

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

### NTU Policy Paper 127

by  
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#### Introduction

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 past years' tax documents compared to today's forms and instructions reveals just how shockingly complicated taxes have become. And the situation is about to get a lot worse.

The current paperwork burden generated by the Treasury Department, more than 90 percent of which consists of tax forms, now totals between 7.6 and 7.8 billion hours, according to data from the Office of Management and Budget and RegInfo.gov. That is the equivalent of about 3.7 million employees working 40-hour weeks year-round without any vacation. That's more workers than are employed at the five biggest employers among Fortune 500 companies – more than all the workers at Wal-Mart Stores, United Parcel Service, McDonald's, International Business Machines, and Citigroup combined.

Individual taxpayers alone will spend an estimated 2.43 billion hours complying with the income tax laws this year. Using the most recently reported average employer cost for civilian workers by the Bureau of Labor Statistics of \$29.37 per hour, this time is worth an incredible \$71.4 billion!

Individual taxpayers will spend a lot of money too: an estimated \$31.5 billion this year for tax software, tax preparers, postage, and other out-of-pocket costs, according to the most recent Internal Revenue Service (IRS) regulatory filing.

Counting time and money for individual taxpayers, the compliance burden would total an incredible \$103 billion for individual taxpayers alone. Keep in mind that these costs do not account for tax minimization strategies, nor do they account for the huge "growth penalty" imposed on the nation's economy by high tax rates.

A search of the most recently published Tax Code, from January 5, 2009, shows a total of 3,784,745 words. Tax changes from 2009 and 2010 have yet to be inserted in the government's

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official Tax Code, but you can bet the next publication will have thousands more with the new taxes passed as part of the expansion of health care spending.

When accounting for all taxpayers – from those who file the simplest 1040EZ to those filing the “long” Form 1040 and many schedules – the IRS now puts the average compliance time at 17.3 hours. Out-of-pocket costs per individual taxpayers (again, using any of the 1040 series) are expected to average \$225. It is important to remember that such costs include taxpayers who do their own taxes as well as those who go to paid preparers.

Nonprofit groups, corporations and partnerships generate an even greater amount of paperwork from the forms they fill out. In one of the agency’s recent annual reports to Congress, the IRS’s National Taxpayer Advocate estimated “that taxpayers spend \$193 billion a year complying with income tax requirements, which amounts to 14 percent of aggregate income tax receipts.”

### **Line by Line, Complexity Is Moving Upward**

Ever since being charged with making an annual evaluation of “The Most Serious Problems Facing Taxpayers,” the IRS National Taxpayer Advocate has put “complexity of the Internal Revenue Code” at the top of the list. But even the Advocate seems to have grown weary of repeatedly citing complexity, as evidenced in her latest report from December 2009:

In several prior reports, I have designated the complexity of the tax code as the most serious problem facing taxpayers and the IRS alike. The need for tax simplification is not highlighted as a separate discussion in this year’s report to avoid repetition, but the omission of a detailed discussion in no way suggests the lessening of its importance.

Seventy-four years ago, the Form 1040 instructions were just two pages long. Even when the income tax became a mass tax during World War II, the instructions were just four pages. Taxpayers today must wade through 174 pages of instructions, over quadruple the number in 1975 and over triple the number in 1985, the year before taxes were “simplified.”

Today’s *short* form, at 49 lines, has double the number of lines on the 1945 version of the *standard* 1040 tax return. The short form’s instructions total 92 pages, more than the long form’s booklet from 1995!

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## Form 1040 - Form and Instructions

Tax Year	Lines/1040	Form Pages/1040	Instruction Booklet Pages/1040
2009	76	2	174*
2008	76	2	161
2007	77	2	155
2006	77	2	143
2005	76	2	142
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

\*Excludes one extra page in the IRS's online PDF version for Haiti relief contributions.

If anything, this table understates the growing complexity of the form. For example, lately many “lines” have had their own sub-lines for parts a, b, c, or even d. This is also the case with many of the schedules that must be filed with the forms. For example, in the 2009 tax year Americans encountered a new Schedule M to report on the “Making Work Pay” credit – a provision in the 2009 “stimulus” bill that was advertised as a simple \$400 (\$800 for joint filers) tax-saving boost to peoples’ paychecks.

