THE FEDERAL INDIVIDUAL INCOME TAX FORM: HOW DOES ITS APPEARANCE MATTER?*

Allen H. Lerman
Office of Tax Analysis, United States Department of the Treasury

INTRODUCTION

TAXPAYERS EXPEND TIME AND INCUR OUT-OF-pocket costs to fulfill their federal income tax obligations. The combination of time and money is their taxpayer compliance burden. Some – but not all – of that burden is the time expended in actually completing their income tax returns. Starting from current IRS tax forms which have been modified and refined over many years, one reasonable question is whether additional changes could reduce taxpayers' burdens.

This paper is the outgrowth of two separate projects. One is an exploration of updating and modifying the federal individual income tax return – the Form 1040 – that was undertaken to meet the requirements of administering the federal income tax system. The other is a long-term research effort to improve the ability of the IRS and the Treasury Department to measure and estimate the burden that the tax system places on taxpayers and shifts in that burden from legislative and administrative changes.

WHAT IS A TAX RETURN?

At the most basic level, a tax return is the vehicle through which taxpayers identify themselves to the tax authority, report tax liability, and certify that the reported liability is correct. But, historically, tax returns usually serve two additional purposes.

First, tax forms provide a service to the taxpayer by guiding the taxpayer through the listing and quantifying income and the other items upon which the amount of tax liability depends and, then, assisting the taxpayer in working through the arithmetic of calculating tax liability and any balance due or refund.

Second, the tax forms assist in compliance by including sufficient information about the taxpayer and the items from which tax liability is determined

to enable the tax authority to determine if the taxpayer is complying with the law or if some post-filing enforcement activities may be appropriate.

Most of the content of tax forms is the result of these two wider purposes, and the same information generally serves both purposes. Effectively, the inclusion of these items is not discretionary if the goal is to have taxpayers determine and pay the proper amount of legally mandated tax liability.

FEDERAL INDIVIDUAL INCOME TAX FORMS

Form 1040 – which is the central and summary form for the federal individual income tax – underwent its last major modification for tax year 1977 when its structure was changed from "building blocks" to "sequential."[1] Previously, data from other forms were entered into separate sections of the 1040, mostly on the reverse side, and the summary amounts from each section were transferred to the front, where the form was signed. That layout required flipping the return over and back several times to copy information. The page flipping was annoying, burdensome, and increased transcription errors.

Since it was revised for 1977, the Form 1040 has been sequential. The form is ordered so that information can be entered in the logical sequence required to identify the taxpayer, to provide relevant demographic information, and then to calculate income, tax liability, and the amount payable or the tax refund due. A taxpayer starts at the top of the front side and proceeds line-by-line down the front side and then down the reverse side. The income amount on the bottom line of the front side and the number of personal exemptions being claimed are the only items that must be copied from the front to the back of the form.

Since the 1977 revision, new or altered tax provisions have required items to be added to the 1040, which has forced lines to be placed closer together and has made the form look more cluttered and forbidding. Overall, the number of lines has increased by 20 percent, the number

---

of checkboxes has increased by 70 percent, and information for other items has been added. More information has been required for children who live with the taxpayer, and sections have been added for direct deposit of refunds and for a third-party designee to answer certain questions on behalf of the taxpayer. Despite these changes, the form has remained sequential and has not been extended beyond two pages.

By 2003, the IRS became concerned that there would not be space for the additional items that, based on historical experience, Congress was expected to enact in the near future. The IRS began to consider changes in the Form 1040 to accommodate future legislative additions.

TAXPAYER BURDEN FROM COMPLETING INDIVIDUAL INCOME TAX FORMS

In the late 1990s, when the IRS and the Treasury Department began a project to improve the methodology for measuring taxpayer compliance burden, it was recognized that what taxpayers do—hence, the burden they incur—is very dependent on how their returns are prepared, so that burden should be examined separately for three types of tax return preparation:

1. Preparation by paid tax preparers;
2. Self-preparation using tax preparation software, such as Intuit's TurboTax or H & R Block's TaxCut; and
3. Self-preparation using manual methods —that is with pen or pencil.

