

National Taxpayer Advocate

Annual Report to Congress

*2010 Annual Report to Congress*

**TELEFILE – TAXPAYERS’  
CHARACTERISTICS AND  
FILING BEHAVIORS**

**A STUDY TO ENHANCE TAXPAYER  
ASSISTANCE BLUEPRINT (TAB) KNOWLEDGE**

TeleFile – Taxpayers’ Characteristics and Filing Behaviors:  
A Study to Enhance Taxpayer Assistance Blueprint Knowledge

## TeleFile – Taxpayers’ Characteristics and Filing Behaviors: A Study to Enhance Taxpayer Assistance Blueprint Knowledge<sup>1</sup>

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## EXECUTIVE SUMMARY

### Introduction

In the 1990s, the IRS developed a system known as TeleFile, enabling taxpayers who filed relatively simple tax returns and met specific requirements to file their returns using a touch-tone telephone. TeleFile was a type of electronic filing that helped the IRS move toward its goal of having 80 percent of tax returns filed via electronic means. However, the IRS discontinued TeleFile in 2005, citing increasing maintenance costs and decreasing use. Proponents of the system suggest the IRS abandoned TeleFile prematurely and left a segment of the taxpaying population with no convenient means of filing electronically. While some former TeleFile users adopted alternative methods of electronic filing, others did not. As part of the Taxpayer Assistance Blueprint (TAB) efforts, the IRS would like to know more about taxpayers who previously used TeleFile to help understand their needs and behaviors, and what would be needed to encourage those filing paper returns to use an electronic filing method.

### Findings

One of the arguments for eliminating TeleFile was that taxpayers would use other electronic filing mechanisms, including the then newly developed Free File system. The data analyzed in this study show, however, that a considerable number of taxpayers with relatively simple tax returns still file on paper. Less than seven percent of former TeleFile users used Free File to submit their tax returns, and nearly 30 percent of former TeleFile users filed a paper tax return in 2008. The IRS was not successful in converting these taxpayers to different electronic filing methods.

Computer use and internet access are contributing factors to electronic filing use. A recent Pew Internet Project survey shows, however, that about one in four U.S. households does not have Internet access. A telephone filing system offers the benefit of being available to taxpayers who do not have personal computers or Internet access, or who are simply not computer savvy. The U. S. Census Bureau’s American Community Survey shows that nearly 98 percent of U.S. households have some type of telephone service – either a landline or cell phone. Further, more than half (53 percent) of Americans who do not use the Internet at all do have cell phones. Overall, 82 percent of Americans own a cell phone, with ownership more prevalent among minorities. The ready availability of telephones makes telephone tax filing an attractive option.

By relaxing eligibility qualifications for a telephone system, the IRS could greatly expand the number of taxpayers who could use such a system - more than 27 million taxpayers could have used a telephone based system in tax year 2008. For a TeleFile system to be successful, the IRS must encourage new taxpayers to use the system to offset the taxpayers that can no longer use it because of changing life circumstances.



### Recommendations

The IRS’s original assumption that taxpayers who previously used TeleFile would automatically turn to another electronic method overstated some taxpayers’ commitment to electronic filing. It would be worthwhile for the IRS to consider adding another filing method, thereby minimizing or eliminating problems associated with paper filing.

The National Taxpayer Advocate recommends that the IRS explore reinstating TeleFile with less restrictive eligibility criteria that allow taxpayers who move to use the system. Changes in the use of telephones and their technologies should be considered and included in the system evaluation so the IRS does not develop a system based on obsolete assumptions or technology. This would include evaluating current telephone technologies to determine the feasibility of allowing taxpayers with simple tax returns (with less restrictive eligibility requirements than those applicable to the former TeleFile system) to interact with the IRS using cell phones and smart phones, as well as being able to file tax returns and interact with the IRS by voice or text.

Absent a telephone-based system, it is likely that the IRS will need to find more efficient alternatives for processing paper returns, because it appears some taxpayers will continue filing on paper unless they are forced to change. The IRS should evaluate how to capture information from paper returns by scanning a bar code rather than by transcription.

## INTRODUCTION

In the 1990s, the IRS developed a system known as TeleFile, enabling taxpayers who filed relatively simple tax returns and met specific requirements to file their returns using a touch-tone telephone. The IRS started TeleFile as a test in one state and eventually expanded it to qualified taxpayers in all 50 states.

TeleFile is a type of electronic filing that helped the IRS move toward its goal of having 80 percent of tax returns filed via electronic means.<sup>2</sup> However, the IRS discontinued TeleFile in 2005, citing increasing maintenance costs and decreasing use. Proponents of the system suggest that the IRS abandoned TeleFile prematurely, and consequently left a segment of the taxpaying population with no convenient means of filing electronically.

The Taxpayer Advocate Service (TAS) Research and Analysis staff agreed to work a project on TeleFile as part of the Taxpayer Assistance Blueprint (TAB) research. One of the goals of the TAB was to ‘Establish a credible taxpayer and partner baseline of needs, preferences, and behaviors.’<sup>3</sup> To this end, the IRS would like a more thorough evaluation of the TeleFile system so it can better understand taxpayers who previously used the system; specifically, how did these taxpayers file their subsequent returns? This information will allow IRS to make informed decisions on how to reach its electronic filing goals.

## BACKGROUND

TeleFile was popular with the IRS and taxpayers in the 1990s and early 2000s. This interactive computer program allowed qualified taxpayers to file a simple federal tax return (Form 1040EZ) electronically by using the TeleFile toll-free number. A personal computer was not necessary. The program would compute the earned income tax credit (EITC) if the taxpayer was eligible, and also automatically computed the refund or balance due.

Several states established programs with the IRS, making it easier for taxpayers to file both their federal and state returns and streamlining processing for both the IRS and its state counterparts. When the IRS abandoned the program in 2005, several states followed suit. Today, the states generally use TeleFile programs to collect business and sales taxes rather than income tax. Canada continues to operate a TeleFile program for individual income tax filers.<sup>4</sup>

For individual income tax returns, the IRS limited TeleFile use to those with a relatively simple return. Eligibility requirements included an income and interest threshold, no dependents, age, filing status, disability, no paid tax preparer use, and address change limitations; and filers had to receive a TeleFile tax package from the IRS. Some of the more

<sup>2</sup> Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98), Title II. In RRA 98, Congress stated that the IRS should have a plan to increase electronic filing and established a goal that at least 80 percent of all federal tax and information returns should be filed electronically by 2007.

<sup>3</sup> Taxpayer Assistance Blueprint (TAB), Final TAB Phase 1 Report, 2 (Apr. 2006).

<sup>4</sup> <http://www.cra-arc.gc.ca/esrvc-srvce/tx/ndvdlst/tf/bt-eng.html> (last visited Nov. 8, 2010). See Appendix D for a more detailed description of the Canadian system.

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popular characteristics of TeleFile were its availability 24 hours a day, seven days a week, the promise of a quick refund, and clear instructions that used graphics. Other important features included simplicity, the ability to correct mistakes, a filing acknowledgement or confirmation number, the toll-free phone calls, that there was no need to file supporting documents, and the ability to have refunds deposited directly in a bank account.<sup>5</sup>

Although this report will focus on TeleFile for individual income tax returns, it should be noted that taxpayers could also use TeleFile for employment tax returns. For tax year (TY) 2004, TeleFile accounted for over 800,000, or nearly 19 percent of electronically filed Form 941 returns, *Employer’s Quarterly Federal Tax Return*.<sup>6</sup> When the IRS eliminated TeleFile, it also eliminated an easy and free method of filing employment tax returns.

The IRS developed TeleFile as a gateway from paper to electronic filing. When deciding to eliminate TeleFile, the IRS did not consider how filing requirements could be expanded to increase the TeleFile eligibility base and reduce the costs of processing each return.<sup>7</sup> Rather than expanding TeleFile and easing its restrictions on eligibility, the IRS chose to discontinue the system and to shift users to Free File, which would allow qualified taxpayers to create and file their returns electronically at no charge. The Free File system requires taxpayers to use a personal computer with Internet connections to access [www.irs.gov](http://www.irs.gov) and then select a link for one of several software companies. In this study, TAS looks at Telefilers, their subsequent behaviors, and how less restrictive TeleFile eligibility requirements could increase the number of taxpayers who could use the system.

### Related Research

Several factors affect the ability of the IRS to meet its electronic filing goals. Among them are computer use and Internet access. A recent Pew Internet Project survey shows that about one in four U.S. households does not have Internet access. Those making less than \$30,000 per year or who lack a high school diploma are considerably less likely to use the Internet than others. Only about 60 percent of adults with low incomes and less than 40 percent without high school diplomas use the Internet.<sup>8</sup> The only viable way for these taxpayers to file electronically is to hire a professional tax preparer, use a computer located elsewhere, or have someone else complete and file their returns for them.

Telephone access is also an important factor when considering a method that involves filing a return by phone. The U. S. Census Bureau’s American Community Survey shows that nearly 98 percent of U.S. households have some type of telephone service – either a landline

<sup>5</sup> 1992 TeleFile Evaluation, 24-29. Report includes findings from taxpayers’ surveys and focus group interviews held with both TeleFile users and eligible non-users.

<sup>6</sup> Small Business/Self-Employed Division (SB/SE) Research, Fiscal Year (FY) 2005 Nationwide Analysis, *Electronic Tax Administration Business Master File Marketing Database* (June 2005).

<sup>7</sup> Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2003-40-092, *Opportunities Exist to Expand the TeleFile Program* 5-7 (Mar. 2003).

<sup>8</sup> Pew Internet & American Life Project, Pew Research Center, *Internet, Broadband, and Cell Phone Statistics* 2, 7 (Jan. 5, 2010). Study methodology includes interviews with 2,258 adults age 18 or older and has a margin of error of plus or minus 2.4 percent. The United States Census Bureau reports that more than 30 percent of households do not use the Internet at home. Current Population Survey (CPS) Table 1 (Oct. 2009).