But simple is in the eye of the beholder – Schedule M contains a total of 14 lines, two of which have subparts. The Instructions contain an eight-line worksheet; several of those lines contain three or more subparts! No wonder the introduction to the interactive “Tax Savings Tool” posted on the White House’s website to tout the stimulus contains the following warning:

The Recovery Act Tax Savings Tool and any output provided by it, are not, and may not be relied upon or cited as a ruling, written determination, legal precedent, or any other type of authority. Taxpayers who have questions regarding their eligibility for tax benefits under the Recovery Act should review the relevant IRS forms and instructions or contact a qualified tax professional.

The forms also ask for information without numbering the line item, such as check boxes for Presidential campaign funding and a personal ID number for a “third party designee” if the filer wants the IRS to ask someone else about information on the tax return.

If a taxpayer needs help beyond the basic form, the IRS now lists 1,909 publications, forms, and instructions for download (some are duplicates in different languages) from its Web site – up from the 1,770 NTU logged last year. For those seeking something in between the “basic” 1040 instruction booklets and this pile of detailed material, the IRS offers Publication 17, *Your Federal Income Tax*, whose introduction claims it “covers the general rules for filing a federal income tax return.” Even though the IRS warns that Publication 17 “does not cover every situation,” the 2009 version manages to encompass 305 pages.

**New IRS Methodology Makes Tax Complexity More Complex (!)**

The IRS recently spent several years updating its methodology to measure the compliance burden of filing tax returns, which includes recordkeeping, preparation of the form, and tax planning. Unfortunately, these new methods make comparisons with prior years impossible. While the IRS’s new completion-time method may not mesh with past statistics, the data still show that compliance with tax laws continues to demand too much time and money.

**Time Burden, Tax Year 2009 (in hours)**

<b><i>By Form:</i></b>	
1040	21.4
1040A & 1040EZ	8.0
<b><i>By Taxpayer:</i></b>	
Wage & Investment	10.7
Self-Employed	31.9

Not only do taxes take too long to prepare, its costs money to pay your taxes too.

**Average Costs, Tax Year 2009 (in dollars)**

<b><i>By Form:</i></b>	
1040	\$280
1040A & 1040EZ	\$96
<b><i>By Taxpayer:</i></b>	
Wage & Investment	\$129
Self-Employed	\$434

The IRS data does not break out the average costs for those who get professional assistance versus those who self-prepare using software. An average 1040 long Form taxpayer is

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paying \$280 in the current tax year for out-of-pocket costs such as software, professional help, copying, etc. Yet, even as these costs have generally increased, overall inflation has remained at near zero. In fact, neither the personal exemption nor the standard deduction for tax year 2010 received a customary inflation adjustment because the change in the measurement on which it was based proved too small.

### **U.S. Tax Burden Hours Rank 69<sup>th</sup> Worldwide**

The United States now ranks an embarrassing 69<sup>th</sup> worldwide (out of 183 countries surveyed) for time spent complying with corporate tax filings, according to a 2010 study jointly published by the accounting firm PricewaterhouseCoopers and the World Bank Group.

The study examined tax compliance burdens faced by a hypothetical flower pot manufacturer and retailer with 60 employees. It estimates that such a company in the U.S. would spend 187 hours filing taxes. By comparison, companies in Hong Kong, the United Kingdom, or France would spend just 80, 110, and 132 hours, respectively.

Tellingly, the U.S. did even worse when ranked by total tax rate alone – 118th out of 183, dropping from 92<sup>nd</sup> out of 181 last year. A total of 45 countries made corporate taxpaying easier last year by cutting rates or streamlining filing processes. America was not among them.

### **The 24,000-Page Tax Return**

If you think your tax return is difficult, be thankful you're not in charge of taxes at General Electric. In 2006, this leading corporation filed what is believed to be the nation's longest tax return, over 24,000 pages had it been printed on paper. It was filed as part of a new mandate that large corporations file their tax returns electronically.

GE's tax return may be even longer today. When NTU's researchers contacted GE's media relations staff this month, we were told that the firm's tax department had stopped counting after the filing documents routinely beat the 24,000-page mark every year!

### **Paid Professionals Now Prepare Most Tax Returns**

As the tax system's complexity has grown, more taxpayers have turned to their computers or to professionals to prepare their returns. The number of taxpayers using paid professionals has soared by approximately nearly two-thirds since 1980 and by almost one-third since 1990. While some of this increase can be attributed to rising incomes, most of it is likely due to complexity.

