COMPLEXITY IN THE FEDERAL TAX SYSTEM

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Prepared by the Staff
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INTRODUCTION

The Senate Committee on Finance has scheduled a hearing entitled "Tax Complexity, Compliance, and Administration: The Merits of Simplification in Tax Reform" for March 10, 2015. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides background on the subject of complexity of the Federal tax system.

[1] This document may be cited as follows: Joint Committee on Taxation, *Complexity in the Federal Tax System* (JCX-49-15), March 6, 2015. This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

I. SOURCES OF COMPLEXITY IN THE FEDERAL TAX SYSTEM

Commentators have pointed to several sources of complexity in the Federal tax system. These sources include complexity in the economy resulting in complex tax rules, the enactment of tax benefits as incentives for social and economic policies, the enactment of temporary tax provisions, and frequent changes in the law.[2] Other sources of complexity mentioned by commentators include statutory provisions that leave determinations to Treasury guidance rather than providing express statutory rules, and complexity stemming from Treasury guidance.[3] A study conducted by the staff of the Joint Committee on Taxation focused on identifying sources and effects of complexity in the tax law with recommendations for simplification based on prior simplification proposals and on analysis provided by advisors with respect to approaches to addressing complexity in the tax law.[4] Additional potential sources of complexity mentioned include (1) the interaction of Federal tax laws with State law, with other Federal laws and standards, and with laws of foreign countries and tax treaties, (2) the Congressional budget process, and (3) ambiguity or lack of clarity in the tax law, whether arising from multiple tax provisions affecting the same area of economic activity, arising from multiple definitions of the same or similar concepts in the tax law, or arising from judicial interpretation of statutory and regulatory language.[5]

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[2] Samuel A. Donaldson, "The Easy Case Against Tax Simplification," *Virginia Tax Review*, vol. 22, p. 645, Spring 2003; David F. Bradford, *Untangling the Income Tax*, Harvard University Press, 1986, p.226; See Testimony of William G. Gale, House of Representatives Committee on Ways and Means, "Tax Simplification: Issues and Options," July 17, 2001, available at http://www.brookings.edu/~/media/research/files/testimony/2001/7/17useconomics-gale/20010717.pdf; Stewart Karlinsky, "Tax Simplification in a Complex World," *Tax Notes*, February 20, 2012; Joel Slemrod and Jon Bakija, *Taxing Ourselves: A Citizen's Guide to the Great Debate Over Tax Reform,* The MIT Press, 1996, p. 139 ("[O]ur tax system is now an awkward mixture of a revenue-raising system plus scores of incentive programs, and is much more complicated than it would be if its only function were to raise revenue in the most equitable and cost-efficient way possible.").

[3] Jasper L. Cummings, "The Sham Transaction Doctrine," *Tax Notes* , December 15, 2014 (commenting on the IRS' issuance of Notice 2014-58 that "reversed the IRS Large Business and International Division's approach of caution in applying the economic substance doctrine and may be read by IRS managers and agents to encourage the use of both doctrines. It clarifies only one point, to the detriment of taxpayers, while adding new ambiguities to the already confusing section 7701(o). The notice proves that there will be no help for taxpayers unless and until the Supreme Court decides…".).

[4] Joint Committee on Taxation, *Study of the Overall State of The Federal Tax System and Recommendations For Simplification, Pursuant To Section 8022(3)(B) of the Internal Revenue Code Of 1986* (JCS-3-01), April 2001, citing other studies and research.

[5] *Ibid.*, Volume I, p. 58; John R. Brooks II, "Doing Too Much: The Standard Deduction and the Conflict Between Progressivity and Simplification," *Columbia Journal of Tax Law*, vol. 2, 2001, p. 203 (noting "the theoretical problems with having a single provision serve both a simplification purpose and a progressivity purpose, and especially that such a dual role leads to conflicting policy arguments for and against the current standard deduction…partly as a result of these conflicts, the standard deduction exerts a significant destabilizing force on policy debates regarding definitions of income and the proper role of deductions."); Deborah L. Paul, "The Sources of Tax Complexity: How Much Simplicity Can Fundamental Tax Reform Achieve?," *North Carolina Law Review*, vol. 76, 1997, p. 151 (referring to a "legal cultural taste for complication"); Bayless Manning, "Hyperlexis and the Law of Conservation of Ambiguity: Thoughts on Section 385," *Tax Law.*, vol. 36, 1982, p. 9.

