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Changes in Tax Preparation Methods, 1993-2003

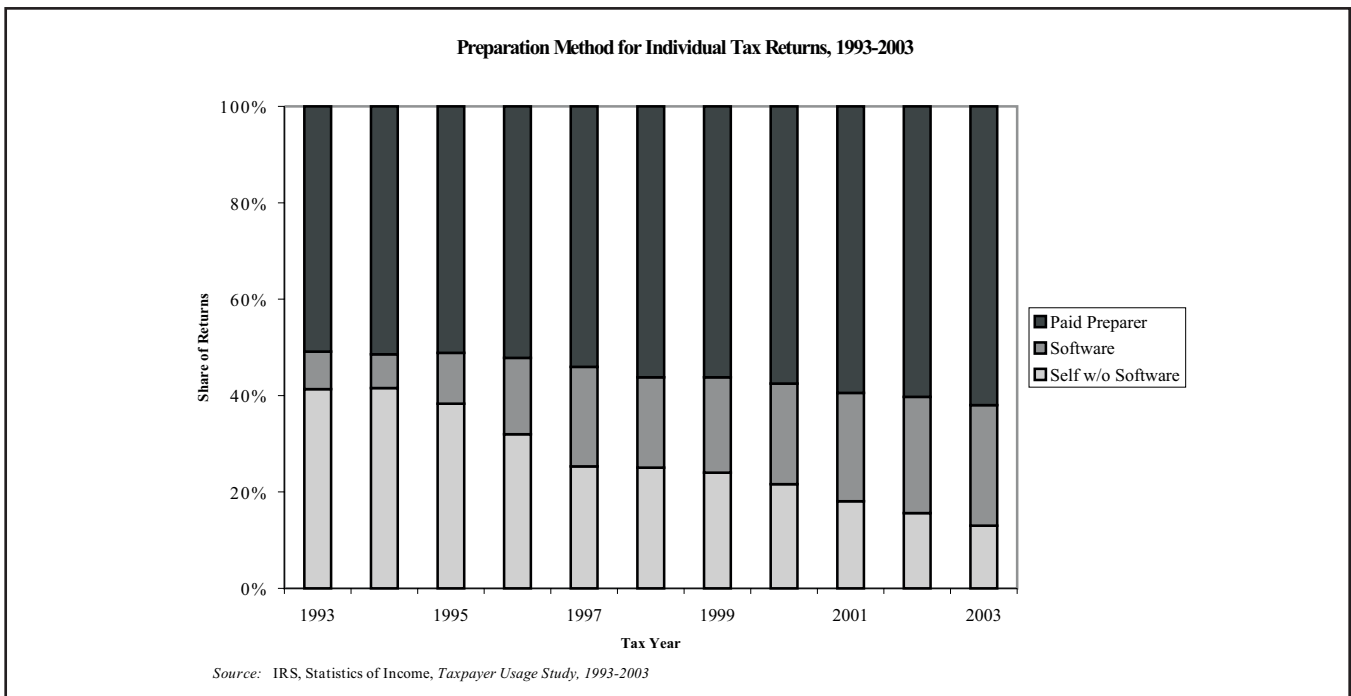
By Eric Toder

The percentage of individual taxpayers who prepare their returns without the use of tax software is declining dramatically. In tax year 2003, only 13 percent of individual taxpayers prepared their returns the old-fashioned way, with pencil and paper — down from 41 percent in 1993. (See chart below.) Both paid preparer and tax software use have increased. Between 1993 and 2003, the paid preparer share of individual returns increased from 51 percent to 62 percent, while the tax software share tripled from less than 8 percent to 25 percent. Preliminary data from 2004 suggest these trends have continued.

The paid preparer industry has been with us for many years, but use of tax software is relatively new. In 1987, for example, while 48 percent of individual taxpayers

used paid preparers, only 13 percent of all returns — including paid preparer returns — were prepared on a computer. It is reasonable to infer that very few self-preparers used software in 1987.

The growth in the use of tax software and paid preparers reflects both improvements in computer technology and the increasing complexity of the tax code. The dramatic decline in computing costs and associated increase in ownership of personal computers have likely been the primary causes of the growth in tax software use by individuals. But using software to ease computational burdens or turning the entire return preparation task to a paid preparer are also responses to an increasingly complex tax code. The private-sector response lowers the compliance burden for any level of tax complexity, but by doing so may reduce the impact of whatever limited political constituency there is for tax simplification. Further, some major sources of compliance burdens, including recordkeeping and tax planning, will remain with us no matter how we prepare returns.



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