

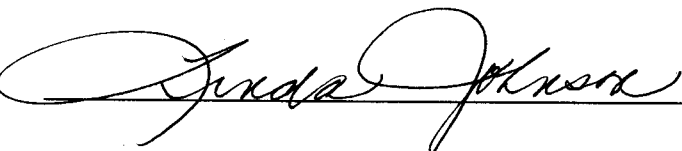
**Northern Illinois University**

**Electronic Filing: What Practitioners of Small and Medium Size Accounting  
Firms are Saying**

**A Thesis Submitted to the  
University Honors Program  
In Partial Fulfillment of the  
Requirements of the Baccalaureate Degree  
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ABSTRACT (100-200 WORDS): Problems presently exist within the government's Electronic Filing System. Since the government has a goal of becoming a paperless tax return filing system, they need to be aware of these problems. A survey of practitioners was conducted in order to understand the problems that practitioners are experiencing with the system, and possible solutions.

All major issues were addressed with possible solutions. The aim of the paper was to make the IRS aware of the problems and I took the side of the devil's advocate showing all the major problems that could be found within the Electronic Filing System.

## INTRODUCTION

Electronic filing, the integration of a tax software system and a modem to transmit tax return information to the Internal Revenue Service (IRS) over telephone lines, was introduced in 1986 as a pilot program. Electronic filing is a major step towards the IRS's long-term goal of becoming a paperless system. In 1990, the first year in which electronic filing was offered nationwide, 4.2 million returns were filed electronically. This number increased to 11 million in 1992 and the IRS has set a goal for 25 million in 1995. Achieving this goal, however, is not automatic, and if the IRS wants to increase electronic filing use, it needs to understand what may prevent certain taxpayers from filing their returns electronically. Thus, further investigation is needed to determine whether this goal is achievable, or simply an unattainable long shot.

Before the income tax filing process can become completely paperless, the IRS must first work out the problems that currently exist with the present system. In addition, the IRS must obtain the support of the two principle participants: the practitioners and the taxpayers. Although the IRS claims otherwise, once electronic filing is completely implemented, the only real winner will be the IRS.

This article reports the results of a research study that interviewed practitioners of small to medium size accounting firms to gain insight into their perceptions of the problems with the Electronic Filing system. Both practitioners who offer electronic filing, as well as those who have opted not to become involved in electronic filing, were interviewed. Based on the data collected from these interviews, a mail survey was conducted to confirm these results with a larger group of practitioners.

Results of both the interviews and survey indicate that practitioners are happy to talk about electronic filing, but what they have to say is not all good. Practitioners not involved with electronic filing have many legitimate reasons for their lack of participation. These reasons range from a nonexistent demand for the service to not having the resources (staff, time, money) to get involved. Practitioners involved with electronic filing all share similar

experiences and have similar concerns. Their reasons for getting involved in electronic filing range from a large demand for the service to the need to offer electronic filing in order to stay competitive.

The remainder of this paper is organized into three sections. First, the manual and Electronic Filing systems are compared to illustrate the benefits of electronic filing. Second, the data obtained from the interviews and survey is analyzed to demonstrate how the electronic filing system affects the practitioners. Finally, the problems with the Electronic Filing system are addressed and proposed solutions are suggested.

## **THE FILING PROCESS**

### **Manual Filing**

The traditional paper process begins with the preparation of the tax return. Once completed, the taxpayer mails the return to the IRS Center, where it is hand-sorted into various categories (e.g., business vs. nonbusiness returns; married vs. unmarried taxpayers). Each return then receives a code number and the information from the return is manually coded and entered onto a computer. The two biggest problems with the manual filing system are the error rate and the processing costs. According to IRS estimates, the error rate for manual filing is 19 percent. These errors occur primarily because much of the work is done manually. In addition, the IRS estimates the cost of processing a single return to be at least 40 cents. To combat these problems, the IRS has established a goal of turning the filing of income tax returns into a paperless system.

### **Electronic Filing**

The electronic filing processing starts with a computer generated tax return that can be transmitted by modem to the IRS. This step is significant because it eliminates most of the manual processing that often leads to errors. Once received by the IRS Service Center, a magnetic tape is created and the return is automatically checked for obvious errors (IRS Pub.

