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Tax Complexity 2016: The Increasing Compliance Burdens of the Tax Code

By Demian Brady

I. Summary of Findings

National Taxpayers Union Foundation's (NTUF's) annual analysis of tax complexity in the United States reveals yet another year of unacceptably heavy burdens on America's taxpayers and businesses. The future does not look bright.

Based on the most current public estimates, the value of the time (6.1 billion hours) plus out-of-pocket costs expended annually on complying with the individual and corporate Tax Code amounts to an economic loss of $234.4 billion. Of this total, $64.6 billion is attributable to lost productivity from 1.9 billion hours spent on the 1040 tax form series alone. While $29.6 billion can be chalked up to software, tax preparation fees, supplies, and other overhead for the yearly tax filing chore. The remainder of the costs, made up mostly of corporate compliance pains, affects the economy in numerous ways such as higher prices for consumers, lower returns for shareholders, and less competitive operations abroad.

More misery is on the way. The Internal Revenue Service's (IRS's) combined regulatory "inventory," comprising the impact of all the tax agency's current or immediately planned rulemakings, is a staggering 8.96 billion hours. That time represents the equivalent of nearly 4.5 million Americans working a 40-hour week year-round. This tax compliance "army" is actually nine times larger than the active-duty strength United States Army, and more than twice as large as the active and reserve components of all the armed forces.

Incredibly, even as Americans read about the regulatory excesses of agencies like the Environmental Protection Agency or the Transportation Security Administration, the IRS imposes almost four out of every five hours of paperwork burden in the entire federal government-wide inventory.

Once this inventory is fully inflicted on the American people, the tax-related loss to the economy (including out-of-pocket costs) could exceed $330 billion. That's more than enough money to fund the legislative and judicial branches of the federal government, plus the U.S. Departments of Education, Homeland Security, Housing and Urban Development, Interior, Justice, and Transportation … along with NASA.

High U.S. tax rates are certainly an impediment to economic growth. The corporate income tax is a drag on America's competitiveness around the world. When ranked against some of our biggest trading partners, American businesses face much bigger compliance headaches than their counterparts in other countries. Meanwhile, as families, small business owners, tax preparers, and even the IRS itself struggle to comprehend the tax laws, the entire structure of raising revenue threatens to collapse under the weight of its own complexity. The need for a simpler way of taxing that minimizes the damage to our economy and our civil rights has never been more imperative.

II. Introduction

> *"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."*
> *U.S. Constitution*

On February 3, 1913 the United States Congress ratified the words above in the Sixteenth Amendment to the Constitution, thereby ushering in new governmental powers subjecting Americans to the federal income tax. The new tax regime enabled the federal government to more easily and readily raise revenues. But over time the system gradually became more onerous and burdensome to taxpayers. The convoluted process of preparing and filing tax forms is a source of real stress, fear, and dread for many taxpayers. The system today bears little resemblance to the relatively simple one codified in 1913.

The Tax Code has grown increasingly and astonishingly complex over the past century. Its annual enforcement and compliance costs require billions of hours, hundreds of billions of dollars, and thousands of federal employees. The complexity of the Code has spawned a multibillion-dollar industry, made up of professionals who spend years training in order to help individuals and businesses navigate the system (and frequently, even that is not enough to ensure accurate filings). New technology offers both benefits and risks. While technology makes it easier for many to file, it also puts taxpayer data at risk, a growing problem facing many.

The escalating economic costs of the Tax Code, combined with the IRS's deteriorating ability to protect and assist taxpayers, make it abundantly clear the current system is in need of reform. Simplifying the laws would immediately and directly improve the country's economic condition as well as taxpayers' everyday lives, and should be an urgent priority for lawmakers on Capitol Hill. In the words of the IRS's National Taxpayer Advocate Nina Olson: "… I believe we need fundamental tax reform, sooner rather than later, so the entire system does not implode."[1]

III. Complexity Continues to Grow

A. Compliance Time and Costs

The basic form that taxpayers must file to account for their federal income taxes is the 1040, along with its simplified alternatives the 1040A and the 1040EZ. Many middle-class filers use the regular 1040, requiring an average of 16 hours for preparation and submission time and $270. For these three forms combined and then averaged across the filing population, the activity of keeping records and completing, submitting and complying with the Internal Revenue Code's (IRC's) basic series of returns requires 13 hours from each filer. In total, the time spent on the 148 million 1040 forms filed in 2015 consumed 1.92 billion hours of productivity. This is time spent figuring out how much we collectively owe the federal government, a significant opportunity cost. To put this figure into perspective, think of it this way: this is equal to 80,000,000 days and over 219,000 years.

We can arrive at an estimate of the value of this time by framing it in terms of private sector labor costs. According to the Bureau of Labor Statistics, U.S. employers spent an average of $33.58 per hour worked on total non-federal civilian employee compensation in December 2015 (that figure includes wages and salaries as well as benefits).[2] For 1.92 billion hours of such work, Employers would have paid $64.6 billion, valuable labor that will instead be lost to Tax Code compliance. Add that to the $29.6 billion in estimated out-of-pocket costs taxpayers spent on software and professional preparation services[3], and the total economic value of compliance burden for just the 1040 forms can be valued at **$94.2 billion.**

As costly and significant as this is, it just represents the veritable tip of the iceberg. In 2010 the National Taxpayer Advocate calculated how much time is spent complying with the entire Tax Code, not just those portions dealing directly with the 1040 series. Under this estimate, Americans spend an average of 6.1 billion hours annually![4] It is difficult to fully comprehend how staggering that figure is even when one measures it against a more familiar context: that is just over 696,347 years, the equivalent of 152.5 million 40-hour workweeks. It would take 59,580 American workers, who begin employment at age 18 and work every single week of their lives with no days off, until reaching the full Social Security retirement age of 67, to account for that much time.

