

A Taxing Trend: The Rise in Complexity, Forms and Paperwork Burdens

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Like old age, tax complexity has been creeping up on us. We may not notice it one year at a time, but a review of older tax instructions reveals just how shockingly complicated taxes have become today.

Let's begin our tour of the tax law's complexity by looking at the growth of Form 1040 over the years. Sixty-five years ago its instructions were just two pages long. Even when the income tax became a mass tax during World War II, the instructions took just four pages. Today taxpayers must wade through 117 pages of instructions, triple the number in 1975 and more than double the number in 1985, the year before taxes were "simplified."

Form 1040 -- Form and Instructions

Tax Year	Lines 1040	Form Pages 1040	Instruction Booklet Pages 1040
2000	70	2	117
1995	66	2	84
1985	68	2	52
1975	67	2	39
1965	54	2	17
1955	28	2	16
1945	24	2	4
1935	34	1	2

If you need help with something more complicated, the IRS prints at least 943 forms and instructions. UncleFed.com added up the length of these publications at our request and found a total of 12,933 pages for this tax-filing year alone.

Paid Professionals Now Prepare Most Tax Returns

As the tax system's complexity has grown, more taxpayers are running to tax professionals to prepare their returns. While it is too early to come to a final conclusion, it appears that more taxpayers will use a tax pro this year. Through March 17, 56.3% of taxpayers used a pro, up from 53.8% at the same time last year. The more complex tax returns, which require professional assistance, tend to be filed later in the season.



The number of taxpayers using paid professionals has soared by 48% since 1980 and by 17% during the past decade. While some of this increase can be attributed to rising incomes, the growing use of home computers and tax preparation software has likely curtailed the rush to paid professionals.

The growth in the use of paid preparers can be accurately tracked because beginning in 1977 tax professionals have been required to sign returns they have been paid to prepare.

Tax Returns Signed by Paid Preparers

Tax Year	Paid Preparer Returns (percent)
1980	38.0%
1985	45.9%
1990	47.9%
1995	49.9%
1999	56.2%
2000*	58.0%

*NTU estimate

Between 1966 and 1977, anyone who prepared a return was required to sign it in addition to the taxpayer, meaning many unpaid relatives or friends signed the returns. Therefore, the data for the first few years probably overstates paid-preparer participation, because undoubtedly many unpaid people who had signed returns for years kept doing so even after the law had changed.

Tax preparation software has grown in sophistication as Windows software has come to dominate the PC market, enabling more taxpayers to sit in front of a computer and answer a seemingly endless stream of questions while the computer figures out how to prepare the return.

In 1980 no individual taxpayers used computers to prepare their taxes. Yet today, when accounting for paid preparers *and* computer returns combined, about 80% of all returns are prepared with such assistance.

Use of Paid Preparers and Computers

Tax Year	Paid Preparer plus Computer Prepared Returns (percent)
1980	38.0%
1996	66.4%
1997	70.5%
1999	76.3%
2000*	80.2%

* Through Mar. 17

Tax Preparation Fees are Rising Too

Tax preparation fees have increased substantially, largely due to increased complexity of the average tax return. One way of tracking the trend in fees is to examine the average fees charged by H&R Block, a publicly-traded company.

H&R Block is the nation's largest tax preparation firm, and alone accounts for about one in seven tax returns filed by all Americans. Since 1985 the average fee has increased 136% in nominal dollars, or 42% after accounting for inflation.

The rise in fees has occurred despite a huge increase in the capability of tax return software and speed of printers since 1985. The efficiency gain of computers and printers has likely been overwhelmed by the increases in complexity.

Average Fee Charged by H&R Block

<u>Calendar Year</u>	<u>Nominal Dollars</u>	<u>Adjusted for Inflation</u>
1985	\$45.39	\$75.33
1988	\$49.21	\$74.47
1998*	\$84.39	\$91.44
1999*	\$92.57	\$98.65
2000**	\$97.13	\$100.76
2001**	\$107.26	\$107.26

* Through April 15

** Through March 15

Federal Law Orders Cut in Paperwork, but Tax Paperwork Burden Rises

In an attempt to bring the paperwork burden under control Congress passed the Paperwork Reduction Act of 1995, which set annual goals for Federal agencies to meet. According to the Office of Management and Budget, the new law "set an annual government-wide goal for the reduction of the total information collection burden of 10% during each of Fiscal Years 1996 and 1997 and 5% during each of Fiscal Years 1998 through 2001. The baseline is the total burden of information collections as of the end of FY 1995."

