



Electronic Tax Administration Advisory Committee

Annual Report to Congress



June 29, 2001

Executive Summary

Creating A Modern Tax Administration Environment at the IRS

The IRS Restructuring and Reform Act of 1998, which established the Electronic Tax Administration Advisory Committee (ETAAC), identified goals and objectives for the IRS related to electronic tax administration, in the larger context of transforming the IRS into a more efficient and more customer service oriented organization. Over the past several years, with generally heightened customer expectations for quality service and the new communication capabilities of the Internet, the focus at tax agencies around the world has shifted to enhancing the effectiveness of customer service systems, particularly through the use of alternative electronic channels. While efficiency and cost-reduction are not neglected as objectives, quality customer service is now the main theme when tax executives talk about their burning issues. There's also a growing recognition that improvements in customer service and easy access to accurate tax law information can increase voluntary revenue collection. While some argue that tax agencies aren't likely to win many new customers by providing superior service, there are clearly revenue benefits to be derived from making it easier for willing taxpayers to comply.

In the tax environment, the notion of "customer" isn't straightforward. Tax agencies provide services to individuals, businesses of all sizes and in various industries and tax professionals who represent taxpayers in various matters, ranging from filing returns to defending legal actions. The tax administration world is a complex place. It's governed by multi-jurisdictional statutes and rules, involving highly specialized knowledge and processes and inhabited by a broad range of customers, who mostly conduct business with tax agencies by mandate rather than by choice. This would seem to be a challenging place to build a customer service focused organization, but enlightened tax professionals understand that most taxpayers want to be compliant. Improving service to tax customers, and making it easier for them to understand and comply with their obligations can enhance voluntary compliance and improve taxpayer perception of the IRS.

In addition to improving the taxpayer's experience, the modernization of IRS business systems and information processing can provide significant improvements in the efficiency, timeliness and accuracy of tax administration. The transition to computerized tax calculation and electronic filing of returns should significantly reduce the workload and cost of return processing and resolution of accidental errors. By reducing the percentage of the IRS resources devoted to manual processing of paper returns, more of the agencies personnel can be devoted to pre-filing education and to compliance activities. However, more analysis of the actual potential reduction in total costs from converting to full electronic tax processing is needed to help guide the agency, and evaluate the many investments that may be needed to achieve that goal.

Progress in Meeting Electronic Tax Administration Strategic Goals

Filing season 2001 saw a 4.7 million increase in electronically filed returns over filing season 2000, as of June 21, 2001. This represents an overall 13.4 percent year over year increase in electronic filing, compared to a projected increase of approximately 19 percent. To establish a base of understanding for this Report, it's important to understand the trends within each component of electronic filing.

- **Practitioner electronic filing** increased nearly as projected (14.8 percent actual vs. 15.6 percent projected).
- **On-line electronic filing** grew by 36 percent. While in one sense this is a significant increase, it falls short of the projected growth rate of 66 percent. The base of on-line electronic filers is small relative to the base of practitioner electronic filers, driving the need for higher growth rates to achieve IRS goals. Online filers represent 17 percent of total electronic filers, whereas practitioners file 72% of all electronic returns.
- **Tele-File** use decreased by 15.4 percent, continuing a trend started in 1998.

Overall, e-filing growth in Individual Tax returns is less than projected, largely due to the reduction in returns filed via Tele-File and the lower-than-expected growth in on-line filing.

Assessment of Progress

Overall

At an aggregate level, the 2001 filing season results indicate a significant reduction in the rate of increase of electronic filing. This isn't entirely unexpected; ETAAC discussions have focused on the fact that the biggest gains in e-filing should be expected in the early years of the program. We realized that there'd be a reduction in the growth rate after the "early adopters" made their transition, but it hasn't been possible to predict when we'd begin to see it. The 2001 aggregate growth rate of 13.4 percent, extrapolated forward to 2007, would result in approximately 58 percent e-filed returns, compared to the 80 percent target. However, e-file participation rates varied by taxpayer and tax preparer segment, and by source or "channel" of e-filing (i.e., practitioner, online and Tele-File), as described in the following paragraphs.

Online Filing

Over time, the compounding affect of a large rate of increase (36 percent in 2001) on a small initial base would have the impact of rapidly growing the number of online e-filers in the years approaching 2007. Consequently, if this year's online filer growth rate of 34 percent can be sustained, without diminishing the rate of increase in practitioner e-filing, the IRS could achieve nearly 75 percent e-filed individual returns by 2007. However, these results are easier to calculate on paper than to achieve in the real world. The ETAAC questions whether online filing growth rates can be sustained at this level through 2007, given current indications. We suspect that future gains will be harder to achieve than past increases.

Tele-File

Tax Season 2001 saw yet another decline in the use of electronic filing via Tele-File. As ETAAC noted last year, the cause of the continuing decline should be analyzed and the future of this service evaluated. As the number of participants decreases, the cost per return almost certainly goes up, and the value to customers in the aggregate goes down.

Practitioner

We believe the increase in forms available for e-file, increased marketing and advertising, along with a closer connection to the IRS (account managers, more communication vehicles, etc.) motivated tax practitioners in promoting e-filing this tax season. The commitment shown by the IRS and its ETA division in supporting and promoting electronic filing has buoyed tax professionals' efforts to encourage their customers to e-file. But issues still remain. To gain wider acceptance by tax practitioners and their customers, the IRS needs to continue to focus on allaying security concerns, reducing e-filing costs for practitioners, software providers and taxpayers, as well as making e-file a true paperless exchange. It will be difficult to sustain the historical rate of increase in practitioner e-filing, now that the national mass-market firms have so fully embraced the program.

Prospects for the Future

The early years of IRS e-file resulted in rapid growth as many early adopters took to the technology and the new opportunity to file primarily paperless returns. As we review tax season 2001, in comparison to the last several tax seasons, we see an expected leveling of the growth rate. Now that IRS e-file is established, most forms are accepted, and the PIN program is in place, the IRS should focus on targeting specific taxpayer segments in order to increase growth in the program. Emphasis on the segment most likely to convert to e-filing, and with the biggest impact on achieving the goals of 2003 and 2007, would be the best use of funds, time and energy. ETAAC will work with the IRS ETA over the next year to identify these prime target segments.

Progress in Business E-Filing

Status of Business E-Filing Initiatives -- The launch of e-filing capabilities continues to focus on those products that capture the most volume first. This prioritization is necessary in allocating limited resources effectively with the greatest capacity for results. Business e-filing services involve fewer, more complex returns that require more sophisticated e-filing systems and capabilities. Programs to date have focused on electronic transmission of payroll reports and related payments, fiduciary income tax returns (form 1041 and related K-1's), and recently, partnership income tax returns (form 1065 and related K-1's).

Projected Market Penetration. The market penetration of business e-filing has not been as high as with individual e-file. However, given the pervasive use of computers and electronic communications in business, ETAAC expects that there's potential for significant future gains in business e-filing. The IRS has extended its marketing efforts into the business community and needs continued budget support and resources in this area. In conjunction with outside consultants, the IRS is developing an overall marketing strategy for ETA business products and services, primarily focusing on the top six business

returns including form 1065, the Form 941 suite of products, Form 1041 and information returns (W-2's, 1099, etc). One of the primary keys to successful expansion of the program in the future is to ensure a standardized, business-friendly approach to formats, protocols and program requirements.

Key Recommendations

This report builds on the 2000 ETAAC Report to Congress and should be viewed as a cumulative effort. The 2001 ETAAC recommendations are presented throughout the Report and in the last section. The following is a summary of the key points:

- The IRS Electronic Tax Administration (ETA) program continues to make progress in meeting congressional objectives. ETAAC encourages Congress to continue to support the ETA with funding for modernization efforts and with timely passage of new tax legislation to allow the IRS to respond with well-tested, customer-friendly system changes. ETAAC also encourages Congress to continue to support the goals articulated in RRA 98, which to this point have provided a clear focus and powerful motivation to the IRS and others involved in promoting electronic tax administration.
- Ensuring data security and protecting privacy need to be top priorities at the IRS. A breach of public trust would set the ETA program back significantly.
- The IRS should pursue a targeted approach to further expansion of e-filing, by striving to understand obstacles and motivators by customer segment, and developing specific plans of action addressing the needs of each group.
- Having made substantial progress in growing mass market practitioner participation in individual e-filing, the next big drive needs to be aimed at non-mass-market practitioners and the population that prepares and files its own returns.
- The pilot Debt Indicator program has been a popular and effective tool for reducing fraud and encouraging practitioner participation. The Debt Indicator program should be made permanent and expanded to include more information about each debt, which practitioners could then use to assist their customers in resolving the problem.
- As a low-cost, high-visibility means of encouraging taxpayers to e-file, ETAAC recommends that Congress authorize an extended filing and payment due date for e-filed returns.
- The ETAAC recommends that all paid tax preparation firms and independent tax practitioners who are not EROs be required to register with the IRS and meet the same standards required of EROs. IRS registration of all practitioners would remove the significant disincentive that now exists for tax practitioners to become EROs.
- The IRS should revise the standards for taxpayer assistance programs funded by the IRS to require E-Filing of those returns. The IRS currently assists over 1,140,000 taxpayers with filing at IRS offices and another 4.6 million at volunteer sites at which the service provides preparation software and computers. A large percentage of these returns are then filed on paper forms. All returns prepared at IRS offices, as well as those prepared by publicly funded voluntary and military organizations, should be filed electronically.
- A large number of self-filers continue to prepare and file their returns on paper. The reasons for their behavior are not well understood, nor are the potential motivators that would convince them to switch to e-filing. Consistent with the 2000 ETAAC Report to Congress, the 2001 ETAAC recommends a reassessment next year of the online filing marketplace and of the progress in meeting online filing objectives. In preparation, ETAAC strongly recommends that the IRS perform or

contract for a targeted review to determine the obstacles, motivations and mitigation strategies, if any, required to ensure continued growth in self-preparer e-file participation. Since repeated annual E-file growth rates for self-filers in the range of 35-40 percent will be required to meet the 80% goal, it's essential that IRS develop a better understanding of the behaviors, concerns and motivations of this taxpayer segment.

