DOCUMENT RESUME

00280 - [A0751279]

[Simplication of Tax Form 1040A]. GGD-77-26; B-137762. February 9, 1977. 9 pp. + enclosure (1 p.).

Report to Rep. Al Ullman, Chairman, Joint Committee on Taxation; by Elmer B. Staats, Comptroller General.

Issue Area: Tax Administration: Simplifying and Communicating Tax Law Requirements to Taxpayers (2704); Federal Records Management (1400);Tax Policy (1500).
Contact: General Government Div.
Budget Function: General Government: Central Fiscal Operations (803).
Organization Concerned: Internal Revenue Service.
Congressional Relevance: House Committee on Ways and Means; Senate Committee on Finance; Joint Committee on Taxation.
Authority: Tax Reduction Act of 1975 (P.L. 94-12). Revenue Adjustment Act of 1975 (P.L. 94-164). Tax Reform Act of 1976 (P. L. 94-455).

A series of meetings, attended by GAO staff, the Chief of Staff, and other staff of the Joint Committee on Taxation, were held to discuss alternative ways by which Congress could simplify the 1040A individual income tax return form. Recommendations: Alternative ways to achieve simplification, which Congress should consider during its deliberations on the President's economic proposals, are: to eliminate the optional standard deduction and the optional general tax credit, to reduce the tax rate and increase personal exemption, and to use the same tax credit on all tax returns. (Author/SW)

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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FEB 9 1977

B-137762

The Honorable Al Ullman, Chairman
Joint Committee on Taxation
Congress of the United States

Dear Mr. Chairman:

In November and December 1976, we held a series of meetings with the Chief of Staff and other staff of the Joint Committee on Taxation to discuss how we could assist the Congress in finding ways to simplify tax laws and tax instructions. The Chief of Staff requested that we submit in writing certain alternatives that we had discussed on ways to simplify the preparing of the 1040A individual income tax return form.

The purpose of the 1040A is to provide a simplified means to determine the income tax owed by those persons who use the standard deduction and whose incomes are primarily from wages and salaries. About 80 percent of the 30.2 million taxpayers expected to file the 1040A this year will have adjusted gross incomes under $10,000.

The current 1040A, unlike its earlier predecessors, is no longer simple. The form used in 1954 required about 30 entries and the ability to add. The current form requires almost 50 entries plus the ability to add, subtract, calculate percentages and multiply.

Part of the complexity resulted from changes made to carry out provisions of the Tax Reduction Act of 1975 (P.L. 94-12), The Revenue Adjustment Act of 1975 (P.L. 94-164), and the Tax Reform Act of 1976 (P.L. 94-455). These laws created or extended the use of

--a standard deduction calculated at 16 percent of the adjusted gross income with a minimum (called a low income allowance) and a maximum standard deduction for each filing class (i.e., single, married filing jointly, unmarried head of household, etc.); and

--a general tax credit which reduces the computed tax liability by the larger of (1) $35 for each person for whom the taxpayer claims an exemption deduction, or (2) 2 percent of the taxable income that does not exceed $9,000 ($4,500 for married persons filing separate returns).

GGD-77-26

Congress has previously tried to minimize the need for lower income taxpayers to make percentage computations when determining their Federal income tax. This was done by providing taxpayers below a certain income level who used standard deductions a tax table which told them how much their tax was. The present tax law not only requires that these taxpayers apply percentages but also that they determine which of two or more alternative amounts is the proper figure to enter on their tax return.

The Internal Revenue Service has reported that about 11.5 percent of the 1040A tax returns filed in the early weeks of the current tax season contained errors. About 2.3 percent of the returns had errors in computing the standard deduction and 4.6 percent had errors in computing the general tax credit. If these error rates are indicative of the error rate that will be experienced on all 1040As filed, about 700,000 returns will have errors in computing the standard deduction and 1.4 million returns will have errors in computing the general tax credit.

