

# The Compliance Costs of IRS Regulations

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President

## Key Findings:

- The growing complexity of the U.S. tax code has led to large compliance costs for households and businesses.
- Using data from the Office of Information and Regulatory Affairs and the Bureau of Labor Statistics, it is possible to estimate the total cost of tax compliance on the U.S. economy.
- Americans will spend more than 8.9 billion hours complying with IRS tax filing requirements in 2016.
- All in all, tax compliance will cost the U.S. economy \$409 billion this year.

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## Introduction

There are many reasons to reform the U.S. tax code. The United States has a high marginal corporate tax rate, a poorly defined tax base, and an out-of-date international tax system. However, one often overlooked issue in tax reform is complexity. For decades, the tax code has become more and more detailed, with thousands of additional pages of statutes, regulations, and case law. This added complexity imposes a real cost on the U.S. economy. Tackling the cost of tax complexity to our nation's economy should be a priority for lawmakers.

## The Expanding Size of the Tax Code

Over the last century, the federal tax code has expanded dramatically in size and scope. In 1955, the Internal Revenue Code stood at 409,000 words. Since then, it has grown to a total of 2.4 million words: almost six times as long as it was in 1955 and almost twice as long as in 1985.

However, the tax statutes passed by Congress are only the tip of the iceberg when it comes to tax complexity. There are roughly 7.7 million words of tax regulations, promulgated by the IRS over the last century, which clarify how the U.S. tax statutes work in practice. On top of that, there are almost 60,000 pages of tax-related case law, which are indispensable for accountants and tax lawyers trying to figure out how much their clients actually owe.

## It Takes America 8.9 Billion Hours to Comply with IRS Paperwork.

Tax complexity creates real costs for American households and businesses, starting with just the time it takes us to comply with the tax code.

According to the latest estimates from the Office of Information and Regulatory Affairs, Americans will spend more than 8.9 billion hours complying with IRS tax filing requirements in 2016.<sup>1</sup> This is equal to nearly 4.3 million full-time workers doing nothing but tax return paperwork. The majority of the 8.9 billion hours will be spent complying with U.S. business (2.8 billion hours) and individual income (2.6 billion hours) tax returns (Table 1, below).

It wasn't long ago that official estimates put the annual IRS paperwork burden at 6.1 billion hours.<sup>2</sup> However, the IRS recently revised its estimate of the hours required to comply with business tax returns from 363 million to 2.8 billion,<sup>3</sup> which increased the total time estimate by nearly 50 percent.

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1 The raw data behind these estimates can be found at Office of Information and Regulatory Affairs, "Information Collection Review," <http://www.reginfo.gov/public/do/PRAMain>.

2 National Taxpayer Advocate, *2012 Annual Report to Congress*, December 31, 2012, <http://taxpayeradvocate.irs.gov/2012-annual-report/downloads/2012-Annual-Report-to-Congress-Executive-Summary.pdf>

3 Dan Goldbeck, "The IRS's New Year's Resolution," *Insight*, American Action Forum, January 4, 2016. <http://www.americanactionforum.org/insight/the-irss-new-years-resolution/>

## The Tax Complexity Will Cost the U.S. Economy \$409 Billion This Year.

The time it takes to comply with the tax code imposes a real cost on the economy. Individuals and businesses need to devote resources to complying with the tax code instead of doing other productive activities. For example, a business owner who needs to file a complex tax return each year may hire an accountant or tax lawyer to do it. This tax professional may cost \$70,000 a year or more. This is \$70,000 that this business owner cannot devote to purchasing equipment or hiring workers. Economists refer to this as an opportunity cost, and it results in lost productivity.

Put in dollar terms, the 8.9 billion hours needed to comply with the tax code computes to \$409 billion each year in lost productivity, or greater than the gross product of 36 states (Table 1).<sup>4</sup>

Table 1.