Unless something is done to permanently address (as opposed to enacting one-year "patches") the growing number of taxpayers subject to the Alternative Minimum Tax (AMT), the use of preparers will likely continue to rise significantly. Nearly 80 percent of taxpayers with AMT liabilities use paid preparers.

The growth in the use of paid preparers can be accurately tracked because from 1977 onward, tax professionals have been required to sign returns.

### **Tax Returns Signed by Paid Preparers**

Tax Year	Paid Preparer Returns (Percent)
1980	38.0
1985	45.9
1990	47.9
1995	49.9
2000	57.5
2005*	61.2
2006*	62.8

Taxpayer Usage Study report of the IRS.

\*As of April 9, 2010, the IRS had not made more recent data available on paid preparer statistics.

Tax preparation software has grown in sophistication, 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 nine in 10 returns are prepared with such assistance.

### **Use of Paid Preparers and Computer**

Tax Year	Paid Preparer plus Computer Prepared Returns (Percent)
1980	38.0
1996	66.4
2000	78.4
2006*	89.9

Taxpayer Usage Study report of the IRS.

\*As of April 9, 2010, the IRS had not made more recent data available on paid preparer statistics.

As is the case with other parts of this paper, the IRS has not published current information to assist with updating the charts above. In April of 2009, the IRS reported that it “accepted 31.2 million returns filed from home computers, up 19.3 percent from the same time last year.” This might indicate that over 90 percent of taxpayers now utilize a computer or paid

preparer for their returns. However, it is also possible that some Americans, feeling the pinch of the recession, simply decided to go at it alone with software for the first time instead of shelling out money for professional services they would otherwise normally retain.

**Tax Preparation Costs and Fees Are Rising Too**

Tax preparation fees have also increased substantially, largely due to the increased complexity of the average tax return.

A good way of tracking the trend is to examine the average fees charged by H&R Block, a publicly traded company. It is the nation’s largest tax preparation firm and alone accounts for about one in seven tax returns filed by all Americans.

This year the company’s average fee per client rose slightly, by 2.3 percent. Between 1980 and today, the average H&R Block tax preparation fee increased by more than double after accounting for inflation. Since 2000, the inflation-adjusted fee has risen by nearly 50 percent.

The rise in fees has occurred despite a huge increase in the capability of tax return software and the speed of printers, which may have temporarily cut the inflation-adjusted cost of tax preparation in the late 1980s and early 1990s. The efficiency gain of computers and printers has likely been overwhelmed by the increases in complexity.

**Average Fee Charged by H&R Block**

Calendar Year	Nominal Dollars
1980	\$27.36
1985	\$45.39
1990	\$49.99
1995	\$61.77
2000	\$101.40
2005*	\$145.08
2006*	\$150.06
2007*	\$160.27
2008*	\$170.28
2009*	\$183.79
2010*	\$188.01#
*Through March 15. In 2004, H&R Block appears to have changed its method for calculating its average fee. This figure includes other services, such as Refund Anticipation Loans.	
# Amount based on percentage increase announced in H&R Block March 23, 2010 press release.	

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### **Preparer Fees Vary Widely for Different Taxpayers**

In 2006, the IRS published an extensive list of typical costs paid by taxpayers who had their taxes prepared by a professional. Here are some of the common combinations of tax forms filed by taxpayers and their estimated out-of-pocket costs. Bear in mind that tax preparation fees can vary widely, according to the IRS, “depending on the taxpayer’s tax situation and issues, the type of professional preparer, and the geographic area.”