Distinction by the method of tax form preparation is crucial because software preparers—which include virtually all paid preparers—do not really use the IRS-developed tax forms. Instead, the interfaces of the tax preparation software are their tax forms—and those interfaces can be, and often are, completely different from IRS-developed tax forms. The IRS can change the paper tax forms, but IRS *cannot* control the software interfaces so long as they collect the information which the IRS requires to be submitted.

The new burden methodology developed by the IRS-Treasury project uses a microsimulation model—the Individual Taxpayer Burden Model, or ITBM—to estimate compliance burden taxpayer-by-taxpayer for a sample of taxpayers believed to be representative of the entire tax-filing population, and results are weighted to population levels. The ITBM uses known information to impute and quantify behavior that generally cannot be observed. The ITBM separates burden into total out-of-pocket expenditures and seven distinct categories of activities.[2] The ITBM-produced estimates of the shares of time expended on each activity category are shown in Table 1. For changes in the appearance of the Form 1040, only tax form completion burden is relevant, since the burden for the other activities will not be affected.[3]

Table 1 highlights that the time burden from tax form completion is only a relatively small share of total tax burden. For all taxpayers grouped together, form completion is 12.7 percent of total tax burden. For taxpayers who prepare their returns manually, and these are the only taxpayers whose form completion burden is affected directly by the IRS' tax forms, form completion is 24.1 percent—that is, one-fourth—of burden. (Record keeping and tax planning are the other two major categories of taxpayer burden. Taxpayers spend only one-eighth of their time on the remaining four burden categories.)

More detailed information about the time burden from tax form completion that the IRS can affect

Table 1
Shares of Taxpayer Time Burden by Activity, 2005

Burden Category	All Tax Returns	Manually Self-Prepared Returns
Record Keeping	57.0%	46.7%
Gathering Tax Materials	3.0%	4.3%
Using IRS Services	1.1%	2.1%
Using a Paid Professional	6.5%	1.1%
Tax Planning	17.4%	17.2%
Form Completion	**12.7%**	**24.1%**
Form Submission	2.2%	2.5%

Source: Individual Taxpayer Burden Model

directly, and its share of total burden, is shown in Table 2.

For tax year 2005, taxpayers expended 3.48 billion hours in complying with the federal individual income tax. (Taxpayers also incurred $26 billion in out-of-pocket costs.) However, only 15.0 million of the 133.9 million of tax returns filed – that is, about 11 percent, or one-out-of-nine returns – were self-prepared manually. These manual self-preparers had about 9.3 percent of the total time burden, or about 323 million hours.

The time burden from tax form completion by manual self-preparers was 24.1 percent of the 323 million hours, or 78 million hours. The 78 million hours of tax form preparation burden for manually self-prepared tax returns represents only 2.2 percent of the aggregate time burden of 3.48 billion hours for all activities of all taxpayers.

ACCOMMODATING ADDITIONAL PROVISIONS ON FORM 1040

In response to concerns about how additional items could be accommodated on Form 1040, the IRS began to explore two possible changes.

The first change was straightforward: extend the length of the current sequential form from two pages to three or even four pages. More pages would provide space for new items, would permit separate lines for items that are currently inserted as write-ins, and would permit layout changes that would make the form appear simpler, more "user friendly," and less cramped and cluttered.

