



Reliable References

Student Handout #6: “**Estimating the Compliance Cost of the U.S. Individual Income Tax**” (Excerpts)

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Measuring Burden

IBM collected data from W&I and SE taxpayers to measure the time and out of pocket expenses incurred to comply with federal tax rules and regulations.⁶ Both sets of taxpayers were asked questions about a variety of demographics, tax related activities, and compliance methods (e.g., use of a paid professional), as well as questions about the time and money they spent to comply with tax rules and regulations. Respondents provided this information either by participating in a 15 to 20 minute telephone interview or by completing a 10 to 12 page selfadministered questionnaire.

In evaluating the success of our taxpayer surveys, we relied on two primary metrics—response rate and number of completed interviews relative to the desired number of completes. Our goal in the W&I survey was to complete 6,000 interviews—300 in each of the 20 sampling strata. In the end, we completed 6,366 interviews, including approximately 60 percent (3,815) by telephone and 40 percent (2,551) by mail. For the SE study, we completed 9,081 interviews—exceeding our goal of 8,000.⁷ The overall response rate was 60.5 percent for the W&I study and 56.4 percent for the SE study.

Qualitative research conducted early in the study revealed that many SE taxpayers were unable to break out their paid professional expenses into, (1) fees paid for Federal income tax services, versus (2) fees paid for other services (e.g., financial planning, employment tax compliance, business tax returns). To support the decomposition of paid professional fees, IBM conducted a separate survey of paid professionals. IBM completed 415 interviews with paid professionals between October and December 2001.

Overall Estimates of Compliance Costs

Tables 4 through 6 provide descriptive statistics on the overall level of compliance burden in tax year 2000 (TY00), as estimated using the ITBM. Key findings include:

- In TY00, 125.9 million individual taxpayers experienced a total compliance burden of 3.21 billion hours and \$18.8 billion. This translates into an average burden of 25.5 hours and \$149 per taxpayer. (Table 4)

- Although SE taxpayers represent only about 25 percent of all individual taxpayers, they experience approximately 60 percent of the time and money burden. As a result, the average time and money burden of SE taxpayers (59.5 hours, \$363) is substantially greater than that of W&I taxpayers (13.8 hours, \$75). (Table 4)
- Average time burden is higher among taxpayers who use software (40.1 hours) or a paid professional (26.1 hours) than it is among taxpayers who prepare their return independently (18.2 hours), although this is likely due to differences in the average complexity of their returns. Not surprisingly, taxpayers who use a paid professional spend much more money on tax compliance (\$244) than do software users or self-preparers (\$47 and \$20, respectively). (Table 4)
- Average time and money burden are greater among taxpayers who have a more complex primary form (Form 1040 instead of 1040A or 1040EZ), and among taxpayers who have higher adjusted gross income. An exception to the latter pattern is that taxpayers with negative AGI have relatively high time and money burden, probably because many of these taxpayers have complex returns with a significant amount of positive income offset by business losses. (Table 4)
- Average return complexity—as measured by the attribute index—is dramatically higher for SE returns than for W&I returns. Similarly, returns that are prepared by a paid professional or with tax software tend to be more complex than returns that are self-prepared (Table 4).
- By applying a dollar value to each hour of time burden, we obtain an estimate of total monetized compliance costs for individual taxpayers. The authors make no recommendations regarding the appropriate monetization rate, but note that alternative rates (between \$15 and \$25 per hour) yield a total compliance cost that varies between \$67 billion and \$99 billion. Roughly 60 percent of these total compliance costs are experienced by SE taxpayers. (Table 5)
- Average compliance burden is consistently higher among taxpayers who have more complex tax returns, and this pattern applies to both W&I and SE taxpayers. For example, W&I taxpayers who itemize their returns spend an average of 21.3 hours and \$114 on tax compliance, compared with 11.4 hours and \$63 for W&I taxpayers who do not itemize. Similarly, SE taxpayers who file Form 6251 (Alternative Minimum Tax) spend an average of 97.3 hours and \$752 on tax compliance, compared with 56.6 hours and \$334 for SE taxpayers who do not file Form 6251. (Table 6)