#### **Preparer Fees by Form Schedule**

<b>Form</b>	<b>Fee</b>
Form 1040 and other forms and schedules, but not Schedule A or D	\$121
Form 1040, Schedule A, and other forms and schedules, but not Schedule D	\$174
Form 1040, Schedule D, and other forms and schedules, but not Schedule A	\$125
Form 1040, Schedules A and D, and other forms and schedules	\$313
Form 1040, Schedule C or C-EZ, and other forms and schedules, but not Schedule E or F or Form 2106 or 2106-EZ	\$329
Form 1040, Schedule E, and other forms and schedules, but not Schedule C, C-EZ, or F or Form 2106 or 2106-EZ	\$685
Form 1040, Schedule F, and other forms and schedules, but not Schedule C, C-EZ, or E or Form 2106 or 2106-EZ	\$296
Form 1040, Form 2106 or 2106-EZ, and other forms and schedules, but not Schedule C, C-EZ, E, or F	\$349
Form 1040 and forms and schedules including more than one Schedule C, C-EZ, E, or F, or Form 2106 or 2106-EZ	\$866
Note: Here is a brief explanation of each Schedule listed above: Schedule A – itemized deductions; Schedule C – self-employment income; Schedule D – capital gains and losses; Schedule E – supplemental income from partnerships, rents, royalties, trusts, etc; Schedule F – farm income; and, Schedule 2106 – employee business expenses.	

#### **Tax Complexity to Get Worse**

Tax complexity probably will get worse before it gets better. Although the tax relief legislation signed into law in 2001 and 2003 cut tax rates, both increased complexity. The expiration dates of many tax cut provisions and the uncertainty about the death tax are causing new tax planning headaches. Congress’s recent spending spree and the record levels of debt add an even greater potential for tax complexity, driven by political desire to obfuscate about tax increases. For example, President Barack Obama has recently proposed to limit tax deductions

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to their value at the 28 percent tax bracket – which will clearly raise the top tax rate higher than the Administration’s proposed 39.6 percent. Plans to reinstate older limits on itemized deductions and personal exemptions would also increase the top tax rate.

The potential return of the estate and inheritance tax – repealed for this year only – could by itself paralyze the economy by billions of dollars in deadweight losses. Even if lawmakers bring back the death tax at a lower rate and with a larger exemption, businesses and individuals will spend a great deal of time and effort on tax minimization strategies designed to stay on the “right side” of the exemption.

The Congressional Joint Committee on Taxation (JCT) recently published its *General Explanation of Tax Legislation Enacted in the 110th Congress*. This alone spanned 642 pages!

But we haven’t seen anything yet. Earlier this year, JCT reported that 69 separate tax law provisions are expiring in 2010, not to mention 72 others that have already lapsed during the year 2009. Many of the latter items would be addressed in what has become an annual rite in Washington – “tax extenders” legislation, a version of which is still being debated in Congress at the time this was written.

Worst of all is the rising threat from the specter of the AMT, a parallel and complex tax system once aimed at ensuring the rich paid a substantial tax bill. By 2011, nearly 30 million taxpayers will have to compute and pay the AMT (for the Tax Year 2010). Ironically, that number will rise if the current tax rates are extended – to 52 million by the year 2020.

This tax complexity monster is already striking unsuspecting taxpayers, some earning less than \$50,000 per year. The IRS National Taxpayer Advocate has noted that the AMT is “so complicated that many taxpayers are not aware that they may be subject to it.”

In many cases, taxpayers must decipher a separate instruction booklet, and then fill out a 55-line form, only to discover they don’t owe the AMT. This exercise is a major detour in tax preparation. No wonder about eight in 10 taxpayers who owe the AMT pay a tax professional to compute their taxes.

Though tax rate brackets, personal exemptions, and the standard deduction rise with inflation, the AMT tax structure remains frozen. Each year, the AMT identifies a growing number of taxpayers as “rich” even though their real income hasn’t changed.

Congress and the President waited until after Christmas Day of 2007 to enact a one-year “patch” sparing about 20 million Americans from having to wrestle with the AMT ... or did it? Because Washington was so late to act, the IRS was forced to reprogram and test its systems after the agency had already prepared for a tax filing season without the patch. As a result, taxpayers with possible AMT issues were told to wait until February 11 last year to file their returns. This included not only taxpayers filling out the AMT form, but also those using five other forms with AMT consequences – including Schedule 2 of Form 1040A, *Child and Dependent Care Expenses*.

The latest AMT patch, for the Tax Year 2009, was enacted in the “stimulus” bill. At the time of this writing, no action has been taken on a 2010 patch.

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The best solution for the AMT is to simply get rid of it altogether, a remedy repeatedly recommended by the IRS National Taxpayer Advocate. But if Congress can't or won't do that, then it should at least adjust the tax's application to avoid a complexity nightmare for taxpayers and the IRS. Unless Congress acts soon, one in four tax filers will pay the AMT, and half of all married filers with dependents will be liable.