1345). These tapes are then used to check for details that need to be investigated. The government believes that by integrating all of these systems, the error rate can be lowered to 4.5 percent and the processing costs can be reduced to around four cents per return (Zeidner 638).

The benefits from electronic filing are evident given the understanding that today's technology is headed towards total computerization, and the IRS understands the need to stay abreast of all the new technology. The primary problem with the Electronic Filing system is that the IRS currently receives all the benefits from the program. By informing taxpayers that electronic filing will provide them with their refunds faster, the IRS attempts to make taxpayers believe that they are getting something by electronically filing. However, what they fail to inform taxpayers is that the cost of the "speedy" return often outweighs the benefit of having the refund earlier. In addition, for practitioners to participate in the Electronic Filing program, they must purchase the software, hardware, and file an application with the IRS. To offset these costs, practitioners must charge their clients who use the service. The problem is that a high volume of returns must be transmitted in order to offset the initial cost of getting involved.

Eleven million taxpayers filed electronically in 1992. The IRS estimates that number will rise to 15 million in 1993 and has set as a goal 25 million for 1995. To meet these goals, four things must happen. First, the IRS needs to expand the form availability. Currently, not all returns can be transmitted electronically. Second, the IRS needs to make the service more beneficial to the taxpayer. The cost/benefit ratio needs to favor taxpayers and make them want to file electronically. Third, more practitioners need to get involved with the program. If this is the wave of the future, it should be a prerequisite to being in business. Finally, the IRS needs to continue to be aware of the problems with the system and work them out.

Practitioners who are using electronic filing are in the best position to tell of the problems that they are having with the Electronic Filing system. To better understand their concerns, practitioners of small to medium sized accounting firms were interviewed and asked

about their concerns and for their insights about what needs to be done in order for the IRS to reach their future goals.

Based on the data collected from the interviews, a survey was constructed and sent out to 114 practitioners of small to medium sized accounting firms in a large midwestern city. The participants were randomly selected from the yellow pages of the phone book. The sample was restricted to practitioners of small and medium sized firms, since those firms are currently the ones offering electronic filing. Prior to sending out the questionnaire, participants were contacted by phone to verify their addresses, notify them of the survey, and explain the importance of their responses.

The survey was constructed such that practitioners who are involved in electronic filing completed one side of the survey, while those not involved in electronic filing answered questions appearing on the other side of the survey. Of the 114 questionnaires mailed, 70 responses were received resulting in a 61.4 percent response rate. Of those surveyed, 58.6 percent of those who responded were not presently involved in the Electronic Filing system, while 41.4 percent currently offer electronic filing to their clients.

### **PRACTITIONERS CURRENTLY OFFERING ELECTRONIC FILING**

This section will begin by discussing the findings of the survey for those practitioners presently involved with the Electronic Filing system and conclude with the findings of the personal interviews. Of the practitioners interviewed, there were mixed emotions. Some were optimistic, others skeptical, and those newly involved with the program were hopeful.

#### Survey Results

Of the respondents, 41.4 percent offer electronic filing. Sixty-six percent of those involved in electronic filing were considered medium-size firms preparing over 250 returns each year. Nearly 90 percent of those who offer electronic filing transmit fewer than 250 returns per year, and 76 percent refuse to transmit a return that they did not prepare. Some

practitioners were apprehensive about transmitting returns they did not prepare, often stating that time, space, or staffing limitations prevented them from offering the service to non-clients. These practitioners were also concerned the price that they would have to charge would not be competitive with firms specializing in high-volume electronic filing.

Results of the survey indicate that the reasons for getting involved with electronic filing are extensive and varied. Being able to compete and offer a full line of services to clients was listed by 43 percent of the respondents. A significant number (18 percent) of practitioners see electronic filing as the "wave of the future" and prefer to be at the forefront of the process. One practitioner commented, "We believe that it [electronic filing] will be mandatory in the relatively near future and, as such, we wanted to get accustomed to the process." Thirty-six percent of the practitioners clients involved in electronic filing state that the primary reason for being involved is that their clients demand the service. Other reasons listed for being involved in the electronic filing program were that it was easy to administer and use, that it brings in clients, and that the software company offered the service for free.

