



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 **6.7 billion hours**, according to data from the Office of Management and Budget (OMB). That is the equivalent of about 3.35 million employees working 40-hour weeks year-round with just two weeks off. Incredibly, that is more than 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 second-largest occupation in the country, just slightly ahead of "Cashier" and substantially ahead of the 2.9 million total employment in the Bureau of Labor Statistics category "Combined Food Preparation and Serving Workers, Including Fast Food." It's more than double the number of elementary school teachers and more than ten times the number of mail carriers.

The value of the labor behind the 6.7 billion hours amounts to a jaw-dropping **\$206.6 billion**, when calculated with the most recently reported average employer cost for civilian workers by the Bureau of Labor Statistics: \$30.84 per hour. Add in the \$34.1 billion spent on tax software and other out-of-pocket costs for individuals and the total is **\$240.8 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 \$34.1 billion in out-of-pocket expenses includes “tax return preparation and submission fees, postage and photocopying costs, and tax preparation software costs,” according to the most recent IRS regulatory filing.

Counting this money, plus the component in the time figure above pertaining just to individual filers for Form 1040 and supporting forms and schedules, the compliance burden would total \$116.8 billion for individual taxpayers alone.

The most recently published Tax Code had a mind-boggling 3,951,104 words, an increase of more than 112,000 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 3.95 million words are about seven times the length of Leo Tolstoy’s *War and Peace*, one of the longest novels ever written. Significant changes from tax statutes have yet to be completely 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 over 14,000 pages with 10.48 million words, meaning the law and regulations now top 14.4 million words in all.

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.” This year the Advocate has taken to highlighting the problem in a new way, with an “info graphic” on its website proclaiming, “The Time for Tax Reform Is Now.”

The National Taxpayer Advocate’s December 2012 Annual Report to Congress notes that “[T]here have been approximately 4,680 changes to the tax code since 2001, an average of more than one a day.” She pointed out, “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-plus 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 214 pages of instructions, about five times the number in 1975, and quadruple the number in 1985, the year before taxes were “simplified.”

That’s also a big jump from the number of pages in previous year’s instructions. One culprit might be the inclusion in the brochure of instructions for recently introduced forms to report investment activities and child tax credits. In the past filing season some taxpayers were required to attach multiple versions of Form 8949, “Sales and Other Dispositions of Capital Assets,” to the same return depending upon their investment circumstances.

Today’s *short* form, at 46 lines, has nearly double the number of lines on the 1945 version of the *standard* 1040 tax return. The short form’s instructions total 96 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
2012	77	2	214
2011	77	2	189
2010	77	2	179
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 2,022 publications, forms, and instructions for download from its website – up from the 1,770 National Taxpayers Union logged in 2009. Calling the tax agency could be an equally daunting proposition. A Government

Accountability Office (GAO) report on the last tax filing season (from December of 2012) found that the average wait time for the IRS’s telephone assistance line was 17 minutes. Notably, the length of “live” Customer Service Representative (CSR) calls to the IRS has increased by 19 percent since 2009. IRS officials told GAO this was due to the fact that “as more automated telephone features are added, the calls that CSRs actually answer have increased in complexity.”

But most ironically, GAO reported that the IRS itself is having trouble keeping up with its own paperwork. Of the 21 million pieces of “paper” correspondence the tax agency received last year, 40 percent was considered “overage” – meaning, the IRS failed to respond with 45 days of receipt. That’s up five percentage points from Fiscal Year 2011.

For those seeking something in between the “basic” 1040 instruction booklets and a 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 2012 version manages to encompass 292 pages (counting the cover). But taxpayers can take heart – this is a whopping 12 pages shorter than the tax year 2011 version!

This year’s 1040 tax instruction booklets contained a statistic that might be an ominous sign of things to come for taxpayers. The IRS projects that in the current filing season, 69 percent of taxpayers will use the 1040 “long” form as their primary form, up sharply from 2010 and 2008. This proportion clashes with recent tax filing statistics, which show that typically fewer than 60 percent of filers must resort to the more complex 1040 form.