### **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. According to the Office of Management and Budget (OMB), the new law "set an annual government-wide goal for the reduction of the total information collection burden of 10 percent during each of Fiscal Years 1996 and 1997 and 5 percent 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 complete failure, largely due to the increasing burdens at the IRS, which accounts for nearly 80 percent of the federal government's entire paperwork load imposed on citizens.

Yet, the IRS is not to blame for the rise in the paperwork. The Government Accountability Office (GAO) praised the IRS for being one of only two agencies in the entire government that had implemented a procedure that reduced paperwork. Unfortunately, Congress is adding to the tax laws' complexity faster than the IRS can simplify its forms.

The new method of computing filing burdens could help taxpayers get a break from the onslaught of complexity if Congress puts it to work. The OMB reports that by using the new tax complexity model, the "IRS will now be able to analyze the burden impacts of proposals to revise the Tax Code or IRS administrative procedures. For the first time, the burden implications of achieving policy objectives through new legislative and administrative tax proposals can be estimated and considered *before* the changes are adopted and implemented."

The new methodology also resulted in significant revision of the total time spent filing returns, with hundreds of millions of hours added to the burden. This does *not* mean the paperwork burden changed by *exactly* that amount. In addition to statutory and administrative changes, the *estimate* of the burden increased under the new method.

An earlier Paperwork Reduction Act passed in 1980 required federal agencies to track the burden imposed on citizens and businesses by their forms and recordkeeping requirements. To comply with the law, the IRS commissioned Arthur D. Little to undertake an estimate of tax compliance costs for the tax year 1983. This survey was the basis for the methodology used to track tax paperwork burdens that the IRS finalized with the 1988 tax year.

**Paperwork Burden Hours  
Department of the Treasury**

Fiscal Year	Burden Hours (In Millions)	Paperwork Reduction Act of 1995 Target (In Millions)	Cumulative Increase Since 1995	Compared to Target (In Millions)
1995	5,331.30			
1996	5,352.85	4,798.17	0.4 percent	554.68
1997	5,582.12	4,318.35	4.7 percent	1,263.77
1998	5,702.24	4,102.44	7.0 percent	1,599.80
1999	5,909.07	3,897.31	10.8 percent	2,011.76
2000	6,156.80	3,702.45	15.5 percent	2,454.35
2001	6,415.85			
2002	6,750.43			
2003	6,589.76			
2004	6,406.18			
2005	6,434.98			
2006	6,965.63			
2008	7,785.02			
2010*	7,552.09			

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

\* Based on a search at RegInfo.gov, April 5, 2010.

If the Treasury Department were to reduce its burden by the average that was mandated by the 1995 Paperwork Reduction Act, the amount would have declined to 3.702 billion hours in 2000.

Prior to this year, the Office of Management and Budget published future projections of Treasury burden figures in its annual *Information Collection Budget*. That task has since been reconfigured on an Internet portal called RegInfo.gov. However, the annual reports still provide an interesting look back on actual, as opposed to projected, paperwork burdens. According to the latest report from the fall of 2009, in Fiscal Year 2008 the total paperwork burden at the Department of the Treasury was nearly 7.8 billion hours.

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In turn, about 90 percent of the Treasury's burden consists of tax paperwork, the majority of that belonging to income taxes (as opposed to excises or other kinds of taxes). Indeed, the Current Inventory Report of Approved Information Collections, accessed online for this report, shows that 99 percent of the inventory belongs to the IRS; the rest is scattered among other Treasury agencies such as the Office of Thrift Supervision.

Various factors affect this figure, some from acts by policymakers, and others by economic and demographic changes. For example, recessionary activity can often cause a drop-off in the number of households liable for completing a tax return because their income falls below established filing thresholds.

Nonetheless, the 1040 tax Form series alone piled more than 375 million extra hours onto the Treasury-imposed paperwork load in FY 2008, compared to the prior year. As the 2009 Information Collection budget explained, there were both positive and negative trends contributing to the net figure:

The major drivers of burden change due to new legislation are the Alternative Minimum Tax patch, elimination of the additional filing volume attributable to the Telephone Excise Tax Refund, the presence of additional filing volume attributable to the Economic Stimulus Package, and expiration of the Katrina-relief provisions. The major drivers of burden change due to IRS action result from changes in recordkeeping requirements for cash charitable contributions and the introduction of Form 8917 for Tuition and Fees Deduction. The major drivers of the burden change due to the adjustment are population growth, macroeconomic growth, inflation, a technical change in calibrating the relative shares of taxpayers by preparation method, a technical change in the growth factors for out-of-pocket costs for software and paid professional fees, and updating the tax return micro data file used by the model.

