



Electronic Tax Administration Advisory Committee

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Electronic Tax Administration Advisory Committee

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PREFACE

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) authorized the creation of the Electronic Tax Administration Advisory Committee (ETAAC). ETAAC has a primary duty of providing input to the Internal Revenue Service (IRS) on its strategic plan for electronic tax administration. Accordingly, ETAAC's responsibilities involve researching, analyzing and making recommendations on a wide range of electronic tax administration issues.

Pursuant to RRA 98, ETAAC also annually reports to Congress concerning:

- IRS' progress in meeting the goal to receive electronically 80% of tax and information returns;
- The status of IRS' strategic plan for electronic tax administration;
- Legislative changes that would assist IRS in meeting the 80% goal; and,
- The effects on small businesses and the self-employed of electronically filing tax and information returns.

IRS ensures that ETAAC membership reflects broad experience and stakeholder perspectives, including representation from state departments of revenue, large tax preparation companies, solo tax practitioners, software companies and business filers from both the non-profit and for-profit sectors. ETAAC member biographies are found in Appendix A.

In conducting its assessments and formulating its recommendations, ETAAC relies on a variety of information sources. Most importantly, ETAAC participated in several interactive discussions with IRS representatives. ETAAC also reviewed several reports, including those from the IRS Oversight Board (Oversight Board), the National Taxpayer Advocate, the Government Accountability Office (GAO), and the Treasury Inspector General for Tax Administration (TIGTA). We are most grateful for their insights. Finally, on occasion, ETAAC sought background insights from both industry and state departments of revenue. Notwithstanding the foregoing, the recommendations and opinions expressed in this report are solely those of ETAAC.

The Oversight Board, also established pursuant to RRA 98, has among its duties a similar Congressional reporting responsibility with respect to advancing electronic tax administration. Over the past ten years, the Oversight Board and ETAAC have concurred in many opinions and recommendations on the IRS' progress in the areas of electronic filing and electronic tax administration.

Finally, ETAAC recognizes the employees and leadership of the Internal Revenue Service for their continued efforts to administer an increasingly complex tax system and successfully process billions of transactions and hundreds of millions of tax returns. Our tax system could not operate without their dedication and commitment. Notwithstanding their busy schedules, IRS employees and managers made themselves available during the filing season to brief ETAAC on a variety of issues and initiatives, answer our questions and provide us with requested information – particularly the employees of the IRS Electronic Tax Administration Division (ETA). We appreciate their dedication, openness and candor. Without the continuing and full support of IRS, we could not perform the job you have assigned to this Committee.

Public comments on this report may be sent to etaac@irs.gov.

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EXECUTIVE SUMMARY

ETAAC's key observations and recommendations are below. The remainder of this Report is organized into major sections covering ETAAC's analysis, assessment and recommendations. We hope that this Report will help Congress and IRS make the best possible decisions in service to American taxpayers.

1. IRS MADE STEADY PROGRESS IN FILING SEASON 2011 AGAINST THE 80% E-FILE GOAL (PAGE 2)

IRS and industry delivered a banner year for increased electronic filing of individual tax returns, leading the way to one of the largest overall e-file rate increases in many years.

2. IRS MADE STEADY PROGRESS AGAINST ETAAC'S 2010 RECOMMENDATION AREAS (PAGE 7)

IRS made steady progress in key areas related to ETAAC's 2010 recommendations including driving the implementation of the preparer oversight and preparer e-file requirements, as well as delivering more stable performance of 1040 Modernized e-file (MeF) during the filing season. Opportunities for progress remain in other important areas, including increasing electronic filing of employment returns, reducing e-file rejects and leading enhanced industry collaboration and partnership.

3. THE FUTURE ENVIRONMENT WILL BE MORE CHALLENGING (PAGE 9)

IRS will face mounting headwinds as it deals with increased tax complexity, expanded responsibilities, reduced budgets and increased taxpayer expectations. IRS will need to assess its investment decisions and resource allocation rigorously, make the right tradeoffs and, importantly, challenge its current way of "doing business" by implementing new and innovative business processes and collaborative engagements with industry and states.

4. ETAAC HAS RECOMMENDATIONS IN FIVE KEY AREAS (PAGE 11)

ETAAC is making recommendations in five key areas (summarized below) that drive three key outcomes.

Key Outcome 1: Build a highly professional and capable electronic tax preparation and filing industry.

Recommendation 1: IRS should set appropriate standards for the electronic tax community in the key areas of security and accuracy.

Key Outcome 2: Focus on delivering those taxpayer services that only government can provide.

Recommendation 2: Congress should fully fund MeF, and IRS should complete MeF implementation as well as take prompt action to work with industry to reduce the volume of e-file rejects.

Recommendation 3: IRS should focus more attention on increasing the electronic filing of employment tax returns and, particularly, Forms 940 and 941.

Key Outcome 3: Leverage the capabilities and diversity of the electronic tax preparation and filing industry to deliver taxpayer services that can be better met through private sector innovation.

Recommendation 4: IRS should begin engaging with industry to discuss the Commissioners' vision for accelerated information reporting and real time data matching, but defer any further consideration of Simple Return.

Recommendation 5: IRS should increase and focus its collaboration with electronic tax administration stakeholders to drive efficiency, lower cost and improve taxpayer service.

1 PROGRESS TOWARD 80% E-FILE GOAL

One of ETAAC's primary responsibilities is to assess IRS' progress toward achieving its 80% e-file goal for major returns.¹ IRS made strong progress in 2011 with a 6% increase in electronic filing of major returns. IRS can continue to make steady progress with increased focus and active engagement with industry.

In reviewing historical data, ETAAC has identified several different measures used over the years to report and measure the e-file rate. To create a consistent measure, standardize cross-year comparisons, and facilitate analysis, ETAAC has developed an electronic filing "Index" (EFI) for use in this Report. The Index assesses the e-file rates of a defined set of major tax returns, including a methodology to project full year e-file rates based on "season to date" information for the main driver of electronic filing rates – the individual tax return. Details about the Index and ETAAC's methodology are in Appendix B.

1.1 ETAAC IS PROJECTING ANOTHER YEAR OF E-FILE GROWTH FOR IRS MAJOR RETURN TYPES

ETAAC estimates a 65.8% e-file rate for all major return types in 2011 driven by a full year individual return electronic filing rate of 77%.² (See Table 1) The current e-file level reflects strong growth – approximately a 6% annual increase for major return types. (See Table 2)

Table 1: 2011 Projected Electronic Filing Index (EFI)

Type of Return	2011 Projection		
	Total	E-Filed	EFI
Individual (Forms 1040, 1040-A, and 1040-EZ)	141,122,600	109,101,882	77.31%
Employment (Forms 94x)	28,981,600	6,891,100	23.78%
Corporation Income Tax (1120, 1120-A, 1120-S)	6,537,600	2,496,800	38.19%
Partnership (Forms 1065/1065-B)	3,797,600	1,414,600	37.25%
Fiduciary (Form 1041)	3,066,500	1,122,400	36.60%
Exempt Organizations (Forms 990, 4720, 5227)	607,000	162,900	26.84%
Total	184,112,900	121,189,682	65.82%

Source: IRS Doc. 6186 (Rev. 10-2010) Table 2. Calendar Year Projections of the Number of Returns to be Filed with IRS. See Appendix B.

Table 2: 2009, 2010 and 2011 Electronic Filing Index

Electronic Filing Rate	2009	2010	2011 Projection
EFI	56.94%	59.66%	65.82%

Source: IRS Doc. 6186, and actual data through 4/29/2011 with historical analysis of rate degradation. See Appendix B.

1.2 THE GROWTH OF INDIVIDUAL RETURN E-FILE DROVE THE OVERALL E-FILE GROWTH RATE

IRS and industry drove a significant increase in the electronic filing of individual tax returns in filing season 2011. This resulted in about a 12% increase in the number of electronically filed individual

1 In the 80% goal, IRS considers the major tax returns filed by individuals, businesses and tax exempt entities. IRS Strategic Plan 2009-2013, Pub. 3744 (4-2009) (IRS Strategic Plan). As used in ETAAC's report, "major types of tax returns" refers to the most significant of those returns as identified in Appendix B.

