

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

NTU Policy Paper 126

by
David Keating

April 15, 2009

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 compared to today's forms and instructions reveals just how shockingly complicated taxes have become.

The current paperwork burden generated by the Treasury Department, more than 90 percent of which consists of tax forms, now totals 7.75 billion hours according to data derived at RegInfo.gov. That is the equivalent of 3.7 million employees working 40-hour weeks year-round without any vacation. That's more workers than are employed at the five biggest employers among Fortune 500 companies – more than all the workers at Wal-Mart Stores, United Parcel Service, McDonald's, International Business Machines, and Citigroup combined.

Individual taxpayers alone will spend an estimated 3.8 billion hours complying with the income tax laws this year, up from 3.6 billion hours last year. Using the most recently reported average employer cost for civilian workers by the Bureau of Labor Statistics of \$29.18 per hour, this time is worth an incredible \$110.6 billion!

Individual taxpayers will spend a lot of money too: An estimated \$29.33 billion this year for tax software, tax preparers, postage, and other out-of-pocket costs, according to a November 2008 Internal Revenue Service (IRS) regulatory filing.

Counting time and money for individual taxpayers, the compliance burden would total an incredible \$140 billion for individual taxpayers alone. Keep in mind that these costs do not account for tax planning or tax minimization strategies, nor do they account for the huge costs imposed on the nation's economy by high tax rates.

A search of the most recently published Tax Code, from two years ago, shows a total of 3,692,671 words. Tax changes from 2007 and 2008 have yet to be inserted in the government's official Tax Code, but you can bet the next publication will have thousands more. If you downloaded the Code, pasted it into a Word document, and printed it, you better have plenty of paper and ink on hand because it would take 9,114 pages.

When accounting for all taxpayers – from those who file the simplest 1040EZ to those filing the “long” Form 1040 and many schedules – the IRS now puts the average compliance time at 26.4 hours, up from 25.4 hours four years ago. Out-of-pocket costs per individual taxpayer are expected to average \$209, up from \$185 (also four years ago). It is important to remember that out-of-pocket costs include taxpayers who do their own taxes as well as those who go to paid preparers.

More paperwork is generated from forms filled out by nonprofit groups, corporations and partnerships. In all, the IRS’s National Taxpayer Advocate estimates “that taxpayers spend \$193 billion a year complying with income tax requirements, which amounts to 14 percent of aggregate income tax receipts.”

The increase in the tax law’s complexity has, by itself, added well over 1 billion hours in annual paperwork burdens over the past 10 years.

Is it any surprise that 37 million taxpayers forgot to claim a tax credit in the 2007 tax filing season?

Line by Line, Complexity Is Moving Upward

The IRS National Taxpayer Advocate recently reported that the “most serious problem facing taxpayers today is the complexity of the Internal Revenue Code.” Not surprisingly, it was “Topic #1” in the report, as it was last year.

Seventy-four years ago, the Form 1040 instructions were just two pages long. Even when the income tax became a mass tax during World War II, the instructions were just four pages. Taxpayers today must wade through 161 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 48 lines, has double the number of lines on the 1945 version of the *standard* 1040 tax return. The short form’s instructions total 84 pages, equal to the long form from 1995!

Form 1040 - Form and Instructions

Tax Year	Lines/1040	Form Pages/1040	Instruction Booklet Pages/1040
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

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.

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

If a taxpayer needs help beyond the basic form, the IRS now lists 1,770 publications, forms, and instructions for download from its Web site.

New IRS Burden Methodology Confirms Tax Complexity Still Rising

The IRS recently spent several years updating its methodology to measure the compliance burden of filing tax returns. The new methods appear to be more accurate, but they make comparisons with years prior to 2004 impossible. While the IRS’s new completion-time method may not mesh with past statistics, the data for the first four years show that compliance with tax laws continues to demand more time and money.

Time Burden (in hours)

	TY 2004	TY 2008
<i>By Form:</i>		
1040	32.5	32.7
1040A & 1040EZ	9.8	10.6
<i>By Taxpayer:</i>		
Wage & Investment	13.4	14.2
Self-Employed	55.8	57.1

Since tax year 2004 (tax returns filed in 2005), the typical filer who used the 1040 long form saw his time burden rise from 32.5 hours to 32.7 hours. Self-employed taxpayers experienced an increase from 55.8 hours to 57.1 hours.

Average Costs

	TY 2004	TY 2008
<i>By Form:</i>		
1040	\$242	\$264
1040A & 1040EZ	\$62	\$73
<i>By Taxpayer:</i>		
Wage & Investment	\$97	\$114
Self-Employed	\$408	\$447

The IRS estimates that average costs for software, professional help, copying, postage, or other out-of-pocket costs related to filing taxes also have risen. 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 paid \$264 last year for out-of-pocket costs such as software, professional help, copying, etc.

Although the IRS can't conduct estimates for Tax Year 2009, other statistics in this paper suggest that these time burdens and costs are unlikely to go down significantly anytime soon.

Corporate Tax Compliance Costs Equal 54 Percent of Corporate Income Taxes

NTU estimates that the cost for compliance by corporations is \$159.4 billion. To put that figure into perspective, it represents 54 percent of corporate income taxes collected in FY 2008 and 89 percent of estimated collections for the current fiscal year.