The second possible change was to transfer less-frequently used items from the Form 1040 itself to a new, separate, intermediate form – dubbed Schedule O – with the subtotals from the intermediate form transferred to the 1040. With fewer lines, the Form 1040 could be made more visually attractive,

Table 2
Estimated Total and Form Completion Burden by Return Preparation Method, 2005

	Number of Returns (millions)	Aggregate Time Burden (millions of hours)		Aggregate Time Burden (hours)		Form Completion as Percent of Total
		Total	Form Completion	Total	Form Completion	
All Returns						
Self-Prep without Software	15.0	323	78	21.5	5.2	24.1%
Self-Prep with Software	35.8	942	209	26.3	5.8	22.2%
Paid Preparation	83.1	2,214	156	26.7	1.9	7.0%
All	133.9	3,480	443	26.0	3.3	12.7%
Form 1040						
Self-Prep without Software	7.7	233	56	30.2	7.2	23.8%
Self-Prep with Software	21.3	779	151	36.6	7.1	19.4%
Paid Preparation	64.0	2,051	135	32.0	2.1	6.6%
All	93.0	3,063	341	32.9	3.7	11.1%
Form 1040A						
Self-Prep without Software	3.2	49	12	15.3	3.9	25.4%
Self-Prep with Software	6.9	99	32	14.3	4.6	32.4%
Paid Preparation	12.7	125	15	9.8	1.2	12.1%
All	22.8	273	60	12.0	2.6	21.8%
Form 1040EZ						
Self-Prep without Software	4.1	41	10	10.1	2.4	24.3%
Self-Prep with Software	7.7	65	26	8.4	3.4	40.8%
Paid Preparation	6.3	38	6	6.0	0.9	15.5%
All	18.1	144	42	7.9	2.3	29.5%

Source: Individual Taxpayer Burden Model

and only a few million taxpayers would be required to use the intermediate form. Use of the intermediate form, however, would *not* be consistent with the sequential concept of the current Form 1040. Including a Schedule O form would require taxpayers to go back and forth between the various source forms, the Schedule O, and the 1040.

In order to explore the benefits and possible public reaction to the two possible form changes, the IRS partially developed a version of Form1040 that was three pages long and a version that included a separate Schedule O. In the fall of 2003, the participants in 10 focus group sessions in three cities helped evaluate the alternative concepts. Focus group participants had several common observations and evaluations.

- For the three-page Form 1040:
  – Participants were not overly concerned about the length of the three-page 1040. Often, after a moment of initial shock, participants noticed that the form did not require additional information and that the more open layout made the form seem easier and less intimidating.
  – Participants liked having more adjustments and credits listed on the 1040. Many felt that the more complete listing would serve as a checklist that would call their attention to benefits that they might otherwise overlook.
- For the shorter Form 1040 with the new Schedule O, there was recognition:
  – That the Schedule O would often just be a transmittal form for information already entered elsewhere, and that most taxpayers would not have to use the Schedule O. Nevertheless, the extra transcription and extra page flipping for taxpayers who did have to use it was a concern.
  – Participants mentioned that those not using the Schedule O would not have an opportunity to see a full listing of tax provisions that might be of benefit to them.
  – There was concern that taxpayers would have to return to Schedule O more than once. There seemed to be a consistent preference for tax forms that permit each form to be completed in its entirety without jumping back and forth to other forms.

- However, overall, there was neither a strong preference for, nor strong aversion to, either of the new forms.

Following the initial focus group testing, there was an extended period of evaluation and further development. The IRS seemed to favor the Schedule O concept rather than a longer Form 1040. The IRS position was based largely on optics and internal form processing constraints. Shifting away from the sequential concept of the current 1040 was not considered to be a major problem.

The most important factor favoring the Schedule O concept was the increasingly frequent enactment of tax legislation late in the year for which the changes would apply. The Schedule O approach would permit the IRS to accommodate much late legislation without having to delay the distribution of the Form 1040 itself or delay the processing of large numbers of tax returns not affected by the legislative change. Many types of late changes could be included on the Schedule O—at least for the initial year—and the IRS could finalize the 1040 itself and could process most tax returns without delay.

After further development and refinement, the alternative concept tax forms were subjected to further focus group testing. The most recent focus group sessions—in November, 2006—stressed the Schedule O approach, although a four-page Form 1040 was discussed briefly.