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or cell phone.<sup>9</sup> Cell phone use is more prevalent today than when the IRS last offered TeleFile, and technological advances in cell phones and smart phones open up new possibilities for filing tax returns by phone.<sup>10</sup> Taxpayers’ accessibility and willingness to use a telephone to file will play a large role in their decision of whether to use a system like TeleFile.

Taxpayers who elected to use the TeleFile system could do so at no cost and have the assurance of having a more accurate return than one prepared on paper because of the error checking built into the system. Returns filed through the TeleFile system were subjected to the same data screening validations as those filed through other e-filing methods to identify potentially erroneous claims. If errors were identified, the IRS would not accept the return for processing and would notify the taxpayer of the error by letter, telling him or her to resubmit the return on paper or by another e-file method.<sup>11</sup>

The preparation time for a TeleFile tax return was much faster than for a paper return. For TY 2002, the IRS estimated that it took one hour and 43 minutes to prepare a TeleFile tax return, whereas it took the same taxpayer three hours and 43 minutes to prepare a paper Form 1040EZ.<sup>12</sup> The Treasury Inspector General for Tax Administration estimated this two-hour time saving would translate into monetary savings of \$53 per taxpayer.<sup>13</sup>

The decision to discontinue the TeleFile Program followed a recommendation made by the Electronic Tax Administration Advisory Committee (ETAAC) to eliminate TeleFile and redirect the funds to the Modernized e-File Project. The IRS testified that it would save

<sup>9</sup> U.S. Census Bureau, *2009 American Community Survey*, C25043. The universe for this data is occupied housing units which were estimated at 113.6 million. Roughly two percent of households do not have telephone service available. In one study, 83 percent of households indicated that they have some type of cell phone. Pew Internet & American Life Project, Pew Research Center, *Internet, Broadband, and Cell Phone Statistics* 12 (Jan. 5, 2010). There are two major differences between smart phones and cell phones: smart phones can run applications and can access the Internet directly, while cell phones cannot run applications and rely on a carrier to get Internet access. Cell phones’ primary purpose is to make phone calls although they are no longer limited to voice calls and text messaging. Many can play music, take pictures, or connect to the web through a phone carrier. Smart phones come with advanced data features including the ability to manage and transmit data, use third party applications, and make voice calls. Computer World, *Cell Phone, Smartphone – What’s the Difference?*, [http://www.computerworld.com/s/article/9129647/Cell\\_phone\\_smartphone\\_what\\_s\\_the\\_difference\\_](http://www.computerworld.com/s/article/9129647/Cell_phone_smartphone_what_s_the_difference_) (last visited Dec. 20, 2010) and Yahoo Technology, *The Real Difference Between Smart Phones and Regular Cell Phones*, [http://www.associatedcontent.com/article/5868240/the\\_real\\_difference\\_between\\_smart\\_phones.html](http://www.associatedcontent.com/article/5868240/the_real_difference_between_smart_phones.html) (last visited Dec. 20, 2010).

<sup>10</sup> Eighty-three percent of households indicated that they had some type of cell phone in December 2009 compared with 66 percent in January 2005. See Pew Internet & American Life Project, Pew Research Center, *Internet, Broadband, and Cell Phone Statistics* 12-13 (Jan. 5, 2010); Pew Internet & American Life Project, *Cell Phones and American Adults*, 1-5, 28 (Sept. 2, 2010). Overall, 82 percent of Americans own a cell phone, with ownership more prevalent in minorities – 87 percent of African Americans and English speaking Hispanics report owning a cell phone (compared with 80 percent of whites). Lower income, elderly, and rural Americans are less likely to have a cell phone than others. Seventy-one percent of those making less than \$30,000, 57 percent of those 65 or older, and 72 percent of rural Americans own cell phones. Interestingly, more than half (53 percent) of Americans who do not use the Internet at all have a cell phone.

<sup>11</sup> TIGTA, Ref. No. 2003-40-092, *Opportunities Exist to Expand the TeleFile Program* 7 (Mar. 2003).

<sup>12</sup> IRS, *2002 1040EZ Instructions*, 24; *2002 TeleFile Tax Record and Instructions*. For 2008, the IRS estimates the time to prepare a paper Form 1040EZ at over ten hours. *IRS Form 1040EZ Instructions*. The IRS now provides only one combined estimated time figure for 1040EZ and 1040A returns.

<sup>13</sup> TIGTA, Ref. No. 2003-40-092, *Opportunities Exist to Expand the TeleFile Program* 15 (Mar. 2003).

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between \$17 and \$23 million by eliminating TeleFile.<sup>14</sup> The ETAAC proposed putting this money into other electronic filing methods. While the IRS has made significant strides in expanding the use of electronic filing, a sizeable population of taxpayers, most notably those with low incomes, continues to file paper returns.

## METHODOLOGY

TAS Research extracted data for taxpayers who filed their federal income tax returns using the TeleFile system at least once in tax years 2002, 2003, or 2004, using the IRS’s Compliance Data Warehouse (CDW). Research identified these returns from the Electronic Tax Administration (ETA) Individual Marketing database by filing type. The ETA data was supplemented with data from the Individual Returns Transaction File (IRTF) to obtain general characteristics of the target group (such as preparer indicators, type of return filed, date of death, unemployment compensation, additional child tax credit, and other form/schedule indicators). Appendix A also compares taxpayers using TeleFile to eligible taxpayers who chose another method.

Next, Research created a longitudinal data file by capturing filing pattern data for this population for TYs 2005, 2006, 2007, and 2008 from the ETA Individual Marketing database and IRTF. The TeleFile population for this study consists of 6.3 million taxpayers.<sup>15</sup> The longitudinal analysis of those using TeleFile included any primary taxpayer who used TeleFile for any of the tax years 2002 through 2004.

The data file was used to determine subsequent filing behaviors (how tax returns were filed – paper, electronic, TeleFile, etc.) and general characteristics of the target group. The data were used to evaluate how TeleFile filers filed their tax returns over time.

### Limitations

The longitudinal file contained all taxpayers who TeleFiled in tax years 2002, 2003 or 2004, except for taxpayers who:

- Died during the 2002 - 2008 tax years;
- Had inconsistent data over time;
- Were no longer primary taxpayers in tax years 2005 - 2008; or
- Were originally listed as spouses.

<sup>14</sup> ETAAC, which consisted of members selected by the IRS to represent a broad spectrum of the private sector, included tax preparers, tax software developers, payroll companies, financial institutions, small businesses, state governments and taxpayers. TIGTA, Ref. No. 2007-40-116, *Eliminating TeleFile Increased the Cost and Burden of Filing a Tax Return for Many Taxpayers* 2-3 (July 2007). *2005 Tax Return Filing Season and the IRS Budget for Fiscal Year 2006, Hearing Before the Subcommittee on Oversight of the Committee on Ways and Means, U.S. House of Representatives*, 109th Cong. (Apr. 14, 2005). However, ETAAC does not include representatives of consumer organizations.

<sup>15</sup> Some taxpayers were removed from the analysis – taxpayers who used TeleFile in 2002, 2003, or 2004 and passed away sometime before 2009 were eliminated from the data file. For tax years 2003 - 2008, fewer than one million former primary taxpayers were no longer shown as a primary taxpayer. This, along with non-filers and deaths, contribute to the changing population from one year to the next. The final longitudinal dataset consists of 6,294,604 taxpayers.

During data cleaning, nearly 20,000 taxpayers were removed from the longitudinal dataset because they died during the 2002 - 2008 tax years. Records with inconsistent data over time were also removed. For example, six records included multiple birth dates for one Social Security number (SSN) and thus were removed because of inconsistent data. The dataset excludes taxpayers who were originally listed as a spouse (the secondary taxpayer) on a TeleFile return in TY 2002, 2003, or 2004 and subsequently filed their own returns. Data was based on taxpayers’ primary SSNs and limited to those who used TeleFile in TY 2002, 2003, or 2004. Taxpayers who moved were identified by whether they had a different nine-digit zip code from one year to the next.

### Objectives

The IRS wanted to learn about the behavior of former TeleFile users, particularly what might contribute to the changes in their use of various tax return filing methods. TAS developed a plan to identify appropriate research questions and answered them based on ETA and IRTF data. The research questions for this study follow:

- How many taxpayers used TeleFile in tax years 2002, 2003, and 2004?
- What are the characteristics of the TeleFile population in tax years 2002, 2003, and 2004?
  - What are the differences in demographic characteristics (*e.g.*, age, filing status, total taxable income) of Telefilers compared to other taxpayers who did not TeleFile?
- What method did former Telefilers use to file subsequent tax returns?
  - What are the characteristics of TeleFile eligible taxpayers who were filing via some electronic means versus those who filed by paper in tax year 2008?
- How many taxpayers would be eligible to use TeleFile today given the qualifying restrictions?
  - What filing method are these eligible taxpayers using?
- How many taxpayers would be eligible to use TeleFile if the restrictions were modified?
  - Is there a group of taxpayers who would be eligible for TeleFile who are not filing electronically?

## FINDINGS

### How Many Taxpayers Used TeleFile in Tax Years 2002, 2003, and 2004?

More than 11 million tax returns were filed via TeleFile for tax years 2002 – 2004. About 6.3 million taxpayers filed via TeleFile during TY 2002, 2003, or 2004. Approximately 60 percent of taxpayers who received the TeleFile package were eligible to use the system.<sup>16</sup>

<sup>16</sup> Taxpayers had to receive a TeleFile package to be eligible to use the system. Tax packages were not forwarded to taxpayers.