Here is how NTU calculated this estimate. The IRS National Taxpayer Advocate reports the total paperwork burden for all income taxes is 7 billion hours (the total Treasury paperwork burden of 7.75 billion hours could include paperwork for non-income taxes as well as financial regulations). A recent IRS *Federal Register* filing indicated that individual income tax filings, including various self-employment forms, accounted for 3.8 billion hours, leaving a corporate income tax paperwork burden of approximately 3.2 billion hours for 2008. The cost of the labor was derived by adjusting a Tax Foundation estimate of the hourly wage for tax accountants for inflation to \$49.82.

U.S. Tax Burden Hours Rank 65th Worldwide

The United States now ranks an embarrassing 65th worldwide (out of 181 countries surveyed) for time spent complying with corporate tax filings, according to a 2009 study jointly published by the accounting firm PricewaterhouseCoopers and the World Bank.

The study examined tax compliance burdens faced by a hypothetical flower pot manufacturer and retailer with 60 employees. It estimates that such a company in the U.S. would spend 187 hours filing taxes. By comparison, companies in Hong Kong, United Kingdom, or France would spend just 80, 105, and 132 hours, respectively.

Tellingly, the U.S. did even worse when ranked by total tax rate alone – 92nd out of 181. A total of 36 countries made corporate taxpaying easier last year by cutting rates or streamlining filing processes. America was not among them.

The 24,000-Page Tax Return

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

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 65 percent since 1980 and by 31 percent since 1990. While some of this increase can be attributed to rising incomes, most of it is likely due to complexity.

Unless something is done to permanently address (as opposed to enacting one-year “patches”) the growing number of taxpayers subject to the Alternative Minimum Tax (AMT), the use of preparers will likely 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 for which 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
2000	57.5
2005*	61.2
2006*	62.8

Taxpayer Usage Study report of the IRS.
*As of April 10, 2009, the IRS had not made any data available on paid preparer statistics.

Tax preparation software has grown in sophistication, enabling more taxpayers to sit in front of a computer and answer a seemingly endless stream of questions while the computer figures out how to prepare the return. In 1980 no individual taxpayers used computers to prepare their taxes. Yet today, when accounting for paid preparers and computer returns combined, about nine in 10 returns are prepared with such assistance.

Use of Paid Preparers and Computer

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

Taxpayer Usage Study report of the IRS.
* As of April 10, 2009, the IRS had not made any data available on paid preparer statistics.

Tax Preparation Costs and Fees Are Rising Too

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

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

This year the company's average fee per client rose 7.9 percent. Between 1980 and today, the average H&R Block tax preparation fee increased by more than double after accounting for inflation.

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

Average Fee Charged by H&R Block

Calendar Year	Nominal Dollars
1980	\$27.36
1985	\$45.39
1990	\$49.99
1995	\$61.77
2000	\$101.40
2005*	\$145.08
2006*	\$150.06
2007*	\$160.27
2008*	\$170.28
2009*	\$183.79

*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.

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."

Form 1040 and other forms and schedules, but not Schedule A or D	\$121
Form 1040, Schedule A, and other forms and schedules, but not Schedule D	\$174
Form 1040, Schedule D, and other forms and schedules, but not Schedule A	\$125
Form 1040, Schedules A and D, and other forms and schedules	\$313
Form 1040, Schedule C or C-EZ, and other forms and schedules, but not Schedule E or F or Form 2106 or 2106-EZ	\$329
Form 1040, Schedule E, and other forms and schedules, but not Schedule C, C-EZ, or F or Form 2106 or 2106-EZ	\$685
Form 1040, Schedule F, and other forms and schedules, but not Schedule C, C-EZ, or E or Form 2106 or 2106-EZ	\$296
Form 1040, Form 2106 or 2106-EZ, and other forms and schedules, but not Schedule C, C-EZ, E, or F	\$349
Form 1040 and forms and schedules including more than one Schedule C, C-EZ, E, or F, or Form 2106 or 2106-EZ	\$866

Note: Here is a brief explanation of each Schedule listed above: Schedule A – itemized deductions; Schedule C – self-employment income; Schedule D – capital gains and losses; Schedule E – supplemental income from partnerships, rents, royalties, trusts, etc; Schedule F – farm income; and, Schedule 2106 – employee business expenses.

Tax Complexity to Get Worse

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

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

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 2010, more than 30 million taxpayers will have to compute and pay the AMT; that number will rise after 2010 if the current tax rates are extended.

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

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

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

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

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

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

By that measurement, the law has been a failure, largely due to the increasing burdens at the IRS, which accounts for nearly 80 percent of the federal government’s entire paperwork load imposed on citizens.

