

How costly is complexity?

Tax compliance imposes three major costs: taxpayers' time spent filing returns; their out-of-pocket costs of keeping records, hiring preparers, buying software, and the like; and government costs of administering the tax system. All of those costs increase with the complexity of the tax system, but their magnitudes are difficult to measure.

If policymakers knew how much a given change in the tax code would raise or lower taxpayers' compliance costs (and government's administrative costs), they could more easily evaluate the trade-offs between complexity and other goals. But complexity and its costs are hard to quantify. Calculating the total costs of the current tax system requires dividing compliance costs into several components: the value of the time taken to comply with system requirements; the out-of-pocket costs for recordkeeping, outside tax preparation, and the like; and the administrative costs borne by government.

A number of surveys have tried to measure the burden of tax compliance. Most find that the average taxpayer devotes little time to paying taxes, but that a small subset (many of them high-income and self-employed individuals) devotes much more.

COSTS OF FILING TAXES

In a 2013 study, IRS and Treasury analysts estimated that taxpayers spent 1.8 billion hours and \$28.3 billion preparing and filing individual income taxes in 2010. These figures correspond to an average of 12.5 hours and \$198 per taxpayer. But the numbers varied considerably by taxpayer income and complexity of the tax return. For example, taxpayers with adjusted gross incomes under \$30,000 spent an average of about 10 hours and just over \$110 preparing their returns, compared with about 14.5 hours and \$328 for those with adjusted gross income between \$100,000 and \$200,000.

Compliance costs vary with the forms needed to file tax returns—simpler forms take less time to complete and require less information. In 2012, 42 percent of taxpayers filed a simplified version of the standard 1040 form, either the 1040A or the 1040EZ. In this group, nearly half did not itemize deductions, less than one-fourth claimed capital gains or losses, and nearly three-fourths had no business income—all factors that complicate tax filing.

Information on the use of paid preparers gives further hints about how complex taxpayers find the system to be. In 2012, 56 percent of tax filers used paid preparers. Among those who filed the 1040, 63 percent used preparers. Even among 1040A and 1040EZ filers, 47 percent used preparers. It is unclear, however, whether these figures indicate that tax filers are using paid preparers because they cannot navigate the tax code themselves, or whether they simply dislike the paperwork enough to pay others to do the work for them.

The IRS currently uses models from Arthur D. Little consultants to estimate the time required to complete forms and schedules. These estimates are published with the tax forms as part of the Paperwork Reduction Act Notice. For fiscal 2010, the Office of Management and Budget estimated that taxpayers needed 2.4 billion hours to comply with the requirements of all tax forms and IRS regulations (Office of Information and Regulatory Affairs 2011). This estimate applied to both businesses and individuals, and included all federal taxes, not just income taxes.

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