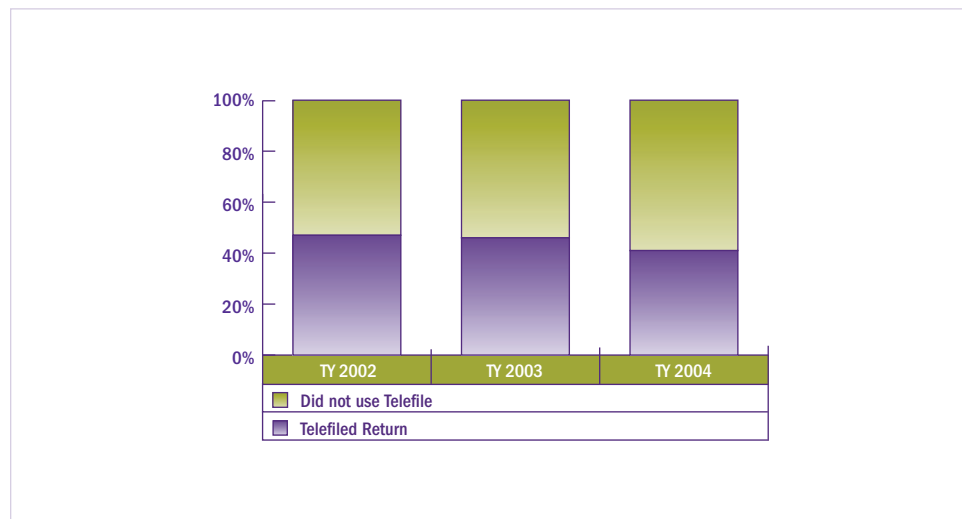
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**TABLE 2.7.1, TeleFile Packages Sent, Eligible Taxpayers, and Users for TY 2002 - 2004<sup>17</sup>**

	TY 2002	TY 2003	TY 2004
IRS Sent TeleFile Package <sup>18</sup>	14,194,544	14,056,571	13,290,499
TeleFile Eligible <sup>19</sup>	8,492,703	8,214,726	7,903,490
TeleFile Ineligible <sup>20</sup>	5,701,841	5,841,845	5,180,100
TeleFile Users <sup>21</sup>	4,026,693	3,769,606	3,293,652

About 40 percent of taxpayers who received the TeleFile package were not eligible to use the system. Overall, only about 25 percent of those who received the package actually TeleFiled. Yet as Figure 2.7.1 shows, more than 40 percent of those eligible used the system to submit their tax returns.

**FIGURE 2.7.1, Package Recipients Who Were Eligible for TeleFile<sup>22</sup>**



<sup>17</sup> Electronic Tax Administration (ETA), *Marketing Database, TY 2002 - 2004 and Individual Returns Transaction File, TY 2002 - 2004*.

<sup>18</sup> Which forms were filed with the previous year's return and whether the taxpayer used a paid preparer were primary factors in deciding whether to send a taxpayer a tax package and if so, which package was sent. The IRS limited who would receive a TeleFile package based on the amount and types of income, filing status, dependents, and whether they moved since their account was last updated.

<sup>19</sup> Wage and Investment Division (W&I) Research Group Phoenix-Los Angeles, *ETA Project 5-06-08-1-015N*, Full Year ETA Individual Marketing Databases for TY 2001, TY 2002, TY 2003 and Partial Year Database for TY 2004 (filed through July 2, 2005 – cycle 26) (Dec. 2005).

<sup>20</sup> W&I Research Group Phoenix-Los Angeles, *ETA Project 5-06-08-1-015N*, Full Year ETA Individual Marketing Databases for TY 2001, TY 2002, TY 2003 and Partial Year Database for TY 2004 (filed through July 2, 2005 – cycle 26) (Dec. 2005).

<sup>21</sup> ETA, *Marketing Database, TY 2002 - 2004*.

<sup>22</sup> ETA, *Part Year TeleFile Analysis, Project 5-06-08-1-015N*.

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## What Were the Characteristics of the TeleFile Population in Tax Years 2002, 2003, and 2004?

### Demographic Characteristics of Telefilers

The TeleFile population is different from the general taxpaying population. Its members are younger, have lower incomes, tend to be single, file relatively simple tax returns, prepare the returns themselves, and move more than other taxpayers. Many of these differences are expected because of the limiting criteria for TeleFile use. The following table compares Telefilers in the year indicated to the remaining taxpayers for various return characteristics.

**TABLE 2.7.2, Characteristics of Individual Tax Returns: TeleFiled vs. Other (All Individual Returns not TeleFiled) for Tax Years 2002 - 2004<sup>23</sup>**

Tax Year	2002		2003		2004	
	TeleFile Returns	Other Returns	TeleFile Returns	Other Returns	TeleFile Returns	Other Returns
<b>Number of Returns</b>	<b>4.0 M</b>	<b>122.7 M</b>	<b>3.8 M</b>	<b>123.3 M</b>	<b>3.3 M</b>	<b>125.3 M</b>
Age						
- Mean	31	44	32	45	32	44
- Median	25	41	25	42	26	42
Filing Method						
- Paper	0%	60.2%	0%	53.2%	0%	48.0%
- TeleFile	100%	0%	100%	0%	100%	0%
- Practitioner – ELF	0%	30.3%	0%	35.5%	0%	38.4%
- Online	0%	9.6%	0%	11.3%	0%	13.6%
Filing Status						
- Single	96.6%	42.1%	96.0%	41.9%	95.6%	42.2%
- Married filing joint	3.4%	40.9%	4.0%	40.9%	4.4%	40.5%
- Married filing separate	0%	2.0%	0%	2.0%	0%	2.0%
- Head of Household	0%	15.0%	0%	15.2%	0%	15.3%
- Qualifying Widower	0%	0.1 %	0%	0.1%	0%	0.1%
Income						
- Mean	\$17,905	\$46,896	\$18,463	\$51,808	\$19,508	\$53,020
- Median	\$15,298	\$29,203	\$15,817	\$29,681	\$16,709	\$30,558
Income Type						
- Wages & Interest	93.5%	84.1%	87.9%	83.9%	84.5%	83.9%
- Schedule C	0%	14.7%	0%	15.4%	0%	15.7%
- Other	6.5%	7.9%	12.2%	8.0%	15.5%	8.1%
<b>Moved in Last Year<sup>24</sup></b>	<b>0%</b>	<b>3.1%</b>	<b>0%</b>	<b>3.2%</b>	<b>0%</b>	<b>3.1%</b>
<b>Refund Returns</b>	<b>93.3%</b>	<b>79.5%</b>	<b>93.2%</b>	<b>80.9%</b>	<b>93.0%</b>	<b>78.7%</b>
Refund						
- Mean	\$557	\$2,388	\$569	\$2,486	\$574	\$2,513
- Median	\$444	\$1,349	\$453	\$1,428	\$464	\$1,433

table continued on next page

<sup>23</sup> ETA, *Marketing Database, TY 2002 - 2004 and Individual Returns Transaction File, TY 2002 - 2004*. This data is only comparing Telefilers in the indicated year to all other filers for that tax year.

<sup>24</sup> Taxpayers were identified as moving if the nine-digit ZIP codes did not match from one year to the next. By definition those who used the TeleFile system could not have moved.

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Tax Year	2002		2003		2004	
	TeleFile Returns	Other Returns	TeleFile Returns	Other Returns	TeleFile Returns	Other Returns
Repeat TeleFile Users <sup>25</sup>	60.4%	n/a	60.3%	n/a	58.9%	n/a
Return Complexity <sup>26</sup>		n/a <sup>27</sup>				
- Simple	100%		100%	31.1%	100%	29.3%
- Intermediate	0%		0%	29.0%	0%	39.3%
- Complex	0%		0%	40.0%	0%	31.4%
Who Prepared Return						
- Self	100%	39.4%	100%	38.0%	100%	37.9%
- Paid Preparer	0%	60.6%	0%	62.0%	0%	62.1%

In addition to looking individually at Telefilers in tax years 2002, 2003, and 2004, this study explores the entire group of taxpayers who used TeleFile from 2002 to 2004 and how their characteristics changed over the course of tax years 2005 - 2008. The following data are based on this longitudinal analysis.

Overall, the number of taxpayers using the TeleFile system declined from tax year 2002 to 2004. One factor contributing to this decline was that taxpayers who used a preparer were no longer sent a TeleFile tax package and thus could not use the system. Several other changes can be seen over this time: Telefilers’ incomes rose and came from sources other than just wages and interest. Similarly, a greater portion of Telefilers moved, making them ineligible for the system. The following discussion highlights several of these demographics in more detail.

### Age

TeleFile users tend to be relatively young with an average age of 32 and a median age of 25. This does not mean that older taxpayers did not use the system, as those over 35 account for nearly one of every three Telefilers. However, even by 2008, few former Telefilers would have been disqualified from using the system if it had been in existence because they exceeded age eligibility requirements.<sup>28</sup>

Taxpayers who do not use TeleFile are considerably older, with the average age in the mid-forties and the median in the early forties, surpassing the average and median ages of Telefilers by about 13 and 16 years respectively. This is not unexpected, given that the eligibility criteria for TeleFile specifically targeted returns with lower income and less complexity.

<sup>25</sup> Repeat Telefilers are defined as taxpayers who filed tax returns using TeleFile for at least two years for tax years 2001 - 2004.

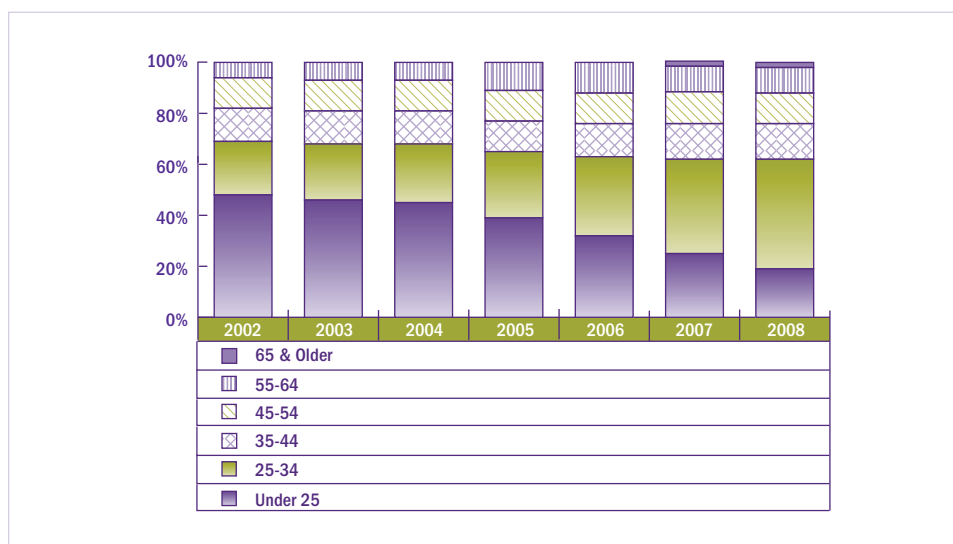
<sup>26</sup> Simple returns include Forms 1040, 1040A, or 1040EZ and no additional forms or schedules. Intermediate returns are Form 1040A with schedules or 1040 with schedules A, B, D, Additional Child Tax Credit, Educational Credits, Child Care Credit, Credit for the Elderly, or EIC. Complex returns are defined as Form 1040 with schedules C, E, or F or other schedules and all other specific Forms 1040, e.g., 1040(PR).

