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# Executive Summary

Most Americans naturally think of their income tax burden simply as the amount at the bottom line of their 1040 form. Economists, on the other hand, may express Americans' tax burden as a percentage of GDP or even as a date on the calendar, such as Tax Freedom Day. But such measures fail to register another cost to taxpayers — the cost of complying with the tax system.

This study estimates how much it costs both individuals and businesses to read the rules, fill out the forms, and do all the other things necessary to comply with the nation's tax laws.

It is important for the public to have an estimate of this cost because the performance of the economy is dramatically affected by the state of tax law. If lawmakers create an Internal Revenue Code that is terribly complex or that changes rapidly, taxpayers may not be able to obtain a reasonably certain conclusion about how taxation will affect a business plan or investment. When the tax consequences of various economic activities are unpredictable, then tax policy is handicapping the growth and dynamism of the U.S. economy.

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In fact, the U.S. income tax — the core of our government's tax system — is one of the most complex legal structures currently used for taxation by any government in the world.

Income tax complexity is almost wholly related to tax base questions — that is, questions or uncertainty about the timing or definition of taxable transactions. In other words, an income tax is inherently complex because it is so difficult to define income and determine when to recognize income and expense for tax purposes. Over time, the political give-and-take has made these difficult tax base questions inordinately complex. The definition of taxable income has not only expanded dramatically, but it has undergone chronic change.

*As if the complexities inherent in taxing income did not pose a sufficiently daunting challenge to the writers and administrators of the code, political and social demands must also be taken into account.*

As if the complexities inherent in taxing income did not pose a sufficiently daunting challenge to the writers and administrators of the tax code, political and social demands must also be taken into account. In particular, two goals for the code that contribute to complexity are "fairness" and social utility. They come into play when determining how much individual taxpayers should owe — the "ability-to-pay" principle, and when providing incentives for socially beneficial activities.

Many studies of the tax code find that our system, particularly the income tax code, is excessively complex. This study concurs, quantifying the code's complexity in a way that makes clear how unnecessary much of it is. In 1999 individuals and businesses spent over 4.3 billion hours complying with the federal income tax, with an estimated cost of compliance of over $125 billion. This amounts to imposing a 12-cent administrative burden for every dollar the income tax system collects.

If the high cost of complying with the federal income tax were a necessary price to pay for a fair and effective tax system, perhaps there would be little room for complaint, but in fact the complaints are justified.

# The Complications of the Federal Income Tax

Most Americans naturally think of their tax burdens as simply the amount they see at the bottom line of their 1040 forms. Economists, on the other hand, may try to express Americans' tax burden in broader terms, such as the government's take as a percentage of GDP or even as a date on the calendar, such as Tax Freedom Day. But such measures fail to register another cost to taxpayers — the cost of complying with the tax system.

*Experts complained about the complexity of the federal income tax system as early as 1914, the year immediately following the adoption of the 16th Amendment to the Constitution which authorized the income tax.*

The cost of complying with a tax system is directly related to the complexity of the system. In terms of complexity, it is fair to say that the U.S. income tax system — the core of the federal government's tax system — ranks among the most complex of the tax systems employed by any government in the world. Ironically, the term "income" itself accounts for the inherent complexity. There are so many different types and sources of income that it becomes extremely tricky to define and as a result has always added excess complexity to our tax system.

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Experts complained about the complexity of the federal income tax system as early as 1914, the year immediately following the adoption of the 16th Amendment to the Constitution which authorized the income tax. Since then, the quest for tax simplification has waxed and waned with generally little progress over the years as the tax code grew in complexity. Veteran tax professionals commonly point to the Tax Reform Act of 1969 as the legislation that infused much needless complexity into the income tax code. But they say nothing in that Act came anywhere near the bewildering complexities that were introduced by the tax enactments of the 1980s.

Within a three-year period in the first half of the 1980s, the income tax code was subjected to three massive pieces of legislation. First was what became known as "the Reagan tax cut," the Economic Recovery Tax Act of 1981. This was followed immediately by the Tax Equity and Fiscal Responsibility Act of 1982, and soon thereafter came the Deficit Reduction Act of 1984. However, the tax drama had not yet reached its climax, which occurred in 1986 with the enactment of the Tax Reform Act of 1986 (TRA'86).

TRA'86 was meant to make a clean break from the past complexity and instability in the tax code. The primary goal of its authors was tax simplification, and toward that end, the act reduced the number of rates and expanded the tax base (through the elimination of numerous tax loopholes). While the goal was laudable, the nation did not end up with a simpler tax code — especially from the perspective of businesses. Previous research by the Tax Foundation has found that there is near unanimity among senior corporate tax officers that TRA'86 brought tax complexity to an unprecedented level. They point to the alternative minimum tax, inventory capitalization rules, and foreign income rules as the main culprits.

