

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

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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 may soon get even worse.

The most recent estimate of the current paperwork burden generated by the Treasury Department, nearly all accounted for by the Internal Revenue Service (IRS), now totals 6.38 billion hours, according to data from the Office of Management and Budget (OMB). That is the equivalent of about 3.19 million employees working 40-hour weeks year-round with just two weeks off. Incredibly, it comes close to the number of workers at the four biggest retailers among Fortune 500 companies – more than all the workers at Wal-Mart Stores, McDonald's, Target, and Kroger combined! It's more than triple the number of workers employed at the top four banks -- Bank of America Corp., Wells Fargo, Citigroup, and J.P. Morgan Chase & Co.

If this unseen army of taxpayers worked full-time as an occupation in tax compliance, it would be the third-largest occupation in the country, just slightly behind "Cashier," but larger than the number of all the office clerks nationwide. It's more than double the number of elementary school teachers and ten times the number of mail carriers.

Americans spent more than 6 billion hours complying with our federal tax laws. Since time is money, that adds up to a jaw-dropping \$194.3 billion, when calculated with the most recently reported average employer cost for civilian workers by the Bureau of Labor Statistics: \$30.45 per hour. Add in the \$34.1 billion spent on tax software and other out-of-pocket costs for individuals and the total compliance cost is \$228.4 billion a year.

These costs do not account for numerous hours taxpayers spend on state and local taxes, pursuing tax minimization strategies, or responding to IRS notices and audits; nor do they include the huge "growth penalty" imposed on the nation's economy by high tax rates.

The over \$30 billion in costs consists of tax software, tax preparers, postage, and other out-of-pocket costs, according to the most recent IRS regulatory filing.

Counting this money, plus the component in the time figure above pertaining just to non-corporate filers, the compliance burden would total \$115.7 billion for individual taxpayers alone.

The most recently published Tax Code, from January 7, 2011, had a mind-boggling 3,939,937 words, an increase of more than 102,000 words from February 1, 2010. To put the increase in perspective, according to Wikipedia, “Many universities limit Ph.D. theses to at most 100,000 words, barring special permission for exceeding this limit.”

Furthermore, those 3.9 million words are about seven times the length of Leo Tolstoy’s *War and Peace*, one of the longest novels ever written. Significant tax changes from 2011 have yet to be assimilated into the government’s official Tax Code, but you can bet the next publication will have thousands more words.

And that’s just the law. To help provide additional detail there are 20 volumes of regulations spanning 14,327 pages with 10.1 million words, meaning the law and regulations now top 14 million words in all.

When accounting for all taxpayers – from those who file the simplest 1040EZ to those filing the “long” Form 1040 and its many associated schedules – the average compliance time is 18 hours, up from 17.3 hours two years ago. However, most of the change is due to yet another refinement of the methodology for measuring the paperwork burden. Out-of-pocket costs per individual taxpayer (again, using any of the 1040 series) are expected to average \$230. It is important to remember that such costs include those who do their own taxes as well as those who go to paid preparers.

The IRS reported that taxpayers made an astounding 10.6 million math errors in 2010. However, the problem goes both ways: the National Taxpayer Advocate has observed that “IRS math error notices also are sometimes inaccurate.”

Line by Line, Complexity Is Rising

Ever since being charged with making an annual evaluation of “The Most Serious Problems Facing Taxpayers,” the IRS National Taxpayer Advocate has repeatedly 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 December 2010 report, where she writes, “The National Taxpayer Advocate on numerous occasions has identified the complexity of the Tax Code as the most serious problem facing taxpayers and urged Congress to simplify it.”

The National Taxpayer Advocate’s December 2011 Annual Report to Congress notes that:

[T]here had been approximately 4,428 changes to the code over the preceding ten years – an average of more than one a day, including an estimated 579 changes in 2010 alone. For every one of these changes, the IRS must explain the new provision to taxpayers, write computer code so it can process returns affected by the provision, and train its auditors so that improper claims can be identified.

Seventy-five 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. Today, taxpayers must wade through 189 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 87 pages, more than the long form’s entire booklet from 1995!

Form 1040 – Form and Instructions

Tax Year	Lines/1040	Form Pages/1040	Instruction Booklet Pages/1040
2011	77	2	189
2010	77	2	179
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. 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.