<sup>27</sup> The Return Complexity definition contained only two categories – simple and complex – in tax year 2002. Beginning in 2003, it was expanded to three categories.

<sup>28</sup> About two percent (106,435) of the remaining 4,915,470 taxpayers who used Telefile in tax years 2002, 2003, or 2004 would not have been qualified to use the system if it were still available in tax year 2008 because they exceeded the age criteria.

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**FIGURE 2.7.2, Age Ranges of Former TeleFile Users Tax Years 2002 - 2008<sup>29</sup>**



### Income

As expected, TeleFile users’ incomes are low, with *median* levels in the \$15,000 to \$18,000 range or 52 to 60 percent of the income of non-Telefilers. The *average* income ranged from \$18,000 to \$24,000 or 38 to 46 percent of the average income for those not using TeleFile.<sup>30</sup>

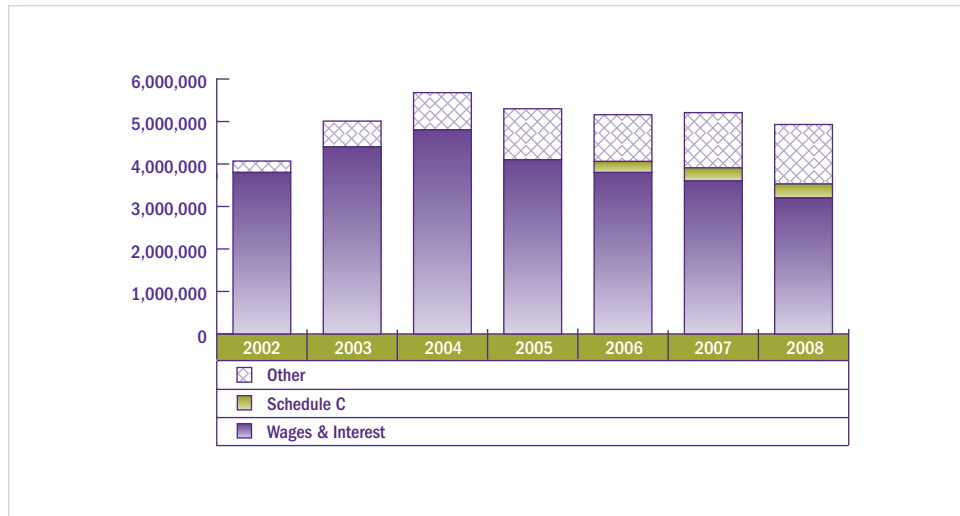
Because of system eligibility criteria, Telefilers are primarily wage and interest earners with small amounts of income coming from other sources. In 2002, more than 93 percent of Telefilers’ income came from wages and interest; by 2008, that figure had dropped to 65 percent. Inversely, the percent of former TeleFile users with Schedule C income increases to about seven percent and other income sources increased from nearly seven percent to 28 percent. Since sources of income impact whether taxpayers are eligible to use the TeleFile system, it is apparent that as taxpayers acquire income from additional sources, their returns increase in complexity and they would not qualify to use a telephone system.

<sup>29</sup> ETA, *Marketing Database for Tax Years 2002 – 2008*, based on taxpayers who used the Telefile system in 2002, 2003, or 2004.

<sup>30</sup> Beginning in TY 2004, the TeleFile taxable income threshold was increased to \$100,000.

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**FIGURE 2.7.3, Income Sources of Former TeleFilers for Tax Years 2002 - 2008<sup>31</sup>**



### Filing Status

Ninety-seven percent of TeleFilers in TY 2002 filed using single status compared with just 76 percent of the 2002 to 2004 TeleFile population in TY 2008. The majority of taxpayers with different filing statuses moved to the married filing joint group, which increased by 13 percent from 2002. Head of Household status was the only other category with a notable increase (six percent) in filers from 2002. This is just one example of how life changes can impact TeleFile eligibility.

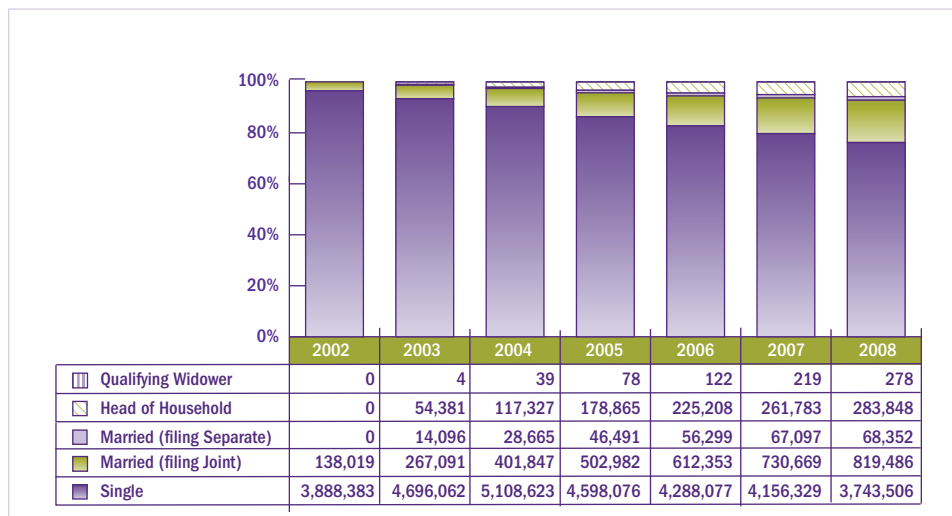
Filing status is one of the characteristics where TeleFilers differ dramatically from the remaining population, at least in part because of the eligibility criteria. For tax years 2002 to 2004, only about 42 percent of taxpayers who do not use TeleFile are single and more than 40 percent use the married filing joint category. Fifteen percent of the remaining taxpayers file as Head of Household.

<sup>31</sup> ETA, Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008.



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**FIGURE 2.7.4, Filing Status Used by Former TeleFile Users for Tax Years 2002 - 2008<sup>32</sup>**



### *Moved in Last Year*

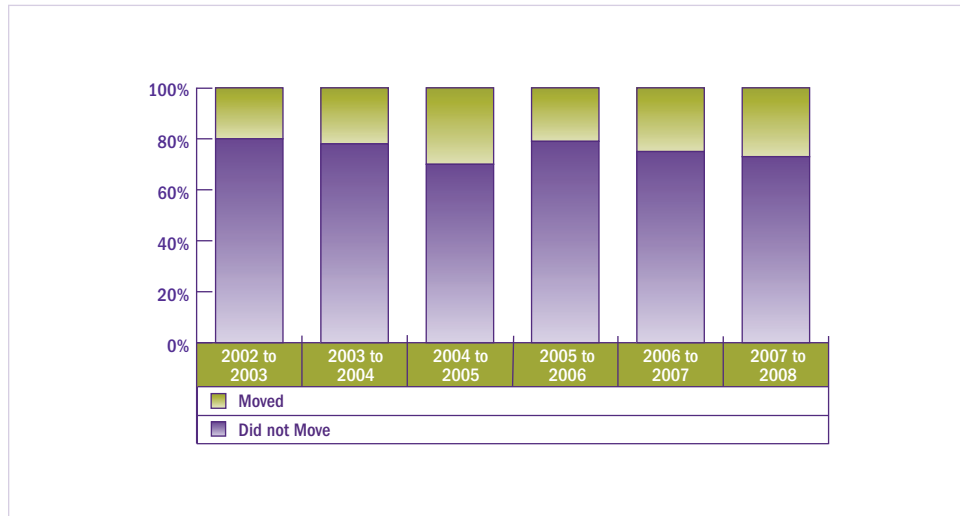
Another example of TeleFile users’ changing life circumstances is shown by how many of these taxpayers moved. At least 20 percent of those who used the TeleFile system moved in any given year between TY 2002 and TY 2008. These taxpayers would not be eligible to use TeleFile in the years they moved unless they informed the IRS of their moves before the TeleFile tax packages were printed and mailed.<sup>33</sup> Only about three percent of the remaining taxpayers moved in any given year from 2002 to 2004.

<sup>32</sup> ETA, *Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008*.

<sup>33</sup> One of TeleFile’s eligibility requirements was that the taxpayer could not have moved because he or she had to have the package to use TeleFile and tax packages were not forwarded. In 2009, more United States residents with low income moved than those with higher incomes. More than 19 million citizens 15 or older with incomes of \$25,000 or less (18 percent of those at this income level) moved compared with nearly eight million (about 14 percent) of those with incomes from \$25,000 to \$50,000, and nearly five million of those who made more than \$50,000 (almost ten percent). U.S. Census Bureau, 2009 American Community Survey, Table B07010.

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**FIGURE 2.7.5, Number of Former TeleFile Filers Moving in Tax Years 2002 - 2008<sup>34</sup>**



This type of requirement contributes to the decline in the use of TeleFile. Other governments have found ways to overcome this challenge and allow movers to file using TeleFile if they meet the other eligibility criteria.<sup>35</sup>

### Refund

About 90 percent of TeleFile filers are due refunds, although the amounts are smaller than those owed to the remaining taxpayers. The difference in refunds is in part attributable to the TeleFile eligibility criteria. A large portion of the group continued to receive refunds over time, dropping a few percentage points from 2002 - 2008. By 2008, former TeleFile users received an average refund of nearly \$1,800 and a median refund of almost \$1,100. The average and median refunds of former TeleFile filers increased over time, doubling and tripling respectively, by tax year 2008.

