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*Session Four:*

# Tax Code Complexity and Compliance Burden



2010 IRS Research Conference

***Individual Taxpayer Compliance Burden: The Role  
of Assisted Methods in Taxpayer  
Response to Increasing Complexity***

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# Presentation Objectives

- Present compliance burden estimates for tax years 2000 to 2007
- Changes in compliance burden over time focusing on:
  - Tax system complexity
  - Assisted preparation methods
  - Technological improvements

# Compliance Burden Research Program

Office of Research effort to measure and model compliance burden

- Individual Taxpayers
  - Studies for TY 1999 and TY 2000
  - Updated for TY 2007
  - New study planned for TY 2010
  
- Business Taxpayers
  - Studies covered small business taxpayers for TY 2003 and TY 2004
  - New study underway to cover all businesses for TY 2009
  - Integrated modeling framework with individual taxpayers
  
- Tax Exempt Taxpayers
  - Study planned for TY 2010

# Burden Research Program Objectives

- Annual estimates provided to:
  - Taxpayers on tax forms
  - OMB for the Information Collection Budget to Congress
- Gain insight into determinants of compliance burden
  - Changes in the macro-economy, tax law, tax administration
  - Support policymaking and tax administration through “what-if” analysis
- Better understand the role of compliance burden in tax administration
  - Compliance costs impede compliance
  - Implications for demand for services

# Compliance Burden Research Methodology

- Surveys measure time and out-of-pocket costs taxpayers spend on pre-filing and filing activities
- Control for substitution of time and money by *monetizing* time and reporting *total* compliance burden
- Establish econometric relationships between total compliance burden and tax return characteristics
- Use econometric micro-simulation model for forecasting and what-if analysis

# Individual Burden Model Econometrics

- Dependent variable: Natural logarithm of total monetized compliance burden
- Includes controls for:
  - Income
  - Preparation method
  - Demographic characteristics
- Complexity as a function of the type and volume of activities performed
  - Proxy for type of activities: Complexity categories
  - Proxy for volume: Money amounts reported on tax form lines

# Changes in Compliance Burden Drivers from Tax Years 2000 to 2007

- Increased use of assisted methods
  - Paid practitioner and software
- Increased tax system complexity
  - About 30 percent increase in tax code subsections and cross references
  - About 8 percent of taxpayers move from low complexity to higher complexity categories
- Technological changes, improved labor productivity
  - 15 to 20 percent increase



## Tax Years 2000 to 2008 1040-Series Returns: Percentage of Tax Returns Prepared with Assistance

Tax Year	Third Party Prep Paid Preparer	Self Prepared with Software Assistance (On-Line Filed/Self V-Coded/Telefiled)	Taxpayers Using a Paid Preparer or Software Assistance or TCE & VITA
2000	55%	17%	72%
2001	57%	19%	76%
2002	57%	20%	79%
2003	61%	22%	84%
2004	59%	25%	85%
2005	59%	25%	86%
2006	60%	26%	87%
2007	56%	26%	85%
2008	60%	29%	92%

Source: R:S-97 Report, IRS Master File System, Compliance Data Warehouse, ETA, SOI

Tabulations: IRS:RAS:R:FDA, April 2010

Notes:

TY 2000 - 2004 software filings include telefiled returns.

TY 2006 data includes Forms 1040/A/EZ returns filed only to claim Telephone Excise Tax Refund.

TY 2007 data includes an estimated 15 million taxpayers that filed solely to claim an Economic Stimulus Payment.