Need help with all these tax forms? The IRS now lists some 2,040 publications, forms, and instructions for download from its website – up from the 1,770 NTU logged in 2009. Calling the tax agency could be an equally daunting proposition. Last month a Government Accountability Office (GAO) interim report on the 2012 tax filing season found that the average wait time for the IRS’s telephone assistance line was 17 minutes.

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*, which according to its introduction “covers the general rules for filing a federal income tax return.” Even though the IRS has previously warned that Publication 17 “does not cover every situation,” the current tax year 2011 version manages to encompass 304 pages (counting the cover). These are massive documents for everyday taxpayers, and they’ll likely become heftier.

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 scorekeeping rules make comparisons with prior years impossible. While the IRS’s new completion-time method may not mesh with past statistics or even 2011, the data still show that compliance with tax laws continues to demand too much time and money.

Form 1040 - Form and Instructions Time Spent, Tax Year 2011 (in Hours)

<i>By Form:</i>	
1040	22
1040A	10
1040EZ	7
<i>By Taxpayer:</i>	
Non Business	12
Business	32

For many years OMB has published an Information Collection Budget tracking the compliance burdens of federal laws and regulations on individuals and businesses. Here again, because the agency relies on the IRS’s revised scorekeeping, multi-year analyses of paperwork burdens are not viable. Normally, many factors affect these figures, some from acts of policymakers, and others due to economics and demographics. For example, in a slow economy the number of households liable for completing a tax return can actually drop because their incomes fall below established filing thresholds.

But even an examination of the most current year’s Information Collection Budget shows that the tax laws generate a greater volume of red tape for citizens than anything else Washington does. As OMB states in its latest report:

Paperwork burdens vary greatly across agencies, and to obtain a full picture, it is important to identify those variations. For example, the Department of the Treasury by itself accounted for 6.3 billion hours of burden in FY 2010, or nearly 72 percent of the total. No other agency accounted for more than 7 percent of the total burden.

While certain components of paperwork estimates will ebb and flow, ultimately Congress is responsible for most of the upward movement. All told, according to OMB, statutory acts alone (as opposed other reported “adjustments”) increased the government-wide regulatory burden in Fiscal Year 2010 by 351.8 million hours. Changes under the Treasury’s rubric accounted for 301.7 million hours, or 86 percent, of the total.

Not only do taxes take too long to prepare, it costs money to pay your taxes too, according to official IRS estimates.

Average Costs, Tax Year 2011 (in dollars)

<i>By Form:</i>	
1040	\$290
1040A	\$120
1040EZ	\$50
<i>By Taxpayer:</i>	
Non Business	\$150
Business	\$410

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 shelling out \$290 for out-of-pocket costs such as software, professional help, copying, etc.

U.S. Tax Compliance Time Burden Ranks 66th Worldwide

The United States now ranks an embarrassing 131st out of 183 countries worldwide in total tax rate, a decline from 124th in the previous year’s report. Additionally, the U.S. ranked 66th worldwide for time spent complying with corporate tax filings, according to “Paying Taxes 2012,” a study jointly published by the accounting firm PricewaterhouseCoopers and the World Bank Group. In this analysis, a ranking of “1” would mean a country’s economy had the *lowest* rate and *least* onerous compliance regime, respectively.

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, the company in Canada (131 hours), Hong Kong (80 hours), the United Kingdom (110 hours), and France (132 hours), all devote less time to paying taxes.

Tellingly, the U.S. did even worse when ranked by total tax rate alone – 131st out of 183, dropping from 124th in 2011, 118th in 2010 and 92nd out of 181 in 2009. Thirty-three countries made corporate taxpaying easier last year by cutting rates or streamlining filing processes. Unfortunately, America could not be counted 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 submit their tax returns electronically.

GE's tax return may be even longer today. When NTU's researchers contacted GE's media relations staff in 2010, 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 two-thirds since 1980 and by roughly one-fourth 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 short-term relief) the rising 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
2007**	58.6
2009***	60.0

1980 to 2000 Data: Taxpayer Usage Study report of the IRS.

* Preliminary Taxpayer Usage Study data as of March 17, 2006.

** IRS Statistics Of Income Division – Historical Data Tables, 2010.

***Treasury Inspector General for Tax Administration Report 2012-40-001, Jan. 2012.

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, more than 90 percent of returns are prepared with such assistance – a telltale sign of the tax complexity problem.