## The Complex Job of Taxing Income

In 1927, the Joint Committee on Internal Revenue Taxation (Vol. 1, p. 5) reported that: "It must be recognized that while a degree of simplification is possible, a simple income tax for complex business is not." This early recognition of how difficult it is to tax income bears repetition and elaboration.

*The Problem of Defining Income*

Income tax complexity is almost wholly related to tax base questions — that is, questions or uncertainty about the timing or definition of taxable transactions. The inherent complexity of an income tax results from the difficulty of defining income and determining when and to whom to recognize income and expense for tax purposes. Over time, the political process of give-and-take has made these difficult tax base questions inordinately complex. The definition of taxable income has not only expanded dramatically, but it has undergone chronic change.

## Non-Economic Demands on the Code

In addition to the inherent complexities of taxing income, an important political goal of our tax system is to ensure that the income tax code is both fair and equitable. This goal comes into play in two important areas of the tax code that contribute to complexity: (1) determining how much individual taxpayers should owe — the "ability-to-pay" principle, and (2) providing incentives for socially beneficial activities.

*Ability to Pay*

From an economic perspective, the most efficient way to levy taxes is with a head tax. In other words, every person would pay an equal lump-sum tax. According to recent Tax Foundation research, if such a head tax were instituted today, every man, woman and child in the nation would have to pay $10,447 to fund the government at current levels. The federal government alone would account for almost 70 percent ($7,238) of the tax bill with state and local governments accounting for the remainder ($3,210).

Economists would call such a head tax efficient because it is economically neutral, avoiding all distortion of the free-market process. In other words, the burden of a head tax does not fall on any particular economic activity, so taxpayers' economic decisions would be completely unaffected by the tax system. Even the simplest income tax could never be 100 percent economically neutral precisely because the burden of the tax falls on income-producing activity, inevitably persuading some taxpayers in some circumstances to earn less income.

*The inherent complexity of an income tax results from the difficulty of defining income and determining when and to whom to recognize income and expense for tax purposes.*

Obviously, such a head tax would be administratively efficient as well, as neither taxpayers nor the government would need to document taxpayers' income. However, the head tax is politically troublesome, to put it mildly. Taxation anywhere near the current level would constitute an insuperable burden for low-income citizens. If television stars and day laborers must pool their resources to fund government operations that consume roughly one third of the nation's income, as they

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now do, then devising a tax system that takes "ability to pay" into account becomes inevitable, even if it does lead to a much more complex tax code.

Today the tax code includes a multitude of provisions to adjust the tax burden according to this "ability-to-pay" principle. The most obvious application of this principle is the graduated rate structure which increases a taxpayer's liability as a percentage of income as income rises. Other provisions adjust for the number of children in the family, family status (single, married, head of household), etc.

*Promoting Socially Useful Activities*

In addition to making allowances for the poor, today's income tax code includes numerous provisions to encourage activities that are deemed "socially beneficial." In the personal code, taxpayers are allowed various credits and deductions such as home mortgage interest, health care expenditures and the child tax credit, to name a few. On the business side, there are various credits — such as the investment tax credit — and preferential depreciation rules. As a result, the income tax code today is a hodgepodge of deductions and credits that have nothing to do with raising the revenue needed to fund government operations. In fact, these tax code items not only reduce revenues but at the same time dramatically increase the complexity of the tax code.

*The income tax code today is a hodgepodge of deductions and credits that have nothing to do with raising revenue for government operations. In fact, these tax code items not only reduce revenues, but at the same time needlessly increase the complexity of the tax code.*

Unfortunately, once inserted into the code, these preferential tax provisions become entrenched over time as various groups lobby for their protection and expansion. To economists this is known as rent-seeking. Such lobbies have a strong interest in maintaining the tax preference because they have usually spent substantial resources obtaining it. Also, the general public usually mounts little opposition since the benefits are concentrated on a relatively small group of taxpayers while the costs are spread amongst everyone else.

For example, let's look at the tax complexity caused by the ever-popular deduction for charitable contributions. As for any itemized deduction, taxpayers must keep an accurate accounting of their charitable contributions. If the value is over $250, the taxpayer also needs a statement from the charitable organization. While such record-keeping does not

*Not all tax evaders are as blatant as the tax lawyer who was recently caught claiming to have given his church $500 every Sunday — when the IRS inquired, the pastor of the taxpayer's church was not obliged to keep his parishioner's sin a secret.*

appear overly onerous, just look at some of the problems lurking in the background.

For one, charitable contributions are a significant source of "tax leakage," a term the Internal Revenue Service uses when it refers to the loss of tax revenue caused by under-reported income or over-reported deductions. For instance, a phantom donation of $25 a week would lead to a deduction of $1,300 a year. Obviously, if a significant number of taxpayers did this, the revenue loss would be quite significant. Not all tax evaders are as blatant as the tax lawyer who was recently caught claiming to have given his church $500 every Sunday — when the IRS inquired, the pastor of the taxpayer's church was not obliged to keep his parishioner's sin a secret. Such over-reporting of deductions leads to higher compliance costs for all taxpayers as the IRS has to resort to increased auditing and/or the addition of more rules and regulations.