2 Typically, the percentage of paper returns filed between the April filing deadline and the end of the filing season in October increases, which reduces the e-file rate. ETAAC projects that the full year individual e-file rate at the end of the season will be approximately 3% lower than the rate as of April 2011.

returns over last year as of the end of the primary filing season,³ and an overall e-file rate of almost 80%. The percentage of individual returns electronically filed by preparers and consumers remained relatively stable – 64% versus 36%. (See Table 3)

Table 3: 2011 Primary Filing Season: Electronic Filing vs. Paper Filing

Individual (Forms 1040, 1040-A, and 1040-EZ)	2010 (Through 04/30/2010)		2011 (Through 04/29/2011)	
	Total	%	Total	%
All Electronically Filed	93,460,000	72%	104,951,000	80%
Preparer (% Displays Share of E-File)	59,784,000	64%	67,096,000	64%
Consumer (% Displays Share of E-File)	33,677,000	36%	37,854,000	36%
Paper Filed				
All Categories	35,808,000	28%	25,755,000	20%
Total	129,269,000		130,705,000	

Source: <http://www.irs.gov/newsroom/article/0,,id=239250,00.html> (Data Rounded)

The year-over-year full year comparisons in Table 4 provide a clear indication of IRS’ e-file opportunities. In particular, the lack of e-file growth in employment returns will become the biggest barrier to IRS’ progress towards the 80% goal, and must be addressed.

Table 4: Estimated and Projected Calendar Year Electronic Filing Index

Type of Return	2010 Estimated			2011 Projection			2011 vs. 2010	
	Total	E-Filed	EFI	Total	E-Filed	EFI	E-File Unit Growth	Change In EFI
Individual (Forms 1040, 1040-A, and 1040-EZ) ¹	140,402,900	98,100,200	70%	141,122,600	109,101,882	77%	11,001,682	7%
Employment (Forms 94x)	28,924,300	6,653,200	23%	28,981,600	6,891,100	24%	237,900	1%
Corporation Income Tax (1120,1120-A,1120-S)	6,456,000	2,187,800	34%	6,537,600	2,496,800	38%	309,000	4%
Partnership (Forms 1065/1065-B)	3,596,900	1,271,300	35%	3,797,600	1,414,600	37%	143,300	2%
Fiduciary (Form 1041)	3,056,200	853,900	28%	3,066,500	1,122,400	37%	268,500	9%
Exempt Organizations(Forms 990, 4720, 5227)	594,900	126,000	21%	607,000	162,900	27%	36,900	6%
Total	183,031,200	109,192,400	60%	184,112,900	121,189,682	66%	11,997,282	6%

Source: IRS Doc. 6186 (Rev. 10-2010) Table 2. Calendar Year Projections of the Number of Returns to be Filed with IRS (some data rounded).
Table Notes: (1) 2011bBased on actual data through 4/29/11 with historical analysis of rate degradation during the extension filing period.

1.3 IRS MUST CONTINUE TO DRIVE INCREASED ELECTRONIC FILING OF INDIVIDUAL RETURNS

As they approach the 80% goal for individual tax returns, IRS and industry cannot declare victory. Individual returns account for the largest number of tax return types by a factor of almost five. The electronic filing rates for *individual* returns must be driven higher to compensate for low e-file rates for employment and business returns.

ETAAC believes there are four key areas to continue driving increased e-file of individual returns.

³ “Primary filing season” refers to the filing period from January through mid-April.

1.3.1 Preparer-Generated Returns

Filing season 2011 was the first year of IRS' implementation of the preparer electronic filing requirement. Electronic filing volume by preparers grew about 12% year-to-date, and will increase as IRS continues to implement this requirement and the filing threshold drops from 100 or more returns to 11 or more returns for filing season 2012. IRS is well-positioned in this area.

1.3.2 Reduce E-File Rejects

IRS must work with industry to reduce the significant number of e-file rejections next season. Simply put, a 15-20% e-file reject rate is unacceptable – one in five taxpayers should not be rejected. Rejects cause significant anxiety for those that have already made a decision to e-file, which is communicated to family, friends and increasingly through social networks. The most notorious cause of rejects is IRS' current identity proofing mechanism – the AGI/PIN signature. ETAAC believes there are more effective approaches to identity proofing that do not create the current level of rejects and, in fact, are better at reducing fraud. IRS will not achieve an 80% electronic filing rate for all major return types unless and until it takes on individual return rejects in a focused, persistent and collaborative effort with industry. (See ETAAC 2011 Recommendation 2)

1.3.3 Computer Self-Prepared Returns

Electronic filing volume of individual returns by taxpayers using computers to prepare their returns continues to grow steadily – almost 12% year-over-year. IRS should continue to foster a credible, financially healthy and competitive consumer tax software industry, and find creative ways to promote the benefits of electronic filing to the steadily declining group of taxpayers who currently prepare their returns on computers but, then, mail them to IRS. Some states have proposed “mandating” that taxpayers using computers to prepare their returns must e-file. ETAAC has serious concerns with this approach. Some taxpayers have significant anxiety about transmitting information over the Internet.⁴ Instead of increasing e-file, such a heavy handed approach could trigger strong adverse reactions from taxpayers and privacy advocates. Given the high growth rate of consumer e-file, ETAAC believes a better way to drive growth is eliminating potential barriers, such as reducing e-file rejects, improving IRS and industry security, and educating taxpayers over time. In any case, consumer concerns about using the Internet are steadily decreasing, and this issue will resolve over time.

1.3.4 Manual Self-Prepared Returns

In 2011, IRS ceased sending paper forms to taxpayers. ETAAC believes this simple step made an important contribution in causing manual taxpayers to “think twice” about their preparation method, and move to computerized tax preparation. One indicator of this shift may be the significant growth (almost 40%) of Free File Fillable Forms usage on www.irs.gov, which is part of the IRS Free File Program.⁵ In fact, the public/private partnerships between IRS, industry and non-profits continue to deliver impressive benefits to lower and middle income taxpayers. For example, the IRS Free File program and the IRS VITA and TCE programs will collectively produce about 6 million returns in filing season 2011, splitting that number roughly in half between the FFA program and VITA/TCE programs.⁶

4 IRS and almost all state revenue agencies acknowledge the concept of “taxpayer choice,” and provide a taxpayer “opt out” from the requirements for professionals to e-file individual tax returns.

5 As of April 20, 2011, over 405,000 returns had been e-filed using Free File Fillable Forms compared to a total volume of 295,000 returns for all of filing season 2010.

6 As evidenced by the 12% increase in consumer online e-filing, Free File usage continues to be significantly affected by the heavy advertising and wide availability of free commercial tax preparation and filing solutions outside of Free File. ETAAC continues to view these marketplace developments as positive because they are driving increased consumer electronic filing of individual returns at very high rates without the need for involuntary actions, such as a consumer e-file mandate. Additionally, Free File continues to be a program

Continued

1.4 IRS HAS A BIG OPPORTUNITY, AND CHALLENGE, TO INCREASE EMPLOYMENT RETURN E-FILE RATES

ETAAC estimates that an additional 26 million returns must be e-filed for IRS to achieve its 80% goal. The largest gap remains employment returns – primarily Forms 940 and 941 (Forms 94X). These returns are projected to have an e-file rate of approximately 24%, and have the largest volume gap to achieve the 80% goal for that form type – about 16 million returns. (See Table 5)

Table 5: E-File Gap

Type of Return	2011 Projection			80% EFI Goal		
	Total	E-Filed	EFI	Total E-Files Required	Numeric Gap ¹	% Gap ²
Individual (Forms 1040, 1040-A, and 1040-EZ)	141,122,600	109,101,882	77%	112,898,080	3,796,198	3%
Employment (Forms 94x)	28,981,600	6,891,100	24%	23,185,280	16,294,180	56%
Corporation Income Tax (1120,1120-A,1120-S)	6,537,600	2,496,800	38%	5,230,080	2,733,280	42%
Partnership (Forms 1065/1065-B)	3,797,600	1,414,600	37%	3,038,080	1,623,480	43%
Fiduciary (Form 1041)	3,066,500	1,122,400	37%	2,453,200	1,330,800	43%
Exempt Organizations(Forms 990, 4720, 5227)	607,000	162,900	27%	485,600	322,700	53%
Total	184,112,900	121,189,682	66%	147,290,320	26,100,638	14%

Source: IRS Document 6186 (Rev. 10-2010) Table 2. Calendar Year Projections of the Number of Returns to be Filed with IRS (some data rounded).