Percentage of Taxpayers Filing 1040 “Long” Form

Tax Year	Percentage
2008	59.1
2010	60.9
2012	69
2008 and 2010 Data: IRS Statistics of Income Division. 2012 figure: 2012 1040 tax form instruction booklet.	

There is no single, evident reason to explain such a change, if it does indeed occur the way it appears in the instruction booklets. Should actual experience in tax filing bear this out, millions of taxpayers would be shifted into a higher category of tax form complexity.

Shifting IRS Methodologies Makes Tax Complexity More Complex

The IRS has 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. Other statistical examinations, however, are still instructive.

For many years OMB has published an Information Collection Budget tracking the compliance burdens of federal laws and regulations on individuals and businesses. Although this information also relies to some extent on IRS scorekeeping, making multi-year analyses difficult, it can provide some useful illustrations.

Normally, many factors affect these OMB 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 available 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. Treasury by itself accounted for 6.7 billion hours of burden in FY 2011, or 74 percent of the government-wide total. Most of Treasury's burden hours are the result of the implementation of tax-related statutes. No other agency accounted for more than 6 percent of total burden hours.

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 to other reported "adjustments") increased the government-wide regulatory burden in Fiscal Year 2011 by 359.5 million hours. Changes under the Treasury's rubric accounted for 345.8 million hours, or 96 percent, of the total. In a spot-on illustration of the fact that "free money" from Washington is never free, two increases in the paperwork load were 40.2 million hours from the Credit for Small Employer Health Insurance Premiums, and an extra 13.8 million hours due to the New Hire Retention Credit.

U.S. Tax Compliance Time Burden Ranks 63rd Worldwide

Tax rates and complexity certainly aren't distinguishing the U.S. among its competitors around the world. America ranked 63rd best out of 185 countries worldwide for time spent complying with corporate tax filings, according to "Paying Taxes 2013," 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 time-to-comply ranking hardly represents a great improvement – all of three places compared to 2012 (when 183 countries were surveyed).

The study examined tax compliance burdens faced by a hypothetical flowerpot manufacturer and retailer with 60 employees. It estimates that such a company in the U.S. would spend 175 hours filing taxes. By comparison, the company in Canada (131 hours), Hong Kong

(78 hours), the United Kingdom (110 hours), and France (132 hours), would devote less time to paying taxes.

Tellingly, the U.S. did even worse when ranked by total tax rate (corporate, payroll, and other taxes) alone – 132nd-best out of 185, essentially unchanged from 2012 (131/183). Four years ago, the U.S.’s ranking was 92nd out of 181, a stark indication that our country is falling behind in global tax competition. In its evaluation of the North American region, PwC noted that “Mexico is the key economy that has implemented” administrative reforms improving the area’s time to comply average, while Canada “has been the main economy driving the fall” in total tax rates.

A total of 31 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 or Computers 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 climbed by almost two-thirds since 1980 and by nearly one-fourth since 1990. While some of this increase can be attributed to rising incomes, most of it is likely due to complexity.

The growth in the use of paid preparers can be accurately tracked because 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*	59.6
2010*	56.5
1980 to 2000 Data: Taxpayer Usage Study report of the IRS.*IRS Statistics of Income Division – Historical Data Tables; 2010 figure based on preliminary data.	

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, the vast majority of forms – 9 out of 10 – are prepared with such assistance. The latest data from the IRS, for the week ending April 5, shows that 89.1 percent of all returns received this year have been filed electronically, which by definition were either completed using a taxpayer’s home computer or a paid preparer’s computer. By adding this 89.1 percent to the number of paper returns that were completed by a professional offline (or were printed off a home computer and mailed), the figure so far in this filing season would be in excess of 90 percent. This is a telltale sign of tax complexity problems.

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 fee 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. According to about.com, in 2012 the company’s average fee “per return” (including various services) was \$192, which would indicate an increase of more than 7 percent. H&R Block has been barred from offering Refund Anticipation Loans, which significantly add to the fees the company can charge many of its clients, but new services are being developed. 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 about 40 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
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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
2012**	\$192

*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). **Reported by about.com, citing H&R Block's 2012 report to shareholders.