However, the current projections for 2010 depicted above could very well increase and eventually exceed the FY 2008 level, depending upon numerous economic, regulatory, and statutory factors. Moreover, the recently enacted health care legislation will almost certainly pile on the burden hours as portions of the new law are phased in during the next several years.

Paperwork burdens aren't the result of IRS bureaucrats mindlessly dreaming up new forms and regulations. Much of the new increase is due to a flood of new tax laws. These laws did cut tax bills for middle-class taxpayers, but significantly increased their paperwork. Recent legislation keeps adding to the complexity. For example, the IRS reported that "the Energy Policy Act (Public Law 109-58) required over 600 changes to 107 tax products (tax forms, instructions, and publications) and [seven] new forms."

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Even several years after their passage, new tax laws can add to the compliance load. According to the 2008 *Information Collection Budget*:

In FY 2007, the most significant statutory burden increase resulted from the Department of the Treasury's implementation of the American Jobs Creation Act of 2004. This required IRS to revise the Individual Taxpayer Tax Return, including the addition of Form 5695, Residential Energy Credits.

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 planning undoubtedly adds many millions of hours to the time spent coping with the tax system.

### **New Paperwork Estimates Make Long-Term Comparisons Impossible**

The IRS has substantially changed the way it estimates tax preparation time. In developing the new methodology, the agency also notes that "comparisons should not be made between [this year's estimates] and earlier published estimates." Nonetheless, NTU can examine the estimates from 2004 and prior years when the old methodology was used – and they've documented a stunning rise in complexity.

### **Historical Data: Time Spent to Prepare and File Tax Returns**

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 2004, the average paperwork time burden climbed from 17 hours and 7 minutes to 26 hours and 48 minutes, an increase of 57 percent. The time burden increased by 26 percent from 1995 to 2004.

## History of Estimated Preparation Time, 1040 Forms 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
<b>Form 1040 and Schedules A, B, and D</b>					
2004	7:18	7:15	10:34	1:41	26:48
2003	7:52	7:25	11:25	1:48	28:30
2000	7:52	7:16	10:05	1:49	27:02
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
<b>Form 1040 Only</b>					
2004	2:46	3:58	6:17	0:34	13:35
2003	2:46	3:51	6:18	0:34	13:29
2000	2:45	3:25	6:16	0:35	13:01
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 became much more complicated. The 1040A and Schedule 1 (interest and dividend income) saw a paperwork burden increase of 44 percent between 1995 and 2004.

## 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
<b>Form 1040A and Schedule EIC</b>					
2004	1:10	3:29	5:26	0:54	10:59
2003	1:10	3:35	5:31	0:54	11:10
2000	1:10	3:05	5:11	0:54	10:20
1995	1:04	2:25	3:02	0:40	7:11
1992	1:42	2:24	3:20	1:22	8:48
<b>Form 1040A and Schedule 1</b>					
2004	1:29	3:32	5:26	0:54	11:21
2003	1:29	3:38	5:31	0:54	11:32
2000	1:29	3:08	5:11	0:54	10:42
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
<b>Form 1040A Only</b>					
2004	1:10	3:28	5:13	0:34	10:25
2003	1:10	3:34	5:18	0:34	10:36
2000	1:10	3:04	4:58	0:34	9:46
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 1040EZ Form, the simplest in the IRS inventory, required 3 hours and 46 minutes for the last tax year reported, up from 1 hour and 31 minutes in 1988 (a jump of 148 percent).

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### 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
2004	0:04	1:41	1:41	0:20	3:46
2003	0:04	1:40	1:39	0:20	3:43
2000	0:05	1:38	1:50	0:20	3:53
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

As future tax seasons move their way forward, more comparative data will be available to measure tax complexity's ongoing toll.

### Experts Agree They Can't Agree on Tax Bills

The Tax Code is so convoluted that no one inside or outside the IRS understands it.