### Repeat TeleFile Filers

TeleFile users continued to use the system to file their returns. Repeat customers are those who used TeleFile in more than one of the tax years studied. About 60 percent of those who filed via TeleFile in tax years 2002 to 2004 used the system in more than one year. Of those who did not repeat TeleFile use in 2003 or 2004, about 20 percent were no longer eligible.

<sup>34</sup> ETA, *Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008*. Taxpayers were considered to move if their nine-digit zip code changed from one year to the next.

<sup>35</sup> See Appendix D for a description of Canada's TELEFILE system. In Canada, taxpayers who did not receive the TELEFILE tax package but believe they meet the system requirements can call a representative to see if they qualify and receive information needed to use the system. <http://www.cra-arc.gc.ca/esrvc-srvce/tx/ndvdl/tf/bt-eng.html> (last visited Nov. 8, 2010).

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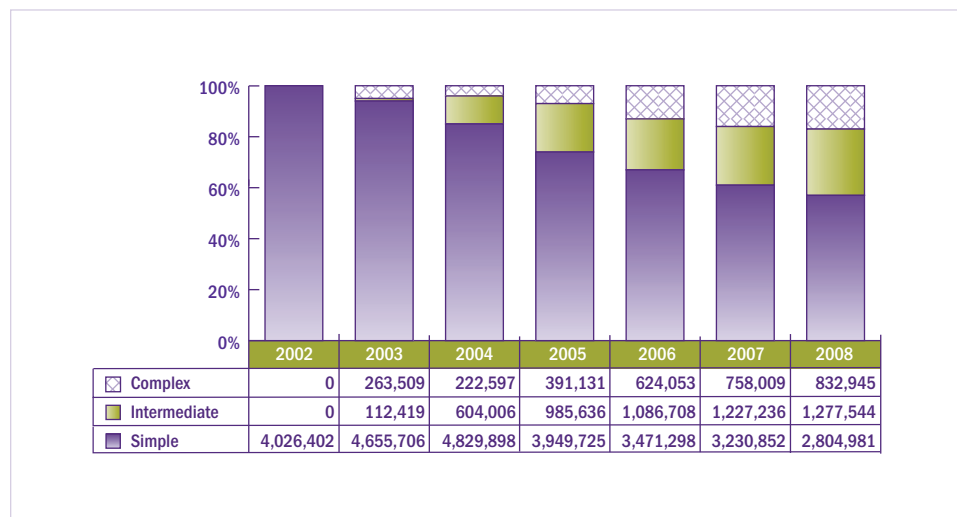
### Return Complexity

Return complexity is determined by the forms and schedules that are included in an individual’s income tax return. Tax return complexity is based on the following definitions:

- **Simple Return** – Form 1040EZ, 1040A, or 1040 with no schedules;
- **Intermediate Return** – Form 1040A with schedules or Form 1040 with Schedules A, B, D, Additional Child Tax Credit, Educational Credits, Child Care Credit, Credit for the Elderly, or Earned Income Tax Credit; and
- **Complex Return** – Form 1040 with Schedules C, E, F, or any other forms or schedules.

The TeleFile’s tax returns became more complex over time. Less than 60 percent filed returns that could be categorized as simple four years after TeleFile’s final year. More than 40 percent of taxpayers who filed a simple return for tax year 2002 (no schedules) filed an intermediate or complex return in TY 2008 (either a Form 1040 or 1040A with schedules or forms attached). The increasing complexity of returns filed by former TeleFile users makes it very important to instill electronic filing behaviors early. If taxpayers are comfortable with electronic transmission of documents for simple tax returns using some system like TeleFile, they may be more likely to use electronic filing means to submit more complex documents or returns.

**FIGURE 2.7.6, Return Complexity of Former TeleFile’s Tax Years 2002 - 2008<sup>36</sup>**

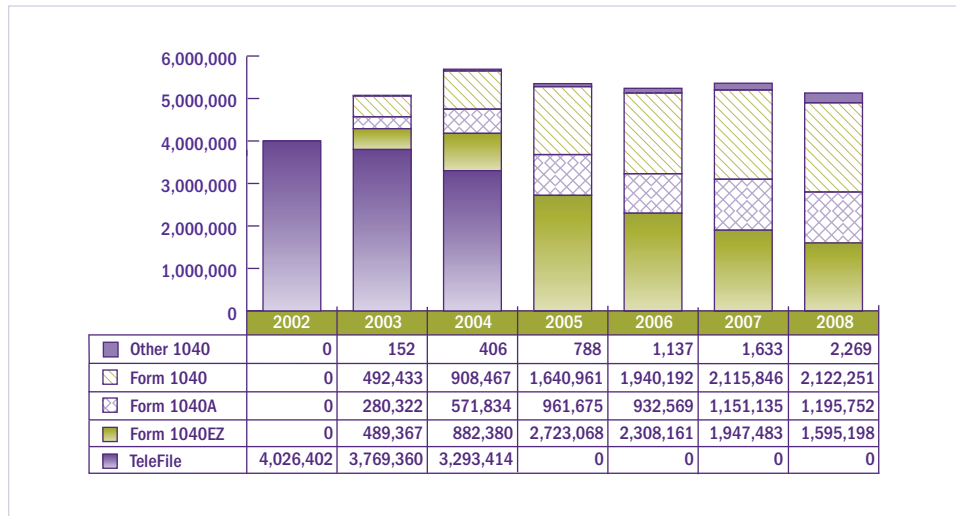


An analysis of forms filed supports the finding that return complexity increased with time for many former TeleFile’s. By tax year 2008 only 32 percent of TeleFile’s were still filing a Form 1040EZ, and nearly 45 percent were filing Form 1040.

<sup>36</sup> ETA, Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008.

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**FIGURE 2.7.7, Type of Tax Form Filed by Former TeleFile Tax Years 2002-2008<sup>37</sup>**

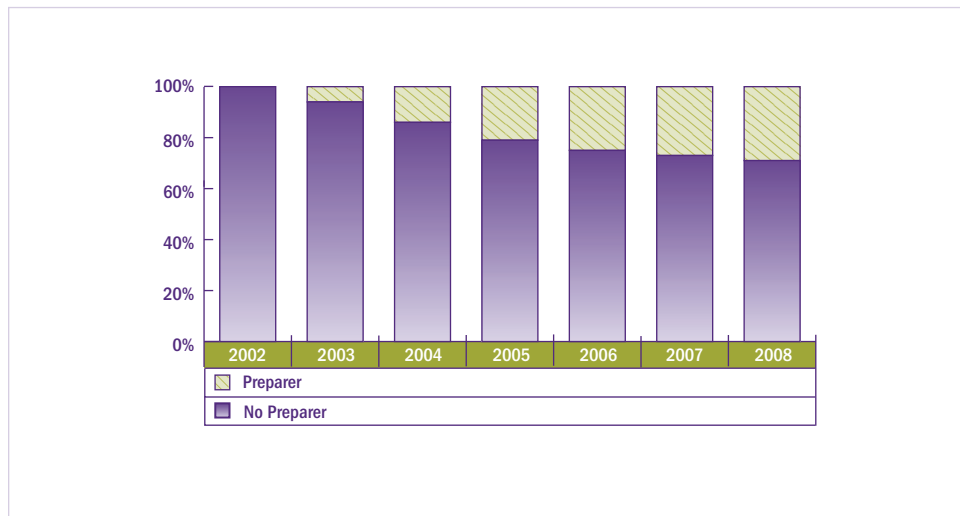


**Who Prepared the Return**

The number of former TeleFile users using a paid preparer doubled four years after the system was eliminated. This suggests that taxpayers either could no longer complete and file their own tax returns or chose not to. It is possible that the elimination of TeleFile was a factor in the decision to start using a tax preparer. By 2008, about 30 percent of former TeleFile users hired a paid tax preparer to complete and file their tax returns, or about half as many as all individual taxpayers.<sup>38</sup>

<sup>37</sup> The “Other 1040” category consists of Forms 1040PC, 1040SS, 1040PR, and 1040NR.

<sup>38</sup> Taxpayer Filing Attribute Report, Pub. 4822, 2 (Aug. 2010). Approximately 60 percent of individual taxpayers hired a tax preparer in TY 2008 to complete and file their individual tax returns.

**FIGURE 2.7.8, Paid Preparer Use by Telefilers for Tax Years 2002 - 2008<sup>39</sup>**

### Other Characteristics

Other factors such as having dependents play a part in TeleFile eligibility. For instance, by TY 2008, nearly 14 percent of taxpayers who used TeleFile in tax years 2002 to 2004 gained dependents and could not use TeleFile.

Over time, taxpayers’ returns change as their lives become more complicated. These changes lead to taxpayers growing out of TeleFile eligibility and using different methods for filing their tax returns. For a system like TeleFile to be effective, the IRS needs to keep bringing new taxpayers into the system, *i.e.*, continually refreshing users. Expanding eligibility criteria and marketing the system to those who are eligible would help bring different taxpayers into the TeleFile system.