### Estimate Hourly and Compliance Costs of IRS Paperwork in 2016

#### Top 50 Most-Costly Code Provisions

Form/Title	Total Annual Hours Burden	Total Annual Cost In Dollars
U.S. Business Income Tax Returns (1)	2,832,500,000	\$147,431,625,000
U.S. Individual Income Tax Returns	2,647,000,000	\$98,680,160,000
Income Tax Returns for an S Corporation (1)	889,393,518	\$46,292,932,612
Form 4562--Depreciation and Amortization (1)	448,368,447	\$23,337,577,666
Employer's Quarterly Federal Tax Return (1)	388,256,964	\$20,208,774,976
Income Tax Returns for Estates and Trusts (1)	375,796,476	\$19,560,206,576
Form 940, FUTA Tax Return (1)	105,295,370	\$5,480,624,009
Form 4797--Sales of Business Property (1)	100,633,248	\$5,237,960,558
Schedule C: Profit and Loss from Business	71,701,693	\$2,673,039,115
Form 1099-INT, Interest Income	63,059,438	\$2,350,855,849
Proceeds from Broker and Barter Exchange Transactions (1)	49,396,988	\$2,571,113,225
IRA Contribution Information	48,731,780	\$1,816,720,758
Short Form Return of Exempt Organizations	43,656,636	\$1,627,519,390
TD 8864 Taxation of Fringe Benefits (1)	37,922,688	\$1,973,875,910
Distributions from Pensions, Annuities, IRAs	37,519,860	\$1,398,740,381
Form 8941 - Credit for Small Employer Health Insurance Premiums	34,278,346	\$1,277,896,739
Form 1099-DIV--Dividends and Distributions	34,115,874	\$1,271,839,783
26 CFR 31.6001-1 Records in general; 26 CFR 31.6001-2 Additional Records under FICA	30,273,950	\$1,128,612,856
Heavy Highway Vehicle Use Tax Return	27,120,040	\$1,011,035,091
Foreign Tax Credit (Individual, Estate, or Trust)	25,066,693	\$934,486,315
W-8 BEN, W-8BEN-E, W-8EIC, W-8EXP, W-8IMY, W-8 MOU Program	25,003,304	\$932,123,173
Return of Organization Exempt From Income Tax Under Section 501(c), 527, or 4947(a)(1)	24,951,529	\$930,193,001
1099-G Certain Government Payments	24,709,380	\$921,165,686
1099-Miscellaneous Income	24,639,062	\$918,544,231

<sup>4</sup> Author's calculations: See the appendix for details.

Table 1. *Continued***Estimate Hourly and Compliance Costs of IRS Paperwork in 2016***Top 50 Most-Costly Code Provisions*

Form/Title	Total Annual Hours Burden	Total Annual Cost In Dollars
Form 8948, Preparer Explanation for Not Filing Electronically	18,270,900	\$681,139,152
Paid Preparer's Earned Income Credit Checklist (Form 8867)	17,824,793	\$664,508,283
Reg-111583-07(TD 9405)(Final) -- Employment Tax Adjustments; REG-130074-11 - Rules Relating to Additional Medicare Tax	16,900,000	\$630,032,000
Employer's Annual Employment Tax Return	15,702,300	\$585,381,744
Split-Interest Trust Information Return	15,152,550	\$564,887,064
Form 2678 - Employer/Payer Appointment of Agent	13,731,200	\$511,899,136
REG-113572-99 (Final) Qualified Transportation Fringe Benefits	12,968,728	\$483,474,180
Form 990-PF	11,054,637	\$412,116,867
Employer's Annual Tax Return for Agricultural Employees	10,880,812	\$405,636,671
Form 3800, General Business Credit	8,345,000	\$311,101,600
Mortgage Interest Statement	8,038,699	\$299,682,699
Profit or Loss From Farming	7,845,596	\$292,483,819
Form 8282, Donee Information Return; Form 8283, Noncash Charitable Contributions	7,806,097	\$291,011,296
Domestic Production Activities Deduction	7,398,000	\$275,797,440
Form 5300, Application for Determination for Employee Benefit Plan	7,201,200	\$268,460,736
Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan	7,005,000	\$261,146,400
Form 8825--Rental Real Estate Income and Expenses of a Partnership or an S Corporation	6,288,600	\$234,439,008
Publication 1345, Handbook for Authorized IRS e-file Providers	6,023,762	\$224,565,847
Exempt Organization Business Income Tax Return	5,262,319	\$196,179,252
Application for Determination for Adopters of Master or Prototype or Volume Submitter Plans	5,139,000	\$191,581,920
Tuition Payments Statement	4,848,090	\$180,736,795
Quarterly Federal Excise Tax Return	4,478,956	\$166,975,480
Form 8957 - Foreign Account Tax Compliance Act (FATCA)	4,446,476	\$165,764,625
Form W-2G--Certain Gambling Winnings	4,304,877	\$160,485,815
Information Return of U.S. Persons With Respect To Certain Foreign Corporations	4,280,244	\$159,567,496
All remaining IRS regulations (1)	285,801,030	\$10,654,662,398
<b>IRS Total</b>	<b>8,906,390,150</b>	<b>\$409,241,340,626</b>