Charitable organizations have to go through an approval process administered by the IRS before a contribution by an individual can be legally declared as a charitable deduction. The burden of this process is not a one-time cost because every approved charity has to be aware at all times that even the slightest change in its mission could nullify its charitable status according to the IRS. Of course, this process is costly, in time and money, for the charities and the IRS.

The rules and regulations governing the deduction not only add to the complexity in the tax code, but naturally, the deduction also lowers government revenue, forcing everyone else to pay higher tax rates. However, while there are a multitude of organizations that stand ready to defend the deductibility of charitable contributions, there are no large groups of taxpayers that oppose its complexity.

The complexity caused by this one popular deduction is like the proverbial tip of the iceberg. There are literally thousands of similar special preferences written into the tax law that promote various activities or benefit a group of taxpayers. These groups of taxpayers stand ready to defend their tax preferences with economic and emotional arguments that relate to the taxpayers' ability to pay or the social benefits of the activity in question. This organized resistance to simplification has been phenomenally successful over many years, causing many legislators to despair of piecemeal efforts at tax simplification.

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### Fundamental Tax Reform

One way to get around the problems caused by rent-seeking, thereby reducing complexity and its attendant costs in the income tax code, is to reform the entire federal income tax system. Reform proposals are currently on the table that attempt to make simplification and the promotion of economic growth the principal strategies of tax policy. These include the national sales tax sponsored by Rep. Billy Tauzin and the flat income tax proposal sponsored by Rep. Dick Armey.

The national sales tax takes the direct approach and moves away from the concept of taxing income completely — taxing consumption instead. The flat tax, on the other hand, moves to cash flow as the tax base, rather than accrued income. A cash flow tax, as it applies to business, totals business receipts and then subtracts purchases from other businesses. On the individual level, the approach resembles a universal IRA.

Both proposals would boost economic performance by eliminating the double tax on savings, and both promise huge reductions in the complexity of the tax code. As of this writing, however, neither plan has garnered widespread support. Even if a plan to fundamentally simplify the tax system did gain momentum, the possibility exists that provisions would be added during the legislative process that would add new complexity, such as happened in 1986.

# The Growth and Instability of the Income Tax Code

Despite decades of concern over its undue complexity, the income tax was formally placed at the core of the federal tax system by the Internal Revenue Act of 1954. Overall, two important measures of tax complexity have climbed dramatically since then — the size and the instability of the tax code.

## The Growth of the Code

Table 1, Figure 1 and Figure 2 chart the dramatic growth over the past 40 years in the combined number of words that define the body of both the federal income tax laws and their attendant regulations. Since 1954, the estimated number of words in the entire tax code devoted to the income tax has grown

Table 1
Growth of the Number of Words in the Internal Revenue Code, Selected Years, 1955–2000

Thousands of Words

| | 1955 | 1965 | 1975 | 1985 | 1995 | 2000 |
|---|---|---|---|---|---|---|
| Internal Revenue Code | | | | | | |
| Income Taxes Only | 172 | 243 | 395 | 645 | 881 | 982 |
| Entire Tax Code | 409 | 548 | 758 | 1,107 | 1,488 | 1,670 |
| Period-to-Period Percent Growth | | | | | | |
| Income Taxes Only | * | 41.4% | 62.8% | 63.2% | 36.6% | 11.5% |
| Entire Tax Code | * | 33.8% | 38.3% | 46.0% | 34.5% | 12.2% |
| Internal Revenue Code Regulations | | | | | | |
| Income Taxes Only | 572 | 1,715 | 2,571 | 3,762 | 4,880 | 5,947 |
| Entire Tax Code | 1,033 | 3,098 | 3,295 | 4,613 | 6,135 | 7,307 |
| Period-to-Period Percent Growth | | | | | | |
| Income Taxes Only | * | 199.6% | 49.9% | 46.3% | 29.7% | 21.8% |
| Entire Tax Code | * | 199.9% | 6.4% | 40.0% | 33.0% | 19.1% |
| Internal Revenue Code and Regulations | | | | | | |
| Income Taxes Only | 744 | 1,957 | 2,966 | 4,406 | 5,761 | 6,929 |
| Entire Tax Code | 1,442 | 3,646 | 4,053 | 5,720 | 7,623 | 8,976 |
| Period-to-Period Percent Growth | | | | | | |
| Income Taxes Only | * | 163.1% | 51.5% | 48.6% | 30.8% | 20.3% |
| Entire Tax Code | * | 152.8% | 11.2% | 41.1% | 33.3% | 17.7% |

Source: Tax Foundation calculations based on the annual publications of "Internal Revenue Code" and "Federal Tax Regulations" from West Publishing Company.

from 42 percent to 59 percent, more than a 40 percent increase over the last four decades. The volume of income tax regulations has grown even more. In 1954, income tax regulations represented 55 percent of the body of tax code regulations. Today, that figure has grown to 81 percent, an increase of more than 47 percent over the past four decades.