For 6.1 billion hours of such work, employers would have paid $204.838 billion, valuable labor that will instead be lost to Tax Code compliance. Add to that the $29.597 billion in estimated out-of-pocket costs taxpayers spent on software and professional preparation services[5], and the total economic value of the compliance burden can be valued at **$234.435 billion.**

Taxpayers should be prepared for this load to get a lot heavier. Each federal agency must submit its estimate ("inventory") of compliance burden hours to the Office of Management and Budget (OMB) for approval. To employ a budgetary analogy, these estimates effectively amount to "authorizations" of programs; the actual compliance burdens represent the equivalent of "outlays." Therefore the inventory of burden hours has a direct relationship to how taxpayers are later hit with a heavier workload at filing time. The latest "Inventory of Currently Approved Information Collections" shows a total compliance burden of over 8.964 billion hours for all activities of the IRS.[6]

B. Length of the Tax Code

The most tangible way to examine the growth of the Code and its overwhelming complexity is to look at its physical length. In 1991 the IRC contained a staggering 45,739 sections, sub-sections, and cross-references; by 2012 that figure had reached 66,812 – a 46 percent increase. From 2004 to 2012, the Advocate reported that there were 4,107 changes to the IRC, an average of more than one every single day. Not all the changes are the result of new legislation. Last year, the IRS announced inflation adjustments to 51 tax provisions.[7]

Exactly how long is the Code? In 2012 the Advocate noted, "The tax code has grown so long that it has become challenging even to figure out how long it is." Using Microsoft Word's "word count" function, it was determined that the statutes contain 3,951,104 words (just over five times the length of the entire King James version of the Bible). [8] In October 2015, the Tax Foundation attempted to recount the Code excluding tables of contents, appendices, references, amendments, and effective dates, whose inclusion may inflate the resulting figure. [9] This brings down the count to 2.4 million words, still a daunting read by any measure, at over twice the length of the entire seven books in the Harry Potter series.[10]

As the late TV pitchman Ron Popeil would say, "But wait, there's more!" Undergirding the complex Code are the 22 volumes of Title 26 of the Code of Federal Regulations.[11] These are the federal tax regulations set forth by the IRS. The Tax Foundation estimates that it includes 7,655,000 words.

C. Federal Tax Forms

For many years, National Taxpayers Union and NTUF have tracked the length of the Form 1040 and its accompanying instruction booklet – materials that many American taxpayers are all too familiar with on a yearly basis. In 1935 the Form was a single page consisting of 34 lines, with two pages of instructions. Now, it has 79 lines over two pages, requiring the equivalent of 211 pages of instructions. Starting in 2014, the IRS removed instructions for two forms and nine schedules from the 1040 instructions booklet and printed them each separately. NTUF accounts for this change in the table below.

Table 1. Form 1040 Form and Instruction Booklet Length

Tax Year	Lines, Form 1040	Pages, Form 1040	Pages, Form 1040 Instruction Booklet
2015	79	2	211*
2014	79	2	209**
2013	77	2	206***
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

Notes:

* *The IRS did not include instructions for Form 1040 schedules in this edition of the instruction booklet. The 2015 Form 1040 instructions amounted to 105 pages. Instructions for Forms 8812 and 8949 and Schedules A, C, D, E, F, R, and SE (which were included in the 2013 Form 1040 instructions) totaled 106 pages.*

** *The IRS did not include instructions for Form 1040 schedules in this edition of the instruction booklet. The 2014 Form 1040 instructions amounted to 104 pages. Instructions Forms 8812 and 8949 and Schedules A, C, D, E, F, R, and SE (which were included in the 2013 Form 1040 instructions) totaled 105 pages.*

*** *Excludes one extra page in the IRS's online PDF version regarding donations for Philippines typhoon relief.*

In total, the IRS currently has 199 individual income tax forms with a reported 2.647 billion annual burden hours, and 235 business tax return forms, with a 2.833 billion annual burden hours.[12] Additional forms, schedules, worksheets, and burden hours are required for other parts of the Tax Code (which add more burden hours), including:

- Income Tax Returns for Estates and Trusts: 14 forms and worksheets, 376 million hours;
- Estate and Generation-Skipping Transfer Tax Returns: 24 forms and worksheets, 2 million hours;
- Income Tax Returns for S Corporation: 7 forms and worksheets, 889 million hours;
- Employer's Quarterly Federal Tax Returns: 14 forms and worksheets, 388 million hours, and
- Short Form Returns of Organization Exempt From Income Tax: 8 forms and worksheets, 44 million hours.

D. The Paperwork Burden

The Paperwork Reduction Act of 1995 requires the OMB to report to Congress regarding the burden imposed on the public complying with federal forms. It should be no surprise that the Tax Code accounts for an incredibly high percentage of the government's overall paperwork burden. The Office of Information and Regulatory Affairs within the OMB tracks the total hours each agency's information collection requirements impose on the public and publishes the results online. Unfortunately, a complete report has not been published since 2014, which included Fiscal Year 2013 data.