Table Notes: (1) Approximate number of additional e-filed returns required to achieve 80% goal for each of the major types of tax returns. (2) Approximate percentage of additional e-filed returns required to achieve 80% goal for each of the major types of tax returns.

Both the Oversight Board and ETAAC have identified the need to investigate the root cause of low e-file rates for Forms 94X. ETAAC has conducted its first initial in-depth review of employment returns, and is pleased to offer several observations and recommendations in this area. (See ETAAC 2011 Recommendation 3) Although IRS must focus more time and resources to increase electronic filing of Forms 94X,⁷ it must not be overly distracted from its effort to drive increased electronic filing of individual returns over the next few years.

1.5 TAXPAYERS CONTINUE TO ADOPT OTHER ELECTRONIC INTERACTIONS WITH IRS

Taxpayers evidenced a modest increase in electronic interactions with IRS in other areas, such as the use of www.irs.gov and the electronic direct deposit of refunds. (See Table 6)

where IRS can pilot new oversight models, such as it has with security requirements, for eventual application to the broader industry outside of Free File.

7 As part of this effort, IRS should assess the availability and adequacy of current IRS data in the Forms 94X area.

Table 6: Other Electronic Interactions Cumulative Data

Type	Tax Year		Growth
	2010 (01/01 - 05/07)	2011 (01/01 - 05/06)	%
Visits to IRS.gov	198,557,847	209,783,439	6%
Refunds:	98,709,000	100,252,000	2%
Direct Deposit	71,103,000	75,374,000	6%
Other	27,606,000	24,878,000	-11%

Source: <http://www.irs.gov/newsroom/article/0,,id=239409,00.html>

2 PROGRESS TOWARD 2010 RECOMMENDATIONS

IRS made good progress toward several key initiatives related to ETAAC's 2010 recommendations.

2.1 CONGRESS SHOULD FUND, AND IRS SHOULD COMPLETE, THE "FOUR PILLARS" OF ITS MODERNIZATION PROGRAM

Most importantly, IRS addressed and improved the performance and stability of the MeF system. However, IRS did not conduct a formal joint "lessons learned" review with state and industry stakeholders of MeF performance of the 2010 filing season. Looking ahead, we believe IRS has opportunities to enhance its MeF stakeholder communications and engagement. (See ETAAC's 2011 Recommendation 2)

2.2 IRS SHOULD APPROACH THE PREPARER E-FILE REQUIREMENT AS A CHANGE MANAGEMENT EFFORT

IRS has engaged proactively with tax professionals and other stakeholders concerning the preparer e-file requirement, and has made appropriate decisions to adjust program implementation.

2.3 THE IRS' INTERNET STRATEGY SHOULD FOLLOW A RIGOROUS IMPLEMENTATION PROCESS

IRS has hired a capable leader and technologist to manage its online strategy. As noted in our 2010 Annual Report, IRS' Internet investment decisions should be made pursuant to a rigorous review process that ensures any online service are aligned with IRS' strategic priorities and yield the highest "return on investment" for taxpayers, IRS, tax preparers and software companies. ETAAC continues to recommend that IRS focus on online solutions that will reduce existing IRS call volumes and associated costs, answer existing taxpayer questions more effectively, improve and expand IRS' online services for preparers and the electronic tax preparation and filing industry, and extend to taxpayers those IRS online services that are currently available only to preparers, such as providing access to prior year tax information.

2.4 IRS SHOULD LEVERAGE COLLABORATIVE INNOVATION WITH INDUSTRY

IRS has taken some actions to increase its collaboration with the tax preparation industry. Looking ahead, we believe IRS has more partnership and collaboration opportunities to leverage process and technical innovations with industry. (See ETAAC's 2011 Recommendation 5)

2.5 IRS SHOULD COMPLETE ITS ADVANCING E-FILE STUDY PHASE 2 REPORT

ETAAC applauds IRS' completion of the Advancing E-File Study Phase 2 Report, which was conducted by MITRE Corporation.⁸ The Report was designed to: identify at a conceptual level the costs, impacts, and adoption of options to increase electronic filing, clarify the motivations for taxpayers and preparers to e-file, and summarize key reports that could influence IRS strategies to increase e-filing. MITRE's analysis determined that, generally, the proposed options to increase e-file would: not produce or accelerate any significant gain in e-file adoption, require substantial investments in technology, management, and organizational capability for IRS to assume new roles in tax preparation and submission, and require

⁸ Advancing E-file Study Phase 2 Report, Examination of Options to Increase Electronic Filing of Individual Returns, December 2010 (Advancing E-file Study Phase 2). See http://www.irs.gov/pub/irs-utl/irs_advancing_e-file_study_phase_2_report.pdf

consideration of the entire tax return preparation and submission experience and potential changes in the tax landscape. However, MITRE's analysis did not address the appropriate role of IRS in the tax landscape or any political/reputational risks associated with any options (such as the impact of systems failures on public trust), or recommend which options IRS should implement. All of these areas, as well as any required IRS "trade-offs" and the "cost per return" of any proposed option, require future consideration.

2.6 IRS SHOULD IMPLEMENT THE RETURN PREPARER REVIEW PROGRAM IN A MANNER THAT DOES NOT UNNECESSARILY, ADVERSELY AFFECT HAVING AN ADEQUATE SUPPLY OF QUALIFIED AUTHORIZED IRS E-FILE PROVIDERS

IRS has engaged proactively with tax professionals and other stakeholders concerning preparer oversight, and has made appropriate decisions in program implementation. IRS' issuance of over 700,000 PTIN's this year is a remarkable accomplishment. IRS should implement a multi-year taxpayer public awareness program to communicate the importance of using qualified preparers. IRS should also organize its industry oversight resources in a manner that leverages commonalities between the oversight of professionals and the tax software industry to increase effectiveness and avoid duplication of effort. (Software companies are a key communications channel between IRS and tax professionals). IRS also made significant initial progress in collaborating on tax software standards. IRS continued a software risk assessment focused on the security, privacy, accuracy and reliability of commercial software and related electronic filing systems. Additionally, the ETAAC Software Subcommittee issued recommendations in both the security and accuracy areas, which ETAAC has adopted in this report. (See ETAAC's 2011 Recommendation 1)

2.7 IRS SHOULD ADDRESS KEY ENABLERS - SECURITY, E-AUTHENTICATION AND E-SIGNATURE

Expanded electronic tax administration cannot be achieved without IRS progress in the areas of security, e-authentication and e-signature. Although progress in the e-signature area has been made in the past year via multiple pilots with industry partners, additional focus and prioritization of these areas is vital to advance IRS' online offerings.

2.8 IRS SHOULD ADDRESS RISKS ASSOCIATED WITH INCREASED INFORMATION REPORTING

Congress has legislatively reversed its expansion of certain 1099 reporting obligations because of the increased business burden. Any future consideration of expanded or accelerated information reporting must fully evaluate the impact of acceleration on both taxpayers and businesses, especially small businesses that have limited resources. Consideration must also be given to IRS' readiness and the investment required to handle any significant increase or acceleration in electronically filed information returns. (See ETAAC's 2011 Recommendation 4)

2.9 IRS SHOULD REVIEW AND ADDRESS UNNECESSARY E-FILE REJECTS

IRS has not implemented a permanent operational process to identify, review and track actions to reduce e-file rejects, or provided a tool to enable the validation of selected taxpayer identification information prior to electronic filing. Looking ahead, we believe IRS must take more aggressive action to achieve its 80% e-file goal by reducing e-file rejects. (See ETAAC's 2011 Recommendation 2)

3 EMERGING ENVIRONMENT AND CHALLENGES

Our self-assessment, voluntary compliance tax system has been designed to serve multiple objectives. The primary objective of our tax system is to identify and collect taxes owed. However, our tax system also serves other purposes beyond the instant objectives of compliance and revenue. Congress continues to leverage the American model of direct citizen engagement in the tax return process as a critical economic policy tool to improve the health of the nation - providing, for example, incentives for economic stimulus, health, education and savings. Those policy needs have not abated.