1.0 Introduction

The National Commission on Restructuring the IRS established a vision for the IRS in its 1997 report, *A Vision for a New IRS*. In 1998, much of that vision was codified into law in the IRS Restructuring and Reform Act of 1998 (RRA 98). Electronic filing, which the IRS has extended to electronic tax administration, was an important part of that vision. Title II of the RRA 98 provided the IRS with the following policy statement with respect to electronic filing:

1. Paperless filing should be the preferred and most convenient means of filing federal tax and information returns;
2. It should be the goal of the Internal Revenue Service to have all returns prepared on computer, filed electronically by 2003, and at least 80 percent of all returns filed electronically by the year 2007; and
3. The Internal Revenue Service should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns.

Recognizing the importance of receiving private sector input to achieving this goal, the legislation further required that the IRS establish an advisory group to provide it with private sector input, and further required that this advisory group report to Congress annually on the following subjects:

- The progress of the IRS in meeting the goal of receiving electronically 80 percent of tax and information returns by 2007;
- The status of the strategic plan to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing gradually over the next ten years;
- The legislative changes necessary to assist the IRS in meeting such goal; and
- The effects on small businesses and the self-employed of electronically filing tax and information returns.

The Electronic Tax Administration Advisory Committee (ETAAC) was established to provide continued input to the development and implementation of the IRS strategy for electronic tax administration. Members of ETAAC represent a diverse cross-section of IRS partners, customers and stakeholders (see Appendix A for a list of current ETAAC members).

Over the past few years, the IRS has made considerable progress toward achieving the objectives identified above. The IRS Electronic Tax Administration Program is to be commended for providing focus, energy and creativity to the effort. Still, the IRS faces formidable challenges in meeting the aggressive goals set for in the Restructuring and Reform Act of 1998. There's no room for complacency. When those goals were first articulated, opportunities for electronic filing and service delivery were fairly limited. Initial efforts focused on expanding the availability of electronic filing and payment services, by including additional form types as well as by providing additional e-services and improving ease-of-use. While those were necessary first steps, we've since learned that it doesn't happen in the tax world the way it happens in the movies – you can build it, but they might not come.

Recognizing that the primary impediments to future growth in electronic tax administration are related to customer acceptance and adoption, the ETAAC concentrated this year on helping the IRS to better understand and overcome obstacles to broad acceptance of electronic service channels and to define

strategies for program growth. To accomplish this objective, the Committee members formed two sub-groups; one focusing on the practitioner community and the other addressing the self-filing population. Within those categories, the sub-groups further defined obstacles and suggested growth strategies that address specific market segments within each area.

Despite the seemingly simple approach, this is a complex challenge, and much of what needs to be done is outside the direct control of the IRS. Approximately 57% of all income tax filers utilize a paid preparer, so 100% participation by that community would only get the IRS about 70% of the way toward its overall goal of 80% e-filing. The remaining progress needs to be made by motivating the majority of self-filers to file electronically, but only a minority of them are now willing or able to pay for the software or web-based services required to submit a return electronically. Many citizens still lack the opportunity or inclination to own or gain access to an internet-connected personal computer or web device. The gap may be closing, but the “digital divide” remains a significant obstacle to IRS attainment of its e-filing goals.

Presently, the universe of taxpayers who have access to e-filing – that is, those who use paid preparers, buy tax preparation software or use web-based services -- is less than the 80% e-filing target. Prior to this year, the IRS had seen e-file growth rates that would suggest they would hit the target. This year, for the first time, the growth rate declined to a level which, if projected forward, would fall short of the goal. This result is not entirely surprising; the “easy” gains have been achieved and the more difficult challenges lie ahead. ETAAC believes that attaining the 80% goal will require innovation on the part of both ETA and private sector providers. An example of such innovation, strongly supported by ETAAC and reinforced by practitioner surveys, is the ETA’s proposal to offer to participating practitioners, as an incentive to e-file, a basket of related electronic services. Such e-file incentives might include online account information and problem resolution and electronic power of attorney. These services could eventually be offered to all customers, but initially would be used to reward e-file participation.

As much as any issue in government today, this problem demands a careful balance of contradictory or potentially even competing forces. Strategies that serve the interests of self-filers may run counter to the concerns of the professional tax preparation or tax software development community. Desires to make information broadly available through electronic self-service run squarely into legitimate worries about security, privacy and confidentiality. The nature of interactive personal computer and web-based tax services tends to blur the lines between private sector enterprise in providing value-enhancing tax preparation service and the IRS’ responsibility to make its services ubiquitously available electronically. Building on past efforts, ETAAC strives in its 2001 Report to Congress to provide guidance on these tough issues.

2.0 Progress of Electronic Filing

2.1 Individual Filing Season Results

The IRS had been growing the e-file program at a steady, high rate since 1997, achieving projected e-file rates each year until 2001. Filing season 2001 saw a 4.6 million increase in electronically filed returns over filing season 2000, as of May 29, 2001. This represents an overall 13 percent year over year increase in electronic filing, compared to a projected increase of approximately 19 percent. This isn't entirely unexpected; ETAAC discussions have focused on the fact that the biggest gains in e-filing should be expected in the early years of the program. We realized that there'd be a reduction in the growth rate after the "early adopters" made their transition, but it hasn't been possible to predict when we'd begin to see it. Achieving future growth rate increases will be a formidable challenge. To establish a base of understanding for the balance of this Report, it's important to understand the trends within each component of electronic filing.

- **Practitioner electronic filing** increased nearly as projected (14.8 percent actual vs. 15.6 percent projected).
- **On-line electronic filing** grew by 36 percent. While in one sense this is a significant increase, it falls short of the projected growth rate of 66. The base of on-line electronic filers is small relative to the base of practitioner electronic filers, driving the need for higher growth rates to achieve IRS goals. Online filers represent 17 percent of total electronic filers, whereas practitioners file 72% of all electronic returns.
- **Tele-File** use decreased by 15.4 percent, continuing a trend started in 1998.

Overall, e-filing growth in Individual Tax returns is less than projected, largely due to the reduction in returns filed via Tele-File and the lower-than-expected growth in on-line filing.

Table 2.1.a. -- Individual Electronic Filing Season Results (in millions)

Electronic Returns	2001 Projected returns for entire year	2001 Actual returns (through 6/21/01)	2000 Actual returns (through 5/29/00)	Percent Projected Change	Percent Actual Change
On-line	8.5	6.8	5	66%	36%
Practitioner	28.9	28.7	25	15.6%	14.8%
Tele file	4.9	4.4	5.2	-5.8%	-15.4%
Totals	42.3	39.9	35.2	20.1%	13.4%

The next table shows this year's growth in the context of the five-year pattern of electronic return filing. This is the first year since the establishment of the Electronic Tax Administration Program that electronic filing fell short of projections.

Table 2.1.b. -- Five-year Growth of Electronic Filing for Individual Tax Returns (in millions)

Year	Total Returns	On-line Returns	Practitioner Returns	Tele-File Returns	Total Electronic Returns	Percent returns e-filed	Percent growth of e-filed returns
2001	130.3*	6.8**	28.7**	4.4**	39.9**	30.5%	13.4%
2000	127.4	5.0	25	5.2	35.2	28%	20.8%
1999	124.9	2.4	21.1	5.7	29.3	23%	20.1%
1998	122.5	0.9	17.6	5.9	24.4	20%	25.1%
1997	120.8	0.4	14.4	4.7	19.5	16%	29.1%

(*Projected)

(**Actual through 6/21/01)

2.2 Significant Accomplishments During 2000-2001

A. E-Filing Participation Increase - Tax Season 2001 saw an increase of 13.4% over last tax season in the number of returns that were electronically filed. Approximately 90% of those returns were e-filed via computer (as opposed to Tele-File) with approximately 81% of all computer e-filed returns originating through tax practitioners. We believe that a portion of this increase can be credited to increased national and local marketing communication from the IRS regarding e-file and its benefits. The information taxpayers received this year helped to somewhat alleviate the fear of use, leading many to change the way they filed their returns. ETAAC encourages the IRS to increase its marketing efforts in the future, to continue to improve awareness of e-filing benefits and opportunities.

B. Additional State E-Fileers - Inclusion of Hawaii and Vermont onto the list of federal/state e-fileers, which currently stands at 37 states and the District of Columbia, is also a great accomplishment for the furtherance of e-filing. Tax practitioners, in all locations where available, benefit by being able to promote the use of e-filing as a complete “one-package”, paperless proposal. The numbers of electronically filed returns in this category grew a significant 27 percent for tax season 2000 vs. tax season 1999.

C. Additional Accepted Forms - The IRS, with this year’s addition of 23 new forms, and plans next year to add 32 more, will enable 99 percent of forms and schedules to be filed electronically. Coupled with the wide spread use and availability of the self-select PIN program, individual taxpayers were given more reasons to say yes to e-filing. The increased forms acceptance also made it easier for tax practitioners to promote the use of e-filing to their customers.

D. Account Management Program - The Account Management program, announced last year, was beneficial to ERO practitioners as their National Account Managers worked hard to provide relevant information in a timely manner throughout the tax season. The increased communication and access went a long way in helping the tax practitioner feel more like a partner with the IRS.

E. Checkbox Disclosure Authorization - The new Checkbox Disclosure Authorization, which allows taxpayers to easily authorize their return preparers to discuss tax return issues with the IRS, was

another great benefit for taxpayers and their tax practitioners this tax season. Helping to further open the lines of communication between tax practitioners and the IRS, this new feature allows tax practitioners to take a more proactive and helpful position on behalf of their customers.

2.3 Progress Towards Goals

One would expect the rate of electronically filed returns to increase rapidly in the early years and then gradually level off. We are beginning to see a leveling of the rate of increase which does cause concern with respect to achieving the two e-file goals: (1) by 2003, all returns that are prepared electronically will be filed electronically, and (2) by 2007, 80 percent of all returns will be e-filed. The IRS is making meaningful progress in meeting the goals, however, we are concerned the goals will not be met without a new strategic approach.

2.4 Strategic Goal for 2003

The ETAAC 2000 Annual Report to Congress stated that the goal of 100 percent electronic filing of all returns prepared on computer by tax practitioners and taxpayers alike would be a most difficult goal to achieve. Based on the continual growth of electronic preparation for these two segments, we are encouraged that this goal could be achieved if additional incentives are put in place. Tax practitioners and software companies have the ability to materially influence the use of e-filing, but only if given appropriate incentives. Tax practitioners are trusted by their clients, thus given the right incentives, they stand in a great position to allay the concerns of and encourage their clients to e-file. Similarly, software companies and their retail products have established a sense of security and ease of use that repeat customers have come to appreciate and expect. Given the appropriate incentives, the private sector is in a great position to influence behavior and take online preparation to the next step.