For example, commentators have criticized tax incentives for education as complex because of the number of such provisions and lack of uniformity in the definitions used in the provisions. They assert that complexity in this area results in underutilization of intended tax benefits. One analyst testified before a Congressional committee that "the education tax incentives are far too complicated to do their job. The IRS publication devoted to explaining them is 82 pages long! The consequences of this complexity extend beyond mere annoyance and frustration. Evidence shows that simple, easily communicated financial aid programs have a robust impact on college entry and completion, but complicated programs do not."[6] Table 1, below, sets forth present-law tax benefits for education.

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[6] Testimony of Dr. Susan Dynarski, before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means, May 1, 2008, available at http://waysandmeans.house.gov/media/pdf/110/dynarski.pdf. Similar testimony by a witness at a Senate Finance Committee hearing stated, "Simplify the tax code as it relates to higher education expenses: The tax code can play a vital role in assisting students and their families with the cost of higher education, but its complexity discourages many from using it to full advantage. Even tax accountants find it difficult to navigate all the rules." Testimony of Dr. Waded Cruzado, before the Senate Committee on Finance, July 25, 2012, available at http://www.finance.senate.gov/hearings/hearing/?id=16f8c6bf-5056-a032-52e8-40c42f7c9a5f.

Table 1.−Tax Benefits for Education Expenses, 2015

<u>Tax Benefits for Current Expenses</u>
Hope credit and American Opportunity credit
Lifetime Learning credit
Above-the-line deduction for certain higher education expenses (expired December 31, 2014)
Exclusion for employer-provided educational assistance
Qualified scholarships and tuition reduction
Dependency exemption for students ages 19-23
Gift tax exclusion for educational expenses
Business deduction for work-related education expenses
<u>Tax Benefits for Saving for Education Expenses</u>
Section 529 qualified tuition programs
Coverdell education savings accounts
Early withdrawals from IRAs for qualified education expenses
Exclusion of interest earned on education savings bonds
ABLE accounts
<u>Tax Benefits Relating to Past Expenses (Student Loans)</u>
Deduction for student loan interest
Exclusion of income from student loan forgiveness

As another example, a review conducted by the Government Accountability Office ("GAO") found instances "where the same or similar term is defined differently or where taxpayers are subject to different rules under various tax provisions, particularly those aimed at similar objectives."[7] Several different Code provisions modify the definition of adjusted gross income ("AGI") for determining the tax consequences of that provision, the report notes.[8] The definition of a small business differs in depending on the number of employees, the amount of gross receipts, and other characteristics such as gross assets and equity capital.[9] The report also points to multiple iterations of the definition of a disabled person, differing by "duration of impairment, whether proof of disability is required, what type of activity is limited, and whether income replacement benefits are received."[10] Other concepts used in the tax law with differing definitions for different tax purposes are identified in the report (namely, child-related benefits and retirement savings benefits). The GAO report concludes that there would be tradeoffs among policy, revenue, and simplicity goals were the complexity to be reduced by harmonizing the inconsistent provisions.

7 Government Accountability Office, *Tax Policy: Differences in Definitions and Rules in the Tax Code* (GAO-14-652R), July 18, 2014, p. 1, available at http://www.gao.gov/products/GAO-14-652R.

8 The GAO report observes that AGI is modified ("MAGI") for purposes of a MAGI-based limit by adding back a different set of income items for each of 16 tax provisions applicable to individuals, including, for example, the charitable contribution deduction limit, the Roth IRA contribution limit, the child tax credit, the exclusion for employer-provided adoption assistance, the adoption expense credit, and five education tax incentive provisions. "Table 1: Differences in Modifications to Adjusted Gross Income, Tax Year 2013," *ibid.*, pp. 11-17.

9 The report states, "For example, under the Patient Protection and Affordable Care Act, a small business must have 25 or fewer full-time equivalent employees, among other requirements, to claim a certain tax credit, but to be eligible for a Savings Incentive Match Plan for Employees (SIMPLE) Individual Retirement Arrangement (IRA), a business must have 100 or fewer employees, among other requirements. Small business is also defined differently depending on whether a taxpayer is claiming a gain or a loss for a small business stock. If the taxpayer is claiming a gain, the qualified small business is defined by gross assets. If a taxpayer is claiming a loss, the small business is defined by amount of equity capital." *Ibid*., p. 4.