The Tax Foundation has determined that over the past 45 years the number of words detailing the income tax laws has grown from 172,000 words in 1955 to 982,000 today — an increase of 472 percent. Income tax regulations, which provide taxpayers with the "guidance" they need to calculate their taxable income, have grown at an even faster pace from 572,000 words in 1955 to 5,947,000 words today — an increase of 939 percent. Combined, the federal income tax code and regulations grew from 744,000 words in 1955 to 6,929,000 today—an increase of 831 percent.

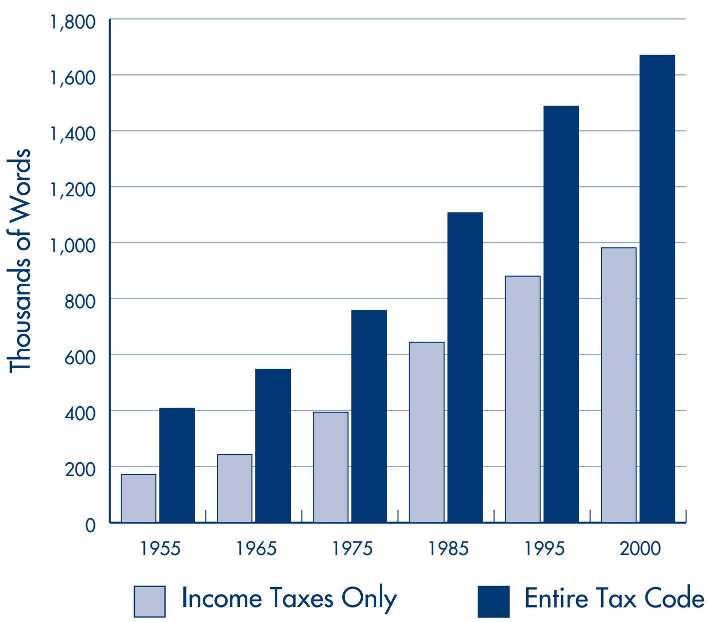
### *Growth of the Code by Subject Area*

Perhaps a more revealing measure of tax code complexity is the multiplication of the subchapters and subsections that comprise the Internal Revenue Code. In 1954, federal income tax law was comprised of 103 code sections. Today, there are 725 income tax code sections, a 604 percent increase. (See Table 2.)

Almost all of the growth relates to tax base questions. For example, since 1954, the number of sections dealing with the "Determination of Tax Liability" has grown 1,150 percent; the number of sections dealing with "Capital Gains and Losses" has grown 1,300 percent; the number of sections dealing with "Deferred Compensation" (e.g., pension plans) has grown 1,450 percent; and the number of sections dealing with the "Computation of Taxable Income" has grown by more than 1,589 percent.

The growth in the volume of the income

## Figure 1
## Growth of the Internal Revenue Code as Measured by the Estimated Number of Words
### Selected Years, 1955 – 2000




| Year | Income Tax Provisions Only | Entire Tax Code |
|---|---|---|
| 1955 | 171,628 | 409,421 |
| 1965 | 242,604 | 547,910 |
| 1975 | 394,985 | 757,890 |
| 1985 | 644,600 | 1,106,661 |
| 1986 | 642,842 | 1,101,094 |
| 1987 | 682,104 | 1,122,190 |
| 1988 | 689,722 | 1,143,286 |
| 1989 | 760,628 | 1,238,804 |
| 1990 | 774,692 | 1,269,276 |
| 1991 | 758,870 | 1,265,760 |
| 1992 | 757,112 | 1,266,932 |
| 1993 | 763,558 | 1,283,926 |
| 1994 | 806,922 | 1,339,010 |
| 1995 | 880,758 | 1,488,440 |
| 1996 (a) | 899,803 | 1,520,084 |
| 1997 | 918,848 | 1,551,728 |
| 1998 | 962,212 | 1,606,519 |
| 1999 | 973,346 | 1,661,310 |
| 2000 | 982,136 | 1,669,514 |

(a) Interpolated.

Source: Tax Foundation calculations based on the annual publications "Internal Revenue Code" from West Publishing Company.

tax laws and regulations is a direct result of the 32 significant federal tax enactments that have taken place since 1954—or approximately one every 1.4 years. Previous Tax Foundation research (based on a sample of one-fifth of the core sections of the income tax code) found that these enactments have not only increased the volume of the tax code, but resulted, on average, in the amendment of each section once ever four years (as of 1994). This instability has been much more pronounced in the past 20 years than it was during the 20 years immediately following the 1954 Act.