In support of these objectives, the IRS' mission is to "*provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.*"⁹ In pursuing this mission, IRS noted six major trends in its Strategic Plan that create challenges and opportunities.

Last year, ETAAC emphasized two other areas – first, the adverse impact that our overly complex tax laws are having on taxpayers and the tax professionals and software companies that serve taxpayers and, second, the anticipated impact that looming federal budget reductions will have on IRS.

3.1 TAX REFORM AND SIMPLIFICATION

ETAAC renews its support for the bipartisan calls for real tax reform and simplification. We must simplify the tax code by consolidating the credits and deductions affecting low and middle income individuals and families. Real tax reform should make these important tax incentives more transparent and understandable, while ensuring a continuing direct engagement between American taxpayers and the tax compliance process that enables the opportunity for improvement of the overall financial health of Americans through increased savings, greater financial literacy, and better personal and family financial management.

However, it's not only *complex* tax laws that penalize taxpayers – *late passed tax legislation* has the same effect. Late tax legislation creates taxpayer anxiety and can prevent them from receiving their refunds as planned. Late legislation also adversely impacts states, and restricts the amount of time that both IRS and software developers have to program and test their systems.

Filing season 2011 provided a good illustration of the adverse impact of late legislation on taxpayers. For millions of Americans, tax refunds are not discretionary funds. In fact, the tax compliance process, and the tax refund in particular, are an integral part of how many Americans manage their personal finances and cash flows. Filing delays, such as those created by late legislation, create significant uncertainty and anxiety for American taxpayers. That anxiety is heightened when electronically filed returns are rejected, and the return processing and refund issuance processes lack transparency. For example, the processing latencies in IRS systems, and associated delays in updating IRS tools like "Where's My Refund," directly contribute to taxpayer anxiety.

3.2 BUDGETARY CHALLENGES

The federal government is facing a future of steadily shrinking federal budgets. Policy makers are clearly aware of our fiscal challenges, and a robust debate is in process.

9 IRS Strategic Plan, p. 5.

This emerging environment requires that every dollar spent by IRS be directed against the most important problems that are barriers to serving taxpayers effectively at the lowest possible operating costs, and any expenditures must be measured and evaluated against clear success metrics. IRS cannot do everything, and tough tradeoffs are required.

3.3 INCREASING TAXPAYER EXPECTATIONS

In this Report, ETAAC is calling out another trend that will increasingly challenge IRS. Taxpayers expect higher service levels, and are evaluating IRS' performance against their other experiences. For example, taxpayers can place an order on the Internet and almost hour by hour track the status and delivery of that item from the warehouse to their doorstep, including the receipt of proactive notifications of status. Taxpayers, increasingly, do not understand or accept that IRS cannot do the same thing with one of their most valuable deliveries – their tax refund. As noted above, the latency in Where's My Refund will be increasingly questioned. Moreover, taxpayers will question the inability of IRS to report timely the status of a tax return's processing, and why it has been delayed. Taxpayers increasingly expect, and require, highly personalized services. A "one size fits all" approach will be insufficient.

3.4 IMPLICATIONS

As ETAAC noted in last year's Report, these trends have several significant implications for electronic tax administration including: reduced IRS funding and resources for its operations; loss of experienced executives, managers and technical personnel;¹⁰ steadily rising taxpayer demands and expectations; a need to focus on core missions; increased reliance on the electronic tax preparation and filing industry to serve taxpayers effectively; the need to think about electronic tax administration as an *end-to-end ecosystem* that includes all the stakeholders, including IRS, states and electronic tax preparation and filing industry; and, the need for robust partnering, collaboration and innovation between IRS and industry to solve taxpayer problems.

Given the strong interdependencies between stakeholders in electronic tax administration, there are opportunities for improved business processes that can address these challenges – both within IRS, and between IRS and other stakeholders. The Oversight Board touched on this need with its theme of IRS "*becoming more effective with less resources.*"¹¹

These trends and implications are foundational to ETAAC's 2011 recommendations. IRS will need to place more focus and attention on IRS/industry partnering and collaborative efforts that can deliver better overall service to taxpayers at lower cost, including reducing e-file rejects.

¹⁰ IRS Strategic Plan, p.9.

¹¹ "The Oversight Board believes that in addition to using modern IT tools and developing a highly-engaged workforce, the IRS must also develop improved business processes." IRS Oversight Board Annual Report to Congress 2010, April 2011, p. 40.

4 ETAAC 2011 RECOMENDATIONS

As reported last year, ETAAC believes that IRS is at a *strategic inflection point* in performing its mission¹² that calls for a focus on accomplishing three key outcomes.

First, IRS must ensure that taxpayers have access to a highly professional and capable tax preparation and filing industry.

Second, given our resource constrained environment, IRS must have a strong focus on doing those things that only government can do – such as systems modernization, timely customer service, removing e-file barriers, and providing return processing and refund issuance transparency.

Finally, with industry and IRS each delivering on their respective roles and responsibilities, IRS and industry need to partner more effectively to deliver and enhance the other services that taxpayers need.

ETAAC's recommendations align with and enable these key outcomes.

Key Outcome 1: Build a highly professional and capable electronic tax preparation and filing industry.

Recommendation 1: IRS should set appropriate standards for the electronic tax community in the key areas of security and accuracy.

Key Outcome 2: Focus on delivering those taxpayer services that only government can provide.

Recommendation 2: Congress should fully fund MeF, and IRS should complete MeF implementation as well as take prompt action to work with industry to reduce the volume of e-file rejects.

Recommendation 3: IRS should focus more attention on increasing the electronic filing of employment tax returns and, particularly, Forms 940 and 941.

Key Outcome 3: Leverage the capabilities and diversity of the electronic tax preparation and filing industry to deliver taxpayer services that can be better met through private sector innovation.

Recommendation 4: IRS should begin engaging with industry to discuss the Commissioners' vision for accelerated information reporting and real time data matching, but defer any further consideration of Simple Return.

Recommendation 5: IRS should increase and focus its collaboration with electronic tax administration stakeholders to drive efficiency, lower cost and improve taxpayer service.

The remainder of this report provides ETAAC's summary and detailed recommendations, and its supporting assessment.

¹² The term "strategic inflection point" was used by former Intel Chairman Andy Grove in his book "Only the Paranoid Survive" (Currency Press, 1999). It characterizes a time in the life of an enterprise when changing fundamentals require full-scale changes in the way business is conducted.

KEY OUTCOME 1

*Build a Highly Professional and Capable
Electronic Tax Preparation and Filing Industry*

RECOMMENDATION 1: TAX SOFTWARE OVERSIGHT

IRS should set appropriate standards for the electronic tax community in the key areas of security and accuracy.

Summary Recommendations

Enhance E-file Security.¹³ Generally, ETAAC recommends that IRS take the following steps with respect to the e-file participants comprising the “digital infrastructure” of the IRS electronic filing program: supplement the guidance provided by the Federal Trade Commission (FTC) Safeguards Rule by requiring the implementation of designated security controls; require annual self-assessments, supplemented by independent third party assessments every three years conducted by commercial third party security experts; and, actively monitor and oversee the ongoing conduct and effectiveness of the security programs implemented by the digital infrastructure of the Authorized IRS e-file Provider program.

Increase Return Accuracy.¹⁴ Generally, ETAAC recommends that IRS improve tax software and tax return accuracy by working with industry to: identify and improve the dependencies and interactions between IRS and software developers that most affect tax software accuracy; recognize a high-level tax software development process that establishes a reference point for tax software developer “best practices”; identify and take specific actions to lower e-file rejects and, thereby, increase the number of electronic returns accepted by IRS and reduce the errors that IRS must process; and, establish an operating mechanism between IRS and industry that enables continuous feedback and targeted problem-solving for issues affecting tax administration.