Use of Paid Preparers and Computers

Tax Year	Paid Preparer plus Computer Prepared Returns (Percent)
1980	38.0
1996	66.4
2000	78.4
2005*	90.4
2009**	92
1980 to 2000 Data: Taxpayer Usage Study report of the IRS. *Preliminary Taxpayer Usage Study data as of March 17, 2006. ** Treasury Inspector General for Tax Administration Report 2012-40-001, Jan. 2012.	

Tax Preparation Costs and Fees Are Rising

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. In 2011 the company’s average fee per client declined slightly, but that’s because H&R Block was barred from offering Refund Anticipation Loans, which significantly add to the fees the company can charge many of its clients. 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 more than 30 percent. The company has not yet announced average fee results through March of 2012.

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 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
2008*	\$170.28
2009*	\$183.79
2010#	\$187.93
2011#	\$179.07

*Through March 15.
#Through March 30.
In 2004, H&R Block appears to have changed its method for calculating its average fee. These figures include other services, such as Refund Anticipation Loans (except no Refund Anticipation Loan services were included for 2011 and later).

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 and Schedule

Form	Fee
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
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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 legislation signed into law in 2001 and 2003 cut tax rates, both increased complexity – as did their temporary extension, which is 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 a political desire to obfuscate about tax increases. For example, President Barack Obama has proposed to limit tax deductions 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, as would surtaxes scheduled to take effect in 2013 as a result of the 2010 health care law.

The return of the estate and inheritance tax – repealed for 2010 – will cost the economy billions of dollars in deadweight losses. Congress and the President agreed in late 2010 to extend income tax rates for two years and create an interim death tax rate and exemption. With the increasing uncertainty about the death tax’s future once the current rate of 35 percent and exemption of \$5 million expire in next year, 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 111th Congress*. This alone spanned 747 pages, up from the 642 pages in the prior Congress!

But we haven’t seen anything yet. Earlier this year, JCT reported that 56 separate tax law provisions are expiring in 2012, not counting special disaster relief provisions. Many of the expiring items would be addressed in what has become an annual rite in Washington – “tax extenders” legislation.

The Alternative Minimum Tax

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, which already snares over 4 million taxpayers. The Congressional Budget Office’s baseline projects that under laws presumed to be in effect by 2022, more than 47 million tax filers will be affected by the AMT. 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 54-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 (outside of periodic "patches" to provide temporary relief). Over time, the AMT identifies a growing number of taxpayers as "rich" even though their real incomes haven't changed.

Congress and the President waited until December 2010 to decide whether to enact another "patch" sparing millions of Americans from having to wrestle with the AMT. Based on past experience – including a law enacted in the final weeks of 2007 – the IRS proceeded with reprogramming and testing its systems earlier in 2010 with the assumption that Congress would eventually get around to renewing the AMT protections. Yet, this proved to be a pyrrhic victory, because lawmakers approved several other extensions the IRS hadn't planned on processing. As a result, millions of taxpayers – including those reporting itemized deductions on Schedule A of Form 1040 – were told to wait until mid-February of 2011 to begin filing their returns.

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 cannot or will not 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.

New Paperwork Estimates Make Long-Term Comparisons Impossible

The IRS has substantially changed the way it estimates tax preparation time and continues to make adjustments. In developing new methodologies, the agency cautioned that "comparisons should not be made between [current 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

Form 1040 is often filed with Schedules A, B, and D, where taxpayers report itemized deductions, interest and dividend income, and capital gains. From 1988, when the IRS started tracking this information, to 2004, the average 1040 paperwork time burden climbed from 17 hours to more than 26 hours, an increase of 57 percent.

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
Form 1040 and Schedules A, B, and D					
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
Form 1040 Only					
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
Form 1040A and Schedule EIC					
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
Form 1040A and Schedule 1					
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
Form 1040A Only					
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

Form 1040EZ, 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).

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 come and go, more comparative data will be available to measure tax complexity's 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* famously 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 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 GAO report issued in 2006 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 reviewed 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 Internal Revenue Service runs a Volunteer Program that serves “low-income to moderate-income, elderly, disabled, and limited-English-proficient taxpayers,” according to the Treasury Inspector General for Tax Administration (TIGTA). TIGTA audited the program for accuracy and in an August 2011 report noted that “Of the 36 tax returns prepared for TIGTA auditors, only 14 (39 percent) were prepared correctly.”

The April 2010 edition of *Tax Savings Report*, a newsletter formerly published under the National Taxpayers Union Foundation, 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 wrote:

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.