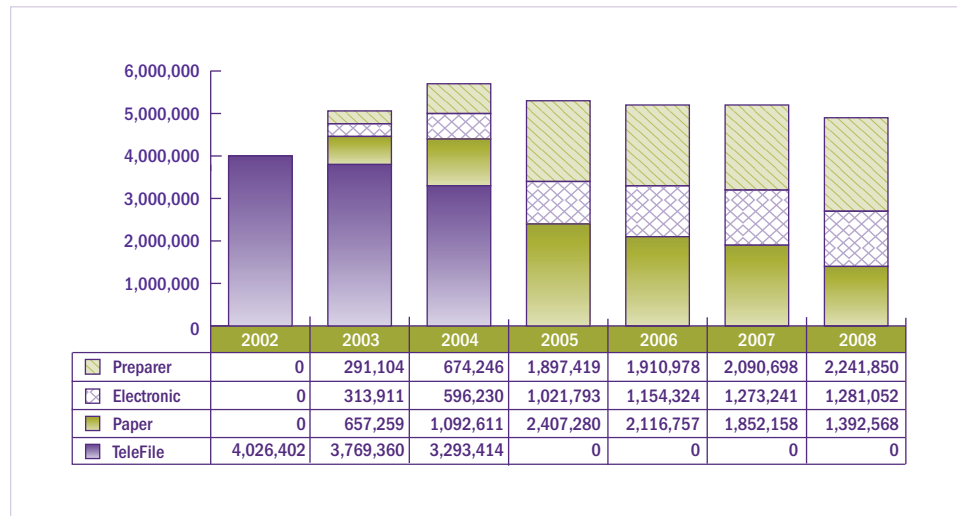
### What Method Did Former Telefilers Use to File Subsequent Tax Returns?

Once the TeleFile system was eliminated, users were forced to change to alternative filing methods. The IRS hoped that taxpayers had a positive experience with a system that did not rely on paper, and would then migrate to electronic filing. To some extent, this has been the case. Over time, electronic filing increased among those who previously used TeleFile while paper filing decreased. Of the 4.9 million former Telefilers who filed in 2008 with their SSN as primary, nearly 30 percent filed a paper return, compared with 26 percent who filed electronically through a preparer and more than 45 percent who filed electronically without preparers.

<sup>39</sup> ETA, Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008.

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**FIGURE 2.7.9, How TeleFile Users Filed in Subsequent Years<sup>40</sup>**



One of the arguments for eliminating TeleFile was that taxpayers would use other electronic filing mechanisms, including the then newly developed Free File system. Following TeleFile taxpayers’ behaviors in subsequent years, over 12 percent used Free File in 2006 (the first year statistics were kept) but that percentage dropped to less than seven percent in tax year 2008.

When a return prepared on a computer is printed and filed on paper, the IRS refers to it as V-coded.<sup>41</sup> Taxpayers may use a software package to calculate their taxes due or may just fill in a form on a personal computer (PC) before printing the forms and filing them. In tax years 2005 and 2006, nearly 13 percent of former TeleFile users completed their returns on PCs before printing and mailing them to the IRS. By tax year 2008, only nine percent of former TeleFile users were completing their returns on computers and filing them on paper.

### Filing Patterns over Time

Looking at the method of filing over time for taxpayers who used TeleFile in tax years 2002, 2003, or 2004, about 60 percent were consistent in their filing method, so once they switched from TeleFile, they used the same method in subsequent years.<sup>42</sup> More than 20

<sup>40</sup> ETA, *Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008*. Chart includes data for the first year that a taxpayer (identified by the primary SSN) filed via TeleFile and moves forward. For example, if 2003 was the first year a taxpayer used TeleFile; his or her 2002 return is excluded from the analysis.

<sup>41</sup> During the processing of paper tax returns at the IRS service centers, employees in returns analysis check for the presence of an IRS-issued three-digit number on the bottom margin of paper forms 1040 and Forms 1040A. The three-digit number indicates that the return was computer generated. When the three-digit number is detected, a V-code is entered on the return. The V-code is transcribed for inclusion in the Individual Returns Transaction File. This procedure was initially included in the processing routine to enable IRS to suppress the mailing of tax return packages to those individuals who submitted a computer generated form. The V-code indicator has also proved useful in identifying segments of the filing population that may be more easily persuaded to take the next step and file electronically. Individual ETA Marketing Research Part-Year Profile Report Processing Year 2002, 17.

<sup>42</sup> Another seven percent of former TeleFile users were no longer listed as the primary taxpayer and our database did not contain information for secondary SSNs. Filing method data was not extracted for these returns. Consequently it is not clear if these taxpayers used consistent filing methods when submitting subsequent income tax returns.

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percent of these former TeleFile taxpayers reverted to consistently filing paper tax returns. These taxpayers represent a group that might return to electronic filing if the IRS offered TeleFile (if eligible) or something other than computer filing. About 40 percent of former TeleFile filers switched to consistent use of other methods of electronic filing.<sup>43</sup>

**TABLE 2.7.3, Taxpayers’ Filing Methods for Tax Years 2002 - 2008<sup>44</sup>**

Method from	Method to	Quantity	Percent of Former TeleFile Filers (2002-2004)
TeleFile	Paper	1,273,727	20.2%
TeleFile	Electronic	2,515,374	40.0%
TeleFile	No Record <sup>45</sup>	457,063	7.3%
TeleFile	Inconsistent Methods	2,048,878	32.5%

As seen in Table 2.7.3, more than two million or nearly one in three taxpayers used a mixture of filing methods since they last used TeleFile in tax years 2002 - 2004. They may have started out filing a paper return and changed to electronic filing, or the other way around, or kept switching back and forth. Analysis for these taxpayers focused on how they filed in the final year included in the data file – tax year 2008. Nearly 70 percent of former TeleFile filers who used inconsistent filing methods filed electronically for 2008. Since these taxpayers used multiple filing methods, there is no way to be sure they will continue using the methods they used in 2008.

**TABLE 2.7.4, Former TeleFile Taxpayers with Inconsistent Filing Methods 2002 - 2008, Shown with 2008 Filing Method<sup>46</sup>**

Method from	Method in 2008	Quantity	Percent
TeleFile	Paper	444,706	21.7%
TeleFile	Electronic	1,414,193	69.0%
TeleFile	No Record	189,979	9.3%

<sup>43</sup> ETA, *Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008*. About 60 percent of the 2002 - 2004 TeleFile filers filed their income tax returns using the same filing method in each year since they last used TeleFile. Analysis covered tax years 2002 - 2008 for every year they were the primary SSN.

<sup>44</sup> ETA, *Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008*. Numbers may not total to 100 percent due to rounding. About 60 percent of the 2002 - 2004 TeleFile filers used the same filing method each year since they last used TeleFile and another seven percent did not have a record in the dataset of filing a tax return after their last TeleFiled return in tax years 2002 - 2004. Analysis covered tax years 2002 - 2008 and the following is the count of taxpayers who had a secondary SSN for each tax year: 2003 - 110,716; 2004 - 149,653; 2005 - 184,862; 2006 - 179,491; 2007 - 177,102; 2008 - 157,578; for a total of 959,402.

<sup>45</sup> Taxpayers with no record did not have a filing method associated with their SSNs after they last used TeleFile. This could be because they were no longer the primary taxpayer listed on an account or they did not have a filing requirement.

<sup>46</sup> ETA, *Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008*. This analysis excluded taxpayers who were previously categorized as consistent filers. The taxpayers included in the inconsistent filing method group filed using multiple methods from 2002 - 2008 and used the indicated method in 2008.

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### What are the Characteristics of Those Who Filed via Some Electronic Means (TeleFile, Other Electronic Filing) Versus Those Who Reverted to Paper in Tax Year 2008?

As shown in Table 2.7.5 below, nearly 30 percent of former TeleFile users filed a paper tax return in 2008, meaning the IRS was not successful in converting them to different electronic filing methods in 2008. The table below depicts some of the differences between paper and electronic filers who previously used the TeleFile system to submit their tax return. Paper filers who previously used TeleFile tend to be older, have simpler tax returns, and prepare their own returns more than those who filed electronically in 2008. Those who used a paid preparer were more than six times as likely to file electronically as those who self-prepared.

**TABLE 2.7.5, Characteristics of Former TeleFilers (2002 - 2004) in Tax Year 2008**

2008 Characteristics of Former TeleFilers – Comparing Paper to Electronic Filers						
Category	Paper		Electronic		Total	
2008 Former TeleFilers	1,392,568	28.3%	3,522,902	71.7%	4,915,470	100%
<b>Age</b>						
24 & under	217,209	15.6%	703,017	20.0%	920,226	18.7%
25 to 34	430,323	30.9%	1,654,012	47.0%	2,084,335	42.4%
35 to 44	214,453	15.4%	481,483	13.7%	695,936	14.2%
45 to 54	257,952	18.5%	356,063	10.1%	614,015	12.5%
55 to 64	226,862	16.3%	267,661	7.6%	494,523	10.1%
65 and Over	45,769	3.3%	60,666	1.7%	106,435	2.2%
<b>Filing Status</b>						
Single	1,154,075	82.9%	2,589,431	73.5%	3,743,506	76.2%
Married – Joint	185,325	13.3%	634,161	18.0%	819,486	16.7%
Married – Separate	23,722	1.7%	44,630	1.3%	68,352	1.4%
Head of Household	29,404	2.1%	254,444	7.2%	283,848	5.8%
Qualified Widow	42	0.0%	236	0.0%	278	0.0%
<b>Income Source</b>						
Wages & Interest	909,371	65.3%	2,299,232	65.3%	3,208,603	65.3%
Schedule C	86,420	6.2%	241,805	6.9%	328,225	6.7%
Other	396,777	28.5%	981,865	27.9%	1,378,642	28.0%
<b>Return Complexity</b>						
Simple	1,028,196	73.8%	1,776,785	50.4%	2,804,981	57.1%
Intermediate	197,710	14.2%	1,079,834	30.7%	1,227,544	26.0%
Complex	166,662	12.0%	666,283	18.9%	832,945	16.9%
<b>Who Prepared</b>						
Self	1,198,864	86.1%	2,264,317	64.3%	3,463,181	70.5%
Paid Preparer	193,704	13.9%	1,258,585	35.7%	1,452,289	29.5%



**How Many Taxpayers Would Be Eligible to Use TeleFile If the System Was Available?**

Telefilers’ life situations change over time and some would no longer be eligible to use TeleFile based on the limiting criteria, thus reducing the number of previous users who could use TeleFile. Of course, some taxpayers with new filing requirements would be eligible to use a TeleFile type of system. For a TeleFile system to be successful, it must encourage new taxpayers to use the system to offset the taxpayers that can no longer use it because of changing life circumstances.