Source: Reginfo.gov and author calculations based on BLS December 2015 estimate of hourly compensation costs. (1) For large business forms and complex forms such as estates, we used an hourly compensation cost of \$52.05 for professional and related workers. For all other forms, we used \$37.28, the average compensation for all full-time private sector workers, <http://www.bls.gov/news.release/eccec.t11.htm>

The cost of complying with U.S. business income taxes accounts for 36 percent of the total cost of the entire tax code, at \$147 billion. Complying with the individual income tax costs another \$99 billion annually.

Many businesses choose to become S corporations in order to avoid the second layer of tax that is applied to traditional C corporations. This, too, apparently comes with a high compliance cost. The compliance costs for America's 4 million S corporations now total more than \$46 billion annually, nearly \$12,000 per firm.

The estate and gift tax, which will only collect approximately \$20 billion in federal revenues this year, has a compliance cost of \$19.6 billion.

## Conclusion

Time is precious, and Americans should not be forced to waste it complying with IRS tax forms. On other occasions, the Tax Foundation has used macroeconomic modeling to show that a well-designed tax reform plan can improve economic growth, boost wages, and encourage new investment throughout the economy. However, the Tax Foundation's model results generally do not factor in how much time Americans will save complying with a simpler tax code.

The latest official estimates of the eye-popping amount of time and money that Americans lose each year in complying with IRS paperwork—8.9 billion hours and \$409 billion in lost productivity—indicate that the most important benefit of tax simplification may be the gift of time.

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## Appendix

In order to calculate the compliance cost of the total tax form, we used data from the Office of Information and Regulatory Affairs (accessed at [Reginfo.gov](http://Reginfo.gov)) and the Bureau of Labor Statistics.

Reginfo.gov provides the aggregate amount of time taxpayers need to comply with each tax form.

These hourly aggregates were then translated into compliance costs by multiplying them by one of two different hourly compensation numbers. For individual income tax provisions, we used the average full-time private sector worker compensation of \$37.28 per hour.<sup>5</sup> These forms include the individual income tax return, schedule C, Form 1099, IRA contribution information, and all other non-business provisions.

For a select number of business-related returns and more complex provisions—such as returns for estates and trusts, or depreciation schedules—we used an hourly compensation cost of \$52.05, BLS' estimate for professional and related workers, which better approximates the cost of hiring accountants and tax lawyers for business and trust purposes.

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<sup>5</sup> Bureau of Labor Statistics, "Table 11. Private industry, by occupational group and full-time and part-time status," December 2015, [http://www.bls.gov/news.release/archives/ecec\\_03102016.htm](http://www.bls.gov/news.release/archives/ecec_03102016.htm).