imputation method had very little effect on our estimates. The estimated number of returns with overpayments increased by about 2 percent and the amount overpaid increased by about 8 percent above the estimates in our report.

The net effect on overpayment of taxes of our imputed estimates of charitable contributions and real estate and personal property taxes depends on how these three deductions are related to the other itemizable deductions that we estimated. The sum of the largest possible values for each of these imputed estimates does not exceed the standard deduction for any filing status. Only when these imputations are added to the other deductions can the total exceed the standard deduction.

Components of Overpayment

The components of our estimate of overpaid taxes are shown in table 4. Beginning with the component of overpaid taxes for which our data are most reliable—mortgage interest and points—we identified more than half a million taxpayers whose estimated mortgage interest and points alone exceeded their standard deduction. The addition of state and local income tax withholding adds another approximately 430,000 taxpayers whose estimated mortgage interest and points plus state and local income taxes exceeded their standard deduction.

When imputed itemizable deductions are added to our estimated deductions, another approximately 1,209,000 taxpayers are found to have estimated mortgage interest and points, state and local income taxes, charitable contributions, and real estate and personal property taxes that exceeded their standard deduction.

Table 4: Estimated Number of Returns on Which Taxpayers May Have Overpaid Taxes because Itemizable Deductions May Have Exceeded the Standard Deduction, Tax Year 1998 (numbers in thousands)

Return category	Estimated number of returns	Estimated additional returns	Percentage of total additional returns	95% confidence interval
Returns on which mortgage interest and points exceeded the standard deduction	518	518	24	440–611
Returns on which mortgage interest and points and state and local income tax exceeded the standard deduction	948	430	20	607–1,411
Returns on which mortgage interest and points, state and local income tax, and real estate tax exceeded the standard deduction	1,319	371	17	964–1,760
Returns on which mortgage interest and points, state and local income tax, real estate tax, and charitable contributions exceeded the standard deduction	1,899	580	27	1,403–2,512
Returns on which mortgage interest and points, state and local income tax, real estate tax, charitable contributions, and personal property tax exceeded the standard deduction	2,157	258	12	1,602–2,838

Note: Totals may not sum because of rounding.

Source: GAO analysis of SOI and other IRS data and Department of Labor CES data.

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