

IRS Fact Sheet

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IRS E-File: A History

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Within 25 years, the mere trickle of 25,000 electronically filed individual tax returns has turned into a torrent of more than 100 million a year and led to a permanent change in the way Americans file their taxes.

And it started with one IRS employee having to manually turn on a modem every time tax returns were e-filed, a dedicated research and project office staff and an admittedly awkward use of the distinctive “Mission Impossible” theme.

The IRS e-file surpassed a landmark: 1 billion individual Form 1040 tax returns received and processed safely and securely. IRS Commissioner Doug Shulman has called IRS e-file one of the federal government’s most successful modernization programs.

IRS e-file has come a long way from the 25,000 returns submitted by five tax preparers in 1986.

In the 1980s, efficient tax collection was becoming more difficult because of the complex, time-consuming and error-prone process of converting paper returns and information documents into a form that could be processed by machine. Even the mere storage of paper tax and information returns was becoming costly as more and more space was needed for the burgeoning reams of required paper forms and documents.

Even as tax practitioners were starting to use computers to prepare clients taxes, the IRS still forced them to print and mail returns because of the processing system.

Enter IRS e-file. The initial idea sprang from the IRS Research Division, which ran tests to prove the technical feasibility of Electronic Filing System (EFS), a concept it believed would simplify the processing method.

In 1986, a pilot program was launched to test the costs and benefits of EFS and to gauge acceptance by preparers and taxpayers. Only five tax preparers in three metropolitan areas – Cincinnati, Raleigh-Durham and Phoenix – agreed to participate. Then, the system could only process returns that were due refunds.

“The processing system at that time consisted of a Mitron and a Zylog, which most people have never heard of,” recalled retired IRS employee Leonard Holt, who served as a branch manager in the e-file project office. The tax preparer would call a

designated number at the Cincinnati Service Center and an IRS employee would plug the phone into the Mitron, which Holt described as a modem with a tape drive.

When the transmission was finished, the IRS employee would transfer the tape to the Zylog, a super mini-computer, which would massage the data into files that the IRS' Unisys System could process.

To send the acknowledgement, the IRS employee would have to telephone the tax preparer who would plug the phone into his own modem and reverse the transmission process.

Still, the "electronic" process seemed promising. Holt and former IRS employee Mike Jackman, discussing e-file one day after work, sketched the IRS e-file process onto a napkin along with the creation of an e-File Project Office and the equipment needed to move the concept from beyond the research stage.

Mercedes del Toro, also now retired, became a part of the e-file project office team because she had training in COBOL, a computer programming language. She developed the specifications for the Form 1065 for partnerships and Form 1041 for trusts which also were being e-filed along with the Form 1040.

"My first day on the job started by leafing through the many Internal Revenue Manual pages on my cluttered desk," recalls del Toro. After lunch, she told her boss the job would take six months; her boss said she had one month. "Thank God for overtime, coffee, good health, sense of humor and a wonderful team." It wasn't pretty, but the job was done on time.

In 1987, 66 preparers from seven cities participated and filed 78,000 tax returns. That year, electronic Direct Deposit was added to put the refunds directly in the bank accounts.

By 1988, the IRS moved to an IBM Series I processing system, the 16-bit minicomputer, which finally eliminated the need for an IRS employee to plug the phone into a modem. And tax preparers were starting to become curious.

IRS National Account Manager Aaron Welch was in the IRS' Baltimore District in 1988 and recalls when officials from headquarters had to explain to tax preparers what e-file was all about because few other IRS employees understood it.

"We had about 12,000 e-file returns in Baltimore District that first year. That included all of Maryland and Washington, D.C. The second year we had about 60,000, and everybody celebrated. This year, taxpayers in Maryland and D.C. e-filed over 2 million federal returns," Welch said.

Once e-file became operational almost the entire project office was conscripted into marketing the new product to tax preparers.

Laurie Barrett, who now works for IRS Portal Business Management, recalls traveling around Colorado trying to convince tax preparers to make the investment into modems

and join electronic filing. A promotional video featured the distinctive theme from “Mission Impossible” and Greg Morris, who played electronic expert Barney Collier in the hit television show, was the video spokesman promoting e-file. In the beginning, the theme song brought laughs from the audience, recalled Barrett, who served as an IRS district e-file coordinator when the program started.