4.1.1 Detailed Recommendations

4.1.1.1 E-File Security

To bring greater clarity and assurance to the security requirements for certain Authorized IRS e-file Providers, ETAAC recommends that IRS take the following steps with respect to the e-file participants comprising the “digital infrastructure”¹⁵ of the IRS electronic filing program that handle individual and business income tax returns:

- Standards. IRS should supplement the guidance provided by the FTC Safeguards Rule by requiring the implementation of certain NIST SP 800-53 security controls¹⁶ specified in the detailed recommendations of the Security Working Group of the ETAAC Software Subcommittee.

13 The full report and recommendations of the Security Working Group of the ETAAC Software Subcommittee are available in the GSA FACA database for the ETAAC Public Meeting on June 15, 2011, and should be consulted. See <http://www.facadatabase.gov/committeemenu.asp?CID=76687>

14 The full report and recommendations of the Accuracy Working Group of the ETAAC Software Subcommittee are available in the GSA FACA database for the ETAAC Public Meeting on June 15, 2011, and should be consulted.

15 The “digital infrastructure” refers to the e-file providers designated as transmitters, software developers and online providers.

16 Other than the adoption of certain specified NIST SP 800-53 security controls, nothing in the Working Group’s recommendations should be understood to recommend the broader application of FISMA requirements to industry.

- **Assessment.** Consistent with other IRS security programs, IRS should require annual self-assessments, supplemented by independent third party assessments every three years¹⁷ conducted by commercial third party security experts.
- **IRS Validation.** IRS should actively monitor and oversee the ongoing conduct and effectiveness of the security programs implemented by the digital infrastructure of the Authorized IRS e-file Provider program.
- **Implementation:** In implementing the above recommendations, IRS should:
 - Develop and implement any guidance and standards consistent with the guiding principles provided by ETAAC.
 - Phase-in the effectiveness of any new guidance and requirements over a two to three year period, although certain steps could be taken immediately to enhance industry security practices and IRS oversight.

4.1.1.2 Return Accuracy

ETAAC recommends that IRS and industry improve tax software and tax return accuracy by taking the following actions:

- Identify and improve the dependencies and interactions between IRS and software developers that most affect tax software accuracy.
- Recognize a high-level tax software development process that establishes a reference point for tax software developer “best practices,” and can be monitored and updated as necessary.
- Identify and take specific actions to lower e-file rejects and, thereby, increase the number of electronic returns accepted by IRS and reduce the errors that IRS must process.
- Establishing an operating mechanism between IRS and industry that enables continuous feedback and targeted problem-solving for issues affecting tax administration.

4.1.2 Detailed Assessment¹⁸

4.1.2.1 Background

Industry has been a critical contributor to the successful operation and growth of the country’s electronic filing program as recently recognized by the Oversight Board.¹⁹ The security, privacy, accuracy and reliability of commercial tax software and electronic filing are vitally important to the continued success of electronic tax administration.

The Government Accountability Office considered the role of tax software in electronic tax administration in a February 2009 Report. GAO did not report specific deficiencies in commercial tax software or the electronic filing digital infrastructure. However, GAO did note IRS’ limited oversight of the software industry’s efforts to ensure that taxpayer information is secure, and raised a concern that *“While the likelihood of [security breaches, disruptions in electronic filing, and missed opportunities to*

17 Under the “IRS Safeguards Program” administered under IRS Publication 1075, IRS relies heavily on the support of external commercial security experts to conduct Safeguards reviews every three years.

18 This Assessment is not a substitute for reading the more detailed analysis and recommendations contained in the reports of the Security and Accuracy Working Groups.

19 “Of course, [the progress of electronic filing] is not solely attributable to the IRS. It could not have been achieved without the active cooperation and initiative of the tax administration community, which includes return preparers, tax software developers, and many other tax-related service providers in the private sector. This successful and commendable partnership between the IRS and private industry to advance electronic tax administration is in keeping with the spirit of RRA 98, which explicitly encouraged such cooperation.” IRS Oversight Board Electronic Filing 2010 Annual Report to Congress, January 2011, p. 4. (IRS Oversight Board Electronic Filing 2010 Report).

identify and correct compliance problems] occurring may be low, IRS does not know whether this is the case.”²⁰

Although the steady growth of electronic filing reflects that taxpayers currently trust that industry will enable them to prepare and file their returns accurately and securely, IRS and industry must be vigilant to take the steps to ensure that trust is maintained.

To that end, ETAAC reinforced the importance of security and accuracy to electronic tax administration a few months later in its 2009 Annual Report to Congress with a recommendation that *“IRS should work with the tax preparation industry and states to set high industry standards and determine the best model for the efficient, effective oversight of tax software services.”²¹* ETAAC’s 2009 Report also discussed the need that any standards should, wherever possible, be selected from among existing, recognized controls-based standards, and avoid excessive rigidity.

ETAAC continues to believe that an effective, efficient oversight model does not necessarily require direct IRS regulation. However, ETAAC does believe that the oversight of private tax software and electronic filing companies must be part of a larger oversight model for the entire tax preparation industry, including preparers, given the related operating efficiencies and leverage.

4.1.2.2 *IRS Software Risk Assessment*

IRS acted quickly on GAO’s recommendations by engaging MITRE Corporation to conduct a software risk assessment, which is currently in progress. In fact, MITRE recently completed a lengthy survey of the tax software industry concerning risks in the area of security, privacy, accuracy, reliability and burden. Although ETAAC supports the survey, ETAAC members who participated in the survey expressed concerns about the complexity and structure of the survey questions. In some cases, the questions could create the opportunity for ambiguous results, which could be misinterpreted by persons unfamiliar with the tax software development process. Therefore, ETAAC believes that MITRE must analyze the survey responses carefully and cautiously, and that any interpretations be provided within the context of a deep understanding of commercial technology development and management.

4.1.2.3 *IRS Formation of ETAAC Software Subcommittee*

IRS also announced that it would establish a task force that would seek the input of all relevant stakeholders, including states and industry, to address the risks associated with tax preparation software and to discuss establishing industry standards.²² This task force was implemented as the “Software Subcommittee” of ETAAC, and included representatives from IRS, states and industry.²³ The Subcommittee formed two separate Working Groups – one to focus on security and, subsequently, one to focus on the accuracy of returns prepared with software.

4.1.2.4 *Work of the Security Working Group*

100% of federal e-files for individual returns transmitted to IRS are handled by the commercial tax preparation industry. The security of the electronic filing program is critical to its continued success and growth, and must be continuously monitored to maintain the confidence of both taxpayers and tax professionals.

20 GAO Report: Tax Administration: Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risks (GAO-09-297), February 2009, p.15. (GAO Tax Software Report).

21 2009 ETAAC Annual Report to Congress (IRS Pub. 3415, Rev. 6-2009), p.22.

22 IRS Return Preparer Review, Pub. 4832 (Rev. 12-2009), p.5.

23 Working Groups members are listed in their respective Working Group Reports available in the GSA FACA database.

The Security Working Group determined that its initial focus should be on the e-file providers that serve as aggregation points for large volumes of electronically filed tax returns – namely, the transmitters, software developers, online providers, and intermediate service providers.²⁴

IRS asked the Security Working Group to make recommendations with respect to the following questions:

1. Standards: What additional guidance or standards should IRS set in connection with the current responsibility of Authorized IRS e-file Providers to comply with the FTC Safeguards Rule?
2. Review: What review methodology should IRS require to ensure that Providers are complying with the FTC Safeguards Rule and any other relevant security standards?
3. Validation: What approach should IRS take to ensure that it is informed whether a particular company has successfully completed any security review and is meeting applicable standards?
4. Implementation: What plan/schedule should IRS follow to implement any new security requirements in this area?

Importantly, all Authorized IRS e-file Providers are currently required by FTC Safeguards Rule to have comprehensive information security program. Therefore, ETAAC was not asked to consider whether companies should have a security program – that is already a requirement. Instead, ETAAC was asked to consider how companies should meet that responsibility, and whether any additional program requirements should be implemented.