However, a negative attitude was also present among those who offer the service. One practitioner stated, "Electronic filing is a big rip-off for low income taxpayers who will pay anything to get their cash as soon as possible. I do not encourage this. The U. S. Government should offer incentives to make it attractive for filers because now it is a lot of work and wasted time not worth the extra revenue." The main reason this practitioner is involved is because his competition offers the service.

Overall, practitioners do not see electronic filing as a way to increase their income base, as the government likes to portray. The pressure to stay competitive and the constant pressure from the IRS are reason enough to be involved with the program. Lenny Holt, Chief of Operations and Marketing for the Electronic Filing program at the IRS says, "Electronic filing is not mandatory, but to be competitive you're going to have to do this. It's not a matter of if; it's a matter of when."



### An Interview with a Practitioner Involved in Electronic Filing and Optimistic About Its Future

This practitioner has offered electronic filing all three years she has been in business. A local firm, employing three to four people, she electronically files 300 to 400 federal tax returns each tax season, and advocates electronic filing as "the way business will be conducted." The cost outlay to open a new business is high and this practitioner claims that she got involved with electronic filing for one reason: fast cash!

After spending roughly \$5,000 on computer hardware and software, she needed money to cover overhead. The majority of electronic filers are lower income taxpayers who need their refunds to pay for living expenses. Her practice is located in a college town where several thousand students who fall into this category. Because tax time comes around the same time as spring break, college students want their refunds as soon as possible. Understanding this, the practitioner advertises in the school newspaper and the response has been overwhelming. So many returns have been brought to her for the electronic filing service that the cost of another employee was necessary if she was going to be able to conduct her tax preparation and advice services.

By charging \$30 per return, the practitioner was able to recuperate her investment in the first year of business. It was a wise and well-planned out decision to make the service look attractive to the clientele that would be willing to pay for this service. She would act as a transmitter, offering to electronically file returns she did not prepare at the same low cost that she charged her own clients. She set her price lower than other local practitioners, including high-volume transmitters. She also spent the extra money and bought a more powerful modem so that she could transmit directly to the IRS, rather than to a third party transmitter. This increased her profits by cutting out the middleman.

Another service offered by the practitioner Refund Anticipation Loans (RALs). RALs are loans given to a taxpayer by a bank once the IRS has accepted his or her return. An IRS acceptance and a copy of the return can be taken to the bank for a loan, or a practitioner can

issue a check in affiliation with a bank. The amount of the loan would be the refund amount less the fees for the service. This way a refund can be received within three working days.

By offering all these options to her clients, this practitioner assured herself success in the local market. Once she recovered her sunk costs, her increased profits motivated her to increase advertising and streamline her electronic filing business into those services that were most profitable. Electronic filing is not the focus of this business, but by getting involved at a point where cash was crucial, this practitioner gave a breath of life to a cash-hungry business.

The electronic filing business has not always been easy for this sole practitioner. There have been problems, the biggest one coming from the software company that she used her first year in business. She tells of an experience where she purchased a software package from a software company that was not legitimate. The software company was new in business and promised satisfaction with strong customer support. Neither of these turned out to be true. Repeatedly, the software would break down due to "bugs" in the system that had not been worked out, and the practitioner tallied up \$300 in phone calls for service she never received. The following summer, the practitioner was calling around asking about different software packages and explaining what had happened to her during the past year. She discovered that the software that she had purchased was "pirated" before all the updates had been completed. She could never get service on the program because the people that she had purchased it from were not the same people who had created it, and they did not know how it worked. When purchasing software, one should make sure the dealer is reputable and has a good service record with its past clients. Saving money at the time of purchase is not worth the added headaches when the software system goes down and you cannot get help.

According to this practitioner, technical assistance can be easily received during the day when dealing with the IRS. This is important for a program as complex as this one. The IRS has assigned an individual to each electronic filing account so that all questions are directed to the same person each time a question arises. This helps build a strong relationship between the IRS and the practitioner. Practitioners enjoy this, yet a problem arises when the contact

person is not working. When your technical advisor is not available, it is not always as easy to get an educated answer. The solution often is just to wait until the advisor returns the phone call. The IRS, in this department, is very prompt with the returning of technical question phone calls. Overall, this practitioner is happy with the Electronic Filing system and sees it as a profit market for the future.