Table 2. Treasury Paperwork Burden Relative to Government-Wide Total

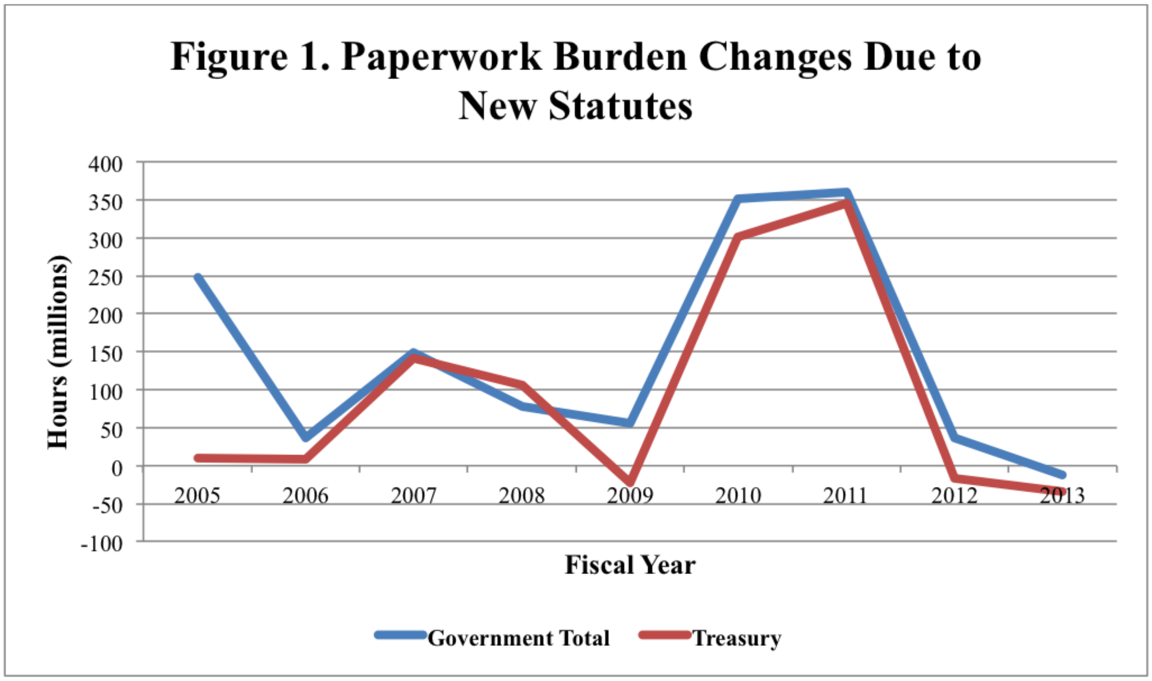
Fiscal Year	Government Paperwork Burden (millions of hours)	Treasury Paperwork Burden (millions of hours)	Treasury Paperwork Burden, Percentage of Government Total
2005	8,241	6,435	78%
2006	8,924	6,966	78%
2007	9,642	7,631	79%

2008	9,714	7,785	80%
2009	9,796	7,643	78%
2010	8,783	6,780	77%
2011	9,138	6,734	74%
2012	9,467	7,062	75%
2013	9,453	7,007	74%
Source: Office of Management and Budget.			

The Treasury's paperwork burden imposed on the public has grown from 6.4 billion hours to 7 billion hours over the period from fiscal year 2005 to 2013, and in that time, has never made up less than 74 percent of the burden imposed by all other government agencies combined.

According to the latest data from the OMB's Inventory of Currently Approved Information Collections, the paperwork burden across the federal government has an approved time burden of 11,435,121,196 hours.[13] As mentioned previously, The Treasury's currently listed share of this burden is 78 percent at 8,964,126,204 hours. The IRS is responsible for 99.6 percent of the entire Treasury Department's time burden. No other entity of the government – not the EPA, the FTC, OSHA, or any of the other regulators in Washington's alphabet soup – comes close to the IRS's regulatory reach.

While in some years an agency's burden hours may actually recede from the previous year due to changes in the law, an agency's discretionary actions, or even economic conditions, the net change in the burden can often serve as a proxy for how much more complicated the agency's workload has become. The graph below shows how new statutory requirements changed the burden hours for the Department of Treasury and the entire government between each fiscal year from 2005-2013.



As Figure 1 shows, the Treasury (largely the IRS) accounts for the majority of the net changes in government paperwork burdens. From Fiscal Year 2005 through 2013, the federal government's paperwork burden imposed on the public due to new statutes increased, on net, by about 1.3 billion hours.[14] The Treasury's rose by 838.4 million hours, about 64.5 percent of the total for all federal agencies combined.

Rarely in recent years have changes in statutes resulted in a net total *reduction* of paperwork burden. Fiscal Years 2010 and 2011, in the immediate wake of President Obama's "economic stimulus" efforts, saw an especially large increase in new paperwork due to statutes: OMB noted that in 2010, the IRS's processing of individual income tax returns (identified as "control number 1545-0074") alone required 319 million hours of additional information collection that year.[15]

E. Paid Preparation: Luxury, or Necessity?

Not only is the Tax Code and its corresponding compilation of regulations extremely lengthy and convoluted, its prose style is also cumbersome, especially for those not steeped in legal writing. Take this section regarding taxation of employee annuities for example:

> *[If] in the case of a contract purchased under a salary reduction agreement, the contract meets the requirements of section 401(a)(30), then contributions and other additions by such employer for such annuity contract shall be excluded from the gross income of the employee for the taxable year to the extent that the aggregate of such contributions and additions (when expressed as an annual addition (within the meaning of section 415(c)(2))) does not exceed the applicable limit under section 415. The amount actually distributed to any distributee under such contract shall be taxable to the distributee (in the year in which so distributed) under section 72 (relating to annuities). For*

purposes of applying the rules of this subsection to contributions and other additions by an employer for a taxable year, amounts transferred to a contract described in this paragraph by reason of a rollover contribution described in paragraph (8) of this subsection or section 408(d)(3)(A)(ii) shall not be considered contributed by such employer.[16]

A number of factors contribute to the complexity: (1) the legal language with specified definitions of key words and terms used in the text, (2) the number of sections and subsections, and (3) the level of interconnectedness – how often other sections of the Code are referenced.