2.5 Strategic Goal for 2007

We believe the second goal, of achieving 80% e-file by 2007 is ambitious. Our review of e-filing progress leads us to two conclusions. One, a more specific plan for achieving this goal should be developed. And second, the plan should be segmented by taxpayer profile (e.g. age, income level) in order to effectively market to and change behavior of that segment. The blanket "shotgun" marketing approach appears to have reached its limits. In reaching out to the younger segment of taxpayers, there is a better chance of changing long term behavior, but traditional marketing may not be effective with this group. Recent surveys suggest that the mature segment of taxpayers are getting "online" at an increasing rate, but an entirely different marketing approach will undoubtedly be needed to reach this segment. We suggest this issue be evaluated in an effort to help identify when, where, and how funds should be spent to generate the biggest impact on e-file growth.

2.6 ETAAC Assessment

Overall

At an aggregate level, the 2001 filing season results indicate a significant reduction in the rate of increase of electronic filing. This isn't entirely unexpected; ETAAC discussions have focused on the fact that the biggest gains in e-filing should be expected in the early years of the program. We realized that there'd be a reduction in the growth rate after the "early adopters" made their transition, but it hasn't been possible to predict when we'd begin to see it. The 2001 aggregate growth rate of 13.4 percent, extrapolated forward to 2007, would result in approximately 58 percent e-filed returns, compared to the 80 percent target. However, e-file participation rates varied by taxpayer and tax preparer segment, and by source or "channel" of e-filing (i.e., practitioner, online and Tele-File), as described in the following paragraphs.

Online Filing

Over time, the compounding affect of a large rate of increase (34 percent in 2001) on a small initial base would have the impact of rapidly growing the number of online e-filers in the years approaching 2007. Consequently, if this year's online filer growth rate of 34 percent can be sustained, without diminishing the rate of increase in practitioner e-filing, the IRS could achieve nearly 75 percent e-filed individual returns by 2007. However, these results are easier to calculate on paper than to achieve in the real world. ETAAC questions whether online filing growth rates can be sustained at this level through 2007. We suspect that future gains will be harder to achieve than past increases.

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Practitioner

We believe the increase in forms available for e-file, increased marketing and advertising, along with a closer connection to the IRS (account managers, more communication vehicles, etc.) motivated tax practitioners in promoting e-filing this tax season. The commitment shown by the IRS and its ETA division in supporting and promoting electronic filing has buoyed tax professionals' efforts to encourage their customers to e-file. But issues still remain. To gain wider acceptance by tax practitioners and their customers, the IRS needs to continue to focus on allaying security concerns, reducing e-filing costs for practitioners, software providers and taxpayers, as well as making e-file a true paperless exchange. It will be difficult to sustain the historical rate of increase in practitioner e-filing, now that the national mass-market firms have so fully embraced the program.

Prospects for the Future

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established, most forms are accepted, and the PIN program is in place, the IRS should focus on targeting specific segments in order to increase growth in the program. Emphasis on the segment most likely to convert to e-filing, and with the biggest impact on achieving the goals of 2003 and 2007, would be the best use of funds, time and energy.

3.0 Practitioner Challenges and Initiatives

As explained above, ETAAC believes that sustaining growth in electronic filing will require a targeted approach aimed at increasing availability, marketing and incentives for taxpayer segments most likely to accept the e-filing alternative and to have the biggest positive impact on reaching e-file goals. At the highest level, taxpayer segments are divided into two major groups – those who use professional tax preparers and those who prepare and file their own returns. Within each of those major groupings, there are segments, as described below.

3.1 Definition of Practitioner Segments

A. Mass-market - This segment is comprised of high-volume national, regional and local income tax preparation firms that usually operate out of storefront offices and primarily serve low to middle-income individual taxpayers. Virtually all mass-market tax firms are EROs because many of their clients seek fast refunds made possible through e-filing. All of the national mass-market practitioners and many regional and local firms offer e-filing “free” with paid tax preparation in order to remain competitive. “Free” typically means that no additional fee is charged for e-filing. Most mass-market tax firms are already meeting or exceeding the IRS goal of having 80% of all tax returns e-filed by 2007.

Mass-market firms currently are responsible for the vast majority of individual income tax returns e-filed by tax practitioners. The volume of mass-market e-filing is also far greater than the volume of self-preparer e-filing. While the national mass-market tax firms, as public corporations, report their annual tax preparation and e-filing results, such information is not readily available from the privately held regional and local mass-market firms. Statistics for the national mass-market firms and estimates for regional and local mass-market firms follow:

Table 3.1.A.1 -- National Tax Firms

Number of 2000 Individual Tax Returns As of 4/20/2001 (thousands)			
	# Prepared	# E-filed	% E-filed
National Tax Firms			
H & R Block	17,794	14,469	81.3%
Jackson Hewitt	2,200	2,090	95.0%
Liberty Tax Service	140	112	80.0%
Tax Services of America	125	119	95.0%
National Firm Totals	20,259	16,790	82.9%
Other Individual Returns Filed	93,459	18,120	19.4%
IRS Totals Filed	113,718	34,910	30.7%
National Firm % of IRS Totals	17.8%	48.1%	

Significant Results:

- National mass-market tax firms processed nearly half of all e-file returns in 2001
- National firms are exceeding the goal of e-filing 80% of returns they prepare
- National firms prepared 17.8% of all tax returns filed
- Only 19.4% of returns filed by non-mass market preparers and self-preparers were e-filed in 2001

Regional and Local Firms. Like many mature industries, the mass-market tax industry has been undergoing consolidation. A number of larger independent tax firms have been acquired during the last several years by the national tax firms (which is reflected in the significant growth of national tax firms). Relatively few high-volume independent tax firms preparing 5,000 or more tax returns exist today. However, a large number of local one-office mass-market tax firms operate throughout the country. One indication of the number of local independent mass-market tax firms may be represented by the memberships of the key professional associations to which many such firms belong. Another indicator would be IRS statistics on EROs who e-file significant numbers (hundreds or thousands) of individual tax returns. The key professional associations to which mass-market tax practitioners may belong are:

- National Association of Tax Practitioners (NATP) – 14,000 members
- National Society of Tax Professionals (NSTP) – 6,000 members

According to Jackson Hewitt estimates, in tax year 2000 practitioners prepared approximately 25 million IRS e-file returns. Of these, the mass-market practitioners e-filed approximately 14 million returns. Their contribution alone was approximately 55% of the entire practitioner segment.

B. Small Accounting/Tax Firms - Many practitioners are self-employed or work in closely held firms. These firms are typically your full service CPA firm, enrolled agent, or accountant who may provide services well beyond the filing season. The tax services includes corporate, partnership, proprietorship, limited liability company and non-profit tax preparation services, as well as estate and gift tax returns. The individual returns prepared by this market segment are among the more complex returns filed with the Service. In addition, this segment typically offers services such as accounting, bookkeeping, payroll preparation, and other services needed by their small business clientele. The key associations to which this group of tax professionals belong to include:

- American Institute of Certified Public Accountants (AICPA) – 340,000 members
- National Association of Enrolled Agents (NAEA) – 11,000 members

C. Large Accounting Firms - The so called “Big 5” Accounting firms dominate this segment. Together, the Big 5 operate in around 150 countries worldwide, employ over 500,000 staff and have revenues of approaching \$64bn.

Without accurate published data from all 5 by service type, their revenues from tax services are difficult to estimate as a proportion of their total revenues. From those who do publish data, revenues from tax services runs around 20% of their gross revenues.

Tax compliance is a small but significant subset of all revenues from tax services, and it is fair to state that large scale tax return preparation is not a major focus of the services provided by the Big 5 firms. As such, their participation in the e-filing process is limited to such items as the electronic filing of partnership returns as mandated by Congress. None of the “Big 5” actively participate in large scale e-filing of individual tax returns.

The firms are:

Company	US Locations	Global locations	2000 Revenue
Price Waterhouse Coopers	117 Offices 50 States 46,000 employees	150 Countries 160,000 employees	Global - \$21.5bn N America – \$9.6bn Tax - \$3.4bn
KPMG	145 Offices 26,900 Employees	800 Cities 159 Countries 103,000 Employees	Global - \$13.5bn N America - \$5.4bn Tax & Legal - \$2.9bn
Deloitte & Touche	>100 Offices 30,000 Employees	700 Offices 130 Countries 90,000 Employees	Global - \$11.2bn
Ernst & Young	98 Offices 40 States	130 Countries 77,000 Employees	Global - \$9.2bn
Arthur Andersen	82 Offices 50 States 30,000 Employees	84 Countries 85,000 Employees	Global - \$8.3bn N America - \$3.7bn Tax, Legal and Bus Advisory - \$2.5bn

The “Next 5” accounting firms are ranked as follows:

Century Business Services (CBIZ)	230 Offices 36 States 5,000 Employees		N America - \$528m
Grant Thornton	47 Offices 3,200 Employees	612 Offices 100 Countries 20,000 Employees	Global - \$1.6bn N America - \$416m
BDO Seidman	37 Offices (+ 88 Assoc. offices) 2,000 Employees	500 Assoc. offices 95 Countries 21,000 Employees	Global - \$2.0bn N America – \$408m
RSM McGladrey (RSM International)	100 Offices 4,000 employees	84 Assoc. offices 74 Countries	N America - \$337m

3.2 E-Filing Benefits, Barriers & Solutions

The ETAAC identified a number of benefits to practitioner market segments from using electronic filing, as well as possible barriers to expanded use by these segments along with potential strategies to overcome them.