#### An Interview with a Practitioner Involved in Electronic Filing, but Skeptical About Its Future

This particular firm employs two professionals and five staff members and files over 350 individual returns annually. Before becoming involved in electronic filing in 1989, the firm was using a modem to communicate between branch offices. Since the software package used included the electronic filing option free of charge, there was no added cost outlay to offer electronic filing. One of the partners interviewed mentioned that the only reason that his firm is involved with electronic filing is because they already were using a modem and the software was free. He stated that the firm's clients do not demand electronic filing and he raised some concerns on the IRS's ability to follow through with its plans to become a paperless system. In addition, he doubts he will need to change the way he operates his business anytime in the near future. He added that the IRS can make all the plans they want, but until it offers incentives to practitioners to get them involved and until it becomes more practical for the taxpayer to get involved, the desired results will not be received.

Over the last three years, this practitioner had electronically filed no more than 25 returns. "It's more headaches than it is worth," he claims. Reasons cited for the firm's lack of involvement included the added paperwork involved with electronic filing, the hiring of a new employee to handle that portion of the business, and just one more thing to worry about in an already complex small business. He understands what the IRS is trying to accomplish, and while he does not believe the IRS will accomplish its goals within their stated time frame, he says that he will be prepared to use electronic filing when implementation is complete. This

gentlemen's attitude was basically negative throughout, yet his reluctance to be too heavily involved with the program was understandable.

An Interview with a Practitioner Newly Involved In Electronic Filing and Hopeful of Its Future

This well-established business's major source of income stems from bookkeeping and tax-related services. This firm, which employs four professionals and eight staff members during tax season and services over 1,500 clients, is unsure of its future focus.

In the past, a few clients have asked about the firm's electronic filing capabilities, but more out of curiosity than desire for the service. Never having advertised, reputation alone has brought clients to this firm over the years. Offering another service to their clients and the belief that electronic filing is "the thing" of the future were reasons given for getting involved in the electronic filing. Another key reason offered for getting involved was the population increase that he sees in the community's future. As business growth continues, an increase in employment opportunity will bring prospective employees to the area and he believes blue collar workers are some of the prime users of the Electronic Filing system. He also believes there is an untapped market among university students. For these reasons, the firm is still unsure about how it is going to offer its electronic filing capabilities.

For now they must decide whether they want to advertise heavily to increase the volume of returns, generating more income and work, or limit electronic filing to their present clients. They also were unsure of whether they would transmit returns that they did not prepare. This practitioner said that they needed to further investigate in order to make an informed decision. He did know that they were going to use a third party transmitter rather than transmit directly to the IRS, as he believed it to be more cost effective for his business. Finally, RALs were never a consideration for this firm. The added paperwork involved with the processing was not worth the added fees that they would generate. This practitioner

believes that the IRS is going to phase out RALs in the future because of the problems that were involved with them in the past.

After attending IRS conferences on electronic filing in each of the past two years, this practitioner was finally convinced that electronic filing was here to stay. Since his firm has a reputation for quality technical service at a reasonable price, he decided it was in his firm's best interest to get involved. In order to compete in a complex, competitive market, one needs to offer as much as one can at as reasonable price as possible if you want to see any growth. If you cannot do the job, offer the service, or turn out a quality product, the consumer will find someone who can. The practitioner said, "We had to keep our options open. We now have to decide where we are going."

#### The Involvement of Banks in Electronic Filing

In addition to practitioners, banks have gotten involved with the electronic filing process to generate fees by using current equipment more efficiently, increasing loans (RALs), and offering another client service. Banks are becoming hesitant to offer RALs due to the high bad debt rate they have experienced. Since electronic filing is a new system, it has not been fully integrated with the other government agencies. Thus, taxpayers who owe funds to other government agencies and still receive their refunds. The IRS also has discovered that speedy processing facilitates taxpayer fraud. For this reason, the IRS has begun to change its policies. For a two week period in January 1992, the government sent acknowledgments that refunds were en route when they were actually being used to offset government student loans and other obligations. When the errors were committed, 1.1 million returns had been filed electronically. The number of returns affected is unknown (Crenshaw C1). This is one type of problem that arises out of RALs.