10 As set forth in "Table 3: Differences in Definitions of Disabled, (Current as of April 17, 2014)," *ibid*., pp. 21-23, provisions applying differing definitions of disabled include, among others, the head of household filing status, the child and dependent care credit, the child tax credit, the earned income tax credit, and the dependency exemption.

II. EFFECTS OF COMPLEXITY ON THE FEDERAL TAX SYSTEM

Quantifying the effect of complexity on the Federal tax system is difficult. Statistically, it may not be possible to separate this particular effect from other factors that may also affect tax collection. Furthermore, there is no generally agreed upon measure of changes in the level of complexity in the Federal tax system over time. Nonetheless, experts generally agree that complexity plays an important role in the effectiveness of the Federal tax system.

While complexity in tax rules may sometimes be necessary to effectively tax a complex economy[11] and while some complexity may be necessary to achieve certain policy goals, such as targeting certain tax benefits to specific taxpayers, there are also associated costs. There are a number of specific ways in which complexity can affect the Federal tax system. Among these are: (1) decreased levels of voluntary compliance; (2) increased costs of compliance for taxpayers; (3) reduced perceptions of fairness in the Federal tax system; and (4) increased difficulties in the administration of tax laws.

A. Decreased Levels of Voluntary Compliance

One effect of complexity on the Federal tax system may be decreased levels of voluntary compliance. The Internal Revenue Service ("IRS") estimates that the gross tax gap, or the amount of tax liability in a given year that is not paid voluntarily and in a timely manner, is $450 billion for tax year 2006.[12] According to the IRS, the overall voluntary compliance rate, or the gross tax gap as a percentage of total true tax liability, is 83.1 percent. Voluntary compliance rates also differ by tax. They tend to be lowest for the individual income tax and the estate tax, and highest for the employment tax and the corporate income tax. For example, in tax year 2006, the voluntary compliance rate for the individual income tax was 77 percent compared to a voluntary compliance rate of 82 percent for the corporate income tax. These data are shown below in Table 2.

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[11] A case study of the Hewlett-Packard company concludes that a significant portion of the complexity and related compliance costs involved in filing taxes for this company stems from the complicated business environment in which Hewlett-Packard operates. See David R. Seltzer, "Federal Income Tax Compliance Costs: A Case Study of Hewlett-Packard Company," *National Tax Journal*, vol. 50, no. 3, September 1997.

[12] Theodore Black, Kim Bloomquist, Edward Emblom, Andrew Johns, Alan Plumley, and Esmeralda Stuk, "Federal Tax Compliance Research: Tax Year 2006 Tax Gap Estimation," *IRS Research, Analysis, and Statistics Working Paper*, March 2012.

Table 2.–IRS's Voluntary Compliance Rates by Type of Tax, Tax Year 2006

Type of Tax	Voluntary Compliance Rate
Individual Income Tax	77.00%
Corporate Income Tax	82
Employment Tax	91
Estate Tax	74
Excise Tax	N/A
Total	83.1

Source: Internal Revenue Service.

Taxpayer noncompliance may take three primary forms: underreporting of tax liability on tax returns; underpayment of taxes due; and non-filing, which refers to the failure to file a required tax return altogether or on time. Of these, the majority of noncompliance takes the form of underreporting of income. Table 3 shows that of the $450 billion tax gap in 2006, $376 billion is estimated to be the result of underreporting of income tax liability. This income tax underreporting includes both nonbusiness and business income tax reporting. Business income for individuals includes income from a variety of business types, including sole proprietors, partnerships, and S corporations, including small businesses. The IRS estimates that nearly 40 percent of the 2006 tax gap can be attributed to business income tax underreporting. The GAO, in a study of the tax gap, notes that one reason for this underreporting may be that sole proprietors' income is not subject to withholding and much of it is not subject to third party information reporting to the IRS.[13]

[13] Government Accountability Office, *Tax Gap: Sources of Noncompliance and Strategies to Reduce It* (GAO-12-651T), April 19, 2012.