Benefits of E-filing	Mass Market	Small Accounting Firms	Large Accounting Firms
Acknowledgement of filing and extensions to confirm receipt by IRS and prevent possible late filing penalties	X	X	X
Error-check increases accuracy for IRS and practitioner	X	X	X
Clients who owe IRS can pay electronically to prevent late payment penalties	X	X	X
Approximately 97% of all returns can be e-filed	X	X	
Competitive advantage for EROs over non-EROs	X	X	
Reduction in postage and paper	X	X	
Advertising and marketing collateral provided by IRS to promote program	X	X	
Taxpayer perception that CPA is current with technology		X	X
Financial savings in material and labor costs	X		
Faster refunds for customers	X		
Facilitates other products and services, such as bank products	X		

Barriers to E-Filing	Mass Market	Small Accounting Firms	Large Accounting Firms	Solutions to Overcome Barriers
Self-select PIN program execution is difficult	X	X		Modify/simplify the self-select PIN program
Still rely on antiquated IRS systems for accurate debt indicator, fraud detection and revenue protection	X	X		Provide an indicator of revenue protected tax returns with acknowledgement, much like the debt indicator
Erroneous client notices regarding processing issues	X	X	X	Adopt appropriate acceptance standards for e-filed returns, comparable to paper acceptance standards
Inability of the e-filing process to accept all forms and “white paper” schedules		X	X	Expand e-filing compatibility to include more “white paper” schedules, especially for disclosure purposes
Lack of software to file the mandated returns (e.g. 1065 experience)			X	Do not use a legislative mandate to require the filing of all returns electronically
Requirements for multiple EFIN’s for multiple office locations	X	X	X	Have single “firm-wide” EFIN’s
Inability to include foreign offices in e-filing process due to “Foreign ERO” problems			X	Work with the International offices of the large firms and the local IRS to bring in the overseas offices into the e-filing net
Concern with transmission and information security breaches	X	X	X	Overcome taxpayer ambivalence with increased education and marketing to taxpayers promoting e-filing as the “cutting edge”
Taxpayers are ambivalent about technology (ease, security)	X	X	X	
Lack of perceived value		X	X	
Erroneous notices to taxpayers on balance due returns	X	X	X	Provide additional customer service support for EROs
Difficulty in reaching IRS e-file coordinators by telephone	X	X	X	
The ERO application and screening process may discourage some practitioners	X	X	X	Require all practitioners to register and meet the same standards imposed on EROs
ETA regulations imposed on EROs are cumbersome with harsh penalties	X	X	X	
Initial additional data keypunch requirements	X	X	X	
Additional requirement for “date of birth” for electronic extensions		X	X	
Technology costs related to transmitting returns	X	X	X	Recommended incentives – see Section 6.0 (G) of the report
Additional cost to firm for some software service providers.	X	X	X	
Dual procedures for providing returns to clients	X	X	X	
Incompatibility of firms return review procedures with e-filing (preparer/manager/partner review of returns)		X	X	
Inability to pass additional costs onto clients		X	X	
Inability to file piggyback with all states	X	X	X	

3.3 Business E-Filing Initiatives

A. Status of Business E-Filing Initiatives - The launch of e-filing capabilities continues to focus on those products that capture the most volume first. This prioritization is necessary in allocating limited resources effectively with the greatest capacity for results. Business e-filing services involve fewer, more complex returns that require more sophisticated e-filing systems and capabilities. Programs to date have focused on electronic transmission of payroll reports and related payments, fiduciary income tax returns (form 1041 and related K-1's), and recently, partnership income tax returns (form 1065 and related K-1's).

B. Legislative Mandate in the Taxpayer Relief Act of 1997 - Congress recently mandated the electronic filing of forms 1065 and related schedule K-1's for certain filers in the Taxpayer Relief Act of 1997. The electronic filing results for the 2000 tax year has surpassed projections for Forms 1065 but not of Schedule K-1. For the 1999 tax year there were 143 Form 1065's and 179,600 Schedule K-1's filed electronically. For the 2000 tax year there were 5,576 Form 1065's and 500,843 Schedule K-1's filed electronically as of April 27, 2001.

This success, however, has not come without challenges and hardship. The IRS has received 220 Form 1065 and 314,652 Schedule K-1 waiver requests asking for exemption from the electronic filing mandate. Essentially, the return practitioners had to re-configure their data base to make sure the data was consistent with filing formats and specifications in order to accommodate the electronic transfer. This conversion is a very complicated, time consuming, and a labor intensive task. E-filing is not just about "electrifying a paper return". Private industry is sensitive to government mandates that impose added cost and difficult time constraints. The ETA indicated the time constraint was a burden for them as well. Given adequate time to research and prepare, one would expect the waiver requests to be fewer in the future.

C. Development of Additional Business E-Filing Initiatives - There are many business e-filing initiatives in various stages of development. The following is a description of the e-filing services and anticipated time framework.

Program	Time Framework	Description
1065 with Payment	2002	Accommodate capacity and program requirements of legislative mandate in the Taxpayer Relief Act of 1997 requiring certain filers to submit Forms 1065 and Schedule K-1 electronically.
1065-B and Foreign Address	2004	To enhance the current 1065 e-file Program, the IRS needs to accept Form 1065-B and partnership returns with a foreign address electronically.
1120 with Payment 1120S with Payment	2003	To develop plans to move these forms and schedules to some form of electronic filing.
7004 with Payment	2004 +	Develop capability to receive extension requests electronically and transmit a payment record for the balance due amount of an electronic return.
New 1041	2004	Receive form 1041 data electronically through EMS.
2290 with Payment	2004	An integrated file and payment option will be offered.
990 Family	2004	Identify requirements and optimum alternate ways of filing electronically.
TIN Matching for Payers	2002	Develop the capability for payers of certain form 1099 income to match payee's name and taxpayer identification number with IRS records before filing.
Forms 5471 and 6166	2003	Identify requirements and develop capability to receive both forms electronically
Form 8850	2002	A partnership has been formed with stakeholders to develop an electronic transmission for form 8850 (Pre-screening notice and certification for the Work Opportunity and Welfare-to-work credits).

D. Projected Market Penetration - The market penetration of business e-filing has not been as high as with individual e-file. However, given the pervasive use of computers and electronic communications in business, ETAAC expects that there's potential for significant future gains in business e-filing. The IRS has extended its marketing efforts into the business community and will need continued budget support and resources in this area. In conjunction with outside consultants, the IRS is developing an overall

marketing strategy for ETA business products and services, primarily focusing on the top six business returns including form 1065, the Form 941 suite of products, Form 1041 and information returns (W-2's, 1099, etc). One of the primary keys to successful expansion of the program in the future is to ensure a standardized, business-friendly approach to formats, protocols and program requirements.

The success of the business e-filing initiatives will be directly related to the ease of use and market acceptance. A recent CERCA (Council for Electronic Revenue Communication Advancement) Practitioner Survey reported that 37% of the practitioners who currently prepare business returns would e-file them. Approximately 60% of those polled would not e-file, including 49% who were not at all likely. The ETAAC makes the following recommendations with respect to business e-filing initiatives.

- **No Congressional mandates.** E-filing service success should be based on ease of use and convenience, not on government mandates.
- **Work with the small business organizations.** The large volume of business returns are small business filers. Small business has different challenges and needs. Congressional mandates impose undue burdens on the small business community. We recommend that the ETA and the Small Business/Self-Employed Division work closely with the small business organizations and conduct market research in developing services to insure the programs developed are of benefit and will be used voluntarily by the small business community.
- **Work with other stakeholders.** Bringing together a task force of stakeholders to identify and solve the barriers of business e-filing is an efficient process resulting in cooperation, acceptance, and ownership. E-filing will flourish.
- **Marketing, education, and security measures.** Target marketing of business e-filing services is critical in informing business of the e-filing opportunities and respective benefits. As the business community becomes more informed and educated, the concerns of security will lessen, and e-filing will become the accepted means of filing returns.

4.0 Self-Preparer Challenges and Initiatives

Initial electronic filing initiatives were aimed at the professional tax preparation community. As a group, that segment has responded with steadily increasing rates of participation and generally positive reactions to IRS initiatives aimed at encouraging private sector partnership. However, nearly half of all individual filers prepare and submit their own tax returns, without the assistance of professional practitioners. Most of these taxpayers currently submit paper returns, which the IRS must then process through its manual data capture systems. This results in high handling and data entry costs as well as the costs of resolving math calculation errors that would have been resolved prior to filing by computerized return preparation software.

To achieve the goals set for 2003 and 2007, the IRS has to make significant gains in convincing self-filers to prepare their returns by computer and to submit them electronically. Self-filers have two primary options for filing electronically:

- Tele-File, using a touch tone phone, is available for certain simple returns;
- Online filing, either using privately-purchased tax preparation software available for personal computers or using services provided at software provider websites.

Tele-File usage has been steadily declining from a relatively small base, and is not viewed as a strategic tool for the IRS. The constraints of following a prompting script and accurately entering data using the telephone touch pad restrict this e-file alternative's utility to simple returns.

Year to year online filing growth was 34 percent in 2001. That's a significant growth rate, but the base of online filers is still relatively small (6.7 million filers). A major challenge for the IRS – and an essential element of any plan to reach 80 percent e-filing -- is finding ways to encourage self-preparers to take advantage of online filing opportunities. While the Tele-File option is provided directly by the IRS at no cost to the user, online filing options are provided through private-sector third parties. Most charge a fee for either the online preparation service or the electronic filing. There are limited no-cost online filing options offered by some providers to certain taxpayer segments, but there is not a generally available no-cost filing option for federal e-filers, as there is for some state filers, where the state provides a direct online filing option.

Self-Preparer E-Filing Status and Analysis

While self-preparers comprise approximately 43 percent of all individual return filers and filed approximately 56 million returns in 2001, only 11.1 million of those returns (less than 20 percent) were filed electronically. Electronic returns received from self-preparers represented less than 28 percent of all e-filed returns.

On-line electronic filing grew by 34 percent in 2001. While in one sense this is a significant increase, it falls short of the projected growth rate of 66 percent, required to keep IRS on the path to its goals of 80 percent electronic filing by 2007 and 100 percent electronic filing of computer prepared returns by 2003. The base of on-line electronic filers is small relative to the base of practitioner electronic filers, driving the need for higher growth rates to achieve IRS goals. However, the compounding effect of high growth rates could

increase the universe of online filers rapidly in the years approaching 2007. Online filers represent 17 percent of total electronic filers, whereas practitioners file 72% of all electronic returns.

Tele-File use decreased by 15.4 percent in 2001, continuing a trend started in 1998. If the filers abandoning Tele-File were shifting to online filing, this would not be a serious concern, other than bringing into question the continued viability of the Tele-File program. However, it appears that these filers are reverting to paper filing, suggesting we're losing ground with this segment. We urge the IRS to critically review the status of the Tele-File program and assess how best it fits, if at all, into the overall e-file program.

Overall, shortfall in projected growth in e-filing of Individual Tax returns in 2001 was largely due to the reduction in returns filed via Tele-File and the lower-than-expected growth in online filing.

A. E-File Users - According to 1999 IRS market research, the profile of e-filers looks as follows:

- e-file users are younger than non-users in every market segment;
- e-file users have lower income than paper filers; and
- e-file users more often are single, have a refund due, claim EIC and take advantage of direct deposit.