Assistant Attorney General Shirley D. Peterson said that a typical scenario is where criminals use phony "taxpayers" to file returns and receive a refund anticipation loan, often using false W-2 forms. The proceeds are then split between the conspirators. Hank Philcox,

the Services Chief Information officer, says that the system is vulnerable because the quick turnaround does not allow the checking of the submitted information before the refund is sent out.

The value of fake returns in the state of California alone has grown from \$280,000 in early 1991 to \$3.4 million in 1992 (Jones 669). It is estimated that in 1991, tax crooks filing fraudulent income tax returns cost the government between \$2 to \$4 million (Hubbard 129).

Next, the results of the survey and the responses of the personal interviews with those practitioners who are not involved with Electronic Filing are discussed.

## **PRACTITIONERS NOT CURRENTLY OFFERING ELECTRONIC FILING**

### Survey Results

Of the respondents, 58.6 percent of those practitioners were not involved in the Electronic Filing program. Approximately 59 percent of those who responded are considered medium to large practitioners, preparing over 250 returns annually, and 97.6 percent of these practitioners prepare their clients' returns on the computer. This is an important point because these returns are then printed off and mailed to the IRS Service Center where they go through the manual filing process. Technology, in this regard, has been wasted. The IRS needs to see this untapped market and somehow get these practitioners involved in the program.

Reasons for not being involved in the Electronic Filing program varied. Nearly 66 percent of the responding practitioners claimed that their type of clients do not demand or qualify for the electronic filing service. The cost of being involved versus the benefits received was stated by 37.2 percent as a reason for not being involved. Another 14.6 percent stated that money was not the only resource that they were concerned with, but that lack of time, personnel, equipment, or office space prevent any new type of business. Other reasons given for lack of involvement include:

- Software does not offer electronic filing capabilities
- Not in a high volume/low price business
- No incentives to be involved
- Do not trust system
- Insignificant time differential between electronically and manually filed returns
- Hassle of additional paperwork
- Too lazy to learn new way to file

One practitioner writes, "We have chosen to maintain our practice for more sophisticated taxpayer needs which are more interesting and lucrative." Another practitioner states that he was involved in the electronic filing process in 1990 but "only four clients used it." The cost to keep an employee up to date on the changes in the filing system is not even covered by the revenue earned. Consequently, this practitioner no longer offers the service.

#### Personal Interviews with Those Not Offering Electronic Filing

One practitioner had just started his accounting service and without reserve said, "I don't see the need for getting involved." He went on to say that he is the only worker in his newly formed firm, and as such he cannot offer the service. Cash constraints, limited office space, and an unsure future were also reasons mentioned for not being involved. This practitioner also stressed as a reason for not being involved the fact that he did not have any clients.

Another practitioner said that his firm is not involved with the Electronic Filing program because they do not want to attract "those type" of clients. He is referring to lower income taxpayers, who are the primary users of the Electronic Filing program. He claims that because they have a modem, computer, and adequate staff, they could offer the service at no added cost outlay. He had been asked by "a few" clients for the service, but to avoid losing a client to a competitor, his firm's policy is to send those clients to a bank who transmit returns rather than another practitioner who offers the service.

Competition is not enough to get all practitioners involved in the Electronic Filing system. A small rural sole practitioner says that he will never be involved with the program. His clientele consists mainly of farmers and elderly taxpayers. Most of the farmers owe tax while his elderly clients overall pay little or no tax and often do not get refunds. This practitioner also believes that there is a trend in today's economy of people preparing their own returns. Content with the way his business operates, this practitioner will listen to what electronic filing has to offer, but does not anticipate implementing the system any time soon.

## PROBLEMS AND SOLUTIONS

### Tax Due Problem

Electronic filing caters to those in a refund due situation. Often, those receiving refunds are lower and middle income class taxpayers who use the money to pay their living expenses. These people are willing to pay the cost to process and suffer astronomical interest rates in order to get their refund quicker. The problem arises in getting balance due taxpayers to file electronically. Presently, the IRS accepts balance due returns nationwide. The IRS allows these taxpayers to defer paying the tax due until April 15, when it would normally be due. Under this system, the only incentive for balance due taxpayers to file electronically is the acceptance that the IRS gives a return (Godfrey 144). Most taxpayers who owe money will not pay the cost of electronic filing for this feeling of relief.