In 2007, *USA Today* asked five professionals to calculate a family's tax bill. And of course, they all got a different answer! After reviewing each other's work, they couldn't agree on who was right. The newspaper reported, "As the Tax Code turns ever more unwieldy, deciphering it has become more art than science, tax experts say."

The person who designed the test had the highest tax bill for mom and dad, but the lowest overall family tax bill.

He got the biggest refund for the family by having the "23-year-old [son] claim his 16-year-old sister as a dependent." This anomaly is the result of some tax goof-up in Congress, and is entirely legal, if a bit strange.

As *USA Today* reported:

In 2004, Congress sought to clarify the definition of a 'qualifying child' for parents and others who claim various tax breaks. In the process, though, lawmakers inadvertently created a loophole: It lets young working adults who are living with their parents claim younger siblings.

For many years, *Money* magazine's annual test of tax preparers for a hypothetical

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household proved that paid professionals often make huge mistakes. In 1998, the last year *Money* administered the test, all 46 tested tax professionals got a different answer, and none got it right. The professional who directed 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 professionals “ranged from \$34,240 to \$68,912.” The closest answer still erred in the government’s favor by \$610.

Information revealed from a recent GAO report provides little comfort that the inaccuracies among preparers have dramatically improved. GAO auditors, posing as taxpayers, retained the services of major tax preparation firms at 19 outlets in a major metropolitan area, and found:

- 10 of the 19 preparers failed to report business income information.
- In five of the 10 instances where the “client” *might* qualify to claim the Earned Income Credit, preparers claimed an ineligible child.
- Preparers filed inadequate deductions or failed to itemize in seven of nine applicable cases.

GAO noted that had the IRS review these mock returns, several of the preparers could owe serious penalties for their mistakes.

Alas, just like *Money* magazine’s test, GAO could not guarantee that its own findings were on the mark. After consulting with Congress’s JCT to develop “correct” answers to the scenarios the auditors were to pose, JCT “cautioned that a paid preparer might reach a reasonable conclusion different from JCT’s on certain issues....”

The April 2010 edition of *Tax Savings Report*, a publication of NTU’s research affiliate, described just one of the many bizarre quirks in the laws with which taxpayers might have to contend. Nationally recognized tax expert Bill Bischoff authored an article which outlined the tax implications of converting a home into a rental property, and the complexities involved in determining the tax basis for purposes of depreciation and tax losses once the property is sold. As Bischoff noted:

When selling, the tax results might surprise you. *Reason:* You must use the ‘special basis rule’ to calculate any deductible tax loss, but use the ‘regular basis rule’ for purposes of calculating any taxable gain. If following these two rules results in two different basis numbers, you can potentially wind up in no man’s land where you have neither a tax gain nor a tax loss. That will happen when the sale price falls between the two basis numbers.

Based on the complexity of the examples Bischoff used to illustrate his point, it’s clear that some taxpayers might go through a series of costly and time-consuming tax-calculation gymnastics, only to have no reportable transaction.

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## **Tax Software Often Doesn't Compute**

A disturbing number of reports give anecdotal evidence that computer tax preparation software often comes up with the wrong tax. In March 2009 *PC World* performed a *Money* magazine-style test updated for the information age. In this case the hypothetical taxpaying family was a couple with: one child, base income of \$100,000, an additional \$1,000 of interest income, \$6,000 of IRA contributions, and deductions for child care, student loan interest, and mortgage interest. The family also made donations of clothing and household items, sold some stock they acquired that same year, and sold a modest vacation home. *PC World* then ran the scenario through five of the most popular online self-guided tax preparation sites, and found:

Each site told us that the family owed a different amount in taxes, and the difference between the lowest and highest bill was almost \$2000, or about 10 percent of the family's total tax bill.

Which site was correct? It's hard to say. The disparity in the returns (on a total tax bill of more than \$20,000) stemmed from the instructions the tax sites provided (or failed to provide), but it also reflected a lack of concrete guidance from the IRS.

Other software reviewers report different but still troubling problems. On March 14, 2010, the *Washington Post's* Personal Technology Columnist Rob Pegoraro reported, "It's alarming and maddening, then, if you cannot count on two different tax applications to yield the same figure. But that's what happened in both last year's review of tax-prep programs and in this year's test." This year the two online programs tested with fairly simple returns showed a \$13 difference. He did not test complicated returns, but the variance hardly builds confidence.