Most taxpayers do not need to delve this far in to the weeds of the law, but as the Tax Code grows more complex, an increasing number of taxpayers are likelier to pay money for professional services or other assistance to help them accurately file returns. The IRS reported that over 60 percent of filers employed a paid preparer.[17] Many others are turning to tax software. The practice has become virtually standard with the Advocate reporting that in 2013 over 94 percent of filers paid someone or used software to help prepare their returns.[18] According to market research firm IBISWorld, the tax preparation industry generated over $10 billion in revenue in 2015 and was comprised of 292,718 employees (down from 318,926 employees in 2014) across 118,890 businesses.[19]

For several years, National Taxpayers Union and NTUF have tracked the average fee charged by H&R Block, one of the largest such preparation businesses in the U.S. Perhaps not surprisingly; those fees have steadily increased along with the system's complexity.

Table 3. Average Fee Charged by H&R Block

Calendar Year	Average Fee
1980	$27.36
1985	$45.39
1990	$49.99
1995	$61.77
2000	$101.40
2005*	$145.08
2010#	$187.93
2011**	$190.97
2012**	$189.96
2013**	$192.24
2014**	$215.06
2015	$224.02

Source: National Taxpayers Union, H&R Block.
**Through March 15. #Through March 30. **Through April 30; total U.S. tax preparation fees divided by number of company-owned retail returns.*
H&R Block's calculation of the net average fee per return has changed in recent years, sometimes including fees from other services such as Refund Anticipation Loans.

It’s worth noting even after adjusting the $27.36 average fee from 1980 for inflation (equal to $78.73 in 2016 dollars), the cost of return preparation has nearly tripled since then, suggesting that the growth in tax complexity is outpacing even the technological and administrative improvements that have been made to professional preparation firms in that time.

As more filers seek professional assistance out of fear of making a mistake and receiving a dreaded audit notice, the IRS has been attempting to tighten its oversight of preparers. In 2011 the IRS attempted to impose a licensing scheme that was subsequently struck down by court rulings that determined the IRS had exceeded its statutory authority. The Tax Return Preparer Competency Act of 2015 introduced in the House of Representatives would provide the tax agency with new credentialing powers. However, safeguards are already in place as each preparer must use a unique Preparer Tax Identification Number that can be used to identify patterns of fraudulent or questionable returns. Granting additional authority to the IRS could end up forcing many independent tax preparers out of business due to increased compliance costs. The result would mean less competition and fewer choices for filers.

Equally daunting is another longstanding scheme called the “Return-Free” system, which would have the IRS send prepared tax forms to citizens for their signatures. Aside from potentially duping taxpayers of considerable savings if they were to complete returns themselves or with private assistance, many Americans would likely be intimidated into submitting to the IRS’s supposed “voluntary” procedure out of fear that not doing so would provoke government retaliation. In any case, a highly successful public-private partnership known as the Free File Alliance has for more than a decade provided free electronic tax return filing to millions of moderate-income filers. This service, scrupulously overseen by more than a dozen online tax preparation firms, has saved the consumers and taxpayers more than $1.4 billion in overhead costs since its inception.

F. Affordable Care Act Introduces New Complexities

President Barack Obama’s signature health care law, the Patient Protection and Affordable Care Act (PPACA), enacted 21 new tax changes, imposing additional cost and complexity burdens on filers.[20]

It was an extremely complicated legislative package. At the time, then House Majority Leader Nancy Pelosi pleaded with voters, “But we have to pass the bill so you can find out what is in it … .” Over the years since passage, very few people have actually read all of the legislation, but the IRS has published thousands of pages of regulations related to administration of the law as well as a compendium of resources to help explain compliance with the law to taxpayers and tax preparers. The IRS website has a section devoted to “Legal Guidance and Other Resources”[21] which links to dozens of separate pages containing informational PDFs, third party resources, and multimedia related to PPACA compliance. These include:

- 151 tips since 2013 under the “Health Care Tax Tip Archive” page[22];
- 15 flyers, publications, and trifolds totaling 161 pages;
- Links to 22 YouTube videos available in English, Spanish, and Sign Language;
- 10 podcasts; and

- 5 webinars.

The IRS also lists, in electronic form, many of the various legal guidance, notices and regulatory decisions it has issued regarding PPACA implementation and compliance. On its "Affordable Care Act Tax Provisions" page, the IRS links to thousands of pages of regulations (including proposed, temporary, and final versions), Q&A documents, notices, news releases, and procedures.[23] The "Affordable Care Act Legal Guidance and Other Resources" page has even more documentation, many of which overlap with those listed on the Tax Provisions page.