This year a survey from the National Society of Accountants pegged the average fee for a 1040 itemized tax return with Schedule A (plus a state return) at \$246. But woe to the small business owner, who would have to pay extra for forms like the 1040 Schedule C (\$205) or the Form 1120S for a Subchapter S Corporation (\$717).

Preparer Fees Vary Widely for Different Taxpayers

Even official sources show how, schedule by schedule, the fees can add up quickly. 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	\$329

Form 2106 or 2106-EZ	
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.	

“Taxmageddon” Avoided – Or Was It?

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. Even though major portions of those laws were made permanent through the American Taxpayer Relief Act of 2012 – enacted January 2 of 2013! – this “fiscal cliff” avoidance package introduced new pitfalls. The highest statutory tax rate for 2013 will be 39.6 percent. Plus, it only extended certain provisions such as the deduction for state and local income taxes and favorable small business expensing until the end of this year, guaranteeing more “cliffs” ahead. Worse, it reestablished phase-outs of the personal exemption and itemized deductions for upper-income earners, and with it more complex filing rules. One of the few elements in the Bush-era tax relief laws to actually simplify the system was getting rid of these two claw backs.

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 cap tax deductions to their value at the 28 percent tax bracket – which will clearly raise the top tax rate higher than the 39.6 percent set by the fiscal cliff package, plus the 2010 health care law’s surtaxes that took effect this year, plus the itemized deduction limit just cemented into law! Though each of the 2013 current-law provisions – the higher rate, the “ObamaCare” surtaxes, and the limits on exemptions and deductions – was designed to hit higher earners, they will kick in at variously defined income levels from \$200,000 to \$450,000. Unlucky taxpayers who aren’t sure whether they fall over these thresholds will have a lot of work to do on their 2013 returns to determine their fate.

The 2012 taxpayer relief law was also supposed to settle the disposition of the federal estate and inheritance tax. Beginning this year, the death tax rate was permanently increased from 35 to 40 percent, while the exemption (adjusted for inflation in the future) would be set at \$5 million. Unfortunately, barely four months after he signed the fiscal cliff package, President Obama is seeking to make sharpen the tax’s bite. His budget proposes a 45 percent rate and a \$3.5 million exemption beginning in 2019. No wonder businesses and individuals have spent,

and likely will spend, a great deal of time and effort on tax minimization strategies designed to stay on the “right side” of any exemption.

At least one measurement in this “Taxing Trend” report might give taxpayers some cause for comfort. The Congressional Joint Committee on Taxation (JCT) recently published its *General Explanation of Tax Legislation Enacted in the 112th Congress*. This spanned 261 pages, making the 2011-2012 look like tax-policy pikers compared to their predecessors. JCT’s document for the 111th Congress occupied 747 pages, while the 110th publication ate up 642 pages.

But lest taxpayers get too comfortable, there will still be plenty of tinkering with the tax laws for Congress to do this year. Despite the extension of more than 50 tax provisions in January’s fiscal cliff legislation – even including a break for NASCAR – JCT reported in January that no fewer than 56 parts of the law will once again be expiring by the end of the year. These items, ranging from the American Samoa economic development credit to the three-year depreciation for race horses two years and younger – will become the subject of what is an annual lobbying ritual in Washington: “tax extenders” legislation.

As a result, taxpayers should remain concerned over future tax-filing season delays due to last minute dithering in Congress. After all, the end-of-year wrangling in Washington over the fiscal cliff caused a snafu in finalizing various compliance rules. The upshot was a pushback in tax filing until January 30, and even later for other forms.

Because Congress put off action on key tax-law questions all the way into the New Year, the IRS was saddled with even later-than-usual updates to a variety of forms. While the average taxpayer was moderately affected, the forms that were significantly held up ran a wide gamut from education credits, to mortgage interest and an electrical vehicle credit.

This wasn’t the first time tax filers were frustrated. 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 Alternative Minimum Tax (AMT, see below). 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.

