



Testimony of Daniel M. Clifton
Federal Affairs Manager
Americans for Tax Reform

Hearing before the
Committee on Government Reform
Subcommittee on Energy Policy,
Natural Resources & Regulatory Affairs

April 20, 2004

Chairman Ose, Ranking Member Tierney, and members of the Committee, thank you for the opportunity to testify concerning the paperwork and regulatory impact placed on taxpayers by the tax code.

My name is Daniel Clifton and I currently serve as Federal Affairs Manager and Chief Economist for the Americans for Tax Reform. ATR is a non-partisan, not-profit coalition of taxpayers and taxpayer groups throughout the country dedicated to lower taxes, fewer regulations, and free markets.

This hearing could not have occurred at a better time. Last week was the passing of another Tax Day, the final day for taxpayers to pay their taxes to government. This is the most relevant time to discuss tax and regulatory issues as taxpayers become focused on both the time and money burden imposed by the tax system since they are filling out their forms and writing checks to the federal and state governments.

Over the past year the news for taxpayers improved on the *tax payment* side of the equation as the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) passed by this Congress and signed into law by President Bush provided the most historic tax relief to American taxpayers since the 1981 Reagan tax cuts. As you know, the legislation reduced income taxes for all taxpayers, increased the per child tax credit, cut the capital gains tax, slashed the double tax on dividends, and increased businesses allowances for purchasing.

According to the Treasury Department, 111 million individuals and families received an average tax cut of \$1,586 in 2004 because of the tax cuts enacted in 2001 and 2003. A family of four earning \$40,000 saw their taxes reduced \$1,933 a 96 percent reduction. As of April 13th, the average tax refund was over \$2,000 an increase of nearly 9 percent compared to last year. By next year's Tax Day, more than 14 million tax filers will have been completely removed from paying taxes since 2000.

The tax cuts were more than just providing tax relief to families as it spurred faster economic growth as well. The economy has expanded at a quarterly average of more than 6 percent since the tax cut has been put into place. Shareholder wealth has increased \$2.5 trillion. Dividend issuance is up more than 60 percent as companies are now returning more cash to shareholders. Business investment has increased more than 10 percent per quarter. Initial unemployment claims are down 25 percent and more than 700,000 jobs have been created. All told, the tax cuts are working and have paved the way for strong economic growth moving forward.

Under President Bush's leadership, taxes have been cut three times in as many years, however, the tax cuts have also resulted in changes to the tax code that has increased the cost of tax compliance to taxpayers. In 2003, this hearing discovered that the Internal Revenue Service (IRS) paperwork burden accounted for an astonishing 80 percent of the entire federal government paperwork burden, roughly 6.7 billion hours.

So how did we ever get to this point? Our income tax system began as a system to fund the government, yet Congress and Presidents have continually used the system to fund new

deductions and special interest provisions while putting limits and qualifiers on existing rules to increase revenue or clamp down on cheats. The result of these actions has been to move the paperwork burden in the wrong direction even in the wake of the Paperwork Reduction Act. The fact is we are now at a point of near collapse and the system needs to be fixed.

It is my belief that both the IRS and Office of Management and Budget (OMB) understand this situation and have attempted to reduce unnecessary and duplicitous measures in the tax forms over the past several years. Yet, this effort has been akin to running up a downward moving elevator. As minor changes are made to reduce the burden on taxpayers, more complexity is added leaving a net increase in the burden.

In fact, since the passage of the Paperwork Reduction Act in 1995, the number of lines on the 1040 form has increased from 66 to 73 while the 1040 instruction page booklet has increased from 84 pages to 131 pages. Without question, the number of rules, limits, terms of conditions and other qualifiers are increasing the paperwork burden on working Americans and the U.S. economy.

A recent study by the National Taxpayers Union places in context the growth of tax compliance as it relates to the Paperwork Reduction Act. According to the report, "If the Treasury Department were to reduce its burden by the average amount mandated by the 1995 Paperwork Reduction Act, the burden would have declined to 3.702 billion hours in 2000. Instead, the Treasury overshot that target by 2.429 billion hours." The result has been a 15 percent increase from 1995 through 2000 instead of the mandated 31 percent reduction target set by the law.

The Tax Foundation reported the cost to comply with the tax code in dollar terms last year was \$203 billion, which was greater than the revenues of America's second largest company ExxonMobil. And this burden is growing. Since the Tax Relief Act of 1997, the cost of tax compliance has increased more than 25 percent.

With the accelerating tax compliance burden, taxpayers are now spending 35 percent more time filling out their tax form than in 1995 when the Paperwork Reduction Act was passed. In 1988, the IRS reported the average paperwork burden was 17 hours, today that same burden is 28 hours. Even the EZ file time requirements are significantly increasing.