### Quantifying the Cost of Complexity and Tax Compliance

The complexity generated by the growth and constant change of the tax code creates two general types of economic cost: overhead and opportunity cost. Overhead can be divided into three principal activities: the economically sterile exercises of tax planning, compliance, and litigation, all of which act like tax surcharges on taxpayers.

- The first type of overhead is tax planning, which in this context refers to all the economic decisions that individuals and firms make because of the tax code.
- The second type of overhead, tax compliance, refers here to the basic actions required to comply with the federal income tax, including record keeping, education, form preparation and packaging/sending.
- The third type of overhead is litigation, referring to the cost of the IRS and the Tax Court, as well as all the legal costs that taxpayers incur while dealing with these two government institutions.

Of these three costs, the second — tax compliance — is the only one estimated in this report. It is for this reason that the data presented here should be viewed as extremely cautious estimates of the federal income tax compliance burden on taxpayers.

For example, a company plans to build a manufacturing facility. However, after tax planning, the decision is reached to build a slightly different facility in a different location. The company later files a tax return on the activities of the facility, but the IRS objects to some aspect of the tax return, and after some legal wrangling, the return is finalized. In this case, only the firm's costs of actually calculating and filing its tax return are part of the Tax Foundation's estimate of the "cost of compliance."

As for the second general type of economic cost caused by the tax system — opportunity costs — they are also excluded from Tax Foundation estimates of the compliance burden. Arriving at an estimate of opportunity costs is a much more difficult and speculative task.

For instance, imagine a software developer who has to spend time complying with the tax code. Data are available to compute an estimated value of the tax work he accomplishes, and this report does that. But it is not possible to estimate with any precision the val-

**Table 2**
**Growth of Subsections in the Internal Revenue Code**
**1954 and 2000**

| Subchapter of Income Tax Code | Number of Sections in Subchapter 1954 | 2000 | Percentage Growth |
|---|---|---|---|
| Determination of Tax Liability | 4 | 50 | 1150% |
| Computation of Taxable Income | 9 | 152 | 1589% |
| Corporate Distributions and Adjustments | 14 | 35 | 150% |
| Deferred Compensation | 2 | 31 | 1450% |
| Accounting Periods and Methods | 6 | 33 | 450% |
| Tax-Exempt Organizations | 4 | 19 | 375% |
| Corporations Used to Avoid Income Tax on Shareholders | 4 | 27 | 575% |
| Banking Institutions | 3 | 8 | 167% |
| Natural Resources | 3 | 10 | 233% |
| Estates, Trusts, Beneficiaries, Etc. | 7 | 32 | 357% |
| Partners and Partnerships | 7 | 36 | 414% |
| Insurance Companies | 5 | 30 | 500% |
| Regulated Investment Companies, Etc. | 1 | 22 | 2100% |
| Tax Based on Income from Within or Without the United States | 9 | 79 | 778% |
| Gain/Loss on Disposition of Property | 7 | 40 | 471% |
| Capital Gains and Losses | 4 | 56 | 1300% |
| Readjustment of Tax Between Years and Special Limitations | 6 | 7 | 17% |
| Tax Treatment of S Corporations | 0 | 14 | NA |
| Other (a) | 8 | 44 | 450% |
| TOTAL | 103 | 725 | 604% |

(a) Includes all subchapters not explicitly listed as well as Chapters 2–6 of Subtitle A of the Internal Revenue Code.
Source: Tax Foundation computations from Internal Revenue Code.