By that measurement, the law has been a failure, largely due to the increasing burdens at the IRS. Burden hours at all agencies are expected to increase from 6,901 million hours in 1995 to 7,435 million hours in 2000.

Instead of declining by double-digit rates, tax paperwork burdens will soar by about 15% during the five years ending in 2000.

An earlier Paperwork Reduction Act passed in 1980 required federal agencies to track the paperwork burden imposed on citizens and business by their forms and recordkeeping requirements. In order to comply with the law, the IRS commissioned Arthur D. Little to undertake a comprehensive estimate of tax compliance costs for the tax year 1983, and this

survey served as the basis for the methodology used to track tax paperwork burdens that the IRS finalized with the 1988 tax year.

While the Little study is by far the most comprehensive available, James Payne estimated in his 1993 book *Costly Returns* that even it may understate the real burden "perhaps by about 20-30 percent."

While no figures are separately published for the IRS, tax form paperwork burdens alone account for roughly 80% of the total paperwork burden hours of the United States Government. The IRS is part of the Department of the Treasury and very nearly accounts for the Department's entire paperwork burden.

In Fiscal Year 2000, total paperwork burdens for all agencies were estimated at 7,447.20 million hours, and the Treasury Department accounts for 6,131.85 million of these hours, or 82%.

Paperwork Burden Hours Department of the Treasury

Fiscal Year	Burden Hours (in millions)	Paperwork Reduction Act of 1995 Target	Cumulative Increase Since 1995	Compared to Target
1995	5,331.30			
1996	5,352.85	4,798.17	0.4%	554.68
1997	5,582.12	4,318.35	4.7%	1,263.77
1998	5,702.24	4,102.44	7.0%	1,599.80
1999	5,909.07	3,897.31	10.8%	2,011.76
2000	6,131.85	3,702.45	15.0%	2,429.40

From the Information Collection Budget, Office of Management and Budget.
Target hours assume Treasury Department reductions meet the law's overall average reduction for all Federal paperwork.

If the Treasury Department were to reduce its burden by the average amount mandated by the 1995 Paperwork Reduction Act, the burden would decline to 3,702 million hours in 2000. Instead, the Treasury has overshot that target by 2,429 million hours.

Paperwork burdens aren't the result of IRS bureaucrats mindlessly dreaming up new forms and regulations. Much of the burden increase is due to a flood of new tax laws, including the Taxpayer Relief Act of 1997. That law did reduce tax bills for middle class taxpayers, but significantly increased their paperwork burdens. The 1997 Taxpayer Relief Act alone added an estimated 92 million hours to the paperwork burden.

These figures apparently only account for the time spent in keeping the necessary records and learning about and complying with the law. Yet a significant additional but uncounted burden comes from trying to exploit the law's loopholes to the maximum extent. For example,

millions of citizens subscribe to personal finance publications and much of the advice offered deals with taxes. Taxpayers are often advised to consider the tax consequences of any major financial transaction, and this form of tax planning undoubtedly adds many millions of hours to the time spent coping with the tax system.

It's Taking Longer to Prepare and File Tax Returns

Despite the passage of the 1995 Paperwork Reduction Act, the time it takes to file commonly-used individual income tax forms has increased.

The 1040 form is often filed with Schedules A, B and D where taxpayers report itemized deductions, interest and dividend income, and capital gains, respectively. From 1988, when the IRS started tracking this information, to 2000, the average paperwork burden hours climbed from 17 hours and 7 minutes to 27 hours and 2 minutes, an increase of 58%. The time burden has increased by 28% since 1995.