Tax complexity also increases noncompliance with the tax code and non-filing as taxpayers become frustrated with the process. Others use the complexity to hide money and exploit loopholes. Taken together, this drives up the cost to all taxpayers.

The growing tax compliance also places a negative drag on the economy by stifling productivity and allocating resources less efficiently. The use of paid preparers is up more than 60 percent since 1980 and 25 percent since 1995 as a result of complexity. The code has become the full employment act for creative accountants.

This is redirecting accountants away from productive activities such as auditing companies like Enron to ensure markets are working properly and making them full time tax preparers. At the same time, more demand for tax preparers is driving up the cost for working families.

With resources allocated less efficiently productivity stemming from the tax law is declining. This stands in stark contrast to the rapid productivity experienced in the private sector. Private businesses have moved with speed to knock out inefficiencies while the tax code continues to place a drag on the economy as it grows out of control.

I can go on all day with stats on the tax code and compliance costs. But I would rather just examine how this affects the average American family. To illustrate how the growing complexity and paperwork burden impacts the average American family, Exhibit A are savings accounts used by millions of Americans.

The IRS publication explaining Individual Retirement Accounts (IRAs) is now 104 pages long – in 1982 the publication was just 12 pages. As a result of Congressional action, there are now six different accounts all with special and clever acronyms which make little sense to a working mother who is more concerned with getting her children to soccer and band practice than with the intricacies savings program rules.

To participate in the programs, average Americans need tax accountants to explain the programs exist, whether they qualify, and what are the limitations before they can even decide whether they will participate, which essentially requires them to have a preparer to be able to take advantage of Congress' well intentioned programs. Moreover, these families must pay for these services. Once they find out that they can participate in a program, say for education savings accounts, then they most likely can not make that contribution until the following year.

As you can see this process is frustrating and that stifles participation. In 1981 Congress liberalized the rules governing IRAs and as a result, IRA contributions exploded. As former Assistant Secretary of Treasury Pam Olsen mentioned in a recent speech, from 1980 to 1986, contributions to IRAs rose nearly ten-fold, from \$4 billion to \$38 billion. When Congress restricted the deductibility of IRA contributions in 1986 and added greater complexity, the level of annual IRA contributions fell sharply and never recovered to \$15 billion in 1987 and \$8.4 billion in 1995.

This regulation disproportionately hurt lower-income families. Among families retaining eligibility to fully deduct IRA contributions, participation declined by 40 percent between 1986 and 1987, despite the fact that the change in law did not affect them. The number of IRA contributors with income of less than \$25,000 dropped by 30 percent in that one year.

Much of the efficiency and productivity from simplicity was lost and has not returned. Instead of returning to simplicity, thus fixing declining participation, new rules and provisions, as well as numerous and differentiated saving incentives added more complexity to savings. As complexity increases, the inability to standardize transactions grows, and thus, the cost of administration grows, which leads to lost efficiency, lost productivity, and lost savings.

This is just one of many examples of how the growing burden continues to overwhelm families and small businesses.

So how do we overcome the elevator problem mentioned above? How do we fix the problem facing the IRS of removing three lines and then adding six more because of Congressional and Administration changes?

In the immediate Congress needs to significantly improve on the 1998 IRS Restructuring and Reform Act and the Paperwork Reduction Act. The 1998 law required Congress to consider complexity before enacting a tax law, however, it did not quantify the number. This should be upgraded to reflect the cost or savings of a proposal and be coordinated between the IRS Restructuring and Paperwork Reduction Act.

However, recommendations like this are just window dressing for what really needs to be done. Congress needs to move towards comprehensive, fundamental tax reform – tax reform that taxes income one time and one time only, while removing the special interest deductions. Tax rates need to be lowered, while increasing the tax base by lowering the deductions.

Under President Bush's leadership, this process has begun in incremental steps. Each tax cut has an element that brings the country closer to tax reform, whether it is lowering marginal tax rates, increasing savings contributions to IRAs, lowering and eliminating double taxation, or improving our international tax code. Without repeal of say the capital gains tax, complexity will always increase when we seek to lower this economic damaging tax.

Under this system, the hodgepodge of six different savings programs referenced above would be completely eliminated. So too would be the 102 page booklet describing the programs and taxes. Schedule D would be completely eliminated and taxpayers would need just one page to fill out their income, their standard deduction, the amount of taxes owed. The resulting simplification measure will increase compliance and boost growth. When Russia moved to a similar system in the late 1990's revenues soared as compliance increased.

Overall, the only real way to actually reduce the taxpayer paperwork burden is to fundamentally change the nature of our tax code back to its original purpose – to raise revenue to run the government.

Thank you.