For the November, 2006, focus group testing, Form 1040 was made shorter, with about the same number of lines as the current Form 1040A. The Schedule O was extended from the one page with two sections in the version tested in 203 to two pages with four sections. The sections were for Adjustments to Income, Tax Credits, Other Taxes, and Other Payments. The Schedule O had 53 numbered lines.

Another important change was that the Schedule O would be used only if a taxpayer needed to use more than one line in a section of the Schedule O or for items – such as alimony payments – not entered on another source form. Otherwise, the taxpayer would bypass the Schedule O and would transfer the information directly from the source form to the Form 1040. The taxpayer would also enter the source form number on the Form 1040. Allowing some taxpayers to bypass the Schedule O was intended to provide simplification and reduce taxpayer burden.

The bypass feature was tested by having the focus group participants complete an example in which they calculated an adjustment to income for moving expenses. In the example, they did not need to use Schedule O because moving expenses were their only adjustment to income. The instruction for the last line of the moving expenses form was:

Subtract line 4 from line 3. **This is your moving expense deduction.** If this is the only deduction you are claiming on Form 1040, line 23f, enter this amount on line 23f, and enter "3903" in the space provided. Otherwise, enter this amount on Schedule O (Form 1040), line 3.

As the focus group members reached this instruction, their facial expressions and body language made it clear that they were confused and were having difficulty following the instruction. The subsequent focus group discussions and the completed example tax forms confirmed the difficulty. Many subjects used the Schedule O unnecessarily. Others correctly bypassed the Schedule O but failed to insert the "3903." In the real world, that omission would be costly and problematic.

The reactions of the focus group participants were sufficiently negative to strongly suggest that, if implemented, the use of Schedule O must be mandatory even for taxpayers who need to use only a single line of the Schedule O.

BURDEN CHANGES FROM THE ALTERNATIVE FORMS

The Individual Taxpayer Burden Model (ITBM) was used to estimate the changes in taxpayer burden that could be expected from implementing either of the two major changes to the basic Form 1040, as well as the changes from eliminating a separate Form 1040A if the Schedule O approach were implemented. Using the ITBM to estimate the burden changes served two goals. First, it provided estimates to assist in further evaluating the alternative forms and approaches. Second, it helped to further test and enhance the ability of the ITBM to produce reasonable estimates for potential changes of the "look and feel" of a tax form and changes in how tax forms handle information in situations in which the actual information that is included is not altered.

It was particularly challenging to figure out how to make the ITBM reflect the burden changes from

the "optional" Schedule O approach—that is, the approach under which the Schedule O is bypassed if the taxpayer would need to use only one line in a Schedule O section. The author decided to have the model instruments attempt to emulate the steps that taxpayers might follow during the decision process. When a taxpayer reached the bottom of the first tax form from which the total might be transferred to either the Schedule O or the Form 1040 directly, it was assumed that the taxpayer would look at the instructions next to the entry lines in the particular section of the Schedule O. Then, the taxpayer would read or scan the names and one-line descriptions of the items that would be included on those lines in order to decide whether any of those other lines would be applicable for him or her. It was assumed that the taxpayer would incur the burden associated with scanning those single lines of text next to the entry lines in the relevant section of the Schedule O. However, those burdens were assigned only once. That is, it was assumed that the taxpayer needed to make the decision only once. Thus, if a taxpayer had a second adjustment item that might be included in the same section of the Schedule O, there was no incremental burden of deciding about Schedule O use. Presumably, the first scan enabled the taxpayer to make the correct decision about the need to use Schedule O.