Table 3.–IRS's Estimates of Tax Gap by Type of Noncompliance and Type of Tax, Tax Year 2006

	Type of Noncompliance			
Type of Tax	**Underreporting**	**Underpayment**	**Non-filing**	**Total**
Individual Income Tax	$235	$36	$25	$296
Corporate Income Tax	67	4	No estimate	71
Employment Tax	72	4	No estimate	76
Estate Tax	2	2	3	7
Excise Tax	No estimate	0.1	No estimate	0.1
Total	376	46	28	450

Source: Internal Revenue Service.
Note: Dollars in billions.

Though it is difficult to quantify the precise contribution of complexity to the tax gap, most experts agree that complexity in the tax law can lead to increased levels of tax noncompliance. The GAO explicitly identifies complexity as an important driver of taxpayer noncompliance.[14]

Complexity in the tax law may lead to decreased voluntary compliance in a number of different ways. For example, complexity that causes taxpayer confusion may affect levels of voluntary compliance through either inadvertent errors or intentional evasion by taxpayers. This type of complexity may cause taxpayers to decrease or increase their voluntary compliance. For example, an individual taxpayer preparing his own tax return may, when faced with complexity or ambiguity in the tax law, choose to take a conservative filing position (perhaps out of a desire to avoid controversy with the IRS). Alternatively, the taxpayer may either inadvertently fail to comply, or take an aggressive tax position (perhaps on the assumption that complexity may shield the taxpayer from discovery or prevent the imposition of penalties). Each of these alternative situations can give rise to varying types of compliance costs within the tax system, as discussed below.

Sometimes the tax law is clear but involves a large number of steps or calculations. When faced with complicated and lengthy tax calculations, individual taxpayers preparing their own tax returns may choose to skip the calculations and forgo tax benefits intended for them. For example, the GAO estimates that in tax year 1998, approximately 510,000 individual

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[14] *Ibid.*

taxpayers did not itemize deductions even though it appeared that it would have reduced the amount of income taxes owed.[15]

[15] Government Accountability Office, *Estimates of Taxpayers Who May Have Overpaid Federal Taxes by Not Itemizing,* (GAO/GGD-01-529), April 12, 2001.

B. Costs of Complexity

Complexity may increase both the taxpayer cost of complying with the Code and the IRS's cost of collecting tax liability. The following discussion considers both of these components of overall cost. Specifically, complexity in the Code may take the form of increased time required by taxpayers to prepare and complete tax returns as well as increased use of tax return preparers at personal cost. Second, the IRS may be required to provide increased assistance to taxpayers in the preparation of their returns.

Individual return preparation time

IRS estimates of individual return preparation time

As required by the Paperwork Reduction Act of 1980, the IRS provides estimates of costs to taxpayers of complying with the Federal income tax. Compliance costs in this context refer to the amount of time spent on tasks related to filing individual income tax returns, including Form 1040, 1040A, or 1040EZ, as well as out-of-pocket expenditures on goods and services for such purpose. IRS estimates of time burden include the amount of time taxpayers spend in: (1) record keeping activities; (2) learning how to prepare the return; (3) finding and using tax preparation services and preparing the return; and (4) copying and sending in the return. Examples of out-of-pocket expenditures include tax return preparation and submission fees, postage and photocopying costs, and tax preparation software costs.

Based on these estimates of time spent, Table 4 shows that record-keeping is the most time-consuming aspect of filing taxes for the average taxpayer, relative to tax planning, preparing the return, and submitting the return. Overall, the average time burden for taxpayers is 13 hours of time spent. Of these 13 hours, six hours are spent on record-keeping activities with the remaining seven apportioned across planning, preparation, and submitting activities. Looking specifically at taxpayers filing Form 1040, the average time burden is 16 hours. These costs are estimated to be eight hours for Form 1040A; and five hours for Form 1040EZ. However, there is significant variation within these estimates depending on the type of taxpayer, the type of software, and the geographical region in which the taxes are filed.[16] For example, the average cost of filing for nonbusiness taxpayers is eight hours, while the average cost for business taxpayers is 24 hours. In addition, there may be significant variation in out-of-pocket costs to taxpayers depending on the type of taxpayer, the type of software, and the geographical region in which the taxes are filed.

[16] Internal Revenue Service, "1040 Instructions, 2014," January 26, 2015, p. 54.