Table 5 - Monetized Compliance Burden of Individual Taxpayers in TY00, by Selected Characteristics

Monetized Time Plus Money (\$billions)

Returns (millions)	Hours (billions)	Money (\$billions)	Monetize Time @ \$15/Hour	Monetize Time @ \$20/Hour	Monetize Time @ \$25/Hour	Average @20/Hour (dollars)	
All Tax Returns	125.9	3.21	\$18.8	\$67.0	\$83.0	\$99.1	\$532
By Taxpayer Type							
Wage and Investment	93.6	1.29	\$7.0	\$26.4	\$32.8	\$39.3	\$282
Self-Employed	32.3	1.92	\$11.7	\$40.6	\$50.2	\$59.8	\$1,255
By Preparation Method							
Paid Preparation	70.8	1.84	\$17.2	\$44.9	\$54.1	\$63.3	\$635
Self Preparation w/o Software	38.5	0.70	\$0.8	\$11.3	\$14.8	\$18.3	\$292
Software Preparation	16.7	0.67	\$0.8	\$10.8	\$14.1	\$17.5	\$648
By Submission Method							
Paper	89.8	2.58	\$13.9	\$52.5	\$65.4	\$78.3	\$585
TeleFile	3.9	0.03	\$0.0	\$0.5	\$0.6	\$0.8	\$124
Other e-File	32.3	0.61	\$4.9	\$14.0	\$17.0	\$20.0	\$432
Monetized Time Plus Money (\$billions)							
Returns (millions)	Hours (billions)	Money (\$billions)	Monetize Time @ \$15/Hour	Monetize Time @ \$20/Hour	Monetize Time @ \$25/Hour	Average @20/Hour (dollars)	
By Primary Form							
1040	82.6	2.79	\$16.9	\$58.8	\$72.8	\$86.8	\$712
1040A	24.0	0.26	\$1.5	\$5.5	\$6.8	\$8.1	\$228
1040EZ	19.3	0.16	\$0.3	\$2.7	\$3.4	\$4.2	\$138
By Adjusted Gross Income							
Negative AGI	0.9	0.03	\$0.2	\$0.7	\$0.9	\$1.0	\$749
\$0 to <\$15K	32.5	0.47	\$2.8	\$9.8	\$12.2	\$14.5	\$303
\$15K to <\$30K	31.2	0.54	\$3.3	\$11.4	\$14.1	\$16.8	\$365
\$30K to <\$45K	20.0	0.44	\$2.5	\$9.2	\$11.4	\$13.6	\$458
\$45K to <\$60K	13.3	0.37	\$2.1	\$7.7	\$9.5	\$11.4	\$577
\$60K to <\$90K	14.9	0.57	\$3.1	\$11.6	\$14.4	\$17.3	\$778
\$90K to <\$120K	6.1	0.30	\$1.6	\$6.0	\$7.5	\$9.0	\$982
\$120K or more	7.0	0.49	\$3.2	\$10.6	\$13.1	\$15.5	\$1,523

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About the IRS

The Agency

The IRS is a bureau of the Department of the Treasury and one of the world's most efficient tax administrators. In 2004, the IRS collected more than \$2 trillion in revenue and processed more than 224 million tax returns.

- The IRS spent just 44 cents for each \$100 it collected in 2005.
(Source: Table 31, [IRS Data Book: 2005](#).)

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

This mission statement describes our role and the public's expectation about how we should perform that role.

- In the United States, the Congress passes tax laws and requires taxpayers to comply.
- The taxpayer's role is to understand and meet his or her tax obligations.
- The IRS role is to help the large majority of compliant taxpayers with the tax law, while ensuring that the minority who are unwilling to comply pay their fair share.

Statutory Authority

The IRS is organized to carry out the responsibilities of the secretary of the Treasury under section 7801 of the Internal Revenue Code. The secretary has full authority to administer and enforce the internal revenue laws and has the power to create an agency to enforce these laws. The IRS was created based on this legislative grant.

Section 7803 of the Internal Revenue Code provides for the appointment of a commissioner of Internal Revenue to administer and supervise the execution and application of the internal revenue laws.