History of Estimated Preparation Time, 1040 Form and Common Schedules

Year	Recordkeeping	Learning about the law or the form	Preparing the form	Copying, assembling, and sending the form to the IRS	Total
Form 1040 and Schedules A, B, & D					
2000	7:52	7:16	10:05	1:49	27:02
1999	7:57	5:43	9:59	1:50	25:29
1995	7:04	4:36	7:11	2:21	21:12
1990	7:04	4:04	5:26	1:50	18:24
1988	6:56	3:39	5:02	1:30	17:07

Year	Recordkeeping	Learning about the law or the form	Preparing the form	Copying, assembling, and sending the form to the IRS	Total
Form 1040 only					
2000	2:45	3:25	6:16	0:35	13:01
1999	3:15	2:39	6:22	0:35	12:51
1995	3:08	2:54	4:43	0:53	11:38
1990	3:08	2:33	3:17	0:35	9:33
1988	3:07	2:28	3:07	0:35	9:17

Even the short forms are becoming more complicated. The 1040EZ form, the simplest in the IRS inventory, now requires 3 hours and 53 minutes, up from 1 hour and 31 minutes in 1988,

a jump of 156%. The 1040A and Schedule 1 (interest and dividend income) has seen a paperwork burden increase of 35% since 1995.

History of Estimated Preparation Time, 1040A Forms

Year	Recordkeeping	Learning about the law or the form	Preparing the form	Copying, assembling, and sending the form to the IRS	Total
Form 1040A and Schedule EIC					
2000	1:10	3:05	5:11	0:54	10:20
1999	1:11	2:44	4:45	0:55	9:35
1995	1:04	2:25	3:02	0:40	7:11
1992	1:42	2:24	3:20	1:22	8:48
Form 1040A and Schedule 1					
2000	1:29	3:08	5:11	0:54	10:42
1999	1:31	2:46	4:45	0:55	9:57
1995	1:24	2:27	3:08	0:55	7:54
1990	1:42	2:35	3:26	0:55	8:38
1988	1:53	2:16	3:12	1:10	8:31
Form 1040A only					
2000	1:10	3:04	4:58	0:34	9:46
1999	1:11	2:42	4:31	0:35	8:59
1995	1:04	2:23	2:58	0:35	7:00
1990	1:22	2:31	3:16	0:35	7:44
1988	1:20	2:11	2:52	0:35	6:58

The tax code is so convoluted that no one inside or outside the IRS understands it. For many years *Money* magazine's annual test of tax preparers proved that paid professionals often make huge mistakes. In 1998, the last year *Money* administered the test, all forty-six tested tax professionals got a different answer, and not one got it right. The pro directing the test admitted "that his computation is not the only possible correct answer" since the tax law is so murky. The tax computed by these pros "ranged from \$34,240 to \$68,912." The closest answer still erred in the government's favor by \$610.

History of Estimated Preparation Time, 1040EZ Form

Year	Recordkeeping	Learning about the law or the form	Preparing the form	Copying, assembling, and sending the form to the IRS	Total
2000	0:05	1:38	1:50	0:20	3:53
1999	0:05	1:34	1:47	0:20	3:46
1995	0:05	0:55	1:22	0:20	2:42
1990	0:05	0:34	0:40	0:40	1:59
1988	0:07	0:24	0:40	0:20	1:31

While the 1998 IRS Reform and Restructuring Act requires Congress to at least consider complexity before passing tax legislation, that has not provided enough incentive for Congress to avoid additional complexity or encourage simplification. The tax-writing committees should be required to quantify the costs of proposals that add complexity or the savings from proposals that simplify the law.

The National Commission on Restructuring the IRS suggested that Congress consider a quadrennial simplification process, and Congress and the President should implement such a process either through legislation or by executive order. The Commission found that many members of the private sector tax community were willing to volunteer substantial time to make suggestions for simplification.

A quadrennial simplification commission would harness this volunteer activity and give a broad group of people much more incentive to work for the adoption of simplification rules. This quadrennial commission would also give the Joint Committee on Taxation and the Treasury Department more incentive to suggest simplification of the law.

Conclusion: A New Approach to Taxes Is Needed

Fundamental overhaul of our tax system remains a critically-important goal. As the Internal Revenue Code becomes increasingly incomprehensible, the intrusive measures provided to the IRS for enforcing it seem to become more draconian. Every detail of a taxpayer's private financial life is open for government inspection. IRS employees can make extraordinary demands on taxpayers, and can take extraordinary actions against them. Mixing such broad powers with a vague and complex law is a recipe for a civil liberty catastrophe. The threat of abuse is always present.

Until we change how we tax income, we will continue to have an intrusive agency with broad powers. It doesn't have to be that way. Our economy as well as our civil liberties would be better off with fundamental tax reform.

About the Author

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