# Individual Burden Model Econometric Specification

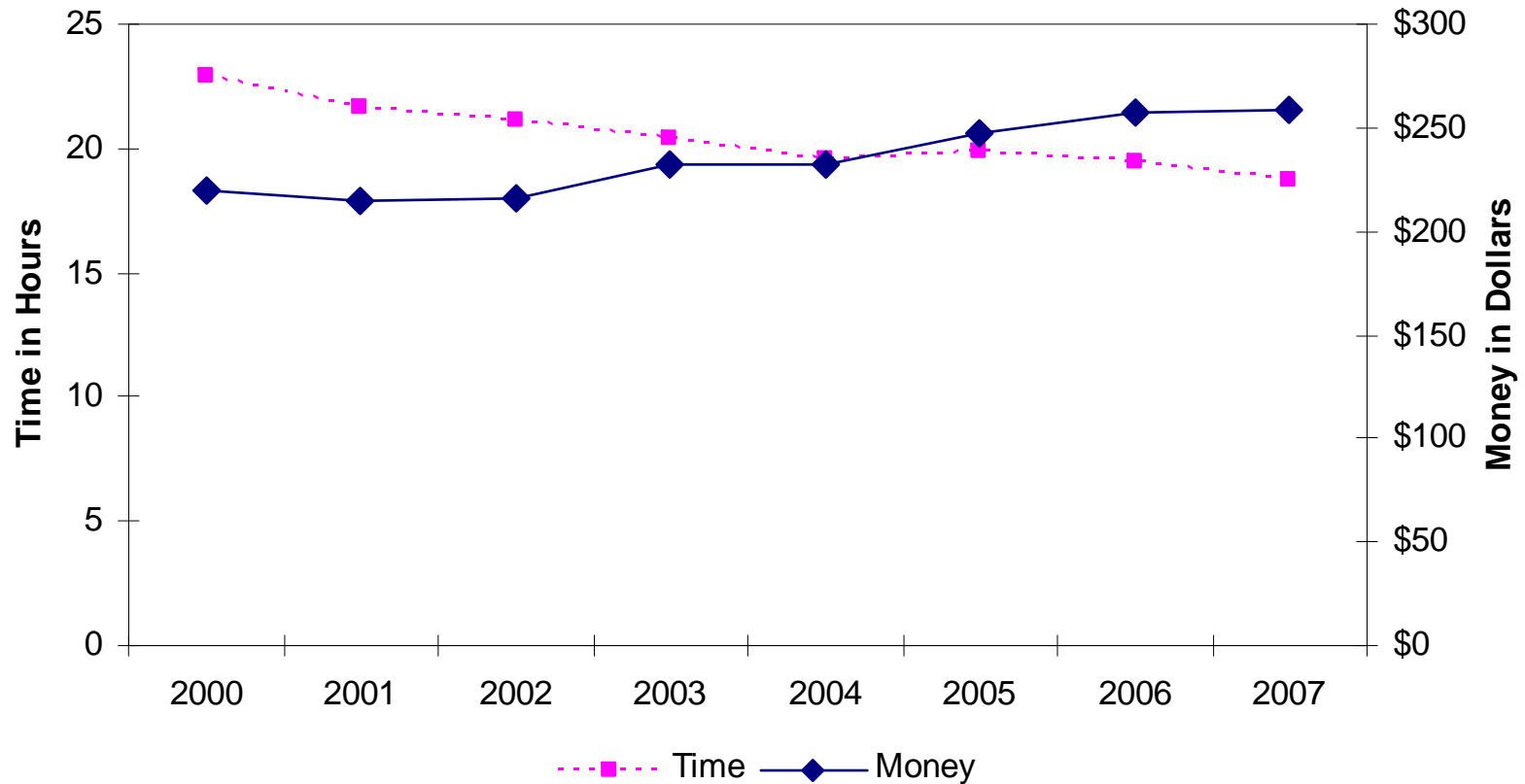
$$\begin{aligned} \text{Log}(\text{Burden})_i = & b_0 + b_1 \text{Log}(\text{mpi})_i + b_2 \text{Low}_i + b_3 \text{Medium\_Low}_i + b_4 \text{Medium}_i + \\ & b_5 \text{High}_i + b_6 \text{Paid}_i + b_7 \text{Soft}_i + b_8 \text{Paid\_mpi}_i + b_9 \text{Consider}_i + b_{10} \text{HH/Widow}_i + \\ & b_{11} \text{Married}_i + b_{12} \text{Log}(\text{Exemptions}_i) + \varepsilon_i \end{aligned}$$

where the letter  $i$  indexes the taxpayer.

