

Can Filing Be Simplified For Most Taxpayers?

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Whatever the successes of the "new" IRS, in the end it will be judged, fairly or not, by whether administrative tax burdens are reduced for the average taxpayer. For most taxpayers there is only one time during the year when they deal in any significant way with the IRS, and that is during the filing season. Ten years from now, therefore, their assessment of recent administrative reform will be based mainly on whether filing has become easier. Before betting that such an assessment will be positive for the IRS, be sure to get some odds. Many more cooperative efforts of Congress, the Treasury, and the IRS are still required, and it's not clear who will lead those efforts.

One area of promise for years has been associated with computerized information systems—the source of so many productivity and time-saving advances in the private sector. Consider the time and effort saved because one can pay at the grocery store or gas station with a simple credit card swipe. Or think about the ease with which items can be purchased on the Web. Yet year after year these types of gains don't seem to make filing with the IRS easier. What is going on?

It's not that there haven't been any gains. Private software packages certainly have made filing simpler for preparers and for some taxpayers. As these packages have improved, they have reduced dramatically the amount of double entry performed by taxpayers when reporting income for federal income tax, state income tax, federal social security tax, and federal minimum tax purposes. They have also made it almost automatic to carry from one year to the next information about such items as required schedules or forms, deductions that carry forward, and the depreciation allowed for assets purchased in previous years.

Although initiated as a compliance measure, the requirement on banks, corporations, brokers, and others to provide information returns on items such as interest, dividends, and gross receipts from sales of capital gain assets also makes life easier for taxpayers. The information is provided at the end of the year directly to taxpayers who often neglect keeping track of related receipts during the year. Improved data systems at mutual funds have led many of these funds to provide further information on net capital gains from sales of shares.

If public advances were running in parallel with these private advances, one might think that tax filing would have become simpler in recent years. Three major obstacles, however, have stood in the way.

The first is well-known. IRS technology, computer architecture, and software have not improved along with the gains in the private sector. Unable to pay for top-notch computer scientists or high-grade computers, the problem only compounded. But despite falling further behind in a relative sense, there were still improvements made by a dedicated, if poorly supported, IRS staff—so this explanation is inadequate by itself. It may tell us why advances were few, but not why matters often got worse.

The second obstacle is more complicated to explain. It involves all those Catch-22 types of situations where the IRS gets close to a solution but then can't proceed further. Consider, in particular, some recent efforts to create what is called a "return-free" system. That idea goes back at least as far as Roscoe L. Egger Jr., who as commissioner pushed for its inclusion in Treasury's 1984 tax reform study. As the availability of information returns on wages, interest, dividends, and social security expanded, it was thought possible that many individuals would not have to file their returns with the IRS but, rather, simply sign on the bottom line to confirm IRS estimates of income and tax due. The IRS would take its own copies of the information returns and put together a tentative return for any taxpayer with limited sources of income.

Unfortunately, a small but significant percentage of information returns were in error. What would the IRS do if it had incorrectly understated the income and tax due when it filed on behalf of citizens? It didn't know. And when these problems were combined with the problems of getting information processed in time, the idea

stalled. And it has remained stalled for 15 years, if not more.

The third obstacle is that more and more provisions have been added to the tax laws. For low and moderate income taxpayers—the primary group for which simplified filing at one time seemed possible—earned income tax credits, child credits, dependent care deductions, educational credits, and presidential campaign finance check-offs, among others, have been added to returns. Unlike the traditional personal exemption and standard deduction, these various provisions often require additional information by the taxpayer. Whatever their other merits, therefore, they have complicated filing significantly.

To top matters off, the IRS has discovered that many of the errors in EITC filing and other allowances are related to claiming children incorrectly, especially when the parents of children are separated, divorced, or never married. To deal with this problem, the IRS has sought additional information from taxpayers to verify their eligibility for different allowances related to children.

In some cases, provisions now in the law are scheduled to add more and more complexity to returns over time. Whatever one thinks about the alternative minimum tax (see this column, Tax Notes, [Nov. 30, 1998](#), p. 1131), the scheduled increase in the number of taxpayers who must pay it represents a prime example of how lawmaking as yet has been unable to grapple with simplification.

Now consider dealing with these obstacles in an integrated fashion. The IRS is going to spend vast amounts to develop new software and buy new computers, but by itself that is not enough to help most taxpayers at filing time. The IRS also needs to minimize errors in information returns, and, when that error rate is sufficiently reduced, to figure out better ways to help taxpayers with their filing by sharing the information it receives. That wouldn't necessarily be a return-free system, but for many filing could be made dramatically simpler.

Such information sharing is now feared by the IRS as a threat to its enforcement function. One wonders, however, if perhaps the standard or bar is not set too high. Consider all the errors in private transactions that occur every day. The private sector, in order to better sell its products, is simply willing to take a hit because the gains exceed the cost. For example, more errors in charge cards purchases than in cash purchases lead to an increase in price, but fewer workers to handle transactions leads to a reduction in price.

In like manner, a moderate amount of under reporting—a likely consequence of errors and omissions in information returns to the IRS—may not be all that bad if it were more than offset by a reduction in filing costs to society. Of course, there would also need to be some safeguards. For example, it is fairly clear that taxpayers couldn't rely entirely on the IRS for types of income not covered on information returns, like most self-employment income.

Finally, Congress can't ignore its role in providing tax filing simplification for the majority of taxpayers. While this territory may be unoccupied recently, it is not uncharted. The standard deduction was created in part to remove from most taxpayers the requirement to keep track of itemizable expenses. Most of the allowances for low and average income individuals, ranging from the EITC to child credits and dependent exemptions, could be combined or simplified significantly, even if some variations had to be eliminated. For example, there's little reason that the personal exemption for dependents couldn't be folded into the child credit.

In sum, simplified filing for taxpayers is possible but requires better computers and software, the more complete transfer of IRS information return data back to taxpayers, and congressional legislation to simplify a variety of credits and allowances. This three-legged stool can't stand unless all legs are built with significant length and strength and interconnecting pieces to support the whole.

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