B. Paper Filers - A large number of self-filers continue to prepare and file their returns on paper. The reasons for their behavior are not well understood, nor are the potential motivators that would convince them to switch to e-filing. According to the 2000 Taxpayer Advocate Report to Congress, the cost of electronic filing was ranked 13th among the issues the IRS should address (the first 12 were not related to e-filing). The Taxpayer Advocate has expressed concern in particular about the impact of cost on low-income taxpayers who claim the Earned Income Credit. Other surveys and conventional wisdom suggest that many taxpayers object to paying for online filing and, absent any other compelling reason to act, choose the option that's perceived to be least expensive to them.

Since, as articulated above, e-file growth rates for self-filers in the range of 35-40 percent will be required to meet the 80% goal, it's essential that IRS develop a better understanding of the behaviors, concerns and motivations of this taxpayer segment. The next section of this Report addresses some of the presumed barriers to greater e-file participation by self-filers.

Addressing Barriers to Self-Filer Participation

There's an abundance of speculation, some inconclusive survey results, but little empirical information to help in understanding why self-filers don't e-file in greater numbers and what would motivate them to do so at greater rates in the future. The following table presents some of the presumed barriers and solutions to overcome them.

Barriers to Self-Filer E-Filing	Solutions to Overcome Barriers
Cost to filers of using third-party online filing software	<ul style="list-style-type: none"> • Provide no-cost or low-cost online filing; increase marketing of no-cost and low-cost alternatives • Provide tax credit or other financial incentive for e-filing • Encourage private-sector third parties to offer free online filing alternatives
Self-select PIN program execution is difficult	<ul style="list-style-type: none"> • Simplify signature alternatives
Lack of perceived value for non-refund returns	<ul style="list-style-type: none"> • Find other incentives, such as extension of time to file and pay • Provide tax credit or other financial incentives for e-filing
Lack of access to personal computers and the Internet	<ul style="list-style-type: none"> • Partner with schools, libraries and community service organizations to provide access for e-filing purposes
Concern with transmission and information security and privacy breaches	<ul style="list-style-type: none"> • Ensure appropriate internal IRS security controls, work with third parties to provide a secure end-to-end process, then take the offensive with an aggressive marketing message regarding security • Develop web-based 2D barcode option
Lack of awareness of program	<ul style="list-style-type: none"> • Targeted marketing campaign
Taxpayers are ambivalent about technology (ease, security)	<ul style="list-style-type: none"> • Overcome taxpayer ambivalence with increased education and marketing to taxpayers promoting e-filing as the “cutting edge”

ETAAC believes that it’s essential to the future success of the ETA program to understand the behaviors, concerns and motivations of this taxpayer segment. Having made significant gains in practitioner participation, future growth is dependent on bringing substantial numbers of new self-filers into the fold. The following section discusses some of the incentives that should be considered to increase self-preparer e-file participation, once the barriers and motivations are better understood.

Self-Preparer E-Filing Incentives

During the last five years, electronic filing at the state and federal level has experienced considerable growth; however, it is not occurring at the pace that the IRS or the states have forecasted. It is clearly understood by all tax administrators that electronic filing is a more cost-effective process. Although there is recognition that paper processing will never completely disappear, the challenge for the IRS as well as the states is to discover new ways to market to and entice the self-preparer to participate in the e-filing programs.

One approach to the e-file participation dilemma is to offer a wider range of incentives to the self-preparer. Many of these incentives require a "thinking outside of the box" mentality and may require Congressional approval. Some of the incentives would also require additional funding; however, the cost savings from not handling paper returns should provide an offset to those costs. A more detailed analysis of potential savings is needed to determine the optimum level of incentives that could be justified to obtain the goal.

Some of the possible incentives include extending payment and return due dates by one or two weeks for e-filers, providing a \$50 - \$100 AGI reduction to the e-filer, and doubling the already proposed \$10 tax credit for first time e-filers. The following table outlines possible incentives to increase self-preparer e-filing participation.

Incentives for Self-Preparers	PRO	CON
Free electronic preparation & transmission software	Reduces cost & improves accuracy of IRS processes; Provides taxpayer with free federal software.	The cost of providing the software free of charge by the IRS.
Free electronic preparation & transmission software, to include state software	Reduces cost & improves accuracy of IRS processes; Provides taxpayer with free federal and state software.	The cost of providing the software free of charge by the IRS. Additional cost of coordinating and packaging specific state software.
Extend filing due dates 7 - 15 days (Carolina has extended due date to May 1st for internet filers)	Allows the taxpayer additional time to prepare their return.	Legislation on the Federal and state level would be required to relax this requirement.
Set up temporary e-file sites	The IRS could set up temporary e-file sites in malls, libraries, community centers, banks, and other locations to make e-filing easier and more convenient for the taxpayer.	Cost associated with multi-site equipment, space rental, staff, etc.
Discount for E-Filers & EFT Taxpayers	The IRS could provide taxpayers with a rebate for e-filing and for making an EFT payment early. For example, a 1% rebate if filed at least 30 days early, and a 1.25% rebate if filed 31 to 45 days early.	Loss of revenues from offering rebate.
\$50 to \$100 AGI reduction	Taxpayers who file electronically would be eligible for an AGI reduction. Taxpayers would be rewarded for e-filing.	Loss of revenues from offering reduction.
\$10 Tax Credit for taxpayers who file their return electronically, tax credit doubled for first time e-filers	The \$10 tax credit was proposed by ETAAC in their 2000 Annual Report to Congress. This incentive would also provide a \$20 tax credit for first-time e-filers, to get them into the program.	Would reduce total revenues collected by the IRS.
Toll-free telephone "help-line" for e-filing support	1997 Survey of tax practitioners indicated that 43% of practitioners would be "Highly Motivated" and 32% would be "Moderately Motivated" to participate in e-filing with this incentive.	The cost of the toll-free line and staffing the "help-line".
Taxpayer's signature not required for each filing	1997 Survey of tax practitioners indicated that 38% of practitioners would be "Highly Motivated" and 31% would be "Moderately Motivated" to participate in e-filing with this incentive. The tax practitioner would not have to obtain their clients signature each and every time that they submitted a return for them, thus speeding up the process and reducing costs.	Legislation on the Federal and state level would be required to relax this requirement. Legal liability may also be an issue. If a taxpayer denies its his/her return, then he/she is probably a non-filer.

Defining New Approaches

A. No Fee and Low Fee Online Filing Alternatives - In its 2000 Report to Congress, ETAAC addressed the complex question of how best to provide no-fee or low-fee online filing alternatives to encourage broader e-file participation by self-preparers. The Report recommended, in summary, that competitive market forces be allowed to play out before the IRS stepped in to provide no-fee, direct online filing. At the time, open competition had contributed to the availability of a few no and low fee alternatives, and it appeared that more would be offered in filing year 2001.

These privately-provided "free" filing alternatives are provided with the expectation of generating downstream benefits, such as future customer loyalty, sale of more deluxe tax preparation services, or purchase of related products. However, the expectation of expanded opportunities for privately-provided no-fee filing was not realized this past year. In at least one case where a private sector provider was expected to provide no-fee online filing, the business model apparently couldn't deliver the expected benefits to justify the expense.

Last year's ETAAC Report recommended a reassessment of the availability of private sector no-fee opportunities in two years. There is a multitude of issues surrounding this question. A few of them are presented below.

- It's important in this context to understand the distinction between fee and cost. Any form of electronic filing comes at a cost; the issue is who bears it.
- Over the past few years, private-sector third parties have provided the only electronic filing options available to taxpayers that don't choose to use a paid preparer. These companies have invested significant amounts of money and effort in building, marketing and providing online and personal computer (PC) based electronic tax preparation and filing tools. They are naturally reluctant to see their business models undermined by government provision of the same or similar services.
- With the filing of paper returns, it's fairly easy to distinguish return preparation from return transmittal. With electronic filing, the boundary is blurred. It's difficult to define a simple, consensus-building model that clearly delineates electronic tax advising functions, which are arguably in the domain of the private sector, from the electronic calculation, error correction and transmission functions, which are arguably a legitimate public sector service.
- The potential increase in online filing that would result from the IRS offering a no-fee alternative has not been identified. Further research is needed to identify the potential impact of free filing software, and the offsetting cost savings to the IRS from achieving the higher levels of E-Filing.
- A significant percentage of Earned Income Tax Credit filers who receive public assistance through their EITC refund pay a preparer to file their return, reducing the public benefit of the payment

Consistent with the 2000 ETAAC Report to Congress, the 2001 ETAAC recommends a reassessment next year of the online filing marketplace and of the progress in meeting online filing objectives. In preparation, ETAAC strongly recommends that the IRS perform or contract for a targeted review to determine the obstacles, motivations and mitigation strategies, if any, required to ensure continued growth in self-preparer e-file participation. This review should include:

- A survey, by demographic segment, of self-preparer awareness of and attitudes toward e-filing;
- A determination of the impact cost has on self-preparer e-file participation, relative to other concerns that impede e-filing;
- An analysis of the current and projected future availability of no fee and low fee online filing;
- An assessment of the current and future direction of no fee and low fee online filing, and what could be done to promote it;
- A ranking of obstacles, by demographic segment; and,
- An evaluation of the motivators and incentives required to advance the self-preparer e-file program.

Time for this review is of the essence, given the critical role this group will play going forward in meeting overall e-file goals. The review should provide the starting point for a segmented strategy, potentially involving marketing, education, outreach and incentives. We recommend that this should be a prime focus for ETAAC as well as the IRS over the next year.

B. Marketing & Distribution - There are some creative ways to enhance marketing and leverage distribution channels to achieve our goal of 80% e-filing by 2007. ETAAC recommends consideration of the following key initiatives to support the e-file value proposition. Our overall marketing goal is to broaden e-file awareness and educate and motivate taxpayers to e-file.

C. Key Channels & Initiatives for Market Awareness - There are multiple channels and media that can be activated to raise awareness, including:

- The IRS Web site
- Employers
- Advertising
- U.S. Government Centers
- Community Activities
- Annual tax materials

D. IRS Web site - This is probably the premiere vehicle for enhancing the e file message and increasing taxpayer adoption.

As the web site advances and provides not only information and the key messages, but also the capability to ask questions, the option to speak or “chat” with a live IRS representative and ultimately to complete online transactions. An improved site should continue to drive more visitors to the site both during tax season as well as throughout the year.