# Individual Compliance Burden Coefficients Tax Years 2000 and 2007

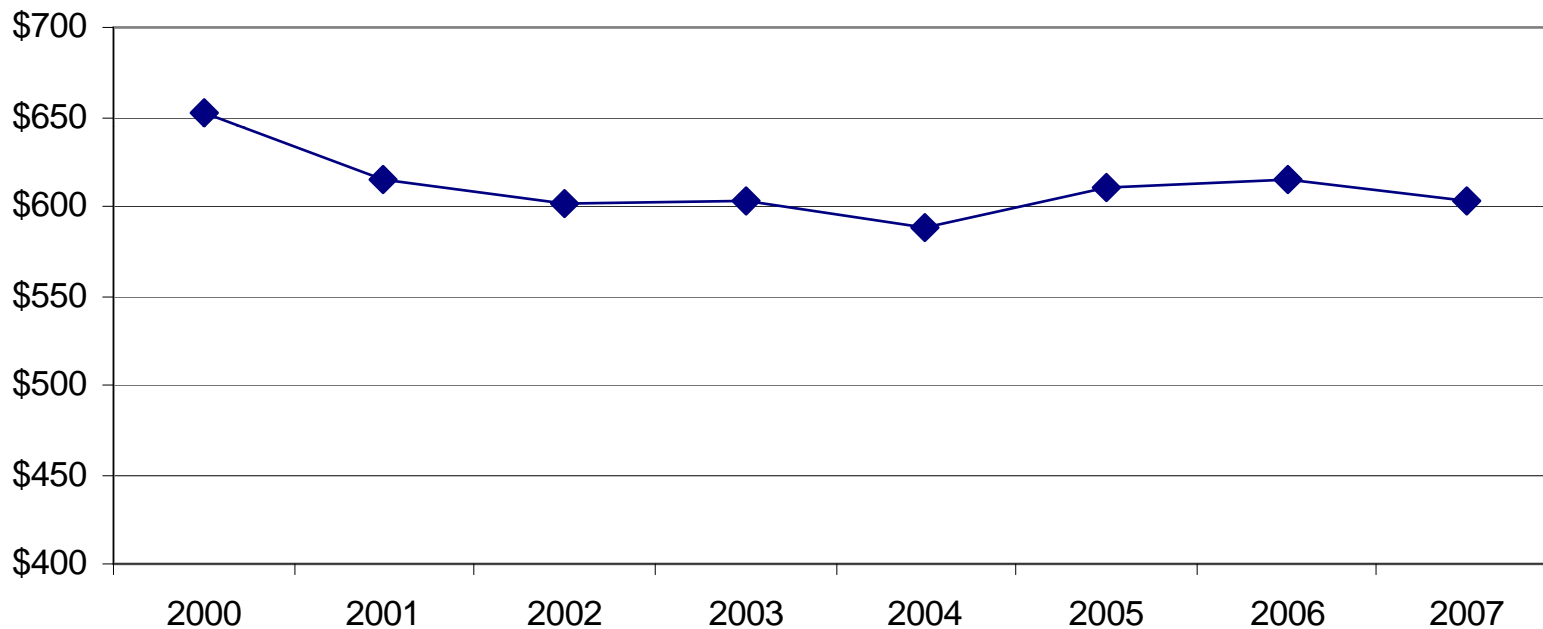
Variable	Survey 2000 Coefficients		Survey 2007 Coefficients	
	Estimate	T-Stat	Estimate	T-Stat
	1	2	3	4
Intercept	0.247	1.53	1.163	<b>4.91</b>
Log (mpi)	0.491	<b>35.62</b>	0.439	<b>26.01</b>
Low Complexity	0.009	<b>11.59</b>	0.005	<b>5.69</b>
Low-Medium Complexity	0.009	<b>14.15</b>	0.008	<b>8.97</b>
Medium Complexity	0.012	<b>18.86</b>	0.013	<b>13.63</b>
High Complexity	0.023	<b>22.46</b>	0.014	<b>10.39</b>
Paid Professional Prepared Return	1.843	<b>9.87</b>	1.299	<b>4.74</b>
Self Prepared Return Using Software	-0.558	<b>-8.39</b>	-1.025	<b>-7.23</b>
Log (mpi) and Paid Professional Prepared Return Consider Factor	-0.224	<b>-14.84</b>	-0.178	<b>-9.15</b>
Head of Household or Widow	-1.556	<b>-17.91</b>	-1.697	<b>-9.26</b>
Married	-0.047	-1.48	-0.013	-0.29
Log (Exemptions)	-0.270	<b>-8.68</b>	-0.306	<b>-6.57</b>
Adj. R-Squared	0.142	<b>5.41</b>	0.186	<b>5.03</b>
	0.603		0.574	

# Time and Money Burden Estimates using Blended 2000 and 2007 Coefficients



2007 constant dollars. TY 2007 excludes economic stimulus only returns.

# Average Monetized Compliance Burden using Blended 2000 and 2007 Coefficients



2007 constant dollars. TY 2007 excludes economic stimulus only returns.

# Conclusions

- Despite increases in federal tax system complexity, we estimate that average constant dollar compliance costs did not increase from 2000 to 2007 and may have decreased
- The leading explanations are increased use of technology-assisted compliance methods, increased productivity, and interactions between the two
- It appears that technology is mitigating the compliance cost impact of an increasingly complex tax system – at least for now