



JOINT ECONOMIC COMMITTEE

SENATOR CHARLES E. SCHUMER (D-NY) – CHAIRMAN



ECONOMIC FACT SHEET

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FREE E-FILING MAKES SENSE FOR BOTH TAXPAYERS AND THE IRS

Filing income tax returns electronically has significant advantages for both taxpayers and the IRS. Electronic filing (e-filing) is more convenient for taxpayers, return processing is faster, and refunds can be sent out more rapidly. For the IRS, there are enormous cost savings from e-filing. While each paper return costs \$2.65 to process, an e-filed return costs only \$0.29.¹ E-filing is also more accurate. The IRS finds roughly 1 error in every 100 returns filed electronically (regardless of whether the return was prepared professionally or self-prepared by the taxpayer), compared to about 1 error in every 5 paper returns.²

While the number of returns filed electronically continues to grow, the IRS clearly will not meet the goal set by Congress in 1998 of having 80 percent of returns filed electronically by 2007. In the 2006 filing season 73 million individual income tax returns were filed electronically, up from 69 million returns in 2005 (See Table). The percentage of returns filed electronically has increased from 10 percent in 1995 to about 54 percent of tax returns filed last year.

Paid preparers submitted approximately 30 million of the 61 million paper returns filed in 2006.³ If only professionally prepared paper returns had been filed electronically, the IRS would have saved about \$70 million. If all paper returns had been electronically filed, the savings would have been nearly twice that.

Current procedures impede the continued expansion of electronic filing. Taxpayers can file electronically only through certain intermediaries and e-filing is not free for all taxpayers. Specifically, a taxpayer wishing to file an electronic return must do so through a paid preparer or by

using commercial tax preparation software. In addition to the fees paid to prepare the return or to purchase tax preparation software, taxpayers often must pay an e-filing to file an electronic return.

Many taxpayers who could easily file an electronic return choose not to do so. Over 40 million paper returns filed in 2006 were initially prepared on a computer but were then printed out and mailed to the IRS.⁴ It would have been a simple matter for taxpayers to transfer the information from their computers to the IRS if there were a direct, free option for doing so. Perhaps they were thinking the same thing as

Electronic Filing of Individual Income Tax Returns, Fiscal Years 1995-2006

	Total Number of Returns (millions)	Number of Electronically-filed Returns (millions)	Electronically-filed Returns as a Percent of All Returns
2006	133.9	72.8	54
2005	132.8	68.5	52
2004	131.3	61.5	47
2003	130.7	52.9	40
2002	130.9	46.9	36
2001	129.8	40.2	31
2000	127.6	35.4	28
1999	125.2	29.4	23
1998	123.0	24.6	20
1997	120.7	19.2	16
1996	118.8	15.0	13
1995	116.3	11.1	10

Source: IRS data available at <http://www.irs.gov/taxstats/index.html>.

National Taxpayer Advocate Nina Olson, who observed in her testimony before Congress that, “Although I deeply believe that e-filing is best for both taxpayers and the IRS for a host of reasons, I resent the notion that I would have to pay separate fees to prepare my return and file it, so I printed out my return and mailed it in.”⁵

In lieu of universal free electronic filing, in 2002 the IRS entered into an agreement with a consortium of tax preparation software companies (the Free File Alliance) to provide free online tax preparation and filing to taxpayers meeting certain income eligibility limits. Under the new agreement, which was renegotiated in 2005 and extends for 4 years, taxpayers with income below the income eligibility limit (\$52,000 for 2006 tax returns filed this year) can file for free, but companies in the Free File Alliance cannot extend free filing to taxpayers with higher income. Approximately 30 percent of all individual taxpayers do not qualify for the Free File program. The new agreement also places new requirements on the marketing of Refund Anticipation Loans by software companies providing the free filing service.

The Free File program has done little to increase the number of returns filed electronically. Just over 5 million taxpayers used Free File in 2005 and the number dropped in 2006. Part of the reason for the decline last year is that at least two of the major software companies allowed all taxpayers using their software to file for free in 2005. It is not surprising that the number of Free File returns dropped when the income limits were imposed. As of March 17 of this year, the number of free file returns was down by 5.2 percent from the number filed by that time last year.⁶

The IRS could provide online forms for taxpayers to fill out and file directly. Nearly half of the states currently allow

taxpayers to file their returns directly online. The claim that free electronic filing would put the IRS in competition with private tax preparation companies is a red herring because private tax preparation offers much more than just electronic filing. Paid preparers and tax preparation software offer step-by-step guidance and suggestions to help taxpayers complete their returns, and are not the simple fill-in-the-blanks forms that IRS would offer. Indeed, the IRS already provides forms that can be downloaded and filled out on a computer, but taxpayers must print out the forms and file them by mail.