E. Employers - Innovative employer programs can promote taxpayer employees to e-file. Cooperative programs can include on-the-job access to PC's and tax filing software, coupons for tax services and general e-file education and information. Incentives for employers could also be considered.

F. Advertising - Advertising is a good medium for raising taxpayer awareness of e-filing and its benefits. The TV and print advertising should continue, but should focus more on the taxpayer benefits of E-Filing. The IRS should continue to analyze the results of its advertising to assess the correlation between improved e-file adoption rates and advertising impact.

G. U.S. Government Centers - Not only can the sanctioned U.S. government centers become distribution centers for tax material and information, they can be leveraged to become education centers. The U.S. Post Offices and libraries and IRS offices could set up "e-file centers" for information, kiosks for questions and messages, comment boards, email and U.S. mail surveys. Also, some centers may want to consider conducting e-file seminars.

H. Community Activities - In addition to the U.S. government centers, local community activities could be established to assist in the education and market awareness campaigns. For example, local libraries or town centers could host e-file seminars with local tax preparers, IRS representatives and/or software companies.

5.0 Overall Issues

The specific goals set by Congress relate primarily to electronic filing, but the overall thrust of Electronic Tax Administration is broader than that, encompassing new ways of doing business through electronic service delivery channels. The next sections of this report address some of those additional Electronic Tax Administration issues.

The Modern Tax Administration Environment

Over the past several years, the focus of many tax agencies around the world has been on improving the efficiency of internal processes and enhancing involuntary collection systems. Recently, with generally heightened customer expectations for quality service and the growth in services provided over the Internet, the focus has shifted to enhancing the effectiveness of customer service systems. While efficiency and cost-reduction are not neglected as objectives, quality customer service is now the main theme when tax executives talk about their burning issues. There's also a growing recognition that improvements in customer service can increase voluntary revenue collection. While some argue that tax agencies aren't likely to win many new customers by providing superior service, there are clearly revenue benefits to be derived from making it easier for willing taxpayers to comply.

In the tax environment, the notion of "customer" isn't straightforward. Tax agencies provide services to individuals, businesses of all sizes and in various industries and tax professionals who represent taxpayers in various matters, ranging from filing returns to defending legal actions. The tax administration world is a complex place. It's governed by multi-jurisdictional statutes and rules, involving highly specialized knowledge and processes and inhabited by a broad range of customers, who mostly conduct business with tax agencies by mandate rather than by choice. This would seem to be a challenging place to build a customer service center, but enlightened tax professionals understand that most taxpayers want to be compliant. Improving service to tax customers, and making it easier for them to understand and comply with their obligations can enhance voluntary compliance and create a more business-friendly environment.

Personalized customer service is a fundamentally constrained resource. This requires a strategy that preserves the most scarce and valuable human resources to address only the most complex tax processing and policy issues. Difficulties in predicting the demand for customer service, linked with the scarcity of real tax expertise, means that the IRS has to implement a customer service program that combines four strategic elements:

- **Improve accessibility of services** by expanding communication channels, reducing the demand for services by improving quality and accuracy, and adding human and technical resources, where necessary.
- **Provide more self-service options** – offloading service demand from scarce human resources to self-service applications through the web and other means while still maintaining level of access and level of service metrics and targets.
- **Improve the ability to provide "one and done" service**, by matching requests to the right resource, by making taxpayer-specific information readily available and by providing access to institutional memory (statutes, regulations, policies, etc.) and "know how" (FAQs, best practices, solution scripts, etc). In this regard, it's also important to increase the education opportunities for service

representatives, focusing on retention and availability and use of knowledge management tools over time.

IRS Web Services

Inherent in any tax system is the obligation to provide all the necessary information that taxpayers, or their tax return preparers, need to comply with the tax system and accurately calculate and report the taxes due. Traditionally, the Internal Revenue Service has provided this information through printed publications, instructions and forms, and through person to person assistance by telephone and at local office sites.

Unfortunately, despite frequent “tax simplification” legislation, the Internal Revenue code has grown to over 1,395,000 words, to which the IRS has added another 8,000,000 words of interpretive regulations and the Tax Courts have added even more case law.

As a result of the complexity and frequent modification of the tax code, use of paper publications requires frequent and wasteful re-printing. Use of paper publications can also result in accidental use of outdated information, and forces taxpayers to constantly request up-dated printed materials. Because of cost constraints, most printed publications also provide only general, frequently used, tax information and do not provide details about unusual situations, or complete information on relevant regulations or tax court rulings. Unfortunately, taxpayers also often don’t recognize the need for materials until very close to filing deadlines, when it is difficult for the Service to provide printed materials within the needed time frame.

The IRS’s programs to provide individual taxpayer assistance through telephone and local office assistance require a substantial commitment of staff and other resources. During 2000, IRS Toll Free tax information staff assisted about 33 million callers, but 22 million taxpayers, about 40% of all callers, were not able to reach assistance. Past surveys of the IRS’s accuracy in providing individual taxpayer assistance have often shown sub-standard performance, probably because of inadequate staff training, the short time available for each contact, and the overall complexity of so many tax issues. In 2000, the Service estimates that the telephone service tax law information they provided was incorrect 26% of the time.

The rapid growth of Internet use, with its wide availability and extremely low cost of information distribution now makes it the ideal medium to provide information and filing services in the future. Compared to paper documents, web based information can be easily, quickly and inexpensively updated with changes in the tax code, or when new regulations are issued. An improved web based tax information system would also provide taxpayers with convenient “anytime access” to all levels of tax information in one easily searchable database. Because the tax information provided on the web site can be easily reviewed for accuracy, and a much more detailed and complete explanation of any tax issue can be provided to the taxpayer, the accuracy of tax information provided to taxpayers should improve significantly. In a fair tax system, all information needed to determine the fair and correct tax amount should be available to all taxpayers, without cost barriers.

Improved electronic data access, information distribution and communication tools offers the potential for significant cost savings and personnel reductions. Current Operating Division plans for pre-filing information assistance still put too much emphasis on traditional, high cost, non-electronic, methods. Inadequate resources are being devoted to rapid e-services implementation for all Divisions.

A. The current IRS Web Site - Because tax issues are important to every individual and business, the current “Digital Daily” web site has received recognition as one of the most frequently used US Government internet sites, with about 1.6 billion hits per year. As one of the first Federal internet sites it tried to be a little of everything, but has no clear data organization, no user customization, and no search capability beyond an index of the general topic areas of the IRS publications posted on the site. The current site, which contains about 900,000 pages of information, does provide the ability to download and print all forms, instructions and publications, which has reduced the need to distribute paper forms, and has also provided a contact point for disseminating news to some taxpayers and practitioners.

B. Future Internet Services - The IRS’s future Internet presence should consist of three separate functional Web systems –

1. A comprehensive, but “user friendly” general public Information and Education site, to replace the current "Digital Daily" format with one that is customizable by user type, and information needs. It would also offer free subscriptions to targeted e-mail "newsletters" to alert people to changes and special events.
2. A highly secure internal IRS "Intranet" system for taxpayer account information lookup and processing, staff communication, and web based employee education.
3. A secure taxpayer and preparer interactive transaction site for account specific information access and electronic form filing.

C. General Information & Education Site - This site would replace the current “Digital Daily” site at www.irs.gov with a completely redesigned, comprehensive tax reference site that would be customized to the user's needs and type of filing entity. This could be done by the use of a main page user-type selection screen, pre-stored user information profiles, or separately bookmark-able sub-pages, similar to the current SBSE menu sub-pages, that are targeted at specific user types. The site should also allow the user to select the level of information detail they want from a basic explanation of an issue using copy from existing publications, to a totally comprehensive hypertext search of all IRS publications, instructions, regulations, IR Code sections, and court rulings. Alternate language sites should also be provided which contain manually reviewed computer translations of all important tax information and form instructions in Spanish and other major foreign languages

Targeted sub-menu pages should be developed for major user groups including -

1. A **New Taxpayers and Students** page for people needing basic information and education about the tax system, using articles similar to some of the "cover stories" from past Digital Daily features, and also including new interactive web based education programs and knowledge retention tests. This sub-site could be used by school districts nationally to provide web-based education to students who are about to become new taxpayers.

2. An **Individual Taxpayer** site focused on information needs of 1040 form filers.
3. A **Small Business/Self Employed** site for schedule C, E, and F filers, partnership, and small-corporation returns, with detailed information further focused by entity or form type, and industry sector.
4. A **Large and Medium Size Business** site for large corporation or partnership information.
5. A **Non-Profit & Government Entity** site with specialized information and education for these unique taxpayers.
6. A **Practitioner** site designed to meet the information, communication, and training needs of the professional preparer community, with fast access to information on both business and personal tax issues. The speed, ease, and completeness of data access will be a key issue in attracting professional users.

The site should also provide the information database engine to support web-linked, line-specific, tax form instructions and information. This on-line help information could be hot linked to both private and public electronic filing software so users could quickly clarify issues or questions from official IRS information, and continue with the filing process. Links should also be provided to all state tax authority sites. Having quick access to line number and issue specific information should be an important incentive to increase e-filing participation, particularly by self-filers.

Targeted e-mail "newsletters", with brief summaries of tax code or procedure changes, with hot links to more detailed information on the web site, should be offered to all key taxpayer groups and the practitioner community. A web site by itself is good for providing reference information, but poor for informing busy users of important changes and special events they may be interested in. The web site should of course provide access to recent back issues of the e-letters as well as offering a form for subscribing and un-subscribing.

The General Information site should be developed and managed by the Electronic Tax Administration section of the Wage & Investment Division, who would be responsible for overall appearance and functionality issues, common data bases, and search functions. Each Business Operating Division would be responsible for developing the information content of its sub-menus and unique content pages linked to them. If the site is moved to a new server provider, as planned, the contract should assure adequate bandwidth capacity for peak filing season usage levels.

D. IRS Enterprise Intranet System - The development of the internal Enterprise Intranet system for staff information access, communication, accounting and problem resolution adjustment transactions should be the responsibility of the CIO and Information Systems Organization, but should be developed in full coordination with the other IRS sites to assure compatibility with future enterprise data models and consistency of internal and external tax law reference information. The multiple use of shared basic data files will also reduce development and long-term maintenance costs. Specifications for the Customer Account Data Engine (CADE) software should consider use of parts of the software to drive the external E-Services customer account information lookup process.