The law requires all Americans to obtain health insurance coverage or be subject under the individual mandate to a tax penalty known as the "Individual Shared Responsibility Provision." The tax penalty for 2015 was the greatest of either $325 per adult and $162.50 per child (capped) or 2 percent of household income. This will rise starkly this year to $695 per adult and $347 per child or 2.5 percent of income. The IRS notes, "The law prohibits the IRS from using liens or levies to collect any individual shared responsibility payment. However, if you owe a shared responsibility payment, the IRS may offset that liability against any tax refund that may be due to you."[24]

PPACA also imposes an employer mandate. In 2015 this required employers with 100 or more full-time employees to provide health insurance. The threshold was expanded in 2016 to include companies with more than 50 employees. The penalty will equal $2,160 per full-time worker, after the first 30 employees. It is expected than many smaller businesses will shed employees or switch to part-time employees due to this compliance burden.

While the mandates were imposed to force individuals and businesses into purchasing health care, a different provision of the law intended to assist low-income earners actually imposes its own compliance burden. An Advance Premium Tax Credit (APTC) is available to offset some of the cost of buying plans through the online marketplaces the law established, but there has been widespread confusion regarding the nature of this credit. At the time of initial purchase of health insurance through a state or federal exchange consumers must estimate the amount of income they will earn through the rest of the year. This is used to determine the amount of federal subsidies they will receive via the APTC. Since projecting personal income over the course of a year can be difficult, many people misestimate. Before an additional year of the premium credits can be claimed, the previous year's amounts must be reconciled to account for overpayments or underpayments.

H&R Block found that 1 out of every 3 marketplace enrollees overestimated their incomes and then discovered they qualify for additional APTC subsidies that averaged $450.[25] Sixty percent of recipients of the APTC lowballed their earnings estimates and had to pay back a portion of their credits to the government. This is up from 52 percent of filers in the last tax season. On average, $579 had to be paid back, compared to $530 the previous year. Because the APTC is a "refundable" credit, available to individuals regardless of their income tax liability, this repayment often hits low-income filers. Mark Ciaramitaro, vice president of H&R Block health care and tax services, said "[t]he level of payback of the Advance Premium Tax Credit is significant in that it's costing taxpayers a large percentage of their refund – a refund many of them count on to pay household expenses."[26]

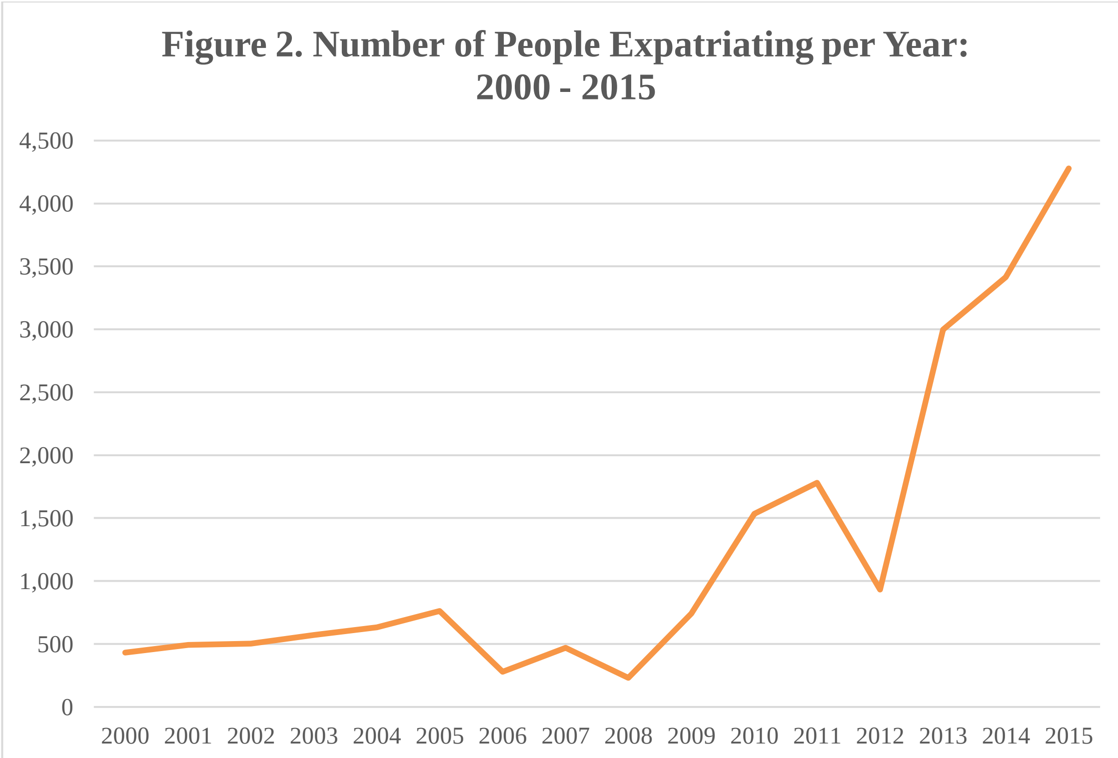
G. The Long Arm of the IRS Reaches Overseas

The United States is the only country within the Organization for Economic Cooperation and Development that taxes citizens wherever they reside. Six million U.S. citizens who live abroad are renouncing their citizenship because of compliance burdens of the Foreign Account Tax Compliance Act (FATCA). Enacted in 2010, FATCA requires any U.S. citizen or person[a] to report and pay taxes on their financial accounts held outside of the United States, even if they reside abroad. The law also requires foreign institutions to report certain information concerning their U.S. clients to the IRS.