Table 4.–Estimated Average Taxpayer Burden by Activity

		Average Time Burden (Hours)				
Primary Form Filed or Type of Taxpayer	Percentage of Returns	Total Time*	Record Keeping	Tax Planning	Form Completion and Submission	All Other
All taxpayers	100	13	6	2	4	1
Primary forms filed						
1040	69	16	8	2	5	1
1040A	19	8	2	1	3	1
1040EZ	12	5	1	**	2	1
Type of taxpayer						
Nonbusiness***	68	8	3	1	3	1
Business***	32	24	13	3	6	2

Source: IRS "1040 Instructions, 2014," January 26, 2015, p. 54.
Notes: * May not add to total due to rounding. ** Rounds to less than an hour. *** A business filer is a taxpayer who files one or more of the following with Form 1040: Schedule C, C-EZ, E, or F or Form 2106 or 2106-EZ. A nonbusiness filer is a taxpayer who does not file any of those schedules or forms with Form 1040 or who files Form 1040A or 1040EZ.

Use of tax return preparers and e-filing

Many taxpayers use one or more of the following forms of assistance to prepare and file tax returns: paid preparers, such as a tax return preparation service, a certified public accountant or an attorney; computer software; and tax guides and other publications. In addition, a taxpayer may choose to file using electronic filing, a telephone, or the Internet. Each of these factors may reduce the overall time required for the preparation and filing of individual income tax returns relative to self-preparation and traditional paper filing.

According to the IRS, an estimated 81.2 million individual tax returns, or 56 percent of approximately 145 million total individual returns, were completed by a paid preparer for tax year 2011.[17] Generally, taxpayers with higher levels of AGI and with more complex returns were more likely to use paid preparers than those with lower levels of AGI and simpler returns. Table 5 shows individual taxpayers' estimated use of paid return preparers by income and type of return for tax year 2011.

[17] Thirty-four percent of taxpayers used computer software to prepare returns for tax year 2011. See: Written Testimony of John A. Koskinen, Commissioner of the Internal Revenue Service, Senate Committee on Finance Hearing on "Regulation of Tax Return Preparers," April 8, 2014, available at http://www.finance.senate.gov/imo/media/doc/Koskinen%20Testimony.pdf.

Table 5.−Individual Taxpayers' Estimated Use of Paid Preparers, by Income and Type of Tax Return, Tax Year 2011

Taxpayer Group	Estimate (percent)
AGI levels	
$0 − 20,000	54
20,001 − 40,000	54
40,001 − 60,000	56
60,001 − 80,000	59
80,001 − 100,000	58
Over 100,000	63
All AGI levels	56
Type of return	
Form 1040EZ	41
Form 1040A	50
Form 1040	63

Source: GAO analysis of IRS SOI data for tax year 2011.

Table 6 shows a large increase over a recent 20-year period in the use of electronic means of filing income tax returns, from approximately 3.7 percent of returns e-filed in 1990 to approximately 67.2 percent of returns filed in 2009. The rate of e-filed income tax returns is projected to reach 80.7 percent in calendar year 2016 and is expected to continue to increase in subsequent years.[18]

[18] In order to reach its strategic goal of 80 percent returns filed electronically, beginning January 1, 2012, the IRS, in keeping with section 6011 of the Code, requires any tax return preparer who anticipates preparing and filing 11 or more Forms 1040, 1040A, 1040EZ and 1041 during a calendar year to e-file. Electronic Tax Administration Advisory Committee, *Annual Report to Congress*, Publication 3415, June 2014; Sec. 6011(e)(3) and Treas. Reg. sec. 301.6011-7.