The standard deduction and tax credit portions of the 1040A, as well as the longer form 1040, can be simplified without significantly affecting the economic objectives the Congress sought to achieve when it enacted the current provisions. We discuss below several alternative ways to achieve simplification that we believe the Congress could consider during its deliberations on the President's economic proposals.

ELIMINATE OPTIONAL STANDARD DEDUCTION

The standard deduction is a major tax simplification tool for individual taxpayers. It allows the taxpayer to deduct a single number rather than itemize a series of individual deductions such as interest expense, State income taxes, medical expenses and charitable contributions. The standard deduction substitutes one entry for an entire page of calculations. Currently, the standard deduction is calculated at 16 percent of the adjusted gross income with a minimum (called the low income allowance) and a maximum standard deduction for each of five filing classes.

Filing class	Minimum deduction	Maximum deduction
Single	$1,700	$2,400
Married filing joint return	2,100	2,800
Married filing separately	1,050	1,400
Unmarried head of household	1,700	2,400
Qualifying widow(er) with dependent child	2,100	2,800

Computing a percentage of income and then choosing between it and two other amounts is difficult and confusing for many taxpayers. The instructions provided to the taxpayer may not eliminate the confusion. (See attachment I.)

The President, in his economic stimulus program, recognized the complexity of the standard deduction and proposed that the deduction for each filing class be the same as the present maximum allowable deduction. This would eliminate the percentage computation and the need to choose between alternative amounts. The deduction would be a flat $2,800 for two filing classes, $2,400 for two other filing classes, and $1,400 for the last filing class (married filing separately). Such a change would simplify the calculation for all users of the standard deduction, including all 30.2 million users of the Form 1040A. In addition, it is estimated that 4.1 million taxpayers who currently itemize deductions would, under this proposal, shift to the standard deduction. The change in the deduction would cost an estimated $4.0 billion annually. 1/

We believe the President's proposal would significantly simplify the 1040A for many filers. The Congress could further simplify the standard deduction if it changed the deduction to a single rate of $2,800 for all filing classes except married persons filing separately. This would permit an additional 700,000 taxpayers to use the standard deduction. In addition, this would eliminate the need for taxpayers (except married filing separately) to use their filing status to determine their standard deduction. In addition, the instructions would be easier to understand since only two instead of five classifications of taxpayers would have to be discussed.

We do not propose changing the $1,400 maximum standard deduction for married persons filing separately because Congress specifically intended that the total deduction allowed married persons be the same whether they file separately or jointly. Without such provision, taxpayers living in community property states and married taxpayers who both work would be able to receive a larger standard deduction filing separately than they would by filing jointly.

The overall cost to the Treasury of using a standard deduction of $1,400 for married persons filing separately and $2,800 for all other filing classes would be $5.6 billion. This is $1.6 billion more than the President's proposal. The tax burden

1/All revenue estimates in this report were generated by using the Treasury's Income Tax model.

would change only on tax returns filed by single taxpayers and unmarried heads of household. The cost difference for these filing classes would have to be considered the price of tax simplification. Examples of these cost differences are shown below.

Gross income	Filing class	Exemptions	Present tax	Tax computed under Admin. proposal	Alternative proposal a/	Difference
5,000	Single	1	$ 412	$ 282	$ 215	$ 67
10,000	Single	1	1,476	1,308	1,212	96
10,000	Head of House	4	902	769	693	76
20,000	Single	1	4,111	4,111	3,975	136

a/ Standard deduction of $2,800 ($1,400 if married filing separately).

A $2,800 standard deduction for four of the five filing classifications would eliminate the $400 difference in the deduction between those who are married filing jointly and those who are single. Congress created this difference in an attempt to reduce what is often referred to as a "marriage tax." This is the additional income tax that working married couples pay over what they would pay on the two incomes if they were single. The $400 difference in the standard deduction does eliminate up to 40 percent of the "marriage tax." Therefore, the objective of this proposal for tax simplification runs contrary to a previously stated congressional objective. However, we believe the need for tax simplification is great and that this alternative proposal warrants consideration.

