

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

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**By David Keating  
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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 older tax documents reveals just how shockingly complicated taxes have become today.

The 1040 form is often filed with Schedules A, B, and D, where taxpayers report itemized deductions, interest and dividend income, and capital gains. These four common forms now take an estimated 28 hours and 30 minutes to prepare. The 1040A, or “short” form, and its Schedule 1 now take nearly as long to prepare, at 11 hours and 32 minutes, as the “long” form of just nine years ago did.

Today’s short form, at 48 lines, has double the number of lines on the 1945 version of the standard 1040 tax return.

The increase in the tax law’s complexity alone has added roughly 1 billion hours in annual paperwork burdens over the last 10 years.

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

Let’s begin our tour of the tax law’s complexity by looking at the growth of Form 1040 over the years. Sixty-eight 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 131 pages of instructions, over triple the number in 1975 and more than double the number in 1985, the year before taxes were “simplified.”



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## Form 1040 - Form and Instructions

Tax Year	Lines/1040	Form Pages/1040	Instruction Booklet Pages/1040
2003	73	2	131
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 anything, this table understates the growing complexity of the form. For example, this year many “lines” have their own sub-lines for parts a, b, c, or even d. The form also asks for information without numbering the line item, such as check boxes for Presidential campaign funding and a personal ID number you select for a “third party designee” if you want the IRS to ask someone else about what you filed on your tax return.

If you need help beyond the basic form, the IRS now prints at least 1,000 publications, forms, and instructions.

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

As the tax system’s complexity has grown, more taxpayers are turning to their computers or running to tax professionals to prepare their returns. The number of taxpayers using paid professionals has soared by 63% since 1980 and by 30% since 1990. While some of this increase can be attributed to rising incomes, most of it is likely due to complexity.

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	57.5%
2001	59.4%
2002	60.2%
2003*	62.1%
*Through April 2.	

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, 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 87% of all 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%
1997	70.5%
1999	76.3%
2000	78.4%
2003*	88.4%
*Through April 2.	

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## **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. 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 boasted that its "average fee per retail office client was \$136.08, an increase of 8.2%." Between 1980 and 2003, the average H&R Block tax preparation fee increased 311%, or 77% 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, 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	Adjusted for Inflation, 2003 Dollars
1980	\$27.36	\$63.49
1985	\$45.39	\$78.40
1990	\$49.99	\$71.51
1995	\$61.77	\$74.95
2000	\$101.40	\$109.34
2004*	\$136.08	

\*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.

## **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 2001 law's long phase-out of the death tax will cause new tax planning headaches.

Worst of all is the growing prospect that by 2010, an estimated 32 million taxpayers will be forced to complete a second tax return for the Alternative Minimum Tax (AMT), a parallel and complex tax system once aimed at ensuring the rich paid a substantial tax bill. As if one tax return wasn't difficult enough already.

This tax complexity monster is already striking unsuspecting taxpayers, some earning less than \$50,000 per year. The IRS National Taxpayer Advocate notes 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, then fill out a 65-line form (up eight lines since last year), only to discover they don’t owe the AMT. This exercise is a major detour in tax preparation, with an estimated paperwork burden of over 3.5 hours for this one form alone. No wonder over 80% of taxpayers who owed the AMT paid a tax pro to compute their taxes.

Even the tax pros complain about this strange and complicated tax. The National Association of Enrolled Agents, the leading tax preparation trade group, labeled the AMT as the most complicated aspect of the tax law, giving it the “Tax Headache of the Year” citation.

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

The best solution for the AMT is to simply get rid of it altogether, a solution even 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 for income growth to avoid a tax complexity nightmare for taxpayers and the IRS.

### **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, 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.

An earlier Paperwork Reduction Act passed in 1980 required federal agencies to track the paperwork burden imposed on citizens and businesses 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. 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%.”

Last year the government for the first time separately published paperwork burdens for the IRS. According to the Office of Management and Budget, the “Internal Revenue Service paperwork [burden] is currently estimated to total approximately 6.7 billion hours.” Tax form paperwork burdens alone account for just over 80% of the total paperwork burden hours of the entire federal government.

**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
2001	6,415.85			

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 have declined to 3.702 billion hours in 2000. Instead, the Treasury overshot that target by 2.429 billion 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, the Economic Growth and Tax Relief Reconciliation Act of 2001, and the Jobs Growth and Tax Relief Reconciliation Act of 2003. These laws did reduce tax bills for middle class taxpayers, but significantly increased their paperwork burdens. The 1997 Taxpayer Relief Act added an estimated 92 million hours to the paperwork burden, and the 2001 law added 214 million hours in 2001 alone.

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 2003, the average paperwork burden hours climbed from 17 hours and 7 minutes to 28 hours and 30 minutes, an increase of 67%. The time burden has increased by 34% 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
<b>Form 1040 and Schedules A, B, &amp; D</b>					
2003	7:52	7:25	11:25	1:48	28:30
2002	7:52	7:26	10:42	1:48	27:48
2001	7:52	7:16	11:10	1:48	28:06
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
<b>Form 1040 Only</b>					
2003	2:46	3:51	6:18	0:34	13:29
2002	2:46	3:45	6:05	0:34	13:10
2001	2:46	3:30	6:37	0:34	13:27
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 much more complicated. The 1040EZ form, the simplest in the IRS inventory, now requires 3 hours and 43 minutes, up from 1 hour and 31 minutes in 1988, a jump of 145%. The 1040A and Schedule 1 (interest and dividend income) has seen a paperwork burden increase of 46% 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
<b>Form 1040A and Schedule EIC</b>					
2003	1:10	3:35	5:31	0:54	11:10
2002	1:10	3:21	5:03	0:54	10:28
2001	1:10	3:10	5:28	0:54	10:42
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
<b>Form 1040A and Schedule 1</b>					
2003	1:29	3:38	5:31	0:54	11:32
2002	1:29	3:24	5:03	0:54	10:50
2001	1:29	3:13	5:28	0:54	11:04
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
<b>Form 1040A Only</b>					
2003	1:10	3:34	5:18	0:34	10:36
2002	1:10	3:20	4:50	0:34	9:54
2001	1:10	3:09	5:15	0:34	10:08
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 for a hypothetical 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 not one got it right. The pro 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 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
2003	0:04	1:40	1:39	0:20	3:43
2001	0:04	1:42	2:05	0:20	4:11
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 Restructuring and Reform 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.

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## **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**

David Keating is Senior Counselor for National Taxpayers Union, and previously served on the National Commission on Restructuring the Internal Revenue Service.