Eileen McCrady, former chief, systems development branch and later marketing branch chief, remembers: “Tax preparers were not buying any of it. Most people figured it was a plot to capture additional information for audits.” Actually, e-filed returns are so accurate that it decreases the chances of hearing from the IRS. In the early days, the number of participating tax preparers was so small that McCrady kept a list, ironically on paper, in her desk. Even at the IRS the use of computers was limited and McCrady often shared one computer with six colleagues.

In 1990, IRS e-file became operational nationwide and 4.2 million returns were filed electronically.

From the beginning, IRS e-file received a tremendous boost when two major tax preparation firms, H&R Block and Jackson-Hewitt, agreed to give it a try. More tax professionals became willing to give it a chance.

And, the e-file seminars eventually became the IRS Tax Forums which now annually draw more than 20,000 tax preparers who learn about the latest tax changes and other IRS activities as well as e-file.

IRS e-file has proven to be a win-win for all involved. Taxpayers get faster refunds, in as few as 10 days if they use direct deposit. Or, they get payment options to file now and pay later. An e-filed return is far more accurate. It has an error rate of 1 percent compared to 20 percent for a paper return.

The IRS currently is phasing in its Modernized e-File (MeF) system, the next generation of electronic filing. MeF means acknowledgements will be sent within minutes as opposed to 48 hours. If a return is rejected, a more detailed message will allow taxpayers to quickly correct errors and resend the return.

MeF uses a transactional based platform that allows individual returns to be transmitted to the IRS. Legacy e-file is based on batch processing that required many returns to be sent at once several times a day.

MeF and the Customer Account Data Engine (CADE), which will replace the IRS master file tapes, will provide the foundation for the future electronic transactions by taxpayers and by tax preparers, eventually providing real-time access to accounts and speeding refunds to a matter of a few days instead of a few weeks.

Now, e-file no longer is the exception; it’s the norm.

E-FILE HISTORICAL TIMELINE

1986: Initial filing season pilot with 5 tax preparers in 3 cities; 25,000 returns filed. The program could only accept simple returns that were due a refund.

1987: Pilot expanded to 7 cities; 78,000 returns filed. Direct Deposit was added as a benefit.

1988: Pilot expanded to 16 IRS districts; 583,000 returns filed. The Form 1065 (partnerships) and Form 1041 (trusts) are added to the e-file list.

1989: Pilot expands to 36 states; 1.1 million returns filed.

1990: E-File expands nationwide; 4.2 million returns filed.

1992: Telefile pilot debuts for 1040-EZ filers to e-file via telephone. The IRS begins to accept individual tax returns where tax is owed and checks can be mailed via paper voucher.

1998: Congress passes IRS RRA 98 containing a provision setting a goal of an 80 percent e-file rate for "all federal tax and information returns."

1999: Electronic payments through credit cards or direct debit introduced; IRS pilots alternative programs to allow taxpayers to sign returns electronically instead of mailing a signature form.

2002: IRS allows taxpayers to sign e-file returns using a Personal Identification Number (PIN) which made the e-file process entirely paperless.

2003: Free File debuts; IRS partners with Free File Alliance, a consortium of tax software companies, to make free tax preparation software and free e-file available to most individual tax payers. In a major step for businesses, e-file is expanded to the quarterly Form 941 for employment taxes and the annual Form 944 for small businesses.

2004: Modernized e-File (MeF), the next generation of IRS e-file, makes its debut, accepting business and information returns such as the Forms 1120, 1120-S and 990 series.

2005: E-filed returns cross the 50 percent threshold; 68.4 million returns filed. Telefile ends after years of declining use as users migrated to tax software and e-file..

2006: MeF becomes mandatory for businesses and exempt organizations with assets of \$50 million or more.

2007: MeF threshold for businesses and exempt organizations lowered to assets of \$10 million or more.

2009: Congress passes a provision requiring tax preparers who file more than 10 individual tax returns to file electronically; IRS phases in the requirement, setting the threshold at 100 or more for 2011 and 11 or more for 2012.

2010: MeF begins a roll out for the Form 1040 series and 23 related forms which will take three or more years to make all the related forms available; IRS stops mailing paper Form 1040 packages.

2011: E-filed returns cross the 100 million threshold in one filing season; cumulative total exceeded 1 billion returns. Approximately three out of every four individual tax returns were filed electronically.