ELIMINATE OPTIONAL GENERAL TAX CREDIT

One of the recent changes contributing to the complexity of the 1040A is the general tax credit. The credit was first incorporated in the Tax Reduction Act of 1975, which provided a $30 credit for each personal exemption claimed. This provision was incorporated in the final bill as a compromise with the Senate version of the Act which provided a $200 tax credit which could be used in place of the $750 personal exemption by low and middle income taxpayers. The House passed version had no comparable provision.

The Revenue Adjustment Act of 1975 increased the credit to the larger of (1) $35 for each personal exemption claimed, or (2) 2 percent of taxable income. The only limit on the amount of a credit which is computed at $35 per personal exemption is that it cannot exceed the amount of the tax. However, if the credit is computed at 2 percent of taxable income it cannot exceed $180 or the amount of the tax whichever is less.

Simplifying the computation for the general tax credit is an impossible task without sacrificing some of its effects. One effect is to give a tax reduction based on the number of personal exemptions. The second effect is to give a tax reduction based on the level of income. The law prevents a taxpayer from benefiting from both.

Simplification could be attained if the effect of the tax credit could be incorporated in the basic tax computation instead of being added on after the tax is computed. This would mean incorporating the principle of the tax credit in the standard deduction, personal exemption, or graduated tax rate. For example, if the tax rate were reduced by 2 percent on the first $9,000 of taxable income the impact would be exactly the same as the 2 percent tax credit.

The effect of the $35 tax credit per personal exemption is virtually impossible to achieve within the existing tax computation structure. The personal exemption deduction could be increased to give some tax relief based on family size. However, instead of a flat rate benefit for everybody, the effect would vary depending on the tax bracket. For example, with a $400 special deduction the taxpayer would receive a $56 tax benefit if he is taxed at the 14 percent rate, $112 at the 28 percent rate, and $200 at the 50 percent rate.

<u>Reduce tax rate and increase personal exemption</u>

A possible compromise between the $35 per personal exemption rule and the 2 percent of taxable income rule is to combine a tax rate reduction for the lower income brackets with an increase in the personal exemption. This would give consideration to both the taxpayer's income level and the number of personal exemptions claimed. For example, if in lieu of the present credits the tax rate for the first five tax brackets were reduced by 1 percent and the personal exemption was increased by $100 the amount of income tax owed would generally be increased by small amounts. High income families would, however, experience a small decrease in taxes owed. The overall revenue effect would be to increase the total tax revenues by an estimated $1.8 billion. The following schedule shows the amount of tax change which would be experienced by some typical taxpayers.

Gross income	Filing class	Exemption	Tax under current law	Tax under proposal a/	Difference
5,000	Single	1	$ 361	$ 368	$ 7
5,000	Joint	2	128	156	28
5,000	Joint	4	0	0	0
7,500	Joint	4	212	268	56
10,000	Single	1	1,325	1,412	87
10,000	Joint	2	943	971	28
10,000	Joint	4	646	665	19
10,000	Head of House	4	762	777	15
10,000	Married-Sep.	2	1,309	1,309	0
20,000	Single	1	3,931	4,037	106
20,000	Joint	4	2,624	2,624	0
30,000	Joint	4	5,552	5,516	-36
210,000	Joint	4	113,740	113,560	-180

a/ Rates reduced 1 percent in first five brackets and personal exemption increased $100.

Use same tax credit on all tax returns

Another alternative is to give a $180 tax credit to all taxpayers. This would reduce the computation to one of subtracting a single figure. Such a fixed credit would only increase taxes on those having six or more personal exemptions and adjusted gross incomes in excess of $7,900. With only five personal exemptions the effect is about the same.