The IRS TeleFile system required a touch-tone phone for submitting information and filing the return. Given today’s technological advancements, this type of restriction may no longer be necessary. However, any technology modifications should be thoroughly evaluated for security concerns, data capture, and ease of use.<sup>47</sup> Additionally, taxpayers with some characteristics that were out of the ordinary, such as being blind or 65 or older, could not use TeleFile because these factors added complexity to the tax return.

Some eligibility restrictions did not affect many taxpayers, while others impacted a substantial number. Modifying the restriction on moving or preparer use holds the most promise for expanding the system without making it unwieldy.

**How Many Taxpayers Would Be Eligible to Use TeleFile If the Restrictions Were Modified?**

If the taxable income threshold remained at \$100,000 and the other eligibility criteria were held constant, more than eight million taxpayers would be eligible for TeleFile.<sup>48</sup> If only the limitation on moving was changed, about two and a half million taxpayers could be added to the base of more than eight million for a total of more than ten million people qualified to use an expanded telephone filing system.<sup>49</sup>

By changing multiple eligibility requirements more than 27 million taxpayers could have Telefiled in tax year 2008. Table 2.7.6 shows the number of taxpayers who would be added to the group eligible to use TeleFile if these criteria are added in the order shown. For example, while eliminating the restriction only on moving would add over two million users, as discussed above, removing all of the other restrictions explored in Table 2.7.6 below in addition to ending the restriction on moving would add over nine million users (*i.e.*, because most of those who moved were also affected by one or more of the other restrictions on eligibility and these other restrictions would also need to be removed for these taxpayers

<sup>47</sup> Pew Internet & American Life Project, *Cell Phones and American Adults* 1-5 (Sept. 2010). More than 80 percent of American adults have cell phones, with African American and Hispanic (English speaking) ownership rates exceeding white Americans. Further, some segments of the population that are typically difficult to reach report having cell phones, giving this technology the potential to improve reach to more Americans. Americans do not just use their cell phones to make calls, they text, use the Internet, use social media and other activities with their cell phones. This willingness to use cell phones for other activities offers possibilities for future use including government interactions or other purposes not previously considered.

<sup>48</sup> See eligibility restrictions, *supra*. The income threshold was raised to \$100,000 in TY 2004. ETA, *Marketing Database, TY 2002 - 2008* and *Individual Returns Transaction File, TY 2002 - 2008*.

<sup>49</sup> 8,039,042 taxpayers represent the base of those eligible to use a telephone system in 2008. Another 2,452,506 taxpayers moved and would be eligible by expanding the criteria to include movers for a total of 10,491,548 taxpayers eligible to use the TeleFile system by removing one eligibility restriction.

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to be eligible to use the system). If dividend or pension income, and education deductions and credits could all be claimed using TeleFile, another two million (above the base level of eight million) could file by telephone. These numbers represent unique individual tax returns, so someone who both claimed dividend income and moved in the same tax year would only be counted once.

**TABLE 2.7.6, Impact of Changing Some TeleFile Eligibility Requirements<sup>50</sup>**

Type of Income, Deduction, or Credit	Increase in TeleFile Eligible
Base Eligible with latest criteria <sup>51</sup>	8,039,042
Dividend Income	362,878
Pension Income	521,749
Education Credits, Tuition fees, student loans, etc	1,509,583
Preparer	7,701,629
Moving	9,287,161
<b>Total that could be eligible for TeleFile</b>	<b>27,422,043</b>

***What Filing Method Are These Eligible Taxpayers Using?***

Taxpayers who would be eligible to file using a telephone system available to more taxpayers (because of less restrictive eligibility criteria) used three different methods for filing their 2008 tax returns. Method use is split fairly evenly between paper, online, and preparer use. Please note that the returns submitted by tax preparers (shown in the table) are also filed electronically. As shown in the following table, the IRS would have the potential to migrate over 9.7 million paper filers to electronic filing if a TeleFile system with less restrictive eligibility requirements had been available for the 2008 tax year.

**TABLE 2.7.7, Impact of Changing Some TeleFile Eligibility Requirements – What Filing Method are these Eligible Taxpayers Using<sup>52</sup>**

2008 Filing Method	Volume	Percent
Paper	9,713,003	35.4%
Preparer ELF (electronic)	8,852,619	32.3%
Online	8,856,421	32.3%
<b>Total</b>	<b>27,422,043</b>	<b>100.0%</b>

<sup>50</sup> ETA, *Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008*. The figures in this table are based on changing TeleFile restrictions and starting from the \$100,000 taxable income base. The analysis used an income range use of + or - \$5 to account for rounding. Taxpayers who used a paid tax preparer the previous tax year were not sent a tax package and thus could not use TeleFile to submit their tax return.

<sup>51</sup> Criteria included a taxable income of \$100,000 or less, and interest income of \$1,500 or less.

<sup>52</sup> ETA, *Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008*. The figures in this table are based on keeping the TeleFile restrictions for taxable income at \$100,000 and expanding the eligibility criteria so that those taxpayers with dividend or pension income, more tax credits, who use a paid tax preparer, and who move are still eligible to use the system.

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### *Is There a Group of Taxpayers Who Would Be Eligible for TeleFile Who Are Not Filing Electronically?*

As the above table indicates, more than one in three taxpayers who could be eligible for expanded TeleFile continues to file paper returns. Moreover, nearly another third of taxpayers potentially eligible for TeleFile are using paid preparers. There is insufficient data to determine whether some taxpayers who are using a paid preparer would change to TeleFile.

The mean and median incomes for the group of taxpayers filing by paper are much lower than for those using a paid preparer or an online method. Taxpayers using preparers have lower incomes than those using an online method. These income amounts, as illustrated by the following table, suggest that lower income taxpayers are either not filing electronically or are possibly being channeled to paid preparers who they may not be able to afford.

**TABLE 2.7.8, Mean and Median Incomes by Filing Method<sup>53</sup>**

Filing Method	Mean Income	Median Income
Paper	\$ 21,735	\$ 11,960
Preparer ELF	\$ 25,704	\$ 19,224
Online	\$ 27,275	\$ 21,758

## CONCLUSION

The data analyzed in this study suggest that a considerable number of taxpayers with relatively simple tax returns still file on paper. The IRS’s original assumption that taxpayers who previously used TeleFile would automatically turn to another electronic method overstated some taxpayers’ commitment to electronic filing. It would be worthwhile for IRS to consider adding another filing method, thereby minimizing or eliminating problems associated with paper filing. An evaluation of any new filing method should include a thorough analysis of technologies, costs, adoption rates, ease of use, and taxpayer burden associated with the proposed filing method.

A telephone filing system offers the benefit of being available to taxpayers who do not have personal computers or Internet access, or who are simply not computer savvy. By modifying eligibility qualifications for a telephone system, the IRS could greatly expand the number of taxpayers who could use such a system. Changes in the use of telephones and their technologies should be considered and included in the evaluation so the IRS does not develop a system based on obsolete assumptions or telephone technology.<sup>54</sup>

<sup>53</sup> ETA, *Marketing Database, TY 2002 - 2008 and Individual Returns Transaction File, TY 2002 - 2008*. The figures in this table are based on changing TeleFile restrictions starting from the \$50,000 taxable income base for TY2002 to \$100,000.

<sup>54</sup> The IRS estimated that it would save \$17 to \$23 million by eliminating TeleFile. *2005 Tax Return Filing Season and the IRS Budget for Fiscal Year 2006, Hearing Before the Subcommittee on Oversight of the Committee on Ways and Means, U.S. House of Representatives, 109th Cong. (Apr. 14, 2005)*.

**For example:** Overall, 82 percent of Americans own a cell phone, with ownership more prevalent in minorities with 87 percent of African Americans and English speaking Hispanics owning a cell phone (compared with 80 percent of whites). Seventy-one percent of those making less than \$30,000, 57 percent of those 65 or older, and 72 percent of rural Americans own cell phones. Interestingly, more than half (53 percent) of Americans who do not use the Internet at all have a cell phone.<sup>55</sup> A TeleFile-type system could introduce these taxpayers to a type of electronic filing, which may result in some converting to computer-based e-filing as they age and their tax situations become more complex.

Absent a telephone-based system, it is likely that the IRS will need to find alternatives for processing paper returns that are more efficient than current methods, because it appears some taxpayers will continue filing on paper unless they are forced to change. The objective would be to eliminate many of the human handling requirements that introduce costly, time consuming inaccuracies into the paper handling process. Bar code technologies might be one alternative that offers promising results.

## RECOMMENDATIONS

The National Taxpayer Advocate offers these recommendations:

1. Explore reinstating TeleFile with less restrictive eligibility criteria that allow taxpayers who move to use the system.
2. Evaluate current telephone technologies to determine the feasibility of allowing taxpayers with simple tax returns (that meet less restrictive eligibility requirements than those applicable to the former TeleFile system) to interact with the IRS using cell phones and smart phones. This would include being able to file tax returns and interact with the IRS by voice or text capabilities.
3. Evaluate how current bar code technologies could be applied to processing tax returns so that information could be captured from paper returns by scanning a bar code rather than by transcription.

<sup>55</sup> Pew Internet & American Life Project, *Cell Phones and American Adults* (Sept. 2010), available at <http://www.pewInternet.org/Reports/2010/Cell-Phones-and-American-Adults.aspx> (last visited Dec. 8, 2010).

## Appendices

### Appendix A: Telefile Eligibles – Comparing Those who Filed a Paper Return Versus Those who Filed Electronically in tax years 2002 - 2004

#### What are the characteristics of TeleFile eligible taxpayers who used TeleFile versus those who filed by some other means in tax years 2002, 2003, and 2004?

The following table includes primary taxpayers who were eligible to use TeleFile in 2002, 2003, or 2004. The analyses in this appendix compare taxpayers who were eligible and filed via TeleFile to those who could have used the telephone to file but chose some other filing method in tax years 2002 – 2004. While these two groups are very similar to one another, there are differences. Those who used TeleFile had slightly higher incomes, were slightly more likely to get a refund, and received larger refunds than those who were eligible and used another filing method. Those filing by a method other than TeleFile were more likely to hire a preparer.