On April 7, 2010, the *New York Times* report noted that "a flaw in the most recent version of TurboTax, the nation's most popular tax-preparation software, may have caused thousands of retired federal employees to overstate their medical deductions and unwittingly underpay" the IRS by hundreds of dollars. A taxpayer who noticed an odd result actually was the one to report the error. The error was reported by a taxpayer who noticed an odd result. Government auditors were initially unable to duplicate the error, but after press inquiries the IRS issued a statement confirming the error.

Despite the widespread press accounts of software not adding up, it appears the government has not checked tax software for errors in at least the last five years.

## **Incentives Needed for Simplification**

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

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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 do a more thorough job of harnessing volunteer activity and give a broad group of people on the inside and outside of government much more incentive to work for the adoption of simplification rules. This quadrennial commission would also give the JCT 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 even 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.

But is such a sweeping effort even possible in the current political and economic environment? The short-term outlook is grim but not hopeless. Last year, the Obama Administration announced that it would appoint a commission to make tax reform recommendations for the President by December of 2009. The President's Economic Recovery Advisory Board (PERAB), led by former Federal Reserve Chairman Paul Volcker, included economic luminaries of many ideological persuasions, including former Reagan and Clinton Administration officials. Although the board was given a fair amount of latitude for its recommendations, a spokesman for the Administration mentioned that several goals of the overview would be to "protect progressivity in the revenue base, close tax loopholes, and find ways to reduce tax evasion." These can be politically loaded terms that have nothing to do with reducing complexity.

PERAB has since evolved into an ongoing entity whose recommendations range outside the purview of conventional tax policy, but as NTU reminded panel members in comments submitted during October of last year, systemic tax simplification would be a benefit to the country because "the unbalanced lawmaking and electoral processes that too often serve *special* interests would be replaced with a new dynamic that works in the *national* interest."

Another path to tax reform was begun a few years ago and continues to show modest promise today. In late 2006, Senator Ron Wyden (D-OR) reached out to liberal and conservative organizations with a long history of involvement in tax issues to help form the Cleanse the Code coalition. Some of these groups participated in the 1986 tax reform campaign that broadened the base of the income tax while lowering and simplifying rates. The signatories ranged from the Progressive Policy Institute to the American Conservative Union, from the National Taxpayers Union to Citizens for Tax Justice, from Taxpayers for Common Sense to the Center on Budget

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and Policy Priorities. All of the groups rallied around three principles that will “provide guidance for debate as we move forward with a substantial revision to the U.S. Tax Code:”

- **Simplification, Transparency, and Certainty.** “Most taxpayers should be able to calculate their taxes on a single form or no form at all, and in most cases by themselves, with a few hours or less of preparation. ... A more transparent Tax Code would make it easier for individuals and businesses to pay the taxes that they owe, and for the IRS to help them comply with their obligations under the Tax Code.”
- **Opportunity for All Americans to Get Ahead.** “All Americans deserve a fair tax system that gives them a chance to get ahead in a marketplace economy. A Tax Code riddled with loopholes is not fair. Any reform effort needs to ... ensure that special preferences are not given to the few at the expense of the many.”
- **Fiscal Responsibility.** “...[O]ver the long-term the amount of revenue government collects and spends cannot be determined independently from each other. As a result of this interplay of revenue and spending, the goal of tax reform must be pursued in a fiscally responsible manner.”

In February of 2010, Wyden joined Senator Judd Gregg (R-NH) in unveiling legislation reflecting these tenets: The Bipartisan Tax Fairness and Simplification Act.

Although NTU also supports more comprehensive legislation to do away with the current tax structure in favor of a flat tax or national retail sales tax, the Wyden-Gregg bill’s overall approach is both sensible and principled: reduce the rates, simplify the base, and streamline the rules. NTU is especially supportive of the bill’s provisions to repeal the personal and corporate Alternative Minimum Tax, abolish the Personal Exemption Phaseout and Pease limits on itemized deductions, consolidate and expand retirement savings vehicles, and establish a single, low corporate tax rate.

Policymakers should bear in mind the tremendous burden that tax complexity imposes on the process of filing as well as paying taxes. 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 far better off with fundamental tax reform.