Adjusted Gross Income		$7,150
Less:		
Standard Deduction	2,100	
Personal Exemption (5 x $750)	3,750	5,850
Taxable Income		1,300
Tax Owed		183
Tax Credit at $35 per personal exemption ($35 x 5)		175
Tax Credit at flat $180		$ 180

As shown by the example a taxpayer filing a joint return who claims more than five personal exemptions would have to earn more than $7,150 (plus $750 for each additional exemption) before the taxpayer would benefit from the additional tax credits based on personal exemptions. Approximately 3.8 million tax returns filed this year will fall into this category.

Although the flat $180 credit has the potential for increasing taxes on these 3.8 million tax returns, it would reduce taxes on 37.1 million tax returns which show fewer than six personal exemptions and taxable incomes of less than $9,000. The revenue cost of this change would be $2.4 billion.

TAX SIMPLIFICATION IS NEEDED

Tax simplification has become an important issue. The Department of the Treasury recently issued a report entitled "Blueprints for Basic Tax Reform." This report addresses the need to simplify our Federal income tax laws. Also, the Congress, in the Tax Reform Act of 1976, directed the Joint Committee on Taxation to undertake a comprehensive study of tax simplification. Simplification, in our opinion, is one step that could be taken to reduce errors on tax returns and reduce taxpayers' need to pay others to prepare their returns.

IRS estimates that for Tax Year 1975 about 7.5 percent of those filers of the 1040A who were entitled to the flat $30 per exemption credit did not claim it. This included 11.6 percent of the 1040A taxpayers with adjusted gross incomes under $5,000. An additional 4.5 percent of the 1040A filers made errors in computing the amount of the tax credit claimed. IRS corrected these returns and sent notices or checks to those taxpayers.

Our April 1, 1976, report to the Joint Committee entitled "Internal Revenue Service Assistance to Taxpayers in Filing Federal Income Tax Returns" (GGD-76-49) discussed our survey of lower income taxpayers (adjusted gross income under $10,000) in six different locations. This survey showed that 70 percent of these taxpayers sought help in preparing their 1973 tax returns. Forty-three percent paid to have their returns prepared. Another 15 percent had somebody else prepare their return and 12 percent prepared it themselves with help.

An IRS study reported that 45.5 percent of all individual taxpayers used commercial preparers to do their return in 1975. This study reported that almost 22 percent of the 27.5 million 1040A's filed were prepared by commercial and professional preparers.

Ideally, tax return simplification would be accomplished by (1) eliminating the need to itemize deductions, (2) eliminating the need to make optional choices, (3) reducing the number of mathematical steps needed to compute the tax due, and (4) reducing the distinctions between the different taxpayer filing classes. Such changes would significantly reduce the amount of instruction material which a taxpayer must digest to determine his tax liability.

The proposals we have discussed meet each of these objectives to some degree. The increase of the standard deduction would enable many more taxpayers to use the standard deduction. In addition, the proposals discussed would further ease tax return preparation for millions of taxpayers by reducing the chore to a process of addition, subtraction, and one multiplication (number of exemptions x $750). The elimination of the distinctions (except for married couples filing separately) among filing classes for purposes of determining the standard deduction would change the need for the lengthy instructions shown in attachment I. Under the alternative all that need be said is "enter $2,800 ($1,400 if married filing separately)."

This report presents our views on some of the ways the 1040A can be simplified. As you know, we have given high priority to efforts directed at simplifying the tax laws and tax instructions. We look forward to continually working with the Joint Committee on these efforts and will advise you of our further findings and recommendations on these matters as we develop them.

We would be pleased to discuss these matters further with the Committee as well as any other assistance we can provide in the area of tax simplification. We are sending copies of this report to the Secretary of the Treasury, the Commissioner of Internal Revenue and the Director, Office of Management and Budget.