Table 6.−Actual and Projected Submission of Individual Tax Returns, 1990-2016

Calendar Year	Total Returns	Total Returns, e-File	Percentage e-Filed	Total Returns, Paper	Percentage Paper
1990	112,305,000	4,204,200	3.7	108,100,900	96.3
1995	116,059,700	11,806,900	10.2	104,252,800	89.8
1998	122,546,900	24,580,300	20.1	97,966,600	79.9
1999	124,887,100	29,329,500	23.5	95,557,600	76.5
2000	127,097,200	35,402,200	27.9	91,695,100	72.1
2001	129,444,900	40,206,800	31.1	89,238,100	68.9
2002	130,341,200	46,836,100	35.9	83,505,100	64.1
2003	130,134,300	52,869,000	40.6	77,265,300	59.4
2004	130,576,900	61,428,300	47.0	69,148,600	53.0
2005	132,275,800	68,463,900	51.8	63,811,900	48.2
2006	134,421,400	73,239,500	54.5	61,181,900	45.5
2007	140,188,000	79,979,000	57.1	60,209,000	42.9
2008	156,297,000	89,886,000	57.5	66,411,000	42.5
2009	141,376,000	94,980,000	67.2	46,396,000	32.8
2010*	138,081,700	97,650,200	70.7	40,431,600	29.3
2011*	138,924,800	101,265,600	72.9	37,659,200	27.1
2012*	140,583,800	105,420,800	75.0	35,163,000	25.0
2013*	142,206,700	109,180,700	76.8	33,026,000	23.2
2014*	143,543,900	112,378,900	78.3	31,165,000	21.7
2015*	144,695,600	115,149,100	79.6	29,546,500	20.4
2016*	145,813,500	117,678,200	80.7	28,135,300	19.3

* Data for this year is projected. Source: IRS (2006) SOI Bulletin Historical Table 22: Selected Returns and Forms Filed or to be Filed by Type, 1990-2007; IRS (2010) Advancing E-File Study Phase 2 Report.

Return preparation time and the cost of compliance

Some analysts suggest that the taxpayer's cost of compliance with the Federal income tax could be measured by applying an estimate of the value of a taxpayer's time to an estimate of the total quantity of time spent complying. In its calculations of average time burden, the IRS provides estimates of the dollar value of these time burdens by the type of form a taxpayer files: $260 for taxpayers who file Form 1040; $80 for taxpayers who file Form 1040A; and $40 for taxpayers who file Form 1040EZ. The IRS also provides calculations of the average dollar value of time burden for the business taxpayer ($410) and the nonbusiness taxpayer ($110).[19]

However, because of the empirical difficulties associated with estimating the value of taxpayer time, there is no clear consensus among economists as to how a reliable estimate of average value of taxpayer time should be made. As a result, popularly reported estimates of taxpayer compliance costs that simply multiply the IRS-provided preparation times by estimated value of taxpayer time may be inaccurate.

IRS assistance provided to taxpayers

While the increase in the utilization of paid preparers and electronic means of tax return preparation and filing may result in less time spent complying with the Federal tax law by individual taxpayers, IRS provides a significant amount of assistance to taxpayers. The following table shows the scope and utilization of this IRS-provided assistance for fiscal year 2014.

Table 7.−Assistance Provided to Individual Income Taxpayers

Returns Prepared by VITA/TCE/AARP*	3,322,582
Number of IRS Taxpayer Assistance Centers (TAC's)	376
Number of TAC Contacts	5,477,279
Total Calls to IRS	100,677,411

Source: IRS TAS Annual Report to Congress, 2014.
* Free, in-person return preparation is offered to low income and older taxpayers by non-IRS organizations through the Volunteer Income Tax Assistance (VITA), Tax Counseling for the Elderly (TCE), and AARP Tax-Aide Programs.

[19] Internal Revenue Service, "1040 Instructions, 2014," January 26, 2015, p. 54.

C. Effect of Complexity on Perceived Fairness of the Federal Tax System

Complexity and ambiguity in the tax law can create uncertainty that may reduce taxpayer perceptions of fairness in the Federal tax system in several ways. First, ambiguity in the tax law can result in disparate treatment of similarly situated taxpayers and can lead individual taxpayers to believe that they bear a disproportionate tax burden. Second, taxpayers may believe that complexity creates opportunities for manipulation of the tax laws by other taxpayers, and that complexity confers an advantage for taxpayers who are able to obtain professional advice on reducing their tax liabilities. Commentators have asserted that, in addition to causing inadvertent noncompliance, complexity or ambiguity in the tax law can lead to taxpayer cynicism potentially resulting in intentional noncompliance.[20]

[20] Recent research indicates that the estimated degree of underreporting of income (as a proportion of "true" income) is higher for taxpayers with high income relative to low income. However, estimates of the degree of underreported tax (as a proportion of "true" tax) are highest for lower income taxpayers. Andrew Johns and Joel Slemrod, "The Distribution of Income Tax Noncompliance," *National Tax Journal*, vol. 63, no. 3, September 2010.