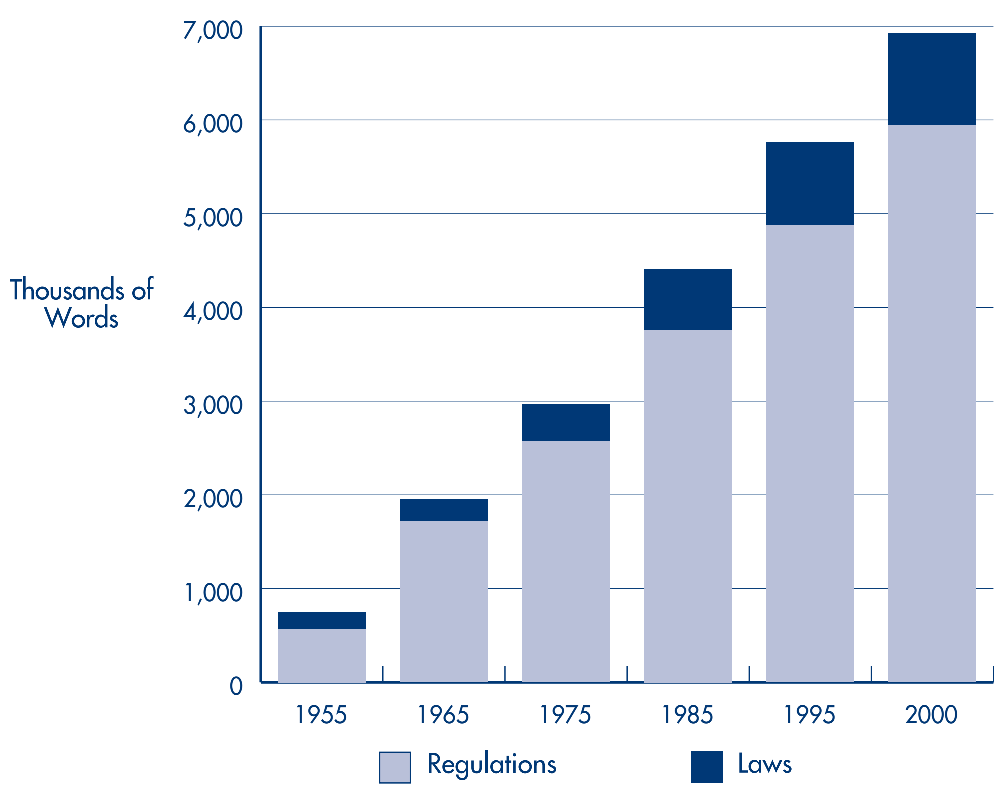
ue of the work that the taxpayer might have accomplished had tax compliance not replaced entrepreneurial effort. This time may have been spent working on a new idea that one day blossomed into the next Microsoft — creating tens of billions of dollars in wealth. And even if phenomenal wealth would not have been created in that time, it is still true that every hour or dollar spent complying with the tax code represents resources that could have been spent tending to business problems, adding value to the economy while doing the work that the taxpayer is good at.

As shown in Tables 3 and 4, the Tax Foundation estimates that in 1999 individuals and businesses spent over 4.3 billion hours complying with the federal income tax. Using an hourly cost of $24.14 for individuals and $34.66 for businesses, the estimated cost of compliance in 1999 was over $125 billion. (See Methodology section for details about how the hours and wages were determined.)

***It is not possible to estimate with any precision the value of the work that a taxpayer might have accomplished had tax compliance not replaced entrepreneurial effort.***

In 1999, the federal government collected $892.7 billion in individual income taxes and $193.9 billion in corporate income taxes. Therefore, the overall compliance cost sur-

Figure 2
Growth of the Income Tax Code's Laws and Regulations
Selected Years, 1955 – 2000



charge alone amounts to nearly 12 cents for every $1 collected by the federal income tax.

To put the tax compliance burden into perspective, the $125 billion tax surcharge is greater than the combined revenue of Motorola ($31.0 billion), Intel ($29.4 billion), Microsoft ($19.8 billion), Cisco ($12.2 billion), Sun Microsystems ($11.7 billion), Oracle ($8.8 billion), Seagate ($6.8 billion) and America Online ($4.8 billion). Put another way, 4.3 billion hours per year represents a work force of over 2,083,000 people, larger than the populations of Dallas (1,076,000) and Detroit (965,000) combined, and more people than work in the auto industry, the computer manufacturing industry, the airline manufacturing industry, and the steel industry combined.

# Conclusion

Because of the complexity and instability in the tax code, taxpayers may not be able to obtain a reasonably certain conclusion about how taxation will affect a business plan or investment. If taxpayers cannot accurately predict the tax consequences of a particular economic activity, either because of complexity or instability in the tax code, then tax policy is handicapping the growth and dynamism of the U.S. economy.

If the high cost of complying with the federal income tax were a necessary price to pay for a fair and effective tax system, perhaps there would be little room for complaint. But the complexity and its costs are unnecessary.

