



FTA bulletin

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Electronic Income Tax Filing Analysis Continued: E-Filing Accounting for Higher Percentage of State Filing

To State Tax Administrators:

Summary

This Bulletin presents an analysis of state electronic filing of individual income tax returns in 2004. This Bulletin is a continuation of an analysis of state electronic filing of individual income tax returns in 2004. It focuses on E-file growth as a portion of total state individual income tax filings. According to FTA findings, paper individual income tax filings no longer account for a majority of returns.

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In any revolution, it is sometimes important to stop and re-examine just how much the landscape has changed. Advances in technology that have swept the world over the last ten years have changed the faces of many industries, not least among them tax administration. On the heels of the Internet came the era of electronic filing, and state revenue agencies have not looked back. The revolution has continued in force, onwards and upwards.

As recently as 2000, paper was the undeniable king of all tax return media, accounting for 80 percent of all individual income returns. Paper returns were the standard and the various forms of non-paper filing (ELF, Direct 1-File, Telefile) were just beginning to make inroads into the market.

In the first years of this new century, those inroads became expanding avenues. E-filing enjoyed several growth spurts, hitting its stride even as the American economy was downsizing. By 2004, simple paper returns had lost their majority status; they now make up only 49 percent of the total market. What seemed impossible just a few years ago is currently becoming a reality as tax administrators bear witness to the demise of the pulpy giant.

Returns that include bar codes also have taken on an increased role in state filing. In 2004, 20 states had a program that called for certain computer-produced returns that are filed on paper to also include a 2-dimensional bar code capable of being read quickly and accurately by either hand-held or high speed scanners. While not as efficient from a processing standpoint as electronic returns, bar code returns substantially reduce the resources required for income tax return data capture for states.

In 2000, bar coding was but a blip on the radar, making up only 1 percent of total state returns. In 2004, that number had jumped to a noticeable 9 percent. Though technically a paper-based system, bar coding takes full advantage of electronic data capture technology to streamline the processing of filed returns.

The various components of “true” electronic filing have also taken a large bite out of the paper behemoth: While direct Internet-filing (returns filed directly to the state through the tax agencies secure website) enjoyed a modest increase over the same 5 year period, from a negligible showing in 2000 to 2 percent of the total in 2004, it is the growth shown by the ELF program and practitioner filing that has threatened the paper return’s throne. In 2000, ELF/practitioner returns made up only 16 percent of all state returns (15 million returns). In 2004, however, that ratio had more than doubled to 38 percent (39.2 million returns).

This is due in part to the adoption of e-filing mandates in several key states. By 2004, five states -- California; Michigan; Minnesota; Oklahoma; and Wisconsin – had mandate programs in place. In 2005, Alabama, New Jersey and Virginia likewise will roll out their respective mandate programs. Beyond these traditional mandates, Massachusetts and Rhode Island have requirements that computer-prepared returns be filed either electronically or with a 2-D bar code allowing rapid capture.

In general, the mandates require practitioners who file a certain quota of returns to file them electronically. The specifics vary between the states but the goal is the same: To facilitate the growth of electronic filing to the detriment of cumbersome and antiquated paper returns. The Electronic Tax Administration Advisory Committee (ETAAC) recommended in its most recent annual report to Congress that the Congress “support mandated e-filing by paid preparers.” The ETAAC argues that “[a] mandate will likely encourage development of consistencies in the processing of tax returns, which will in turn lead to increased efficiency and, eventually, cost savings.”

The mandates also seem to be working in practice. Between 2003 and 2004, state electronic filing grew by 25 percent. However, if you remove those states that have instituted mandates from the equation, that ratio drops by more than half to 12 percent. State-level mandates also have the effect of increasing federal electronic filing. Overall, federal e-filing increased by 16 percent in 2004; if the states with a mandate are ignored, the growth rate drops to 9 percent.

These numbers seem to indicate that achieving the historical rates of growth in e-filing may require the adoption of additional mandates.

