

## **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 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 7.64 billion hours, according to data from the Office of Management and Budget (OMB). That is the equivalent of about 3.82 million employees working 40-hour weeks year-round with just two weeks off. Incredibly, 3.82 million exceeds the number of workers at the five biggest employers among Fortune 500 companies – more than all the workers at Wal-Mart Stores, United Parcel Service, International Business Machines, McDonald's, and Target combined!

If this unseen army of taxpayers worked full-time as an occupation in tax compliance, it would be the second-largest occupation in the country, just behind "Retail Salesperson" but ahead of "Cashier." It's more than double the number of elementary school teachers nationwide.

This massive time expenditure adds up to a whopping \$227.1 billion, when calculated with the most recently reported average employer cost for civilian workers by the Bureau of Labor Statistics: \$29.72 per hour.

In addition to the costly time burden, individual taxpayers will directly spend a lot of money too: an estimated \$35.2 billion this year for 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 \$115.4 billion for individual taxpayers alone.

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

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The most recently published Tax Code, from February 1, 2010, had a mind-boggling 3,837,105 words, an increase of more than 52,000 words from January 5, 2009. Significant tax changes from 2010 have yet to be assimilated into the government's official Tax Code, but you can bet the next publication will have thousands more alterations thanks to the new taxes passed last year 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 its many associated schedules – the average compliance time is 19 hours, up from 17.3 hours last year. However, most of the change is due to a 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 \$250, up 10 percent. It is important to remember that such costs include taxpayers 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 last year, up from 1.3 million the previous year. Even ignoring 4.8 million errors the IRS counted in situations where taxpayers asked the IRS to figure out a complicated credit for them, there were still 5.8 million errors.

### **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 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 2010, 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.”

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 179 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
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. 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 now contains a total of 11 lines. 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 contained 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.

Need help with all these tax forms? The IRS now lists 1,999 publications, forms, and instructions for download from its website – up from the 1,770 NTU logged just two years ago.

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 warns that Publication 17 “does not cover every situation,” the 2010 version manages to encompass 295 pages. These are massive documents for everyday taxpayers, and it’s only getting worse.

**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 or even 2010, the data still show that compliance with tax laws continues to demand too much time and money.

**Form 1040 - Form and Instructions  
Time Spent in Hours**

<b><i>By Form:</i></b>	
1040	24
1040A	9
1040EZ	7
<b><i>By Taxpayer:</i></b>	
Non Business	12
Business	34

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

**Average Costs, Tax Year 2010 (in dollars)**

<b><i>By Form:</i></b>	
1040	310
1040A	130
1040EZ	60
<b><i>By Taxpayer:</i></b>	
Non Business	160
Business	430

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 \$310 for out-of-pocket costs such as software, professional help, copying, etc. Yet,

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even as these costs have generally increased, overall inflation has remained near zero. In fact, neither the tax year 2010 personal exemption nor the standard deduction (for most filers) received a customary inflation adjustment because the change in the measurement on which it was based proved too small.

### **U.S. Tax Compliance Time Burden Ranks 66<sup>th</sup> Worldwide**

The United States now ranks an embarrassing 124<sup>th</sup> out of 183 countries worldwide in total tax rate. Additionally, the U.S. ranked 66<sup>th</sup> worldwide for time spent complying with corporate tax filings, according to “Paying Taxes 2011,” a 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 Canada, Hong Kong, the United Kingdom, or France would spend just 131, 80, 110, and 132 hours, respectively.

Tellingly, the U.S. did even worse when ranked by total tax rate alone – 124<sup>th</sup> out of 183, dropping from 118<sup>th</sup> in 2010 and 92<sup>nd</sup> out of 181 in 2009. Forty economies made corporate taxpaying easier last year by cutting rates or streamlining filing processes. Unfortunately, America could not be reliably 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 file their tax returns electronically.

GE’s tax return may be even longer today. When NTU’s researchers contacted GE’s media relations staff last year, 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!