## Table 3
## Estimated Cost to Individuals for the Federal Income Tax System
## 1999

| Individuals | Number of Returns | Record-keeping | Education | Form Preparation | Packaging/ Sending | TOTAL | Total Hours |
|---|---|---|---|---|---|---|---|
| Forms | | | | | | | |
| 1040 (a) | 72,825,100 | 3.25 | 2.7 | 6.4 | 0.6 | 12.9 | 935,802,535 |
| 1040A (b) | 15,590,600 | 2.3 | 3.2 | 6.1 | 2.0 | 13.6 | 211,252,630 |
| 1040EZ (c) | 17,478,600 | 0.1 | 1.6 | 1.8 | 0.3 | 3.8 | 65,836,060 |
| 1040ES | 41,254,300 | 1.3 | 0.3 | 0.8 | 0.2 | 2.6 | 106,573,608 |
| 1040X | 3,084,000 | 1.3 | 0.5 | 1.2 | 0.6 | 3.6 | 10,948,200 |
| 4868 (Extension of Time) (d) | 7,712,900 | 0.4 | 0.2 | 0.3 | 0.2 | 1.1 | 8,355,642 |
| 2688 (Extension of Time) (e) | 2,778,300 | 0.0 | 0.1 | 0.2 | 0.3 | 0.6 | 1,759,590 |
| 1041 (Estates and Trusts) | 3,486,700 | 46.6 | 18.4 | 34.9 | 4.3 | 104.2 | 363,372,252 |
| 1041ES | 1,615,100 | 0.3 | 0.3 | 1.5 | 1.0 | 3.1 | 5,006,810 |
| 1040 Schedules | | | | | | | |
| Sch A | 48,988,318 | 3.1 | 0.7 | 1.6 | 0.3 | 5.7 | 276,783,994 |
| Sch B | 50,798,115 | 0.6 | 0.1 | 0.4 | 0.3 | 1.4 | 71,963,996 |
| Sch D | 33,223,125 | 1.1 | 2.3 | 1.7 | 0.6 | 5.6 | 184,942,061 |
| Sch E | 19,905,034 | 2.9 | 1.1 | 1.3 | 0.6 | 5.9 | 116,444,450 |
| Sch EIC | 21,685,925 | 0.0 | 0.0 | 0.2 | 0.3 | 0.6 | 13,011,555 |
| Sch H | 410,875 | 0.8 | 0.5 | 0.9 | 0.6 | 2.7 | 1,116,211 |
| Sch R | 558,094 | 0.3 | 0.3 | 0.5 | 0.6 | 1.7 | 920,856 |
| Estate and Gift | | | | | | | |
| 706 and 706NA (Estate) | 113,600 | 10.8 | 6.9 | 12.7 | 9.7 | 40.1 | 4,551,573 |
| 709 (Gift) | 273,900 | 0.7 | 1.1 | 1.9 | 1.1 | 4.7 | 1,287,330 |
| Total (Forms + Schedules) | 341,782,587 | NA | NA | NA | NA | NA | 2,379,929,354 |

(a) Includes 1040PC and electronically filed 1040 forms.
(b) Schedules 1-3 are included in the average time.
(c) Includes Telefiled 1040EZ forms.
(d) Application for automatic extension of time in which to file the individual income tax return.
(e) Application for additional extension of time in which to file the individual income tax return.

# Methodology

The federal income tax compliance cost estimate is based on data from the Internal Revenue Service. Table 3 compiles a list of the core individual income tax forms along with both the estimated paperwork-burden calculation (in hours of compliance time) generated by the Internal Revenue Service. It also reports IRS projections for 1999 of the number of tax returns by type. Table 4 compiles a

## Table 4
## Estimated Cost to Business of the Federal Income Tax System
### 1999

| Business Forms | Number of Returns | Record-keeping | Education | Form Preparation | Packaging/ Sending | TOTAL | Total Hours |
|---|---|---|---|---|---|---|---|
| **Sole Proprietorships** | | | | | | | |
| Form 1040 | 19,176,300 | 3.3 | 2.7 | 6.4 | 0.6 | 12.9 | 246,415,455 |
| Sch C | 14,932,883 | 6.4 | 1.2 | 2.1 | 0.6 | 10.3 | 154,057,576 |
| Sch C-EZ | 2,444,217 | 0.8 | 0.1 | 0.6 | 0.3 | 1.7 | 4,236,643 |
| Sch F | 1,799,200 | 4.2 | 0.5 | 1.3 | 0.3 | 6.3 | 11,364,947 |
| Sch SE | 18,124,550 | 0.3 | 0.3 | 0.4 | 0.3 | 1.2 | 22,353,611 |
| **Partnerships** | | | | | | | |
| Form 1065 | 1,948,600 | 39.8 | 21.5 | 37.2 | 4.0 | 102.5 | 199,731,500 |
| Part. Schedules | | | | | | | |
| Sch D | 1,948,600 | 6.9 | 1.6 | 1.8 | 0.0 | 10.3 | 20,070,580 |
| Sch K-1 | 1,948,600 | 25.1 | 9.3 | 10.2 | 0.0 | 44.6 | 86,940,037 |
| Sch L | 1,948,600 | 15.5 | 0.1 | 0.4 | 0.0 | 16.0 | 31,177,600 |
| Sch M-1 | 1,948,600 | 3.4 | 0.2 | 0.3 | 0.0 | 3.8 | 7,437,157 |
| Sch M-2 | 1,948,600 | 2.9 | 0.1 | 0.2 | 0.0 | 3.1 | 6,073,137 |
| **Corporations** | | | | | | | |
| Forms | | | | | | | |
| 1120 | 2,224,400 | 72.0 | 41.2 | 71.1 | 7.8 | 192.1 | 427,233,093 |
| 1120A | 265,100 | 44.2 | 23.6 | 41.1 | 4.6 | 113.5 | 30,080,013 |
| 1120S | 2,698,200 | 63.4 | 21.4 | 39.2 | 4.6 | 128.4 | 346,538,820 |
| 1120X | 16,000 | 12.4 | 1.4 | 3.6 | 0.5 | 18.0 | 287,467 |
| 1120F | 21,900 | 107.1 | 40.3 | 69.9 | 7.5 | 224.9 | 4,924,215 |
| 1120FSC | 5,500 | 92.6 | 18.1 | 36.0 | 0.0 | 146.6 | 806,392 |
| 1120POL | 5,600 | 15.5 | 6.2 | 15.1 | 2.4 | 39.3 | 219,800 |
| 1120RIC | 10,100 | 58.1 | 18.9 | 35.6 | 4.3 | 116.9 | 1,180,690 |
| 7004 (Extension of Time) (a) | 2,763,200 | 5.5 | 1.0 | 2.0 | 0.3 | 8.8 | 24,178,000 |
| 4626 (AMT) | 355,904 | 18.2 | 14.8 | 15.8 | 0.0 | 48.7 | 17,344,388 |
| 4562 (Depreciation) | 2,489,500 | 37.3 | 5.2 | 6.0 | 0.0 | 48.5 | 120,657,767 |
| 1120 Schedules | | | | | | | |
| Sch D | 2,224,400 | 6.9 | 3.5 | 5.7 | 0.5 | 16.6 | 36,999,187 |
| Sch H | 222,440 | 6.0 | 0.6 | 0.7 | 0.0 | 7.3 | 1,620,105 |
| Sch PH | 111,220 | 15.3 | 6.2 | 8.6 | 0.5 | 30.6 | 3,407,039 |
| 1120S Schedules | | | | | | | |
| Sch D | 2,698,200 | 10.5 | 4.6 | 9.7 | 1.3 | 26.1 | 70,512,960 |
| Sch K-1 | 2,698,200 | 15.5 | 10.4 | 2.1 | 1.1 | 29.1 | 78,472,650 |
| **Business Total** | | | | | | | |
| (Forms + Schedules) | 86,978,614 | NA | NA | NA | NA | NA | 1,954,320,828 |
| **GRAND TOTAL** | 428,761,200 | NA | NA | NA | NA | NA | 4,334,250,181 |