In developing its recommendations, the full ETAAC carefully considered the extensive work product of the Security Working Group,²⁵ which included:

- Reviewing current Authorized IRS e-file Provider security requirements
- Reviewing reported security threats, risks and implications
- Reviewing and comparing security frameworks/requirements with outside experts
- Obtaining qualitative feedback from industry on current security practices
- Reviewing a broad array of industry and government security assessment models with outside and IRS security experts
- Reviewing FTC Safeguards Rule enforcement actions with FTC staff

There is no doubt that companies have a natural self-interest to protect their customers' data.

Nonetheless, ETAAC believes that IRS can enhance the “reasonable assurance” that electronically filed returns are adequately protected by supplementing its existing guidance concerning required security controls and assessments, coupled with a phased implementation plan. ETAAC's recommendations are intended to achieve that objective.

The full report of the Security Working Group, including its detailed recommendations, has been adopted completely and unanimously by ETAAC. That report (and its related ETAAC public meeting presentations) is publicly available in the GSA FACA database, is incorporated by reference and should be referenced for the full details regarding each of ETAAC's recommendations.

24 While an important area, the Working Group deferred consideration of the security of the ERO (paid preparer) working environment in order to focus on the most significant areas of impact.

25 The Security Working Group held over 25 meetings and invested well over 1,000 hours in its investigation and deliberations between December 2009 and March 2011.

4.1.2.5 Work of the Accuracy Working Group

In its 2010 Annual Report, ETAAC noted that significant interdependencies between key stakeholders in our system of tax administration - Congress, Treasury, IRS, the tax preparation industry and taxpayers - heavily influence the ability to make systemic improvements in electronic tax administration. In fact, ETAAC noted that some of the biggest contributors to tax inaccuracy in the tax preparation community are the increasing size and complexity of the tax code itself,²⁶ late passed legislation,²⁷ and the late release of government tax publications, instructions and forms.²⁸ This challenge is exacerbated by the increasing number of states that have not adopted the tax benefits included in recent federal stimulus legislation, or otherwise conform to federal practices.

The Accuracy Working Group was asked to consider recommendations to enhance the accuracy of returns prepared using tax software, where the accuracy of tax software itself is one important contributing factor. Over the course of its work,²⁹ the Accuracy Working Group arrived at some key conclusions:

- The tax software development process is inherently complex, and occurs in a very demanding environment.
- Tax software has driven significant improvements in tax return accuracy despite the development and environmental challenges.
- The increasing complexity of our tax laws is increasing the burden on taxpayers and tax preparers, IRS and software developers.
- The need for tax simplification is well-recognized by policy makers and key influencers, but will take time to complete.
- IRS and industry can still take other actions to drive *continuous improvement* in the accuracy of tax software and of returns prepared using tax software.
- Improvement will require thinking differently about tax software, the interdependencies in the tax administration system, and stakeholder responsibilities.

In recognizing the opportunity to drive continuous improvement in the accuracy of returns prepared using tax software, the Accuracy Working Group noted the need to:

- Recognize certain “realities” about tax return accuracy, such as:
 - Tax return accuracy is a function of a multi-step, end-to-end tax administration system of which tax software is one component that helps to drive overall return accuracy.
 - External factors and stakeholders have a significant impact on tax return accuracy, e.g., the combination of federal and state tax laws coupled with multiple tax types, which is exacerbated by complex, frequently and late changing, and voluminous tax laws.

26 “The most serious problem facing taxpayers is the complexity of the Internal Revenue Code.” National Taxpayer Advocate 2008 Annual Report to Congress, Volume 1, p. 3. See TIGTA: Analyzing Taxpayer Errors Can Help to Improve Forms and Instructions (Reference Number: 2009-30-083), June 11, 2009, p. 1.

27 The adverse impact of late passed legislation, whether at the federal or state level, cannot be underestimated. For example, software developers experience multiple impacts. First, late legislation reduces the amount of time they have to update their software for changes that are almost always complex. Second, where two competing bills are being considered (House vs. Senate), software developers are often compelled to allocate their development resources to the simultaneous development of two parallel sets of code changes in order to meet the delivery requirements demanded by taxpayers and tax preparers – eventually picking the “winner” when the legislation is finalized.

28 The release of tax publications, instructions and forms by IRS and state revenue departments are also impacted by late tax legislation. The earliest possible release of those materials, even in draft form, is critical to enabling software developers to have as much time as possible to analyze the implementation of tax law changes, and to code and test their products.

29 The Accuracy Working Group held over 10 meetings and invested several hundred hours in its investigation and deliberations between December 2010 and March 2011.

- Tax software is significantly more accurate than manually preparing returns, but can get even better with a focus on continuous improvement.
- Revenue agency efforts to increase tax software accuracy have generally been reactive, and would benefit from a recognition of the interdependent, closed loop tax preparation system.
- The needs and capabilities of tax software users (taxpayers or tax preparers) vary.
- Be explicit about each stakeholders' responsibilities in the tax administration system.
- Think differently about the challenge of "tax software accuracy."
- Define and understand the end-to-end tax administration system, and how it influences tax return accuracy.
- Take specific actions that will have the biggest impact on the accuracy of returns prepared with tax software. (These actions are reflected in ETAAC's recommendations)

Some observers have occasionally suggested that IRS should take on the responsibility of testing commercial software. ETAAC agrees with the Oversight Board's observation that IRS should not attempt to take on any role that entails "certifying" the accuracy of commercial tax software,³⁰ whether such certification implies government-approved design or suggests a guarantee of usability, accuracy, security or otherwise.

The full report of the Accuracy Working Group, including its detailed recommendations, has been adopted completely and unanimously by ETAAC. That report (in presentation format) is publicly available in the GSA FACA database, is incorporated by reference, and should be referenced for the full details regarding each of ETAAC's recommendations.

30 IRS Oversight Board Electronic Filing 2009 Annual Report to Congress, January 2010, p.37.

KEY OUTCOME 2

*Focus on Delivering Those Taxpayer Services
That Only Government can Provide*

RECOMMENDATION 2: MODERNIZATION, MEF & ELECTRONIC FILING

Congress should fully fund MeF, and IRS should complete MeF implementation as well as take prompt action to work with industry to reduce the volume of e-file rejects.

Summary Recommendations

Congress should fund, and IRS should complete, its Modernization Program with a focus on Modernized e-File (MeF) before beginning any new significant information technology projects.

IRS should ensure a seamless, high confidence transition from the current Legacy e-file system to a stable, high performing MeF system.

IRS should begin working with industry promptly to identify and implement actions to reduce the number of unnecessary e-file rejects for filing season 2012.

4.2.1 Detailed Recommendations

4.2.1.1 *Fully Fund MeF*

Congress should fund, and IRS should complete, the mission-critical four pillars of its Modernization Program with a focus on Modernized e-File (MeF) before beginning any new significant information technology projects.

4.2.1.2 *Effectively Transition to MeF*

MeF is in a sprint to the finish that requires proactive engagement between IRS, states, and industry. IRS should ensure a seamless, high confidence transition from the current Legacy e-file system to a stable, high performing MeF system by taking the below actions.

Expand Forms Coverage

Implement the additional 128 forms targeted for implementation for the filing season 2012. Add amended return e-file capability not later than the filing season 2013 to increase the number of e-filed returns, reduce processing time, and reduce IRS telephone calls.

Accelerate Adoption

Drive state and industry MeF adoption by promoting the numerous benefits of MeF, and encouraging filing season 2012 returns be submitted through MeF vs. Legacy. That encouragement could take the form of: avoiding significantly stricter business rules in MeF than in Legacy; increasing IRS technical assistance to stakeholders; providing a specific IRS MeF helpline only for industry and states during tax season for production issues; improving program participation document turnaround time; clarifying MeF reject codes; and, improving reporting tools to ensure accountability of submissions.

Create Incentives

IRS should identify potential incentives, such as linking certain non-MeF benefits to MeF. For example, industry might accelerate its adoption of MeF if IRS integrated the existing MeF error validation for the "top 20" e-file rejects as a pre-filing check for MeF, which would increase the rapid notification of

potential rejects and reduce the number of actual rejects thereby resulting in a more seamless experience for taxpayers and increased e-file volume for IRS and states.