Ostensibly designed to increase compliance with U.S. tax law and crack down on tax evasion, FATCA compels the IRS to devote more time and energy overseas. The United States already requires all citizens, regardless of residency, to pay income taxes. And although foreign governments[27] opt involuntarily to the FATCA regulations, the element of choice is nearly non-existent for most overseas institutions: those that don't comply with the law's reporting requirements must withhold a 30 percent tax from account holders.

For American citizens living outside the U.S., FATCA represents more than an additional reporting requirement. It is driving many to reconsider their citizenship altogether, with some polls placing that number at nearly 73 percent of all Americans abroad.[28] The IRS is required to report quarterly on the number of individuals who expatriate. From 2000-2009, 511 people surrendered their passport on average per year. Since 2010, the number has skyrocketed. On average, 2,490 people expatriated per year from 2010 through 2015, with a record number of 4,279 expatriates last year.[29]

[a] The IRS considers a U.S. "person" to include citizens, as well as certain nonresident individuals and estates and trusts if substantial decision-making authority is exercised by a U.S. court. See http://www.irs.gov/Individuals/International-Taxpayers/Classification-of-Taxpayers-for-U.S.-Tax-Purposes.



For the IRS, it is difficult to overstate the challenges that enforcing the law entails. In fact, the agency essentially admitted that it was not ready to do so, issuing a notice in May 2014 that the 2014 and 2015 calendar years would be regarded as a "transition" period for administration and enforcement of FATCA, even though final regulations were issued in January 2013.[30]

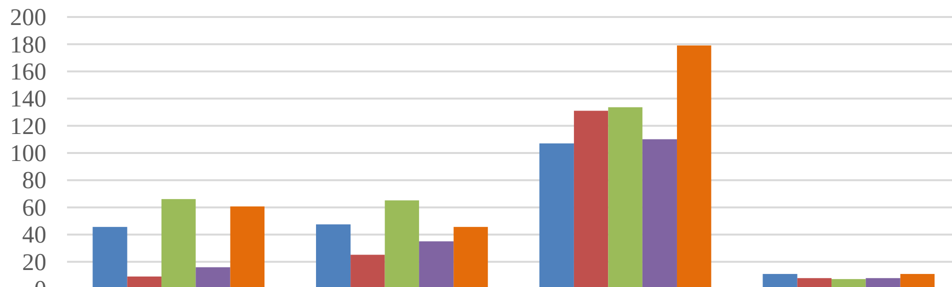
While the law's full implementation is in limbo, some analysts have been skeptical of its ability to generate enough revenue to cover its administrative and enforcement costs, for which there has been no complete estimate. The Joint Committee on Taxation estimated that FATCA's provisions could raise $8.7 billion over ten years, or an average of $870 million per year. By comparison, accounting firm KPMG reported that 25 percent of the global banks it surveyed will budget at least $1 million USD, with many indicating they will require more than $100 million USD annually to comply.[31] The majority of firms surveyed indicated that they would not be able to do so on their own, as KPMG reported that "given the compliance workload involved and how much is at stake, the majority of organizations (57 percent) are using or planning to use a professional services firm(s) to assist with their FATCA implementation program, with another 29 percent considering doing so."[32]

H. The U.S. Tax System Is Lagging Behind Others

It is remarkable how complex the U.S. tax system is when compared to other developed countries. Every year, accounting and consulting firm PricewaterhouseCoopers (PwC) publishes a report entitled "Paying Taxes" which compares the tax burdens faced by a hypothetical business in countries around the world. The burden is measured in hours per year spent complying with the country’s tax filing procedures, the number of payments it must make to do so, the overall tax rate the business would face, and an “ease of payment” ranking that weights those metrics. As an illustration of how bad complexity is in the United States, NTU Foundation compared these measurements to four other countries in the Organization for Economic Cooperation and Development (OECD).

On average, PwC’s studies have shown that the U.S. ranks worst among the five OECD countries compared in terms of the total time a business spends complying with the Tax Code and only France scores a worse overall ease of payment ranking. It is tied for worst when it comes to number of payments required. The study is a sobering reminder of just how much more difficult it is for U.S. businesses to comply with the Tax Code than those in other large economically developed countries.

Figure 3. PwC "Paying Taxes" Metrics, 2011-2016 Average



	Ease of Payment Rank	Tax Rate (Percent)	Hours to Comply	Payments
Australia	45.5	47.5	107	11
Canada	9.2	25.2	131	8
France	66.2	65.2	133.7	7.3
United Kingdom	15.8	35.0	110	8
United States	60.7	45.7	179	11

Australia Canada France United Kingdom United States

IV. Complexity Leaves Taxpayers in the Dark and at Risk

Individuals and businesses are subjected to the administrative burden of an overly complicated tax system, as well as the IRS agents and government officials tasked with enforcing it. Unfortunately for taxpayers, that too often means difficulty getting help when they need it, and a high risk of fraud, identity theft, or otherwise compromised personal information.

A. Taxpayer Services in Decline

On average per year, the IRS is inundated with 100 million phone calls, 10 million written letters, and 5 million in-person visits to its Taxpayer Assistance Centers. [33] This is the task of the IRS, according to the Taxpayer Advocate’s latest report to Congress, and the agency is simply incapable of keeping up with the workload thanks directly to tax complexity. The current state of the tax system means that many of those filers who ask for help will never receive it. That has very real implications for taxpayers' finances, as a slow-to-respond IRS means more preventable mistakes and therefore administrative backlogs; a greater demand for more readily available professional assistance; and more time spent trying to get in touch with the agency.