(a) Application for automatic extension of time in which to file the corporate income tax return.
Source: Tax Foundation, using Internal Revenue Service data and estimation methods.

similar list for the business sector. These lists are far from exhaustive. Not only are many obscure forms and schedules left out, but the lists are also incomplete to the degree that adequate tax return information could not be obtained or estimated for the many schedules and forms that are common auxiliary components of the core forms.

One trend in tax filing has been the growth in alternative methods of filing — the tele-file and the e-file. These filing methods primarily affect the delivery of the tax filings rather than the filings themselves. In the case of the tele-file, the 1040EZ must be used in order to file over the phone. As such, all tele-filed forms were counted under the 1040EZ form. In the case of the e-file, both the 1040 and 1040A forms can be filed electronically. Unfortunately, no data is available to break down the types of e-filings. In order to keep the time estimates on the conservative side, all e-files were counted as 1040 filings (as the 1040 requires less time to file than the 1040A).

Once the total number of hours spent on compliance has been determined, an hourly rate is then applied in order to determine the cost of compliance. This hourly rate was determined in one of two ways.

First, for individuals who filed themselves, the report uses their hourly compensation rate (wages and salary plus benefits) as a proxy for their "tax surcharge." Some may argue that individuals would value their time more highly than their hourly salary rate since it is their leisure time (time not spent in formal work) that is given up to file taxes. However, to avoid speculation, we believe that the hourly compensation rate represents the best estimate of a minimum compliance cost level for individuals.

Utilizing data from the National Compensation Survey and Employment Cost Index published by the Bureau of Labor Statistics, the Tax Foundation estimates a national hourly wage and salary rate of $16.22. In addition, utilizing data from the National Income and Product Accounts published by the Bureau of Economic Analysis, the Tax Foundation estimates that benefits increase total compensation by 18.4 percent, for a total hourly compensation rate of $19.20.

Second, for filings made by tax professionals, the report uses the average compensation rate for tax accountants. Unfortunately, the National Compensation Survey does not list "tax accountants" as a separate occupation. Therefore, the Tax Foundation estimates their rate by averaging "accountants and auditors" and "lawyers" together — since tax accountants must be adept not only in accounting procedures, but also in interpreting tax law and court rulings. This yields an hourly wage and salary rate of $29.27. After adjusting this wage to include benefits, a final hourly compensation rate of $34.66 is reached.

To derive the final average compensation cost for individual filings, the report also takes into account the number of forms prepared by individuals and those prepared by tax professionals. The latest IRS data shows that 56 percent of all forms are prepared by tax professionals. Using a weighted average, the final compensation cost is $24.14. For businesses, the average compensation cost is the rate derived for the average tax accountant — $34.66.