Ensure Successful Transition

Develop by October 31, 2011, specific “shutdown conditions” for retiring Legacy after the filing season 2012.³¹ IRS should develop an internal fallback plan, if the retirement deadline is not met or the MeF platform is unable to handle the volume.

Increase Uptime

Increase MeF uptime by minimizing major version schema changes, scheduling schema changes to minimize impact during high volume or testing periods, providing a grace period to transition smoothly between schema versions, reducing or eliminating down time for annual changes, and increasing server availability.

Improve Two-Way Communications

Publish communication guidelines and increase two-way communication between IRS and stakeholders regarding planned and unplanned downtime, performance issues, and issue resolution response. IRS should also improve its e-help e-mail response time and quality.

4.2.1.3 Reduce E-File Rejects

IRS should form an IRS/industry working group by July 31, 2011, tasked with identifying and implementing actions to reduce the number of unnecessary rejects, which could include (i) implementing a permanent operational process to identify, review and track actions to reduce e-file rejects, (ii) providing a tool that enables the validation of selected taxpayer identification information prior to final submission of the return for electronic filing, and (iii) for filing season 2013, investigating the ability to integrate existing MeF error validation for the “top 20” e-file rejects as a pre-filing check for MeF. (See “Create Incentives” above)

4.2.2 Detailed Assessment

4.2.2.1 Business Systems Modernization Program

The foundation for electronic tax administration is the four pillars of IRS Business Systems Modernization Program (BSM),³² which includes the Customer Account Data Engine (CADE 2), Modernized e-File (MeF), Account Management Services (AMS), and Data Strategy projects.

Each BSM project represents a significant and complex undertaking. Previous GAO³³ and TIGTA³⁴ reports have identified IRS systems modernization as an area of risk and vulnerability, and the Oversight Board again identified system modernization as one of two “systemic weaknesses” at IRS.³⁵

BSM is essential to IRS delivering on its core mission of receiving and accurately processing tax returns, issuing tax refunds quickly (many Americans are increasingly relying on the timely issuance of their tax

31 Criteria for shutdown conditions could include MeF uptime, response time and reject rates at full capacity.

32 TIGTA: Annual Assessment of Business Systems Modernization Program (Ref. No. 2010-20-094), September 23, 2010.

33 Business Systems Modernization: Internal Revenue Service’s Fiscal Year 2010 Expenditure Plan, (GAO-10-539), May 2010. (IRS has identified several risks associated with defining and implementing CADE 2.” p. 4).

34 TIGTA Memo to Treasury Secretary Geithner, Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2011, October 15, 2010.

35 IRS Oversight Board Annual Report to Congress 2010, April 2011, p. 4.

refunds for essential needs, like paying rent), providing more effective customer service, and collecting revenues owed to the government.³⁶

As an illustration, Customer Account Data Engine 2 (CADE 2) is foundational to IRS' ongoing modernization efforts, and a prerequisite for significant expansion of online paperless services and the next generation of enforcement technologies. CADE 2 will build upon the successes of the IRS's Current CADE system, which is in production and delivering faster refunds on a modernized platform. As of December 30, 2010, for filing season 2010, Current CADE posted 41.4 million returns and issued 35.9 million refunds totaling in excess of \$66.7 billion. As of May 23, 2011, Current CADE posted 39.8 million returns and delivered faster refunds to over 35 million individual taxpayers. In 2012, CADE 2 will deliver a single, authoritative relational database and daily updates from core taxpayer account processing applications with capabilities for faster refunds and enhanced services to all individual taxpayers. Similarly, as outlined below, ETAAC believes that MeF is another key project that IRS must complete on schedule.

After the new capabilities of CADE 2 and MeF are available, IRS should put more focus on *"incorporating taxpayer perspectives to improve all service interactions."*³⁷ One key service interaction from a taxpayer's perspective is providing transparency of return processing and refund issuance status. IRS' current tool, "Where's My Refund," has significant lag time that increases taxpayer anxiety and costly calls to IRS.³⁸ This area requires improvement.

ETAAC continues to believe these foundational BSM projects must be completed before IRS management and technical resources can successfully manage and implement other significant electronic tax administration projects.

4.2.2.2 Modernized E-File (MeF) Program – Filing Season 2011

Background

MeF is a Web-based system that provides a more flexible electronic filing system. MeF's key benefits include: faster acknowledgements,³⁹ improved error code explanations, year round electronic filing, e-filing of prior year and amended returns, a more flexible formatting language (XML) that enables data accuracy and enhanced protection of taxpayer information, binary attachments such as .pdf's, and an integrated payment option. MeF also provides a single point of submission and retrieval of State returns.

IRS implemented the first phase of Form 1040 MeF in filing season 2010, which included Form 1040, Form 4868, and 21 other related forms and schedules. For 2011, IRS offered the same forms, but focused on improving MeF platform stability.

State & Industry Participation

For the filing season 2011, MeF adoption continued to increase as more software vendors (industry) and states began to support MeF. In 2011, 20 transmitters and 27 states are currently or will shortly be

36 See IRS Oversight Board FY2012 IRS Budget Recommendation, Special Report, March 2011, p. 27.

37 IRS Strategic Plan, p. 13-14.

38 The lack of this transparency was highlighted when IRS began accepting delayed returns on February 14th. Many taxpayers desperate for refunds could not confirm for 24-48 hours whether their e-filed return had been received, or determine refund issuance accurately. Latencies are due to delays in updating Where's My Refund, driven in part by current Master File and Legacy e-file systems, and changing issuance dates if returns are referred for error processing.

39 MeF issues acknowledgements within minutes or a few hours, compared to the 24-48 hours under Legacy e-file.

accepting returns through MeF. However, an estimated 14 states have not yet issued an individual MeF schema, which suggests they are not prepared to transition to MeF.⁴⁰

Both states and industry currently participating in the Legacy e-file system are aware they must implement MeF because of Legacy's planned retirement.

Filing Season 2011 MeF Performance

Total MeF usage increased by over 1,000%, which helped IRS to validate MeF platform stability and industry to gain confidence in the system.

Table 7: Filing Season 2011 MeF Volumes

Type	Tax Year		
	2010	2011	Increase
Preparer (ERO) Accepted	196,495	4,785,066	2335%
DIY Software (Online) Accepted	458,714	3,132,409	583%
Total	655,209	7,917,475	1108%

Source: IRS Electronic Tax Administration

MeF platform stability and operational effectiveness also increased. In 2011, the MeF reject rates were 13.96% as compared to 14.16% for Legacy. The percent of "fall out" returns was 3.05% for MeF vs. 4.19% for Legacy. Return "fall out" is significant because it can result in delayed refunds and increased taxpayer calls and correspondence to IRS. Moreover, responses to ETAAC's April survey of 39 state revenue agencies and 27 industry participants confirmed that:

- MeF uptime/platform stability improved from filing season 2010
- Speed of IRS issuance of MeF acknowledgments met expectations
- MeF error reject codes are improved over the error codes used by the Legacy e-file system

But ETAAC's surveys also identified specific areas for improvement. ETAAC's 2010 state/industry survey generated recommendations to improve MeF by: increasing batch and acknowledgment limit sizes, providing a performance-testing option for transmitters, providing backwards-compatibility, and/or a grace time period for new or updated MeF schema adoption, not making changes to prior-year schemas in current year, having agreed upon "lock down" dates with customers,⁴¹ providing better handling of no-entry fields, keeping Legacy and MeF tax data requirements consistent, and providing increased transparency into general MeF performance, metrics, and stability. ETAAC is not aware that these recommendations were considered or acted upon.

In ETAAC's 2011 survey, state and industry respondents provided the following insights and suggestions:

- IRS should implement the additional 128 1040-related forms and schedules as planned for Phase III (filing season 2012), and add amended return filing for filing season 2013.⁴²
- Not all stakeholders have a MeF implementation plan aligned with IRS' scheduled retirement of Legacy.

40 AZ, DC, DE, HI, IA, KY, MA, MN, MS, NC, NJ, NM, NY, VT (some may be working to gain TY11 schema approval).

41 States reported the importance of setting MeF system lock-down dates when system updates or enhancements cannot be made (MeF must be available on high volume due dates, on which states should not be requested to bring systems down).