***Proposed Solution:*** Have the government share in the cost of electronic filing by giving taxpayers who file electronically either a deduction on next year's return or credit on their current year return. Taxpayers who owe money and file electronically should receive at least enough benefit from a credit on the amount of tax due to cover the cost of filing electronically. However, in a letter addressed to Rep. Newt Gingrich (R-Ga.), the Treasury states that they are not in favor of a tax credit for individuals who electrically file their tax returns (Tax Notes 944) and that the "major beneficiaries of the Electronic Filing system are the taxpayers who use it because they receive their refunds sooner." They argue that "a large



credit might encourage greater electronic filing but would have revenue costs that are likely to exceed the benefits to the IRS".

### The Growth Problem

The IRS has set tremendous growth goals for itself. The IRS projects that over 50 percent of all returns filed by 1998 will be electronically filed (Colabella 92). The IRS mainframe computers are over 25 years old. With all the technologies that have developed over the past years, these mainframes could be said to be inefficient, at best. With all the planned growth, the IRS is completely updating its systems; however, the problem that arises is full electronic filing implementation before the IRS computer system is updated. Presently, IRS computers can handle up to 25 million electronic filers. That should be enough capacity to meet the needs through 1995, the IRS says (The Wall Street Journal C1).

*Proposed Solution:* The IRS should continue testing electronic filing in major cities, expanding the knowledge base and increasing the tax forms offered to file electronically while the computers are being updated. By waiting to further implement the Electronic Filing system until the IRS computer update is completed, the IRS assures themselves a smooth transition into a paperless system. By the time the IRS is ready to handle all the taxpayers electronically (as far as computer capabilities are concerned), the IRS will have perfected its other expanded services and test programs leading to a more efficient system.

### The Paperwork Problem

Electronic filing was created to allow the IRS to be more efficient in processing income tax returns. While a 19 percent error rate exists for returns that are processed manually, the IRS believes that this rate will fall to around 4.5 percent when returns are processed electronically (Zeidner 638). However, the current Electronic Filing system is not entirely paperless. With the Electronic Filing system, several items still must be submitted via the mail, including:

1. Form 8453, U.S. Individual Income Tax Declaration

2. Copy B of Forms W-2, W-2B, or 1099-R, those normally attached to the front of the return.
3. Documents containing required signatures often associated with one's return.
  - a. Form 2120, Multiple Support Declaration
  - b. A physician's statement (Support Sch. R, Part II)
  - c. A proof of blindness certificate
  - d. Form 8283, Noncash Charitable Contributions
  - e. Form 8332, Release of Claim to Exemption for Child of Divorced Parents
  - f. Form 2848, Power of Attorney and Declaration of Representative (IRS Pub. 1345)

The fact that all these forms must still be submitted manually tends to add doubt that the 4.5 percent error rate is justified. There is still a significant amount being handled manually which tends to increase error percentages.

***Proposed Solution:*** There does not seem to be a clear cut solution to the paperwork problem. If the taxpayer's signature were the only required signature, a keypad could be used for the signature. However, the documents that need to be mailed generally require two signatures (listed above) and these documents will have to continue being mailed to the IRS. However, copies of Forms W-2, W-2G, and 1099-R are another story. As part of its paperwork reduction plan, the IRS requires businesses filing more than 250 of these to submit them on magnetic media. Since the IRS already receives a copy of these from the employer, mailing in a second copy merely increases the paperwork. The solution is better communication between present governmental programs.

#### IRS Service Center Service Problem

With the Electronic Filing system, telephone lines are used to transmit the information to the IRS. Many of the practitioners offering this service have one or possibly two phone

lines. In an effort to keep telephone lines open for client calls during the day, as well as for cost savings, most practitioners transmit during the evening. This is where the problem becomes evident. Getting customer service from the IRS if there is a problem with the transmission is often difficult. Complaints were heard from practitioners who would call at night to the IRS's 800 number to receive help only to get an uneducated person on the other line who takes the message and says that they will get back to you. They return the phone calls as they say they will, but it is a little untimely. One would think that since the whole system is being done to make the IRS more efficient, that they could lend a hand and help make it easier and more worthwhile for the practitioner to execute the program.

