



Information Release

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Tax Software – What Do You Really Get in That Box?

National Association of Tax Professionals (NATP) Appleton, WI – Like boxed American breakfast cereals, do-it-yourself tax software claims convenience, time-savings, and implies healthy long-term results. But does tax software really deliver on those claims? Or is do-it-yourself tax software often sugar-coated, time-consuming, and less-than-the-healthiest choice in the long-run? Here is some food for thought.

First, some facts. The Internal Revenue Service (IRS) statistics reveal that taxpayers using do-it-yourself tax software, spent an average of 6 to 10.3 hours longer preparing their tax returns (depending on the number of worksheets and schedules) than taxpayers who did manual calculations. Further, the IRS estimates that do-it-yourself software users spent an average of 10 to over 20 hours longer than a tax preparer, again depending on complexity.

Fact two: For 2005, legislation from *eight* tax bills, as well as annual inflation adjustments, affect the tax returns taxpayers are about to file. Tax bills are lengthy, complex documents filled with legalese and not easily deciphered. National Taxpayer Advocate, Nina E. Olson, in a report to Congress stated, “Our tax code has grown so complex that it creates opportunities for taxpayers to make inadvertent mistakes as well as to game the system.” Complexities cause taxpayers to suffer and cause those in the tax preparation field to study year-round so they can understand the law and help their clients.

Tax software attempts to make tax filing easier for taxpayers; however costly mistakes and frustration can also accompany tax software. The most common errors result from not understanding the questions asked by the

software program, from entering amounts in the wrong places or not entering some amounts at all, and from not knowing if the software is indeed calculating correctly or capturing all of the information to give the taxpayer the correct outcome. Says Thomas Rains, a tax preparer from Pulaski, Tennessee, "Calculations are based on the answers [taxpayers give] to the online questions. This doesn't make the tax return accurate – only the calculations!"

Do you think you can do better? Consider these real-life situations encountered by taxpayers using tax software programs to file their income taxes, as observed by tax preparers from the National Association of Tax Professionals (NATP) at the end of the 2004 tax season. Note that several of the problems encountered involved an oversight or misunderstanding by the taxpayer, and for most, intervention by a tax preparer.

- A Cincinnati, Ohio preparer had a taxpayer walk in "just to e-file" his tax return, which he had already prepared using software. Several places had already refused to e-file his return, which piqued the preparer's interest. She volunteered to look over his preparation. He had one substantial entry on his Schedule A that she traced back to settlement papers on a refinance. Under "costs of the loan" he had entered the full loan amount instead of the interest, which was incorrect. When the preparer questioned the man about the incorrect entry, he said that the software had asked a question, he had answered, and that's what the software did with the answer. When the preparer pointed out that this error meant that he would not receive the \$5,000 refund he had anticipated—in fact he owed \$3,000—he became belligerent and informed her that his \$39 software was obviously smarter than she was. He grabbed his tax return and left, never to return. This example illustrates some of the most common hazards of using do-it-yourself software: Misunderstanding the questions on the software products and incorrectly entering the amounts.
- Married taxpayers living near the Wisconsin/Illinois border purchased tax preparation software in Wisconsin, but lives in Illinois; something they had done for years without realizing that state taxes differ from state to state. This year, due to confusion with software, they visited a tax preparer. The preparer immediately identified problems because they were filing Illinois taxes using Wisconsin software. Pensions are tax-free in Illinois, but taxed in Wisconsin. The preparer amended returns for three years, giving the taxpayer over \$1,000 in additional refunds for each year. In this situation, the taxpayers were not buying the correct software, and if they hadn't consulted a tax professional they may have never discovered this costly mistake.
- When a now-retired taxpayer brought in his prior year self-prepared forms to a tax preparer for a consultation and tax advice, the tax preparer discovered that the taxpayer's employer had erroneously taken withholding out for the taxpayer. The taxpayer had just assumed the employer had done the accounting correctly and never questioned it; however the tax preparer knew the law and spotted the error. Result? Amended returns and a permanent client. (This type of error is more common than many people think.)
- Using software for a fairly simple tax return, a married Pennsylvania taxpayer filed as married filing separately (MFS) and came up with a \$285 refund [it appeared to come out better than married filing jointly (MFJ)]. When the taxpayer did the same for her spouse, she was horrified to discover that he owed \$969. Had they filed as MFJ, they would have received an \$847 refund. The result? An amended return and taxpayers who will use a tax preparer from now on.

- A taxpayer in New Jersey attempted to file his tax return using software. He had incentive stock options and could not figure out how to handle them. The software product was calculating a tax liability in the high five-figure numbers. Upon seeking the advice of a tax preparer and after reviewing the taxpayer's finances and tax laws, the liability was reduced to approximately \$1,000.
- A taxpayer from the Angola, Indiana area could not figure out how to do the state return to file along with his completed federal return. He brought along his completed federal return when seeking the help of a tax preparer. Not one line of the self-completed federal form was completed correctly.
- After a visit with a tax preparer to review his self-prepared return, a retiree living in New York learned that New York would allow his military pension to be excluded from his adjusted gross income for state tax purposes. The adjustment saved him several hundred dollars which more than made up for the tax preparer's fee for 2004 and for the next ten years.
- Using software in 2003, a Phoenix, Arizona taxpayer had assessed herself a ten percent penalty on her normal retirement, which was incorrect. A tax preparer review uncovered the error and after preparing an amended return, the taxpayer received a refund of \$2,400.
- With software, sometimes the box is empty when it comes to customer service. Last year, a software providers' customer service agent made the following statement to a taxpayer who had questions on software: "We sell software; we don't give tax advice." So where do software users turn for advice? Some end up using their best guess. The wise ones end up seeking out a tax professional. Many become permanent clients afterwards.

These are but a few of many experiences, some of them too lengthy and complicated to recount, of taxpayer frustration which led to them consulting a tax professional. Misinterpretations can be costly in the long-run. Terri Zurcher, a tax preparer from Middleton, Idaho probably summed up the results best: *"Just buying a software program doesn't make you a tax preparer anymore than buying a word processing program makes you an author."*

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Members of the National Association of Tax Professionals (NATP) assist taxpayers with tax preparation and planning. NATP is a nonprofit professional association founded in 1979 and provides professional education, tax research, and products to its members. The national headquarters, located in Appleton, WI, employs 43 professionals and 25 instructors. NATP exists to serve professionals who work in all areas of tax practice and has more than 17,500 members nationwide. Members include individual tax preparers, enrolled agents, certified public accountants, accountants, attorneys, and financial planners. Learn more at www.natptax.com.