

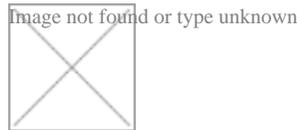


Research

Regulatory and Compliance Implications of Tax Day

SAM BATKINS, GORDON GRAY | APRIL 15, 2014

Today is April 15, Tax Day, the date by which approximately 150 million Americans will have undergone the thankless task of complying with the nation's broken tax code. The figures for cost and the time it takes the average taxpayer to comply with Internal Revenue Service (IRS) forms are truly staggering.



IRS PAPERWORK BY THE NUMBERS

- Hours: 7.7 billion
- Hours per Response: 12.2
- Costs: \$ 170.4 billion
- Forms: 897

The figures above are taken from the Office of Information and Regulatory Affairs's (OIRA) "[Information Collection Review](#)" of IRS paperwork collections and associated costs. To put IRS's 7.7 billion hours in perspective, it would take more than 3.8 million Americans (more than Oklahoma's population) working 2,000 hours annually to complete these requirements.

For costs, IRS reports \$33.8 billion in compliance costs, stemming almost entirely from the individual income tax (\$33.6 billion). IRS monetizes the hourly compliance for only five of its 874 recording and recordkeeping requirements. However, the American Action Forum (AAF) simply applies the average hourly cost of a civilian employee (\$31.57), as reported by the Bureau of Labor Statistics, to the paperwork hours that IRS failed to monetize.^[1] Monetizing all of IRS's paperwork, total compliance costs balloon to \$170.4 billion, five times what IRS reports for compliance costs.

The individual income tax generates 199 forms, or 22 percent of the overall total. There are two requirements tied for second. The Estate and Generation-Skipping Transfer Tax produces 23 forms that Americans must navigate every April. In addition, the Estate Tax imposes two million compliance hours annually. The other notable collection, tax returns for 501(c), 527, and 4947(a)(1) organizations, imposes 23 forms and more than 25.7 million hours of paperwork per year. The "[Form 990](#)" comprises the vast majority of reporting for non-profits. Producing 897 forms might seem like a steep burden, but Health and Human Service's [4,100 forms](#) holds the title, even though Treasury imposes far more paperwork hours.

The average "hours per response" figure of 12.2 is merely a function of dividing the total number of hours, 7.7

billion, by the number of responses that IRS receives from taxpayers. For example, IRS receives more than 150 million responses annually for the individual income tax, which generates 2.6 billion paperwork hours. This translates to 17.6 hours per response. At the extreme, the return for nonexempt [charitable trusts](#) imposes 11 million hours of paperwork from just 55,000 respondents, or 201 hours per response.

LARGEST BURDENS

IRS has a top-heavy paperwork burden, with the five largest requirements consuming approximately two-thirds (5.1 billion hours) of the agency’s total.

<u>Title</u>	<u>Hours (in millions)</u>	<u>Cost (in millions)</u>	<u>Forms</u>
Individual Income Tax	2,674	\$33,672	199
Bond Tax Credit	828	\$26,149	1
Partnership Tax Return	817	\$2	11
Depreciation and Amortization	448	\$14,154	1
Tax Return for an S Corporation	420	\$13,289	6

Notice the “Partnership Tax Return” imposes 817 million hours of paperwork, but supposedly costs only \$2 million annually. The IRS reports completing this paperwork costs less than a cent per hour, compared to the estimated figure of \$13 per hour for compliance with the individual income tax. The other cost figures above, for the Bond Tax Credit, Depreciation and Amortization, and returns for S Corporations, lack monetized figures from IRS. AAF applied the average hourly cost of a civilian employee (\$31.57) to these collections, and the total cost was \$55.5 billion; IRS originally omitted a cost estimate for these three requirements.

MOUNTING PAPERWORK BURDENS



As the graph above displays, the Department of Treasury’s paperwork burden is at its highest level in history. At more than 7.8 billion hours, Treasury’s paperwork budget has increased 1.5 billion hours since FY 2010, or 19 percent. Since 1995, the earliest year AAF could compile data, Treasury’s burden has increased 47 percent.

The Affordable Care Act (ACA) has driven much of the recent paperwork growth at the Department of Treasury. According to [AAF records](#), ACA regulations have added a net of 71.3 million hours to Treasury’s

paperwork burden. Furthermore, there are several pending ACA-related IRS paperwork requirements at OIRA now, including the individual mandate (7.5 million hours) and the “Net Investment Income Tax” (24 million hours). The individual mandate lacks formal OIRA approval, even though the deadline for most tax returns is April 15.

TREASURY’S OUTSIZED BURDEN

When discussing paperwork burdens, no other agency can rival the Department of Treasury. As the graph below reveals, Treasury imposes the vast majority of the federal government’s paperwork burden.



Even Health and Human Services (HHS) barely matches Treasury’s 7.7 billion hours. HHS, at more than 600 million hours, easily outpaces the Department of Transportation and the Environmental Protection Agency.

ALTERNATIVE MEASURES OF MEASURING TAX COMPLIANCE COSTS

As noted by the Taxpayer Advocate Service (TAS), many entities have attempted to estimate the total cost of tax compliance and experts have embraced a range of methodologies.^[2] The TAS, for example, estimated the cost of income tax compliance in 2010 at \$168 billion. Inclusion of additional cost considerations and alternative approaches to monetizing hours spent in compliance alter these estimates considerably. For example, applying just the federal minimum wage (\$7.25 per hour) to the hours that IRS did not monetize would reduce the total cost estimate made in this paper to \$65.1 billion. Fichtner and Feldman recently completed a thorough assessment of the costs that the U.S. tax code extracts from the economy through complexity and inefficiency, beyond TAS’s estimate. According to the authors, in addition to time and money expended in compliance, foregone economic growth, and lobbying expenditures amount to hidden costs estimated to range from \$215 billion to \$987 billion.^[3]

Other measurements beyond mere time and pecuniary estimates reflect an increasingly burdensome tax code. According to the TAS, tax compliance is so onerous for individual taxpayers, 59 percent now pay preparers to do it for them. Among unincorporated business taxpayers, the figure rises to about 71 percent.^[4] The tax code has become so onerous that the IRS struggles to administer it. According to the TAS, the IRS’s ability to answer taxpayer telephone calls and the IRS’s ability to respond to taxpayer correspondence offer key metrics for taxpayer service. According to the TAS, the IRS received 115 million calls in fiscal years 2011 and 2012. In 2012, the IRS was only able to answer 68 percent of calls received, compared to 87 percent in 2004. The IRS failed to respond to 48 percent of taxpayer letters received in 2012, compared to 12 percent in 2004. This worsening response rate comes despite the increasing use of preparers and software by individual taxpayers.

CONCLUSION

The tax code is riddled with inefficiency and complexity that confronts taxpayers and the economy as a whole.

The Taxpayer Advocate Service (TAS), the watchdog office within the IRS, has cited complexity as the single most serious problem with the tax code.^[5] Tax Day will come and go, but absent meaningful tax reform, the complexity of the U.S. tax code will exact an increasing burden the U.S. economy well in excess of mere revenue raised – nearly 8 billion hours and more than \$170 billion in costs.

[1] This method is consistent with that used by the Taxpayer Advocate Service. *See* footnote 9: “The Complexity of the Tax Code.” Taxpayeradvocate.irs.gov. Internal Revenue Service Web.
<http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Most-Serious-Problems-Tax-Code-Complexity.pdf>.