The internal site should maintain the highest levels of access security with multiple firewalls, user authentication routines, strong data encryption, and secure use logging and auditing to check for unauthorized use. The system should also provide data file protection through use of multiple servers, redundant locations, and the highest level of virus protection.

E. Taxpayer and Practitioner Secure Transaction Site - This new secure server site would be dedicated to interactive e-service applications. The transaction web site should have adequate secure bandwidth to support peak transaction levels without loss of the transaction session. Access would be limited to various classes of authorized users through user registration, password, and taxpayer authorization of any third party access to their data records. Like the Intranet system, this site should include high levels of hardware and software security, and strong encryption of all communication. A standard set of XML data element identifier codes or "tags" should be developed, with international coordination, to facilitate software development and transmittal of tax data.

This site should also have customized service option menu pages based on user type and level of authorized access, or "earned" partnership services. Although the site will initially focus on electronic transactions such as TPIN registration, electronic data lookup and programs for basic personal and corporate income tax forms, the e-services site should be designed to provide filing and lookup options for all tax related information from other agencies in a consistent user friendly format. For businesses, this should include integration of the Social Security (SSA) electronic W2 filing program; the Electronic Federal Tax Payment System (EFTPS) for depositing and reporting; the IRS Filing Information Returns Electronically (FIRE) program; and the Simplified Tax And Wage Reporting System (STAWRS) for joint filing of employment tax returns.

User interfaces on all programs should be carefully reviewed for consistency and ease of use and adequate entry field error trapping to assure that all filed data is as accurate and legally correct as possible. Current EFTPS software for example, should be rewritten to improve the user interface and provide better reporting options for users. All programs for making electronic transfer payments should also allow for 24/7 transfers, or at least provide the same deposit service hours for taxpayers in all time zones. The current EFTPS program using only eastern time zone depository banks, reduces the business hours during which west coast time zone businesses can make deposits without having them moved forward to the next banking day, which can be as much as three calendar days on bank holiday weekends. Access to some types of taxpayer account data lookup or preparer services should be limited to e-filers and EROs as an incentive to increase electronic filing.

GAO Security Report

During the 2001 filing season, the GAO issued a report regarding e-file program security weaknesses at the IRS. While the report identified important security issues that the IRS acknowledged and rectified, it was widely misinterpreted in the media and may have had a chilling effect on e-file growth this past season. The IRS attempted to assuage concern by clarifying that no actual breach had taken place and committing to resolving the issues identified in the report. Regardless, the IRS needs to be aware that perception is reality, particularly with respect to matters of confidentiality, privacy and security.

The ETAAC members firmly believe that security and trust are essential to growing the e-file program, and support IRS efforts to both clarify the message about security of e-filing and carry forward its own strong message about its commitment to its fiduciary responsibility to protect taxpayer information.

Impact of IRS Reorganization on ETA

The IRS Reorganization of its numerous operational units into the current four new customer-oriented operating divisions has had a significant impact on ETA. Seated in the Wage and Investment Division as a separate category, ETAAC notes that ETA may not receive the proper visibility and attention needed to obtain the overall level of priority needed to ensure the advancement of electronic tax administration in all Divisions. The Divisions recognize the high priority status of electronic tax administration if ETA is to permeate each and every business area of the Service.

There would seem to be advantages to having ETA placed on a higher organizational level as an independent entity serving the entire enterprise. All Divisions that have direct contact with or impact on the taxpaying community would benefit from the increased synergies and cross-organizational actions and responsibilities such a structure might promote.

The new IRS structure has provided for a number of very positive initiatives. These include the introduction of the National and field-based Account Manager, the creation of the Electronic Tax Administration Advisory Committee and the E-Business Steering Committee, the development and distribution of improved ETA marketing materials, and the overseeing of ETA-specific programs and technology development.

We believe that the wealth of information provided by and the accessibility of Account Managers, as well as the valued and respected interchange of the IRS and ETA Committees, have widened the lines of communication. Tax Season 2001 saw increased usage, and one can surmise, positive response to the marketing materials distributed to tax professionals, as well as ETA paid advertisement placements.

In the area of programs and technology we saw several successes and noted many areas for advanced consideration and improvement. The additional forms and schedules to the e-file system helped to make e-file feasible for many more taxpayers. The turnaround time in getting these items up and available in time for Tax Season 2001 is commendable and can clearly be credited to a better working division.

The area of technology was not as bright. Whether true or perceived, the IRS and ETA still have the battle of informing and convincing taxpayers and tax professionals that the system is easy to use, reliable and safe enough to trust. During Tax Season 2001, delays and rejects, regarding e-file and/or the Self-Select

PIN, rang out as EROs and taxpayers strived to support and take part in IRS e-file as a vehicle to meet their tax responsibilities.

It is critical to note that in order to achieve the main IRS e-file goals, the system must be operationally and technologically consistent and dependable. We understand from the IRS that since the organizational structure is complete, there will be more focus on operations. The four issues in need of continued attention and resources include:

- functionality
- reliability and dependability
- security and privacy
- marketing ingenuity

As the foundation for the success of IRS e-file, these issues, positively affected, can reap significant user results.

E-Filing Fraud Issues

As the filing of individual tax returns via IRS e-file continues to grow, it is anticipated that instances of fraud on those returns will increase as well. E-file, with its inherent checks and balances, cannot be viewed as a more susceptible vehicle for the allowance of fraud. In fact, e-file returns have the ability to be a better detector of fraud compared to paper filed returns. E-file allows for better detection of fraud on several fronts including earned income credit due diligence, W-2 fraud detection, and practitioner detection. This will only be possible with faster electronic filing of all information returns that are needed to check against the tax return, or at least checking of the return against prior year data or information returns for the first three quarters of the year.

Individual tax returns claiming an earned income credit are frequent targets of fraud. Elements of abuse include the fraudulent reporting of W-2 wages and claiming of dependents, resulting in large earned income credit refunds. E-Filing can enable fraud detection by a “real time” electronic matching of W-2 information and dependent social security numbers before a refund is issued. The matching on a paper filed return occurs well after the refund is issued, and the taxpayer can no longer be found.

In addition, electronic fraud detection alerts would enable EROs to be better detectors of fraud. ETAAC believes this capability would be an enormous fraud prevention measure. This, coupled with fraud detection mechanisms built into software and the debt indicator program, may serve to curtail many of the fraudulent return practices that today go undetected and unnoticed. We believe that e-file will change the face of fraud detection and, in the long run, prove to be a superior vehicle in detecting and deterring instances of fraud.

6.0 Recommendations

Requests for Congressional Support

A. Congressional Goal vs. Mandate - The ETAAC sees the goals established in the Internal Revenue Restructuring and Reform Act of 1998 as strong, positive motivators for continuing the focused and innovative e-filing efforts we've seen to date from the IRS. The goals will be difficult to obtain, as they should be. However, with the appropriate focus and resource commitment, ETAAC believes they are attainable. We would strongly urge Congress to resist pressure to reduce the goals at this point.

We would equally strongly urge that Congress not try to force attainment of the goals through statutory mandate. While e-filing efforts may now need a mid-course correction, the Congressional goals are continuing to serve their intended purpose. They stimulate innovation at the IRS, and drive the private sector tax service and software providers and taxpayers to voluntarily choose to e-file, based on perceived benefits, rather than being forced to by mandate.

B. Timely Passage of Tax Legislation - The ETAAC recommends the timely passage of legislation affecting the current year income tax returns. Timely passage of tax legislation would provide much needed time for the IRS, tax preparation software providers, and other suppliers to complete and properly test their systems before the start of tax season. This is particularly critical with electronic filing, since private-sector software providers, as well as the IRS, need additional time to develop and test e-file software.

The Critical Dependency on Security and Privacy

While improving customer service and efficiency are primary objectives of ETA, we also understand the critical importance of protecting privacy and the security of confidential tax information. Opening new channels of service and communication presents significant challenges with respect to ensuring the privacy, confidentiality and security of taxpayer information. On the one hand, The IRS desires to make customer information readily and conveniently accessible. On the other hand, the agency is committed to its fiduciary responsibility to protect that information from unauthorized disclosure and attack.

We understand the urgency of rolling out new self-service options, but are also keenly aware of the chilling impact that a security breach would have on the IRS's customer service initiatives.

Debt Indicator Permanency

The ETAAC recommends that the Debt Indicator be made a permanent tool for all e-file returns. During the last tax season, the Debt Indicator proved to be a critical vehicle in the growth of e-filing. Based on the increase in e-filing and industry insights, it is estimated today that a majority of e-filed returns filed by practitioners are accompanied by an approved refund anticipation loan application from a financial institution. The DI program contributed to the decline in pricing of bank products to taxpayer consumers.

Not without issues, the DI began its second tax season on a negative note. Tax practitioners grew leery as reporting problems, loading data issues, and errors became evident. Many taxpayers were upset when

bank products were denied or not delivered in a timely manner due to DI issues. Because of this, the ETAAC recommends that more internal testing be performed throughout the year, especially in the months prior to the start of tax season. The ETAAC suggests the Treasury work along with the IRS and allow a closer relationship with other Treasury groups, namely Financial Management Service (FMS), to foster cooperation and synergies to make the transmission of information smoother and timelier, and to affect proper system function on the first day of e-file startup.

The ETAAC believes that more descriptive information, i.e. type of debt, delivered through the DI would be beneficial to both tax practitioners and taxpayers. This information would allow tax practitioners to identify fraud during the tax preparation process, as well as notify taxpayers with specific information regarding the organization(s) claiming a debt issue with said taxpayer. Fraud can and should be prevented on the front-end to protect the interests of all taxpayers. Clearly, taxpayers will appreciate an immediate answer as to name of agency or organization claiming a balance due, rather than having to wait several weeks to find out through the mail.

Extend Filing and Payment Deadline for E-filers

As an incentive for taxpayers and practitioners to e-file, the ETAAC recommends the legal deadline for all taxpayers to file and pay any balance due be extended to if they e-file. The ETAAC estimates that half of the returns filed in April carry refunds, which should offset any negative float resulting from delayed receipt of balance due payments. Some benefits may even be realized by spreading out the volume of last minute filing. Extensions should be especially appealing to taxpayers with balance due returns who do not realize the same benefit through e-filing as do taxpayers who are due refunds. We recommend any balance due on an extended filing electronic return be submitted by automatic debit to offset the processing time of a paper filed return with payment by check.