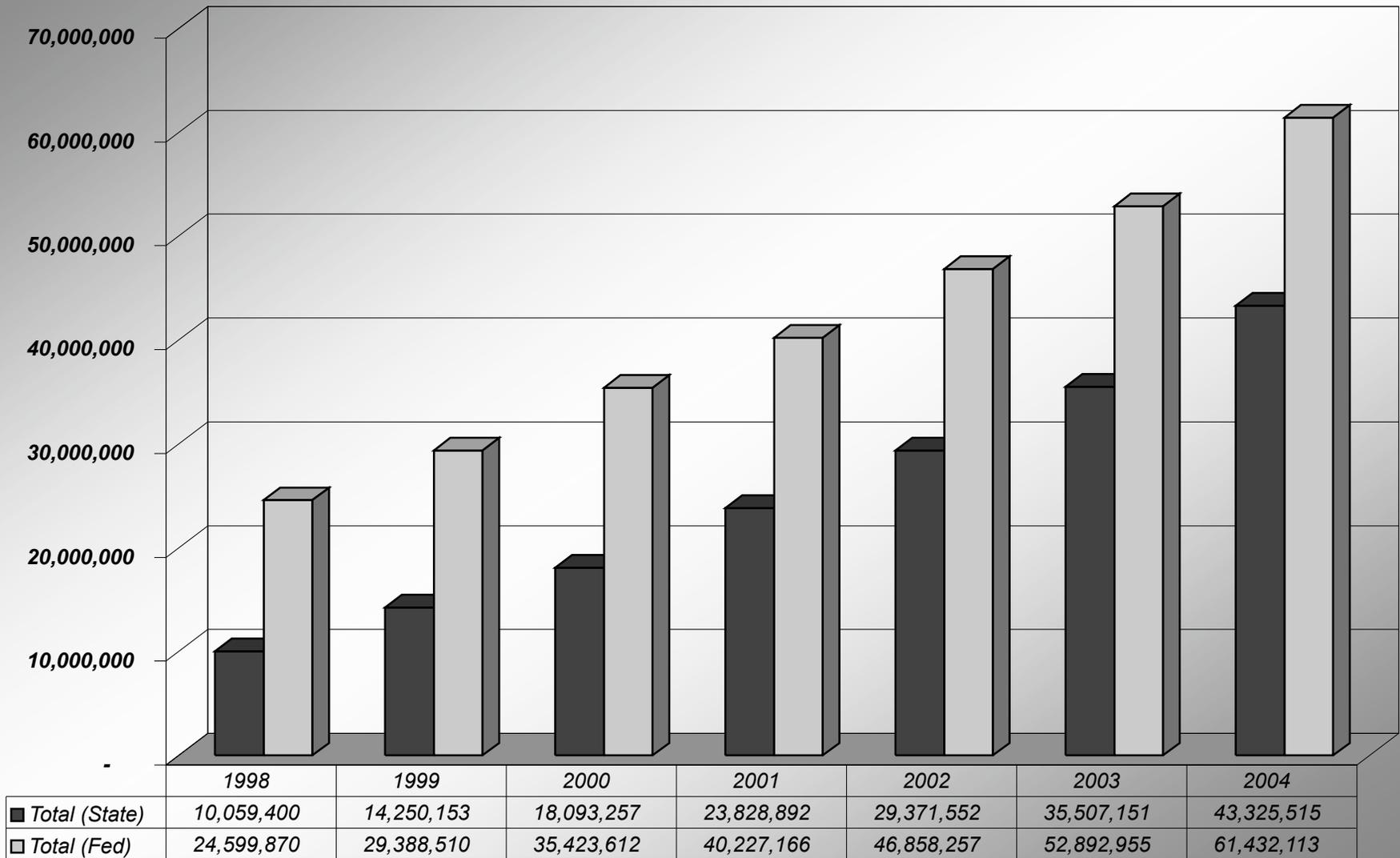
Growth in Electronic Filing, 2003-2004 (Percent Change)