The problem has become so deplorable that the Taxpayer Advocate's 2014 report named the declining quality of service as the single "most serious problem" out of more than 20 others facing taxpayers. One of the clearest ways to demonstrate how increasingly difficult it is to get in touch with the IRS is by examining the "level of service" the agency achieved via its toll-free telephone assistance lines. This is a measure of how many taxpayers were able to get through to an employee and receive help before either giving up or being disconnected.

Table 4. IRS Telephone Level of Service

Fiscal Year	Total Calls (millions)	Level of Service (percent)	Average Wait (minutes)
2009	104.2	70	8.8
2010	104.2	74	10.8
2011	112.7	70.1	13
2012	131	67.6	16.7
2013	128.3	60.5	17.6
2014	99.1	64.4	19.6
2015	111.9	38.1	30.5

Source: Government Accountability Office.[34]

2015 was a bad year for taxpayer services. Earlier the Taxpayer Advocate projected that the IRS would only be able to assist half of all callers. The results fell short of that. While the number of calls rose by 13 percent, the level of service – that is the percentage of taxpayers able to actually reach the IRS – fell by 40 percent. For those who stayed on the line until reaching a live employee, the average wait time to do so was over half an hour. NTUF's own President was among those who called the agency late in 2014 with a question about recordkeeping of employee expenses. He timed the wait on his phone at just less than 45 minutes, and received an incomplete answer to his question.

The scenario is arguably even worse when measured in terms of written correspondence. Taxpayers who are found to have inconsistencies or incongruities on their returns are given an opportunity to explain or offer documentation of their reasoning; the IRS records these as "adjustments inventory." The IRS has established guidelines with the goal that the issue is resolved within 45 days. When a response to the taxpayer is required, the IRS sets a target to respond within 30 days.

As of September 30, 2015, the IRS had 667,242 open correspondence cases. Any that are not responded to within the time limit are classified as "overage." According to the Treasury Inspector

General for Tax Administration, the level of overage climbed from 40 percent in 2012 to over 49 percent in 2015.[35]

Historical data in Table 6 compiled last year by the Taxpayer Advocate (based on a slightly different methodology) shows how the percentage of correspondence not replied to within the designated time has skyrocketed.

Table 5. IRS Correspondence Overage

Fiscal Year	Open Adjustments Inventory	Overage (percentage)
2005	445,595	2
2006	573,175	28
2007	480,292	22
2008	725,943	33
2009	694,137	29
2010	606,029	28
2011	920,768	47
2012	1,028,539	48
2013	1,103,509	53
2014	937,529	51

Source: National Taxpayer Advocate 2014 Annual Report.

The numbers speak loudly and clearly: it is taking longer and longer for the IRS to respond to taxpayers facing problems with their returns in a timely manner. That means a vicious circle of longer administrative backlogs, delayed refunds and resolutions, and a larger workload for the IRS.

Going forward, the IRS has drafted a proposed "Future State Initiative" for taxpayer services.[36] The IRS seeks to shift communications with taxpayers away from phone calls and in-person visits and maximize use of online interactions. However, this plan topped the Taxpayer Advocate's 2015 list of the "most serious tax problems," noting that the IRS has not revealed comprehensive details regarding the plans nor solicited public comment.[37] The Advocate is concerned that the plan will further diminish services for certain taxpayers and drive up compliance costs.

In addition, the IRS is considering using its discretionary authority to increase existing user fees or establish new fees for certain services, but it is also attempting to hide the details of its plans from taxpayers. In the 2015 Annual Report to Congress, the Taxpayer Advocate redacted key portions of a memo evaluating the IRS's proposed new and increased user fees. Nina Olson commented on the unprecedented uncooperativeness of the IRS:

> *Indeed, as we obtained information from the IRS to produce this Annual Report to Congress, the IRS has asserted that numerous data points and documents we intended to include in the report are "official use only" and may not be made public. Never before has the IRS made this assertion in so many instances, and never before have we ultimately failed to come to*

agreement on some disputed items. To avoid the risk my staff or I could be subject to disciplinary action for unauthorized disclosure, we have been forced to redact portions of text in some sections, and we have omitted relevant information in others.

Furthermore, Ms. Olson stated in response to an NTUF inquiry, "Some of the user fees will very likely deter taxpayers from becoming compliant, simply by sending the clear message that you can't get relief unless you pay something. Most of them raise the question: What are the core functions of tax administration? If the IRS's job is to help taxpayers voluntarily comply with the laws, it seems to me it shouldn't be charging a fee when it's doing its core job."