In past decades, when most Americans filed paper tax returns and relied more heavily on instruction booklets through “snail mail,” tax-law changes generally had to be accommodated in the IRS’s printed materials by the fall prior to tax filing season to avoid massive confusion. Today, those paper materials are less critical as most taxpayers file electronically. Leave it to Congress, however, to test the limits of high-tech filing tools. Ultimately, these types of problems will continue to arise with a Tax Code that is too complex to handle any disruption.

Alternative Minimum Tax Threat Recedes ... and Others Arise

For many years Americans faced the specter of the AMT, a parallel and complex tax system once aimed at ensuring the rich paid a substantial tax bill. The AMT already snares over 4 million taxpayers; however, the Congressional Budget Office's (CBO's) baseline had projected that under laws presumed to be in effect by 2022, more than 47 million tax filers would have been affected by the AMT. 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 had long remained frozen (outside of periodic "patches" to provide temporary relief). Thus, over time, the AMT would identify a growing number of taxpayers as "rich" even though their real incomes hadn't changed. That situation was finally rectified with the American Taxpayer Relief Act of 2012, which put a permanent patch into place. Now, the AMT will affect about 90 percent fewer filers than CBO had once forecast.

Ultimately the best solution for the AMT is to simply get rid of it altogether, a remedy repeatedly recommended by the IRS National Taxpayer Advocate. In her most recent report, the Advocate wrote that the AMT "corrodes both the tax system and the democratic process." But at least the latest action from elected officials spares tens of millions of unsuspecting families from this tax complexity monster.

If only there weren't other monsters lurking in the shadows. For example, the 2010 health care law's surtaxes of 0.9 percent and 3.8 percent on earned and "unearned" income, respectively, contain a nasty secret. The income thresholds for these new taxes, such as \$250,000 for a joint-filing household, will not be automatically indexed for inflation each year. Just like the AMT once did over a period of decades, rising numbers of taxpayers will fall into the surtax trap.

For his part, President Obama doesn't seem content with leaving the issue alone. His new budget proposal would hatch a new AMT-like scheme based on the so-called "Buffett Rule" aimed at ensuring the very wealthy pay a high tax rate. The complexity of this new plan comes shining through in this following description, taken straight from the White House's own budget documents:

The Administration proposes a new minimum tax, called the Fair Share Tax (FST), for high income taxpayers. The tentative FST equals 30 percent of AGI less a charitable credit. The charitable credit equals 28 percent of itemized charitable contributions allowed after the overall limitation on itemized deductions (Pease). The final FST is the excess, if any, of the tentative FST over regular income tax (after certain credits, including the AMT and the 3.8 percent surtax on investment income) and the employee

portion of payroll taxes. The set of certain credits subtracted from regular income tax excludes the foreign tax credit, the credit for tax withheld on wages, and the credit for certain uses of gasoline and special fuels. The tax is phased in linearly starting at \$1 million of AGI (\$500,000 in the case of a married individual filing a separate return). The tax is fully phased in at \$2 million of AGI (\$1 million in the case of a married individual filing a separate return).

This provision would not affect many taxpayers, but the amount of instructions, forms, and worksheet to implement it, if it were ever to become law, would be considerable. So would the “deadweight loss” to the economy as “the rich” employ accountants to figure it all out (or try to avoid it)?

The federal government’s obsession with tax avoidance is leading to other tax complexity nightmares, one of which is aimed at Americans of all income levels who work or live abroad. As a recent article from Doug Kellogg posted on NTU’s Government Bytes blog noted, the Foreign Account Tax Compliance Act contains such a massive heap of disclosure and reporting regulations for those holding deposits in non-U.S. banks, the banks themselves are motivated to turn away American customers from opening or keeping accounts. The threshold for the new rules – at least \$10,000 total in non-U.S. banks -- means that many more than just “fat cats” in search of offshore tax havens are being burdened.