The confusion continues. In the tradition of *Money*’s test, this month writer Joel Stein held his own “contest” among four tax preparation services for a feature in *Bloomberg Businessweek*. Using his own personal financial circumstances, Stein quizzed TaxSlayer.com (an online self-preparation site), H&R Block, his regular accountant in Staten Island, New York, and RBZ, an accounting firm in Los Angeles. The results were all over the map. By one reckoning (RBZ) he owed the feds as much \$2,592, while at the other end he had a refund of \$92,309 coming (TaxSlayer.com). After his visit with H&R Block, Stein took another turn on TaxSlayer.com and wound up with a smaller federal refund than initially indicated – \$16,695. The federal refund would have been more than offset by what he owed the state of California.

Tax Software Doesn’t Always Compute

A disturbing number of reports give anecdotal evidence that computer tax preparation software can come 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.” 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 in the clarity of tax laws.

On April 7, 2010, a *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. Government auditors were initially unable to duplicate the scenario, but after press inquiries the IRS issued a statement confirming the error.

In 2011, IDG News Service reported that a TurboTax programming error “recently resulted in a number of Ohio residents receiving letters indicating that eye-popping sums were en route – in one reported case, a cool \$200 million.” The flaw was quickly fixed by the manufacturer.

Despite these and other press accounts of software not adding up, it appears the government has not checked tax software for errors in at least the last six 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.

The National Commission on Restructuring the IRS suggested that Congress consider a quadrennial simplification process, which could be implemented through legislation or 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 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.

One scheme that would take tax simplification in the wrong direction is the “return-free” concept, which would effectively allow the IRS to create returns for taxpayers to sign. Aside from the potential for bureaucratic foul-ups and putting the tax collection agency in the tax preparation business, an NTU letter to Congress warned late last year that:

One overarching goal of fundamental tax reform should be a system that allows all Americans to understand how their individual tax liabilities are calculated and allows them to hold their elected officials accountable for such liabilities. Return-free subverts the concept of transparency by further placing the machinery of the tax laws away from

public view – in the process condemning informed debate over the proper size of government to an obscure periphery of the public square.

NTU-backed legislation known as the Freedom to File Protection Act has been introduced in this Congress.

Conclusion: A New Approach to Taxes Is Needed

Fundamental overhaul of our tax system remains a national priority. As the Internal Revenue Code becomes increasingly incomprehensible, the intrusive measures provided to the IRS for enforcing it become even more disturbing. 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. The trend will accelerate as additional portions of the 2010 health care law – particularly the individual mandate – take effect. 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. Meanwhile, our economy continues to suffer needless compliance costs that divert resources away from innovation and investment.

But is such a sweeping effort even possible in the current political and economic environment? Election-year posturing and institutional inertia notwithstanding, there are occasional signs for encouragement. This year House Budget Committee Chairman Paul Ryan (R-WI) proposed an ambitious plan that includes a simplified two-bracket personal tax with rates of 10 and 25 percent, as well as a streamlined corporate tax featuring a 24 percent federal rate. President Obama's budget calls for a 28 percent corporate rate, though with serious tinkering (in sectors like energy) that would still let government pick winners and losers through tax policy. More comprehensive approaches include replacing the personal and corporate system with a flat-rate arrangement or a consumption tax. The latter proposal is reflected in the Fair Tax Act authored by Rep. Rob Woodall (R-GA) and Saxby Chambliss (R-GA) with 66 House and eight Senate cosponsors, respectively. NTU has long supported this legislation. 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 included the Progressive Policy Institute, American Conservative Union, National Taxpayers Union, Citizens for Tax Justice, Taxpayers for Common Sense, and the Center on Budget 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.”

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- **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 2011 Senator Wyden joined Senator Dan Coats (R-IN) in unveiling legislation reflecting these tenets: The Bipartisan Tax Fairness and Simplification Act of 2011. 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. Still, the legislation has its flaws, such as continuing the uncompetitive policy of double-taxing income earned abroad by U.S. citizens and businesses. Every other major industrialized country shuns this practice in favor of a “territorial” tax system.

Though there are many obstacles to reaching the simpler and less burdensome Tax Code Americans deserve, bipartisan efforts continue to make gradual inroads. The Reforming America’s Taxes Equitably (RATE) Coalition has recently been formed to unite Republicans and Democrats behind a prudent cutback in the uncompetitive federal corporate tax rate.

Aside from the burden of paying taxes, the burden of filing taxes has become onerous in its own right. For the sake of our personal freedom and a more productive economy, policymakers must reform our tax system and reduce its complexity.

About the Author

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