*Proposed Solution:* The solution to the problem of uneducated employees is simple: educate them. When the IRS assigns a contact person for the practitioner, they should assign them two contact persons. Practitioners should be able to talk with the same people each time they contact the IRS. This will build a professional relationship between the two parties. The key is having contact people who are fluent with the system and available to help.

#### Practitioner Incentive-base Problem

The items needed to conduct electronic filing business include a computer, modem, and a software package capable of electronic filing, all of which are substantial investments. Basic computers can be obtained for roughly \$1200; however, the cost varies with the size, memory, brand, and speed. Modems can be internal or external and can vary in size from 4800 baud to 9600 baud. A 4800 baud modem is used for transmission to a third-party transmitter, where a 9600 baud modem is used to transmit directly to the IRS. Modems range in price depending on the model and size; however, \$1,200 for a modem is not uncommon. Software prices also range according to company, customer service, and capabilities. For roughly \$500 you can purchase an adequate software system. Another cost that practitioners must incur is the training of their employees. If this cost is estimated at roughly \$500, then the costs to become involved with electronic filing are roughly \$3,400.

What can justify a practitioner investing this kind of capital in an unsure venture? Initially, the incentive to get involved with the Electronic Filing program will be profit motivated. However, profit motivation will not be enough in the long run. Presently, there are only a few firms transmitting such a large quantity of returns that they are making money. However, as the IRS spearheads the program, more practitioners will get involved, seeing electronic filing as a necessity to staying in business. This increased competition is going to lower the price charged for the service. The electronic filing service will become commonplace and exploited. Furthermore, since it will be required by the IRS, clients will expect the cost to be nominal. The profit to be made in the electronic filing business is now before it becomes a common service. Once everyone gets involved, the primary winner in the Electronic Filing system will be the IRS.

***Proposed Solution:*** The IRS has made it easy for the practitioner to be involved; they now need to make it cost effective. The IRS needs to issue standard software that is compatible with the major software packages being used in order to cut down on some of the practitioners' involvement costs. This would make it easier for the practitioner to be involved. The IRS also needs to eliminate all fees charged practitioners to file electronically.

When advertising electronic filing to the practitioners, the IRS needs to stress the cost savings experienced because a return does not need to be sent to the IRS, leading to cost savings in paper, postage, envelopes, and other assorted processing fees. These cost savings can become significant.

#### The Number of Forms Limitation Problem

A problem arises when taxpayers are excluded due to the massive size of their tax return. For example, someone with greater than four Forms 4562 (Depreciation and Amortization) may not file electronically. This limitation may exclude a large number of farmers who depreciate all of their tools and farm machinery, or sole proprietors who are involved in other business ventures. Also, since a separate depreciation form is needed for

each rental property, taxpayers who own rental properties could also be excluded under this limitation.

Another example is with returns containing Schedule D-1. Schedule D, the form used to report capital gains and losses, contains enough space to report seven short-term and seven long-term transactions. If the taxpayer has more than seven of either short-term or long-term transactions, then Schedule D-1 must be completed. This limitation excludes taxpayers who have significant trading in the stock market from filing electronically.

*Proposed Solution:* If the IRS wants a totally paperless system, they cannot exclude taxpayers due to the massive size and complexity of their returns. The solution is to lift the limitations placed on the number of forms and schedules that can be electronically transmitted. These limitations are placing restraints on the system.

#### SUMMARY

With the implementation of electronic filing, the IRS is heading toward a paperless income tax return system. Although many practitioners see it as "the wave of the future," others are still hesitant to become involved with the system. The cost savings and reduced error rates that exist with the Electronic Filing system justify the system's implementation; however, the government needs the practitioners' involvement if they intend to reach their goal of a paperless system. Before this can happen, the IRS will have to solve the problems that currently exist within the system. Once these problems have been properly addressed and resolved, the IRS will increase the probability of achieving its goal of a paperless system.

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