Develop New E-file Distribution Channels

The ETA should encourage the private sector to deliver e-filing services through major employers, unions, associations and other groups representing large numbers of taxpayers. Such organizations could provide tax preparation with e-filing and e-filing for self-practitioners as a benefit for their employees and members. The ETAAC recommends that the ETA encourage organizations and/or private sector providers to make such services available. Such encouragement might include marketing partnerships and financial incentives.

Expand Taxpayer Education on E-file

The ETAAC recommends that the ETA become more proactive in working with various organizations and entities to increase awareness and understanding of e-file. Examples of groups to work with are the Military, AARP, VITA, and public schools, among others.

Recommendations for ETA to Encourage Practitioners to Participate in E-filing

A. Revisit ERO Regulatory Issues - The ETAAC commends the ETA for making positive changes in ERO regulations. However, there are still issues to be resolved, particularly with regard to ERO sanctions and suspensions. Therefore, the ETAAC recommends that the ETA form an industry task force to study

these regulations and make recommendations for improvements that would result in this being less of a barrier for prospective new EROs.

B. Form a National ERO Organization - The ETAAC recommends that the ETA create a Web-based vehicle for EROs to communicate (i.e., an “extranet”) to obtain information, advice, resources and support to help them increase their levels of participation in the e-file program. Features would include an ERO chat room, bulletin board, list of volunteer ERO mentors, links to Websites of interest to EROs, bibliography of ERO-related publications, ERO resources, calendar of events pertinent to EROs, advice for tax practitioners who wish to become EROs, FAQs, etc. The ETA should also provide an ERO help line.

C. Registration of All Tax Practitioners - The ETAAC recommends that all paid tax preparation firms and independent tax practitioners who are not EROs be required to register with the IRS and meet the same standards required of EROs. IRS registration of all practitioners would remove the significant disincentive that now exists for tax practitioners to become EROs. If all tax practitioners were subject to registration requirements and regulations similar to those imposed on EROs, this barrier to participation would be greatly diminished. The cost of administering this registration process should be less than the cost of providing financial incentives. The ETA could process such registrations along with ERO registrations. Then, when a tax practitioner signs up to become an ERO (as all tax practitioners should eventually do), most of the ERO registration process would already have been completed.

D. Selective Tax Credit for E-filing - Determine a way to provide a tax credit for e-filing that would not extend to all or most taxpayers who are already e-filing for their convenience. A first-time e-filer tax credit might be perceived as unfair to taxpayers who are already e-filing. However, a tax credit for only Form 1040 filers might be palatable to taxpayers and would effectively exclude basic tax returns (for which other provisions could be made) and most EITC returns that are already being e-filed to obtain bank products.

E. Mentoring Program - Electronic filing can easily disrupt the office procedures and there is a definite learning curve involved. By utilizing a mentoring program, veteran e-filers can help those new into this method of tax filing. The mentor/mentee relationship can be accomplished in a variety of ways. The ultimate avenue to accomplish this is a one-on-one pairing of tax professionals. The IRS tax forums would be an excellent place to initiate this program. At these forums, experienced e-filers attend looking for more information, while potential e-filers are searching for practice aids and advice. In a straw poll at the 2000 New Jersey tax forum, over 90% of the participants’ interviewed either welcomed the challenge to become a mentor or embraced the ability to contact a seasoned e-filer.

Mentors should be listed as such on the IRS website. They would allow special recognition to those that volunteer for this program. This program would also alleviate many of the call backups to the state e-filing coordinators. The IRS should set up a bulletin board for all e-filers, both new filers and experienced filers. This will allow peer help and review for those in the program, as well as an archive area and an FAQ (frequently asked questions) area.

The various PowerPoint presentations should be made available to various agencies such as CPA state societies and Enrolled Agents state societies and chapters. This would enlarge the audience to these presentations, thus showing non-filers the benefits of e-filing.

F. E-Services - One very important incentive for e-filing is expanded e-services to qualified EROs. Examples of this may include an expansion of the check the box authorization via electronic means. Some necessary items include the ability to verify estimated payments for the current year and to verify any carryover credits or deductions that affect the taxpayer. Other items include email resolutions for SSN/name match problems with both the service and the Social Security Administration, adjustments to the return, reasons for any refund delay and verification of information returns. Other e-services may include the ERO application and the ease of filing all extensions electronically including 1040, 1065, 1120 and 990. A toll free ERO practitioner hot line would be a valuable service.

G. PIN Program - The PIN program is a great boom to the e-filing field; however, this does not work with certain returns and is not truly a paperless system. There are returns that cannot use the PIN and these returns still must use the form 8453, which is then mailed to the Service center where the return was filed. In order to help complete this paperless cycle, perhaps those required paper forms that negate PIN usage could be faxed to the IRS Service center via a toll-free number. This would reduce the paper and mailing costs for those returns that cannot conform to the PIN program.

H. Self-Select PINs - After a few pilots, the IRS is to be commended for their efforts to establish self-select PINs for e-file taxpayers to use. Available to the majority of electronic filers, the self-select PIN was the next necessary step towards achieving a truly paperless e-file system for the taxpayer. It is important to note that the program holds great promise for the furtherance of e-filing. To address some of the problems encountered with using PINs in 2001, the IRS should reduce the complexity of the “shared secret” component of the PIN, relying instead on a single, easily understood piece of information, such as prior year Adjusted Gross Income (AGI).

Facilitate Stand-alone State E-filing

The ETAAC recommends that the ETA help all states to develop stand-alone e-filing systems, or provide financial incentives for the states to develop their own stand-alone systems. Many states now provide e-filing as a “piggyback” with the IRS return, but do not offer stand-alone e-filing capability. When such “piggyback” state e-filed returns are rejected, they cannot be resubmitted electronically to the state. In most cases, when a state e-file is rejected, the client(s) must be called back to the tax practitioner’s office to sign and mail the state return. This causes inconvenience to the taxpayer, added cost to the tax practitioner, and longer refund time than if the state return had been mailed originally. Many tax practitioners have had to refund state tax preparation fees to clients to keep them as customers. Taxpayers and practitioners become “turned-off” on e-filing by such negative experiences. ETAAC recommends continuing state “piggyback” e-filing with the IRS return (which provides efficiency) and adding the capability for state returns to be e-filed separately directly with each state.

Involve the Stakeholders / Associations in the ETA Planning Process

The ETAAC recommends that association industry groups such as CERCA, NACTP, NATP, NAEA and AICPA be included in the ETA strategic planning process through representation of individual members on the ETA planning group(s). The ETA has regularly invited key industry organizations and individuals to review its strategic plan and make comments and recommendations after the plan has been formulated. The ETAAC believes that this post-planning review occurs too late for the associations to provide meaningful input to influence plans prior to implementation. Input from the associations regarding all

issues being considered should occur during the ETA planning process. Such inclusion should also enhance buy-in by these key stakeholder groups.

In addition, ETAAC recommends the ETA liaison role include close working relationships with the Large Accounting Firms to increase the education and benefits of e-filing. This relationship would insure that future business initiatives (e.g. 1120) include full consultation with the Big 5 firms and their multinational clients before roll out.

Systematic Review & Replacement of Ineffective ETA Programs

The ETAAC recommends that the ETA develop a Systematic Review, abandonment and replacement process. This process would ensure that all ETA initiatives and activities are reviewed and scrutinized, at least annually. The manager of each initiative would be required to justify continuation of the initiative by demonstrating that the initiative is still necessary and that the benefits outweigh the costs, and that the resources could not be applied more effectively in some other manner. Any initiative determined to be unnecessary, ineffective, or inadequate would be abandoned, phased out or diminished. The purpose of this process is to free up scarce resources needed to drive new initiatives. Examples of such necessary changes follow:

A. Replace Magnetic Tape and Diskettes with Electronic File Transfer - The ETA expends a substantial amount of resources to receive, store and process taxpayer files it now receives on magnetic tapes and diskettes. In addition to the monetary cost, significant delays in processing result in inefficiencies and inadequate service to taxpayers and practitioners. The ETAAC recommends that the ETA phase-out magnetic tape and diskette submissions and convert to 100% electronic file transfer as quickly as feasible.

B. Phase out Tele-File in favor of more effective methods - Taxpayer use of Tele-File has been decreasing, while taxpayer demand for Internet based e-filing has been increasing. The ETAAC recommends that the Tele-File program be phased out and that Tele-File taxpayers be encouraged to file using low or no cost private online tax preparation and e-filing services, tax practitioner, existing IRS walk-in, or VITA/TCE services. The ETAAC believes that adequate low or no-cost private Internet, walk-in tax preparation, and e-filing options are already available to accommodate the needs of most Tele-File. The cost of Tele-File is estimated to be \$5.00 per return processed. We recommend funds spent on marketing and advertising this program be used to enhance promotional efforts for more viable ETA programs.

Revise the standards for taxpayer assistance programs funded by the IRS to require E-Filing of those returns

The IRS currently assists over 1,140,000 taxpayers with filing at IRS offices and another 4.6 million at volunteer sites at which the service provides preparation software and computers. A large percentage of these returns are then filed on paper forms. All returns prepared at IRS offices, as well as those prepared by publicly-funded voluntary and military organizations, should be filed electronically. The software provided to volunteer tax assistance organizations should also be appropriate for use by relatively untrained users, to assure taxpayers are provided adequate assistance.

ETA should develop a more detailed analysis of the full cost savings resulting from conversion to electronic filing of each type of form or return, to allow better understanding of the fiscal benefits of conversion

This will allow a better analysis of possible incentive options, and other support programs. A better understanding of the fiscal impacts will allow the development of a "financial statement" to more clearly show and track the public savings resulting from more efficient tax administration.

Undertake specific actions to enhance understanding of self-filer behaviors, motivations and incentives

A large number of self-filers continue to prepare and file their returns on paper. The reasons for their behavior are not well understood, nor are the potential motivators that would convince them to switch to e-filing. Consistent with the 2000 ETAAC Report to Congress, the 2001 ETAAC recommends a reassessment next year of the online filing marketplace and of the progress in meeting online filing objectives. In preparation, ETAAC strongly recommends that the IRS perform or contract for a targeted review to determine the obstacles, motivations and mitigation strategies, if any, required to ensure continued growth in self-preparer e-file participation. Since repeated annual E-file growth rates for self-filers in the range of 35-40 percent will be required to meet the 80% goal, it's essential that IRS develop a better understanding of the behaviors, concerns and motivations of this taxpayer segment.

Appendix A

ETAAC Members – 2000/2001

Kevin Belden, ETAAC Chairperson
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