D. Effect of Complexity on Tax Administration

Costs of administration generally

Although IRS administrative costs are approximately less than one percent of revenue raised,[21] and while they are generally thought to be significantly smaller than the cost of compliance to individual taxpayers, they are an important component of the overall cost of the tax system.[22] Complexity in the Federal tax system can adversely affect not only the ability and willingness of taxpayers to comply with the tax laws, but also can affect the ability of the IRS and its employees to properly administer the tax laws, thereby increasing these costs.

Complex tax laws can be difficult for the IRS to explain to taxpayers in a concise and understandable manner in forms, instructions, publications, and other guidance. Even with an increasing reliance on return preparation computer software by taxpayers and tax return preparers, complex tax laws can increase the administrative burden of identifying and correcting computational mistakes made by taxpayers. As a result, the need to administer complex tax laws can increase the need for larger IRS budgets and higher IRS personnel levels than would otherwise be required with less complexity in the tax laws.

Complexity in the tax laws also can make it difficult for the IRS to adequately train its employees and hire new employees with the necessary skill levels, thus inhibiting the quality of service that IRS employees can provide to taxpayers. The IRS provides various channels for taxpayers to obtain technical assistance in the application of the tax laws, including call sites that assist taxpayers who telephone the IRS with tax law questions.[23] Complexity in the tax laws may also lead to high levels of calls to these call sites[24] and to the IRS. In 2014, the Taxpayer Advocate Service ("TAS") estimates that total calls to the IRS exceeded 100 million.[25]

Costs of disputes

To the extent complexity or ambiguity in the tax law leads to taxpayer noncompliance, disputes between taxpayers and the IRS about the correct result may be increased. These disputes may result in increased costs for the government (as well as for taxpayers). It is difficult

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[21] Joel Slemrod, "Which Is the Simplest Tax System of Them All?" in Henry Aaron and William Gale (eds.) *Economic Effects of Fundamental Tax Reform*, Brookins Institution Press, 1996; Joel Slemrod, "Tax Systems," *NBER Reporter*, Summer 2002.

[22] Joel Slemrod, "Tax Avoidance, Evasion and Administration," in Alan J. Auerbach and Martin Feldstein (eds.), *Handbook of Public Economics Vol. 3*, Ch. 22, 2002.

[23] Other ways in which taxpayers can obtain assistance from the IRS in complying with the tax laws include walk-in sites where taxpayers can get answers to questions, IRS-sponsored volunteer organizations that provide assistance to eligible taxpayers, and various outlets through which taxpayers can receive tax forms and publications.

[24] See Table 7.

[25] IRS Taxpayer Advocate Service, "2014 Annual Report to Congress, Volume One."

to measure the increment in disputes between the IRS and taxpayers that is attributable to complexity or ambiguity in the tax law. However, an increase in voluntary compliance could result in a reduction in the number of audits that are not quickly resolved and a reduction in the amount of tax litigation. Table 8 shows the number of total cases received by the IRS Chief Counsel for selected years, 1998 through 2013.

Table 8.−Chief Counsel Workload: Tax Litigation Cases, by Type of Case

Year	Tax Court cases received[1]	Refund cases received[2]	Non-docketed and other tax litigation cases[3]	Total cases received
1998	21,370	715	9,997	32,082
2000	13,698	389	7,773	21,860
2005	24,671	390	2,504	27,565
2010	29,500	242	2,854	32,596
2013	29,837	263	2,876	32,976

Source: Internal Revenue Services, Statistics of Income, Table 27, Selected Years.
Notes:
[1] Tax Court cases involve a taxpayer contesting the Internal Revenue Service's determination that the taxpayer owes additional tax. The Tax Court provides a forum for a taxpayer to request a determination of the deficiency prior to paying the tax allegedly owed. Other cases that may be considered by the Tax Court include: Collection Due Process, Innocent Spouse Program, Abatement of Interest, Tax-Exempt Status.
[2] Refund cases involve taxpayers seeking refunds of claimed overpayments after taxes have been fully paid.
[3] Non-docketed cases are cases in which a court petition was not filed and Chief Counsel reviewed and advised on a statutory notice of deficiency.