As explained above, changes to paper tax forms that do not affect the content included on the tax form affect only manual self-preparers who use the IRS tax forms. Preparers who use software actually face software interfaces designed by software vendors—which would not be altered directly as the result of the Form 1040 rearrangements being considered by the IRS. Similarly, the Form 1040 changes being considered would not affect taxpayers' activities other than form completion. The time devoted to record keeping, tax planning, gathering tax materials, etc., would not be affected by these Form 1040 changes. Hence, the only impact on taxpayer burden would be in the time devoted to tax form completion by self-preparers who do not use tax preparation software. Thus, only the ITBM estimates of changes in the form completion time of manual self-preparers were considered.[4]

The results of the burden model's simulations indicate that the four-page Form 1040 and the two variants of the shorter Form 1040 using Schedule O all would increase form completion time for Form 1040 filers.

As shown in Table 3, the four-page Form 1040 would increase average form completion time by about one minute, or about 0.2 percent. The shorter Form 1040 with the Schedule O required to be used in all cases would increase form completion time by about 7 minutes, or 1.4 percent. That version would require 2.4 million manually prepared tax returns to include a Schedule O.

The time increase would be greater for the Schedule O version in which taxpayers must decide whether to use or to bypass Schedule O. Although that approach would require fewer than 1.1 million manually prepared tax returns to include a Schedule O, it would increase average form completion time by nearly 17 minutes (3.4 percent) for those who consider using Schedule O but who do not actually have to use it. It would increase average form completion time by 26 minutes (5.1 percent) for taxpayers who actually use Schedule O. (The extra time for those required to use Schedule O rather than just considering its use probably reflects the different characteristics of the different groups of taxpayers.)

These results confirmed the complexity and burden of deciding whether or not the taxpayer needed to use the Schedule O that was observed during focus groups.

The ITBM was also used to estimate the impact of eliminating the separate Form 1040A in conjunction with the introduction of the four-page Form 1040 or Schedule O approaches. The results are summarized in Table 4. Eliminating the Form 1040A and requiring Form 1040A filers to use the a four-page Form 1040 would increase average form completion time by 42 to 43 minutes, or about 19 percent.

If the Form 1040A were eliminated and the Schedule O concept were implemented, the time burden would increase slightly more for the former Form 1040A filers who would be required to use Schedule O. Of the 3.2 manual self-prepared 1040As, 670,000 would have to use Schedule O if Schedule O use were mandatory if any Schedule O line was used. Only 282,000 would have to use Schedule O if its use were required only when two or more lines in a section of the form were used.

As for Form 1040 users, the time increase would be greater for the Schedule O version in which taxpayers must decide whether to use or to bypass Schedule O. Under the mandatory Schedule O approach, the average time increase would be about 47 minutes, which is 5 minutes more than for the four-page Form 1040. Under the optional Schedule O approach, the average time increase would be 50 minutes for those who must consider Schedule O but who do not ultimately use it. The average increase would be 57 minutes for those who ultimately would actually have to use Schedule O.

Table 3
Changes in Form Completion Time: Form 1040 Self-Prepared Without Software, 2005

| | | | Proposed Modification | |
| | | | Shorter 1040 with Schedule O | |
Form 1040 Users	Current Tax Returns (number)	Four-Page Form 1040	Schedule O Required Always	Schedule O Required If 2+ Items
Number of Tax Returns	7,712	7,712	2,402	1,062
Taxpayers who would use Schedule O	1,062	1,062	1,062	1,062
Taxpayers Considering But NOT Using Schedule O	1,340	1,340	1,340	0
Taxpayers NOT considering and NOT using Schedule O	5,310	5,310	0	0
Average Form Completion Time for Current Form and Increase for Proposed Changes (minutes)				
Taxpayers who would use Schedule O	511	1	7	26
Taxpayers Considering But NOT Using Schedule O	501	1	7	17
Taxpayers NOT considering and NOT using Schedule O	399	1	0	0
Source: Individual Taxpayer Burden Model				

Table 4
Changes in Form Completion Time: Form 1040A Self-Prepared Without Software, 2005