**TABLE 2.7.9, Telefile Eligibles - Users vs. Non-Users**

TeleFile Eligible Taxpayers						
Tax Year	2002		2003		2004	
	Filed via TeleFile	Filed Using Some Other Method	Filed via TeleFile	Filed Using Some Other Method	Filed via TeleFile	Filed Using Some Other Method
<b>Number of Returns</b>	4.0 M	4.2 M	3.8 M	4.2 M	3.3 M	4.4 M
<b>Age</b>						
- Mean	31	30	32	31	32	30
- Median	25	25	25	24	26	23
<b>Filing Method</b>						
- Paper	0%	72.8%	0%	69.6%	0%	64.9%
- TeleFile	100%	0%	100%	0%	100%	0%
- Practitioner – ELF	0%	11.1%	0%	11.1%	0%	10.2%
- Online	0%	16.1%	0%	19.3%	0%	24.9%
<b>Filing Status</b>						
- Single	96.6%	95.8%	96.0%	94.8%	95.6%	94.4%
- Married filing joint	3.4%	4.2%	4.0%	5.2%	4.4%	5.6%
<b>Income</b>						
- Mean	\$17,905	\$15,850	\$18,463	\$16,349	\$19,508	\$17,563
- Median	\$15,298	\$11,863	\$15,817	\$12,138	\$16,709	\$12,984
<b>Income Type</b>						
- Wages & Interest	93.5%	93.0%	87.9%	93.1%	84.5%	93.9%
- Other	6.5%	7.0%	12.2%	6.9%	15.5%	6.1%
<b>Refund Returns</b>						
Percent of Returns	93.3%	88.8%	93.2%	88.8%	93.0%	88.8%

table continued on next page

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TeleFile Eligible Taxpayers						
Tax Year	2002		2003		2004	
	Filed via TeleFile	Filed Using Some Other Method	Filed via TeleFile	Filed Using Some Other Method	Filed via TeleFile	Filed Using Some Other Method
<b>Refund</b>						
- Mean	\$557	\$515	\$569	\$527	\$574	\$541
- Median	\$444	\$371	\$453	\$376	\$464	\$390
<b>Who Prepared Return</b>						
- Self	100%	86.3%	100%	86.1%	100%	86.4%
- Paid Preparer	0%	13.7%	0%	13.9%	0%	13.6%

## Appendix B: Description of the IRS’s TeleFile Program for Individuals

### The following information comes from “e-file Using a Telephone (TeleFile)”, TeleFile system facts from the IRS’s internal (intranet) website.

A taxpayer could use TeleFile and file his or her taxes by phone, if he or she received the TeleFile tax package in the mail<sup>56</sup> and:

- Had access to a touch-tone telephone;
- Was still using the address printed on the TeleFile Tax Package for mail purposes;
- Filed single or married filing jointly and had no dependents;
- Was under 65 on January 1;
- Was not blind;
- Had income only from:
  - Wages, salaries, tips, taxable scholarship or fellowship grants;
  - Unemployment compensation;
  - Interest (less than \$1,500 and no withholding deduction);
  - Alaska Permanent Fund Dividends;
  - Qualified state tuition program earnings;
- Had total taxable income of less than \$100,000 (\$50,000 prior to tax year 2004)

A taxpayer could not use TeleFile if he or she:

- Needed to change filing status, name, or address;
- Needed to claim any dependents;
- Needed to claim a deduction(s) for being over 65 or blind;
- Did not receive the tax package;
- Was filing the return of a deceased taxpayer;
- Received any advanced EITC payments; or
- Repaid any unemployment compensation during the year for which the return was being filed.

<sup>56</sup> In general, TeleFile tax packages were mailed to taxpayers who used a Form 1040EZ, were eligible to use Form 1040EZ, or used TeleFile for the prior tax year. The taxable income level for Form 1040EZ was raised from \$50,000 to \$100,000 for tax year 2004, so TeleFile tax packages were sent to 1040EZ eligible taxpayers with a taxable income of less than \$100,000 in the previous tax year.

There are numerous other qualifications for receiving a TeleFile package, including: filed a Form 1040EZ the previous year, did not use a preparer for the prior year’s return (except for those that live in 8 specified states), did not file an amended return that would change their eligibility to use Form 1040EZ, the primary and secondary dates of birth and SSNs are valid, zip code is valid, taxpayer cannot be deceased or in the prisoner file, or have an open Criminal Investigation. This list is not all inclusive, there are numerous other criteria.

These qualifications significantly reduced the number of TeleFile packages that were mailed.

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**Benefits of the system included:**

- **Fast Refunds** – Receive refunds quickly;
- **Quick** – A ten-minute call with proof of acceptance provided before the end of the call;
- **Accurate** – The computer does all the math;
- **Secure** – A dedicated phone line provides a safe transmission;
- **Convenient** – File from home, 24 hours a day seven days, a week;
- **Electronic Payments** – Pay balance due by electronic funds withdrawal or with a credit card;

The phone call typically took about ten minutes. TeleFile did the math and calculated the tax owed or the refund due. There was no need to mail anything to the IRS, and the TeleFile system provided a confirmation number at the end of the call as proof the return was accepted.



## Appendix C: Description of the IRS’s TeleFile Program for Businesses

**The following information comes from a press release issued by the IRS in 1997 announcing the new telephone filing system for Form 941, *Employer’s Quarterly Federal Tax Return*.**

The Internal Revenue Service has good news for over 890,000 business taxpayers – many of them may now be able to throw away the paper and file their quarterly payroll returns, Forms 941, by telephone. The TeleFile system is free and paperless telephone filing method that automatically figures the tax and any refund or balance owed.

The Form 941 TeleFile pilot will begin with returns for the first quarter of 1997. Special TeleFile packages with the necessary information were sent to potential filers. These packages included payment vouchers for those who owe money, along with paper Forms 941 for those who may not qualify for TeleFile. The system started as a test limited to taxpayers in 14 states and expanded to all 50 states in 1998.<sup>57</sup>

### Background

**Purpose** – Employers use Form 941 to report income tax that was withheld from wages (including tips), distributions from nonqualified pension plans (including nongovernmental Form 941 section 457(b) plans), supplemental unemployment benefits, and third-party payments of sick pay. Also use Form 941 to report social security and Medicare taxes.

**Who Must File** – Employers who withhold income tax on wages, or who must pay social security or Medicare tax, must file Form 941 each calendar quarter. After you file your first Form 941, you must file a return for each quarter, even if you have no taxes to report.

**Zero Wage return** – Beginning in April of 2004, U.S.-based (domestic) taxpayers may file their “Zero Wage” Forms 941 by telephone using the 941TeleFile. Eligible filers must have had: (a) no withholding, (b) no federal tax deposits, and (c) no taxes to report the quarter. Dial 1-800-583-5345 (toll free) to use 941TeleFile. If the company goes out of business or stops paying wages, file a final return.<sup>58</sup>

TeleFile was discontinued in August 2005, leaving business taxpayers fewer options for filing their tax returns.<sup>59</sup> When the IRS eliminated TeleFile, an easy and free method for taxpayers to file employment tax returns was also eliminated.

<sup>57</sup> IRS News Release, IR-97-10 (Mar. 1997).

<sup>58</sup> IRS, Instructions for Form 941, *Employer’s Quarterly Federal Tax Return* (Rev. Jan. 2004).

<sup>59</sup> SB/SE Research, Project BKN0045, *FY 06 Nationwide Analysis, ETA BMF Marketing Database* (May 2006).

## Appendix D: Canada's TELEFILE System

### The following information comes from Canada Revenue Agency's website about the TELEFILE Service.

Canada's TELEFILE is a service designed for taxpayers with the most common types of income tax information such as employment income, pension income, interest income, registered pension plan contributions, and charitable donations. The system does not accept more complex information, such as self-employment income, capital gains, and rental income. First-time filers are not eligible to use TELEFILE.

The TELEFILE service is available to taxpayers who have received a specified income tax package or those whose tax situations make them eligible. TELEFILE is designed to accept certain income, deduction, and tax credit amounts. The TELEFILE tax package includes an access code. Taxpayers who do not receive the tax package but feel they are eligible can call a toll-free number to obtain a code if they meet the criteria.<sup>60</sup>

Canada promotes TELEFILE as paperless, quick, free, and easy. Additionally, taxpayers receive a confirmation number showing receipt of the tax return.<sup>61</sup>

### Steps for filing with TELEFILE:

**Step 1**—Complete your tax return, including all necessary forms and schedules, using the information in your tax package.

**Step 2**—Call the TELEFILE service toll-free. You must use a touch-tone telephone and call from within Canada or the continental United States. TELEFILE is available seven days a week.

**Step 3**—Enter your tax information using your telephone keypad. The TELEFILE service will guide you every step of the way.

We will ask you for your Social Insurance Number (SIN) and personalized access code (shown on your personal label sheet included in your income tax package). We will also ask you to confirm your marital status, and if applicable, your spouse or common-law partner's SIN. We may ask for his or her net income and the amount of Universal Child Care Benefit (UCCB) that is included in their net income to determine amounts for which you may qualify, such as the goods and services tax/harmonized sales tax (GST/HST) credit and the Canada Child Tax Benefit (CCTB). You will then be guided through the entry of the information from your tax return.

<sup>60</sup> Changing address does not automatically disqualify a taxpayer from using TELEFILE as was the case with the American TeleFile system. Canadian taxpayers who meet the system qualifications can receive an access code over the phone that allows them to use the TELEFILE system.

<sup>61</sup> <http://www.cra-arc.gc.ca/esrvc-srvce/tx/ndvdlst/tf/bt-eng.html> (last visited Nov. 8, 2010).

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**Step 4**—Confirm that you want to file the information as your tax return. We will give you a confirmation number and immediately begin processing your tax return. Write down this confirmation number and keep it for your records. It is your proof that we have received your tax return.

Note

Your income tax return has not been filed until we issue your confirmation number. Be sure to listen for it before hanging up.



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