Ironically, GE, whose Chairman is regarded as an ally of President Obama, came under criticism last month when *The New York Times* reported that the company had a zero corporate income tax liability in 2010 (the firm did pay other kinds of taxes). Some said “green” tax credits pushed by the current Administration contributed to the situation, while others pointed to high U.S. tax rates that force many businesses to park their earnings overseas and pay taxes there.

After the sensational headlines, a more sober look at the situation was reported in *The Washington Post* on April 10. That article reported the following facts:

Did GE get a \$3.2 billion tax refund? No.

Did GE pay U.S. income taxes in 2010? Yes, it paid estimated taxes for 2010 and made payments for previous years. Think of it as your having paid withholding taxes on your

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salary in 2010 and sending the IRS a check on April 15, 2010, covering your balance owed for 2009.

Will GE ultimately pay U.S. income taxes for 2010? After much to-ing and fro-ing – the company says it hasn't completed its 2010 tax return – GE now says that it will.

Amidst so many claims and counterclaims, one thing seems clear: a complex corporate tax system is at the root of the issue.

### **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 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 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
2007*	58.6

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

\* IRS Statistics Of Income Division Tax Stats - Historical Data Tables, October 22, 2010.

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 90 percent of returns are prepared with such assistance – a clear 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
2009*	90
1980 to 2000 Data: Taxpayer Usage Study report of the IRS. * Estimate of U.S. Government Accountability Office.	

## 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.

This year 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 35 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 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
<p>*Through March 15.  #Through March 30.  In 2004, H&amp;R Block appears to have changed its method for calculating its average fee. These figures include other services, such as Refund Anticipation Loans (except for 2011).</p>	

### **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**

<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
<p>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.</p>	

### **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



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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.

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 2013, 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 111<sup>th</sup> Congress*. This alone spanned 747 pages, up from the 642 pages in the last Congress!

But we haven't seen anything yet. Earlier this year, JCT reported that 65 separate tax law provisions are expiring in 2011. Many of the latter 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. By 2020, nearly 38 million taxpayers will have to compute and pay the AMT. Ironically, that number will rise if the 2001 and 2003 tax rates are extended once more – 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 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 income hasn'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

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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 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 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, 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 IRS's recent 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 the management consulting firm 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			
2009	7,643.49			

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.

OMB reports paperwork burdens the federal government imposes on citizens through an annual Information Collection Budget. Various factors affect these figures, 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 incomes fall below established filing thresholds.

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.

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However, the current projections depicted in the chart above could very well increase, depending upon numerous economic, regulatory, and statutory factors. Furthermore, 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." More recently, among the "Statutes Resulting in Significant Burden Increases in FY 2009" cited in the latest Information Collection Budget (published November 2010) were the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 and the Small Business and Work Opportunity Tax Act of 2007. Together they added 10.6 million burden-hours to the pile for 2009.

These figures apparently only account for the time spent in keeping the necessary records for, 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 these types of constant concerns undoubtedly add significantly 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**

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 and 7 minutes to 26 hours and 48 minutes, 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
<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

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.

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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 a few years ago 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 April 2010 edition of *Tax Savings Report*, a publication of 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 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



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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.

### **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 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.

Earlier this year, 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 error was quickly fixed by the manufacturer.



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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 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.

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.

### **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 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. 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. The recent budget announced by Representative Paul Ryan (R-WI) calls for tax reform, and the new Chairman of the House Ways & Means Committee hopes to advance legislation to simplify taxes and reduce tax rates. In addition, the Chairmen of the House and Senate tax-writing committees recently began a joint "discussion on ideas for reforming the U.S. Internal Revenue Code."

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.

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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.”

Earlier this month, Senator Wyden joined Senator Dan Coats (R-IN) in unveiling legislation reflecting these tenets: The Bipartisan Tax Fairness and Simplification Act of 2011. Although NTU also backs more comprehensive legislation to do away with the current tax structure in favor of a flat tax or national retail sales tax, the Wyden-Coats 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. 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.

The tremendous burden that tax complexity imposes on the American people and businesses long ago exceeded reasonable bounds; and, it costs our economy huge amounts of time and direct expenses, not to mention the threat of penalties or abuse of taxpayers. 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.