			Proposed Modification	
			Shorter 1040 with Schedule O	
Form 1040 Users	Current Tax Returns (number)	Four- Page Form 1040	Schedule O Required Always	Schedule O Required If 2+ Items
Number of Tax Returns	3,204		670	282
Taxpayers who would use Schedule O	282		282	282
Taxpayers Considering But NOT Using Schedule O	388		388	0
Taxpayers NOT considering and NOT using Schedule O	2,534		0	0
Average Form Completion Time for Current Form and Increase for Proposed Changes (minutes)				
Taxpayers who would use Schedule O	218	42	47	57
Taxpayers Considering But NOT Using Schedule O	240	42	47	50
Taxpayers NOT considering and NOT using Schedule O	236	43	42	42

Source: Individual Taxpayer Burden Model

CONCLUSIONS AND IMPLICATIONS

The testing of the two modifications of the paper Form 1040 provides evidence that discretionary changes in the appearance of tax forms are likely, at best, to have only a very modest impact in reducing taxpayer burden and, in fact, may actually increase burden.

Even for the 2 percent of total burden from manual tax form completion, most of what needs to be entered and calculated on tax return forms is effectively determined by the tax laws and, therefore, is not under the control of the IRS. As a result, starting from current tax forms, there is little that the IRS can do to reduce form completion burden.

Since many form changes will have little impact on taxpayer burden, and since ever-fewer taxpayers actually complete the IRS-designed tax forms, it may be appropriate for the IRS to place relatively less emphasis on administrative simplification of tax forms and relatively more emphasis on how the tax forms may affect IRS processing costs, taxpayer compliance, and the need for the IRS to contact taxpayers after tax-return filing. Fewer post-filing contacts would reduce IRS costs and reduce taxpayers' post-filing burdens and, thus, their combined pre- and post-filing burdens.[5]

Finally, it is time for wider recognition that most tax form completion burden – and much of the remainder of taxpayer compliance burden – reflects the complexity of tax provisions and the overall tax law. Major reductions in tax compliance burden can be achieved only through simplification of the tax law – including fewer separate provisions, fewer complicated distinctions, and fewer year-to-year changes.

Acknowledgements

Notes

[1] Two other tax forms are provided for taxpayers with less complicated tax situations. Form 1040A is for nonbusiness, non-itemizers. The items included, hence, the length of the form, have increased over time in order to include many provisions that formerly required use of Form 1040. These changes were made as certain tax provisions were introduced or utilization of provisions increased by tax filers in otherwise relatively simple financial situations. In 1982, Form 1040EZ was introduced

for taxpayers with very limited types of income—mainly wages and limited amounts of interest and dividend income—and who do not have children and do not itemize. Forms 1040A and 1040EZ are both completed sequentially rather than in building block fashion.

[2] For a more detailed description of the ITBM, see Lerman and Lee (2004) and Guyton, O'Hare, Stavrianos, and Toder (2003).

[3] Because the ITBM uses the characteristics of the IRS's paper tax forms as a proxy for the actual, but unknown, activities of taxpayers who use tax preparation software, the ITBM generally produces parallel changes for preparers who use software. In this analysis, such estimated burden changes are ignored as being artifacts of the microsimulation model and not representing actual burden changes.

[4] The ITBM simulations automatically estimate changes in other components of burden. For changes in the location of information to be entered on tax forms, only changes in tax form completion time are relevant. Thus, this analysis ignores other changes.

[5] Post-filing taxpayer burden and the trade-off between pre- and post-filing burden is an area that the IRS is beginning to explore and estimate.

References

Guyton, John L., John F. O'Hare, Michael P. Stavrianos, and Eric J. Toder. Estimating the Compliance Cost for the U.S. Individual Income Tax. *National Tax Journal* 56 (September 2003): 673-688.

Lerman, Allen H. and Peter S. Lee. Evaluating the Ability of the Individual Taxpayer Burden Model to Measure Components of Taxpayer Burden: The Alternative Minimum Tax as a Case Study. In *The IRS Research Bulletin, Proceedings of the 2004 IRS Research Conference*. Washington, D.C.: Internal Revenue Service, 2004, pp. 139-172.