	All States	w/o Mandates
State E-File	25%	12%
Federal E-File	16%	9%

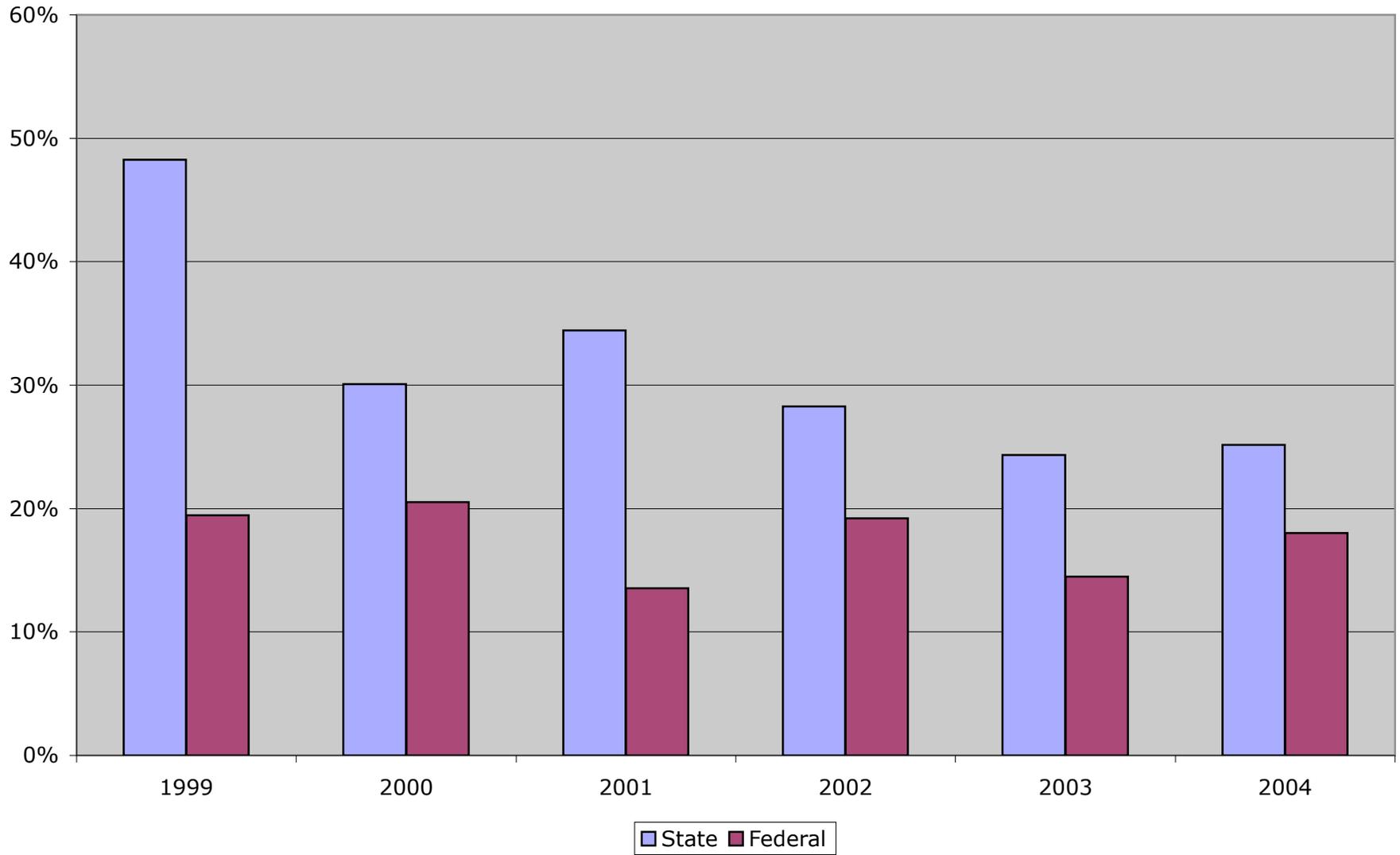
Comparatively, state electronic filing programs continue to grow at a greater rate than their federal counterpart, yet have not yet matched federal totals. After a 48 percent increase between 1998 and 1999, state e-filing totals have settled into a solid pattern of annual growth in the low thirties/high twenties range. Generally, federal growth has lagged behind state growth, allowing the state programs to close the gap between IRS and themselves. In 1998, 10 million state e-filed returns were processed, compared to 24.6 million federal e-filed returns (state/federal ratio – 40.9 percent). In 2004, those figures were 43.3 million and 61.4 million, respectively (state/federal ratio – 70.5 percent).

Electronic filing is not losing steam; on both the state and federal levels, the medium is enjoying steady growth and increased totals, due in part to the success of e-file mandates. In the wake of this electronic tax revolution, only paper returns and Telefile returns are diminishing, falling to systems that are quicker, easier and more reliable. The numbers clearly show that the future is bright for e-filing and if patterns persist, the revolutionary will become the standard.

Growth in State and Federal Electronic Filing



Growth in Electronic Filing (Percentage Change, Year over Year)



Distribution of State Returns by Type (2000 - 2004)



Distribution of State Income Tax Returns by Type