Sincerely yours,

Comptroller General
of the United States

Attachment

Standard Deduction 13a Enter amount from line 12	13a	
b If you checked the box on line: 2 or 5, enter the greater of $2,100 OR 16% of line 13a—but not more than $2,800; 1 or 4, enter the greater of $1,700 OR 16% of line 13a—but not more than $2,400; 3, enter the greater of $1,050 OR 16% of line 13a—but not more than $1,400	13b	
c Subtract line 13b from line 13a and enter difference	13c	
14 Multiply total number of exemptions claimed on line 6f by $750	14	
15 Taxable income. Subtract line 14 from line 13c and enter difference	15	
16 Tax: If line 15 is $20,000 or less, find tax in Tax Table on pages 13–15; If line 15 is more than $20,000, use Tax Rate Schedule X, Y, or Z, on page 16	16	
17a Multiply $35.00 by the number of exemptions on line 6d — 17a		
b Enter 2% of line 15 but not more than $180 ($90 if box on line 3 checked) — 17b. Enter larger of a or b (If box on line 3 is checked see page 11 of instructions.)	17c	
18a Subtract line 17c from line 16 and enter difference (but not less than zero)	18a	
b Credit for contributions to candidates for public office (see page 11 of instructions)	18b	
19 Income tax. Subtract line 18b from line 18a and enter difference (but not less than zero)	19	
20a Total Federal income tax withheld (attach Forms W-2 to front) — 20a		
b Excess FICA, RRTA, or FICA/RRTA tax withheld (two or more employers—see page 11 of instructions) — 20b		
c 1976 estimated tax payments (include amount allowed as credit from 1975 return) — 20c		
d Earned income credit (from page 2 of Instructions) — 20d		
Pay amount on line 22 in full with this return. Write social security number on check or money order and make payable to Internal Revenue Service.		
21 Total (add lines 20a through 20d)	21	
22 If line 19 is larger than line 21, enter BALANCE DUE IRS ➤	22	
23 If line 21 is larger than line 19, enter amount OVERPAID ➤	23	
24 Amount of line 23 to be REFUNDED TO YOU ➤	24	
25 Amount of line 23 to be credited on 1977 estimated tax ➤ 25		

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign here

Your signature — Date — Preparer's signature (and employer's name, if any) — Date

Spouse's signature (if filing jointly, BOTH must sign even if only one had income) — Identifying number (see instructions) — Address and ZIP code

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⑪ Standard Deduction—Line 13b

The standard deduction is a flat amount that you may take instead of itemizing deductions. There are two kinds of standard deductions as explained in (a) and (b). You should use the one that will result in the larger deduction.

(a) Percentage Standard Deduction.—You are permitted a deduction of 16% of your total income, subject to a maximum amount.

(b) Low-income Allowance.—You are permitted a deduction of a flat amount to insure that you will not be subject to Federal income tax if your income is below certain levels.

Note: *If you can be claimed as a dependent by your parent(s), the standard deduction is not available for use against unearned income (lines 10c and 11). Thus, the percentage standard deduction is 16% of your earned income (line 9) and your low-income allowance may not exceed line 9. (See "Caution" on page 11.)*

Enter your standard deduction on line 13b as follows:

A If you checked the box on line 2 or 5 and line 13a is—
- Less than $13,125, enter $2,100.
- $13,125 or more, but less than $17,500, enter 16% of line 13a.
- $17,500 or more, enter $2,800.

B If you checked the box line on line 1 or 4 and line 13a is—
- Less than $10,625, enter $1,700.
- $10,625 or more, but less than $15,000, enter 16% of line 13a.
- $15,000 or more, enter $2,400.

C If you checked the box on line 3 and line 13a is—
- Less than $6,562.50, enter $1,050.
- $6,562.50 or more, but less than $8,750, enter 16% of line 13a.
- $8,750 or more, enter $1,400.

Married filing separately:
If you take the 16% standard deduction, on line 13b, your spouse must also take the 16% standard deduction, and not the $1,050.

Caution: *If you checked the box below line 12 (you could be claimed as a dependent on your parent's return and had dividend or interest income), use the following substitute instruction for line 13b:*

13b Enter the greater of (1) or (2):
(1) 16% of line 9, but not more than $2,400 if single or $1,400 if married filing separately.
or
(2) $1,700 if single, or $1,050 if married filing separately, but not more than line 9.