“ObamaCare”: A Tax Complexity Debacle in Itself

The 2010 health care law has been imposing financial burdens on Americans for some time, but this year it will get a lot more painful. New headaches include surtaxes on upper-income households, an excise tax on the manufacture of certain medical devices, and a new limit on itemized deductions for medical expenses. Although opponents of “Obamacare” expressed fears that it would expand the duties and powers of the Internal Revenue Service (IRS), the topic has received scant media coverage. That’s why a recent special report entitled “Implementing National Health Care” from tax litigation consultant and author Dan Pilla is so important. Pilla lays out in excellent detail the “administrative and compliance challenges facing taxpayers and the IRS.” They include:

- Aside from “ordinary income” and Alternative Minimum Tax income, the IRS will have to contend with a new definition called “household income,” with implications for tax returns, data storage, and reporting. This income would also have to be checked against what citizens would report to the new health care exchanges.
- Because the IRS would need to verify minimum health care coverage, the agency “must proactively engage in collecting data from private insurance companies – something never before done.”
- Compliance with the new Small Business Tax Credit is requiring a whole new level of IRS collection information.
- The tax agency will have heightened interaction with other federal entities such as the Departments of Health and Human Services as well as Homeland Security.

- Handling tax return information disclosures will raise new privacy concerns.
- The restriction on the IRS's lien and levy power to collect "penalties" for not purchasing individual coverage (which according to the Supreme Court, amount to taxes) "is a hollow benefit".

Pilla outlines many other pitfalls of the health care law, not the least of which is that the National Taxpayer Advocate has been given little input into the implementation process. This means that new rules and procedures are likely being designed more for the comfort of the government rather than ordinary Americans. Complexity in the tax system is being taken to a whole new level.

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 in a 2006 GAO report provides little comfort that the inaccuracies among preparers have dramatically improved. GAO auditors, posing as taxpayers, retained the services of major tax preparation firms at 19 outlets in a major metropolitan area, and found:

- 10 of the 19 preparers failed to report business income information.

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

GAO noted that had the IRS 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). “These taxpayers are frequently involved in complex family situations that make it difficult to correctly understand and apply tax law.” TIGTA audited the program for accuracy and in a September 2012 report noted, “we had 39 tax returns prepared with a 49 percent accuracy rate, which is higher than the 39 percent accuracy rate we reported for the 2011 Filing Season.” To most Americans, accuracy below 50 percent is still nothing to cheer.

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, last year 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, NY, 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.

The Treasury Inspector General for Tax Administration's interim report on the 2013 tax filing season highlighted a software error that has received widespread media attention although again, the error has been rapidly addressed. Some tax software was producing insufficient feedback on Form 8863 to help the IRS determine if filers were eligible to claim the education-related American Opportunity Tax Credit. Tax agency officials told TIGTA that about 10 percent of all returns claiming the credit were affected, resulting in processing delays.

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, in late 2011 an NTU letter to Congress warned 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 Free File Program Act has been introduced by Rep. Peter Roskam (R-IL) 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.

Although political and institutional circumstances would seem to be stacked against such a sweeping effort, there remains hope for bipartisan, bicameral cooperation that could send a tax reform plan to the President's desk this year. Recently House Ways & Means Committee Chairman Dave Camp (R-MI) and Senate Finance Committee Chairman Max Baucus (D-MT) announced they are committed to producing tax reform legislation in this Congress reflecting three principles:

- 1) Ensuring that low- and middle-income families pay no more under reform than they are paying now. In an April 7 *Wall Street Journal* article, Camp and Baucus wrote that, "Simplifying the code means regular families will be on a level playing field with those who can afford high-price tax advisers."
- 2) Reducing the competitive disadvantage for U.S. employers, by cutting the economically unattractive corporate tax rate and broadening the tax base.
- 3) Establishing parity for small businesses in the Tax Code compared to large corporations.

Baucus and Camp would have a variety of plans from which to draw ideas and incorporate into their own package. 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 has called 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 63 House and seven 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.”
- **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 recently reinstated 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.

Although politicians often succeed at hiding the pain of *paying* taxes, it is much more evident to the average American than the pain of *complying* with taxes. Yet, the latter burden is becoming a serious threat in its own right to our personal freedoms and our economic productivity. That’s why reforming our tax system and reducing its complexity is more imperative now than ever before.