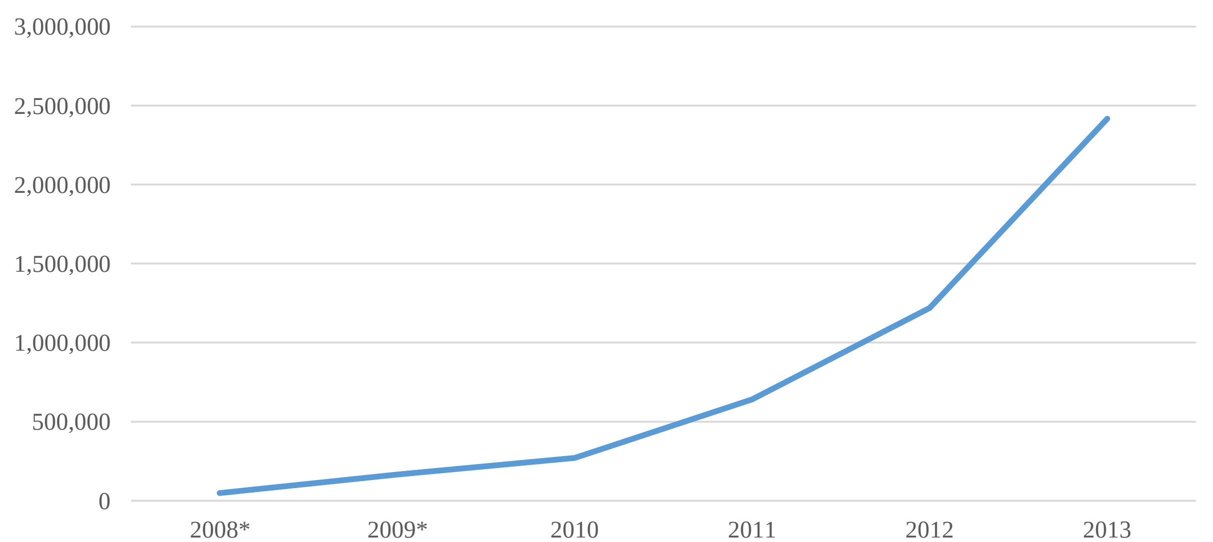
It is unclear to what degree the IRS is serious about pursuing any of these user fee increases, but they would ultimately weaken compliance and increase the cost burdens on taxpayers.

B. Online Tools Convenient, but Identity Theft Presents a Growing Threat

In light of the frustrations they face in their in-person, written, and telephone interaction with the IRS, more taxpayers are turning to the resources on the IRS website to get help navigating the tax system. Online access has increased rapidly in recent years. However, technology often proves to be a double-edged sword. Along with a complicated tax filing process and the massive amount of personal information submitted electronically to the IRS comes a severe security threat.

Recent years have seen a major uptick in taxpayer identity theft. In some cases, non-citizens do this in order to obtain documents necessary to gain employment, but data is also stolen and used to file fraudulent tax returns to claim bogus refunds from the IRS. The latest IRS figures show that there were 2.4 million taxpayers impacted by identity theft in 2013.

Figure 4. Number of Taxpayers Impacted by Identity Theft



* The figures for these years reflect only incidents recognized by the IRS, taxpayer-reported cased were not included.

A more recent and comprehensive accounting is unavailable, but the problem persists. In one major incident last year, criminals gained access to the tax information of over 700,000 people. Ironically, the thieves hacked into an IRS service designed to help the victims of identity theft. In a new benchmark study of corporate and government cybersecurity released just a few days before Tax Day in 2016, the IRS was given a grade of "F" for its network security due to expired certificates, weak ciphers, and open ports that could be vulnerable to hackers.[38]

The good news is the IRS was able to detect a number of these fraudulent filers. Through November of 2015 the agency rejected the processing of 4.8 million suspicious returns and stopped $10.9 billion in fraudulent refunds.[39] Sadly, the victims of identity theft often do not become aware that there is a problem until they learn from the IRS that someone has already filed under their name. The IRS has expanded its Identity Protection Specialized Unit but it is nevertheless overwhelmed with fraudulent returns. The Treasury Inspector General for Tax Administration reports that the average resolution time in 2013 for taxpayer identity theft cases was 278 days – nearly nine months, which is actually an improvement from 2012's 312-day waiting period.[40]

The GAO reported in April 2016 that according to IRS estimates, $25.6 billion in tax-related identity theft refund fraud was attempted in the 2014 filing year, involving 4.9 million returns. On the upside, 88 percent of that total – $22.54 billion – was detected, prevented, and recovered. However, that still means $3.1 billion in fraudulent refunds were issued, and when all is said and done the IRS has no way of knowing if more went undetected.[41]

The issue was front and center in last year's Taxpayer Advocate report which noted that the IRS takes an average of 312 days to resolve an identity theft case, even though cases referred to the Advocate directly can be straightened out in an average of 87 days. The Advocate noted:

> *"To its credit, the IRS has recognized identity theft as a major challenge and has devoted significant resources to addressing it. Yet the IRS still takes much too long to fully unwind the harm suffered by identity theft victims and issue refunds to the legitimate taxpayers. Moreover, the IRS has yet to implement an effective program for overseeing cases with multiple issues that require coordination among [20] different IRS units, and is allowing too many victims to fall between the cracks of IRS bureaucracy. Thus, victim assistance overall, as well as the IRS's specialized but decentralized approach, continues to be inadequate."*[42]

NTU Foundation summarized more of the risks associated with Tax Code complexity in a September 2014 report, *The Need for Tax Reform: Simplicity, Savings, and Security*.[43]

V. Conclusion

> *"No taxes can be devised which are not more or less inconvenient and unpleasant."*
> *George Washington, Farewell Address, September 19, 1796*

Our first President's farewell reminder remains true, but the level of inconvenience and unpleasantness inherent in the current Tax Code is unacceptable. A sound tax system should be based on five basic principles: simplicity, transparency, predictability, responsiveness, and efficiency. The existing system fails on these points. Every tax season that passes in the United States without meaningful tax reform is one in which the entire system becomes closer to falling apart. Rising costs and risks associated with complexity have very real economic impacts that are felt by taxpayers on a daily basis. However, they are also felt by the millions of Americans – at home and abroad – who find themselves willing but unable to comply with the system and in turn are confronted with weeks, months, even years of financial and bureaucratic difficulties as a result. Congress and the Executive Branch must face and address the rising tide of Tax Code complexity not only for the country's fiscal future, but also its citizens' well-being. Americans deserve a better, simpler tax system.

About the Author

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