The national taxpayer advocate has recommended free filing for many years. Legislation introduced in the 109th and 110th Congress by Senators Akaka and Bingaman would require the IRS to provide taxpayers with the ability to electronically file their returns through the IRS website without the use of an intermediary or through an intermediary that contracts with the IRS to provide the free access. Free electronic filing would help taxpayers and save the IRS significant resources. It simply makes sense.

Endnotes

¹ Podcast with Bert Dumars, Director, Electronic Tax Administration, Internal Revenue Service, April 2, 2007. (www.sfgate.com)

² Ibid.

³ Percentage of returns submitted by paid preparers comes from SOI Tax Year 2005 Taxpayer Usage Study, Weekly Report 15.

⁴ Ibid.

⁵ Written statement of Nina E. Olson, National Taxpayer Advocate, before the Committee on Finance, United States Senate, April 4, 2006.

⁶ Statement of James R. White, Director Strategic Issues and David A Powner, Director Information Technology Management Issues, U.S. Government Accountability Office, before the Committee on Finance, U.S. Senate, April 12, 2007. GAO-07-720T.

Appendix: Americans Spent Over 1 Billion Dollars on E-file Fees in 2006

Electronic Filing of Individual Income Tax Returns, 2006

	All Returns	E-file Returns	Money Spent on E-file Fees ⁽¹⁾		All Returns	E-file Returns	Money Spent on E-file Fees ⁽¹⁾
	(thousands)	(thousands)	(millions of dollars)		(thousands)	(thousands)	(millions of dollars)
United States, total	133,917	72,770	\$ 1,011.8	Missouri	2,595	1,475	20.5
Alabama	1,932	1,227	17.1	Montana	444	254	3.5
Alaska	344	177	2.5	Nebraska	811	481	6.7
Arizona	2,446	1,295	18.0	Nevada	1,138	616	8.6
Arkansas	1,144	707	9.8	New Hampshire	645	322	4.5
California	15,402	8,888	123.6	New Jersey	4,120	2,042	28.4
Colorado	2,132	1,029	14.3	New Mexico	836	464	6.5
Connecticut	1,668	920	12.8	New York	8,650	4,236	58.9
Delaware	400	212	3.0	North Carolina	3,837	2,143	29.8
District of Columbia	280	136	1.9	North Dakota	306	181	2.5
Florida	8,282	4,303	59.8	Ohio	5,428	2,788	38.8
Georgia	3,870	2,314	32.2	Oklahoma	1,482	872	12.1
Hawaii	617	268	3.7	Oregon	1,629	866	12.0
Idaho	609	368	5.1	Pennsylvania	5,837	2,739	38.1
Illinois	5,797	2,875	40.0	Rhode Island	499	241	3.4
Indiana	2,873	1,591	22.1	South Carolina	1,868	1,189	16.5
Iowa	1,342	925	12.9	South Dakota	365	207	2.9
Kansas	1,233	703	9.8	Tennessee	2,629	1,558	21.7
Kentucky	1,767	1,037	14.4	Texas	9,584	5,072	70.5
Louisiana	1,682	961	13.4	Utah	1,022	573	8.0
Maine	617	274	3.8	Vermont	308	144	2.0
Maryland	2,652	1,246	17.3	Virginia	3,510	1,808	25.1
Massachusetts	3,062	1,695	23.6	Washington	2,898	1,503	20.9
Michigan	4,544	2,968	41.3	West Virginia	749	380	5.3
Minnesota	2,432	1,637	22.8	Wisconsin	2,641	1,684	23.4
Mississippi	1,142	733	10.2	Wyoming	246	137	1.9

Source: IRS data available at <http://www.irs.gov/taxstats/index.html>.

⁽¹⁾ Assumes that all taxpayers who electronically filed their tax returns (including those who used paid preparers) were assessed an e-file charge of \$14.95 per return. Also assumes that 7% of electronically filed returns were free e-filers who were not charged a fee.