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

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

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

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

Paperwork Burden Hours Department of the Treasury

Fiscal Year	Burden Hours (In Millions)	Paperwork Reduction Act of 1995 Target (In Millions)	Cumulative Increase Since 1995	Compared to Target (In Millions)
1995	5,331.30			
1996	5,352.85	4,798.17	0.4 percent	554.68
1997	5,582.12	4,318.35	4.7 percent	1,263.77
1998	5,702.24	4,102.44	7.0 percent	1,599.80
1999	5,909.07	3,897.31	10.8 percent	2,011.76
2000	6,156.80	3,702.45	15.5 percent	2,454.35
2001	6,415.85			
2002	6,750.43			
2003	6,589.76			
2004	6,406.18			
2005	6,434.98			
2006	6,965.63			
2009*	7,747.24			

From the *Information Collection Budget*, Office of Management and Budget (OMB). Target hours assume Treasury Department reductions meet the law’s overall average reduction for all federal paperwork.
* Based on a search at RegInfo.gov, April 7, 2009.

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

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

As we have reported in previous years, it continues to be the case that the Department of the Treasury, in carrying out its responsibilities under the tax code, constitutes the vast majority (79 percent) of the Federal government's paperwork burden.

In turn, about 90 percent of the Treasury's burden consists of income tax paperwork.

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."

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

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

These figures apparently only account for the time spent in keeping the necessary records and learning about and complying with the law. Yet, a significant additional but uncounted burden comes from trying to exploit the law's loopholes to the maximum extent. For example, millions of citizens subscribe to personal finance publications and much of the advice offered deals with taxes. Taxpayers are often advised to consider the tax consequences of any major financial transaction, and this form of planning undoubtedly adds many millions of hours to the time spent coping with the tax system.

New Paperwork Estimates Make Long-Term Comparisons Impossible

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

Historical Data: Time Spent to Prepare and File Tax Returns

The 1040 form is often filed with Schedules A, B, and D, where taxpayers report itemized deductions, interest and dividend income, and capital gains, respectively. From 1988, when the IRS started tracking this information, to 2004, the average paperwork time burden climbed from 17 hours and 7 minutes to 26 hours and 48 minutes, an increase of 57 percent. The time burden increased by 26 percent from 1995 to 2004.

History of Estimated Preparation Time, 1040 Forms and Common Schedules

Year	Recordkeeping	Learning about the Law or the Form	Preparing the Form	Copying, Assembling, and Sending the Form to the IRS	Total
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

The 1040EZ form, the simplest in the IRS inventory, required 3 hours and 46 minutes for the last tax year reported, up from 1 hour and 31 minutes in 1988 (a jump of 148 percent).

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 grind their ways forward, more comparative data will be available to measure tax complexity's ongoing toll.

Experts Agree They Can't Agree on Tax Bills

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

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

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

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

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

For many years, *Money* magazine's annual test of tax preparers for a hypothetical household proved that paid professionals often make huge mistakes. In 1998, the last year *Money* administered the test, all 46 tested tax professionals got a different answer, and none got it right. The professional who directed the test admitted "that his computation is not the only possible correct answer" since the tax law is so murky. The tax computed by these professionals "ranged from \$34,240 to \$68,912." The closest answer still erred in the government's favor by \$610.

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

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

GAO noted that had these mock returns been reviewed by the IRS, 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....”

Apparently the introduction of computer tax preparation software has not cleared up these fundamental questions of whose conclusion is the most “reasonable.” Last month *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.

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, and Congress and the President should implement such a process either through legislation or by executive order. The Commission found that many

members of the private sector tax community were willing to volunteer substantial time to make suggestions for simplification.

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

Conclusion: A New Approach to Taxes Is Needed

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

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

Another path to tax reform was begun a few years ago and continues to show modest promise today. In late 2006, Senator Ron Wyden (R-OR) reached out to liberal and conservative organizations with a long history of involvement in tax issues to help form the Cleanse the Code coalition. Some of these groups participated in the 1986 tax reform campaign that broadened the base of the income tax while lowering and simplifying rates. The signatories ranged from the Progressive Policy Institute to the American Conservative Union, from the National Taxpayers Union to Citizens for Tax Justice, from Taxpayers for Common Sense to the Center on Budget and Policy Priorities. All of the groups rallied around three principles that will "provide guidance for debate as we move forward with a substantial revision to the U.S. Tax Code:"

- **Simplification, Transparency, and Certainty.** "Most taxpayers should be able to calculate their taxes on a single form or no form at all, and in most cases by themselves, with a few hours or less of preparation. ...A more transparent Tax Code would make it easier for individuals and businesses to pay the taxes that they owe, and for the IRS to help them comply with their obligations under the Tax Code."
- **Opportunity for All Americans to Get Ahead.** "All Americans deserve a fair tax system that gives them a chance to get ahead in a marketplace economy. A Tax Code

riddled with loopholes is not fair. Any reform effort needs to ... ensure that special preferences are not given to the few at the expense of the many.”

- **Fiscal Responsibility.** “...[O]ver the long-term the amount of revenue government collects and spends cannot be determined independently from each other. As a result of this interplay of revenue and spending, the goal of tax reform must be pursued in a fiscally responsible manner.”

Policymakers should bear in mind the tremendous burden that tax complexity imposes on the process of filing as well as paying taxes. Until we change how we tax income, we will continue to have an intrusive agency with broad powers. It doesn't have to be that way. Our economy as well as our civil liberties would be better off with fundamental tax reform.