42 Amended returns cannot be filed electronically, which leads to increased processing time for taxpayers and added expense for IRS. Amended returns are also account for a significant portion of IRS's taxpayer correspondence, and timely IRS processing directly reduces the volume of taxpayer calls made to IRS.

- States have encountered unnecessary barriers to participate in MeF, e.g., one state reported that it submitted its application to participate in MeF to IRS several months before its target go live date, but received IRS approval one month after its targeted go live date.
- Significantly stricter business rules in MeF than in Legacy should be avoided.⁴³
- Downtime for annual changes is too long and disrupts e-filing.
- Major version schema changes are highly disruptive, create downtime, and increase risk of errors during high volume and testing periods.
- There is insufficient time to “cutover” schema changes without disruption.
- IRS communications with states and industry can be improved.⁴⁴
- IRS needs to better communicate MeF downtime, issues and resolution to stakeholders.⁴⁵

4.2.2.3 Modernized E-File (MeF) Program – Filing Season 2012 and Beyond

IRS Legacy/MeF Transition “Plan of Record”

IRS currently plans to significantly expand MeF coverage for the filing season 2012 by adding another 128 forms and retiring the current Legacy e-file system by October 2012. Last year, ETAAC expressed serious concerns about IRS’ ability to develop and deliver a stable, high performing MeF system when adding over 100 forms at once. Today, ETAAC continues to be concerned about IRS’s ability to handle the volume of all e-filed returns on the MeF platform once Legacy is retired, as maximum capacity continues to go untested in production.

Not surprisingly, there are risks associated with shutting down Legacy before MeF has demonstrated it can effectively operate at full capacity.⁴⁶ For example, taxpayer confidence in e-file will suffer if a MeF failure disrupts the acceptance of returns or the issuance of refunds, and there is no backup solution.

Critical Success Factors

Both industry and states overwhelmingly believe the transition to MeF is necessary and vital for all stakeholders.⁴⁷ IRS must transition as soon as possible to one e-file system to avoid costly duplication for all stakeholders, and enable a clear focus on the future.

The transition to MeF must be executed thoughtfully and with deep stakeholder engagement. IRS must review, with stakeholders, the performance of MeF during the filing season 2011 and put in place a game plan to ensure a successful transition to a high performing, highly available MeF platform enabled by proactive, regular two-way stakeholder engagement and communications.

ETAAC’s above recommendations to expand form coverage, accelerate state and industry adoption, improve MeF, increase stakeholder engagement, and create a game plan are all intended to facilitate a successful transition to MeF.

43 The MeF experience must be better than, or at least on par with, the Legacy system to drive MeF adoption. Industry will steer volume to Legacy if there are perceived taxpayer disadvantages of going MeF, e.g., significantly stricter business rules, higher rejects, unclear error messages, slower refunds, or increased chance of error processing.

44 Some respondents reported that IRS “e-help” questions are not always routed correctly, or answered timely or completely.

45 IRS has no published, standard communications policy for MeF system maintenance or issues, e.g., there was no notification about MeF downtime for Daylight Savings maintenance.

46 MeF has not operated at high loads. 8M TY10 returns is a significant improvement, but MeF will have to handle over 100M individual returns in 2012 including sizable filing peaks in January/February and at the April filing deadline.

47 As one state tax administrator put it, “Legacy is getting tired.” That observation was reinforced when Legacy was strained to the limits when IRS opened the door for delayed returns on February 14, 2011, and had to work proactively with industry to “throttle” return submissions during that week.

4.2.2.4 Eliminate and Reduce E-File Rejects

As electronic filing adoption grows, the current 15-20% e-file reject rates have become one of the key barriers to continued e-file growth. One in every five or six taxpayers should not be rejected.

IRS and industry can reduce e-file rejects. Out of the 600 possible error codes, GAO noted that only *fifteen* error codes accounted for *85 percent* of those received by taxpayers.⁴⁸ The most notorious cause of rejects is IRS' current identity proofing mechanism – the AGI/PIN signature. ETAAC believes there are more effective approaches to identity proofing that do not create the current level of rejects and, in fact, are better at reducing fraud.

Attacking the underlying cause of errors driving these reject codes could have a significant improvement in “first time” success of electronic filing by:

- Avoiding or reducing the most common errors that trigger the largest number of electronic filing rejects.
- Reducing the incremental burden created for IRS and other stakeholders from handling errors that subsequently require exception processing to correct.
- Reducing the cost of handling returns that result in paper filings by frustrated preparers or taxpayers.
- Increasing the confidence in and ease of electronic filing, resulting in increased e-file participation.

GAO also noted that, if IRS took advantage of these opportunities, it might be able to reduce the volume of taxpayer phone calls, thereby improving taxpayer access to IRS assistors.

In its 2009 and 2010 Annual Reports, ETAAC made specific recommendations for IRS to work with industry to reduce unnecessary rejects. We continue to believe opportunities exist to formalize the current *ad hoc* process of IRS/industry engagement concerning e-file rejects by forming an ongoing working group to identify, review, track and publicly report on actions taken to reduce rejects.

48 GAO Report: Tax Administration: Opportunities Exist for IRS to Enhance Taxpayer Service and Enforcement for the 2010 Filing Season (GAO-09-1026), September 2009.

RECOMMENDATION 3: EMPLOYMENT TAX RETURNS

IRS should focus more attention on increasing the electronic filing of employment tax returns and, particularly, Forms 940 and 941.

Summary Recommendations

IRS should work with employers and employment tax return software companies and service providers to increase awareness, remove barriers, and make electronic filing the preferred filing method by: increasing IRS education and outreach; increasing industry promotion of electronic filing; reviewing and simplifying the application and filing process; and, investigating the most cost-effective ways to increase Forms 94X e-file.

4.3.1 Detailed Recommendations

Employment tax returns (94X family of returns)⁴⁹ are the largest group of tax returns not being electronically filed. IRS should work with employers and employment tax return software companies and service providers to increase awareness, remove barriers, and make electronic filing the preferred filing method.

4.3.1.1 *Increase IRS Education and Outreach*

IRS should work with tax filers and industry to:

- Identify the “key benefits” for electronic filing Forms 94X;
- Increase awareness that IRS accepts electronically Forms 94X through currently available communications platforms such as the IRS Payroll Newsletter, National Tax Forums, and SBSE and its state liaison meetings;
- Clarify the responsibilities and liabilities of a preparer signing Forms 94X, which are perceived to be greater than they are;
- Establish a simple “one stop location” that provide companies with access to easily understood information and resources to guide them through the Forms 94X registration and filing process;
- Share best practices from stakeholders on ways to promote and increase Forms 94X e-file adoption; and,
- Communicate how to contact IRS support resources (assistors) who can help the Forms 94X filer community in the enrollment and filing process.⁵⁰

4.3.1.2 *Increase Industry Promotion of Electronic Filing*

IRS should have a focused effort to increase the promotion and availability Forms 94X electronic filing by incenting and encouraging the following industry actions:

- Software and service providers that provide a free Forms 94X e-filing capability should promote this service proactively and prominently;⁵¹
- Software and service providers that provide a Forms 94X e-filing capability for a separate fee should restructure their pricing model to eliminate the separate fee; and,

49 ETAAC is focusing on the high volume of Forms 940 and 941 employment tax returns (see ETAAC Assessment section).

50 Some ETAAC survey respondents raised concerns about the responsiveness and availability of IRS support.

51 IRS could, for example, publish those Authorized e-file Providers that offer free or low cost Forms 94X e-filing.

- Software and service providers that do not provide Forms 94X e-filing capability should add that capability to their product.

4.3.1.3 Review and Simplify the Process

IRS should engage with tax filers and software and service providers to review the end-to-end Forms 94X registration and e-file process, and identify easy-to-implement improvements, by:

- Comparing the Forms 94X e-file enrollment process with other enrollment processes, such as the EFTPS program; and
- Identifying and eliminating unnecessary and burdensome requirements that serve as barriers to registration or e-filing Forms 94X.⁵²

4.3.1.4 Investigate the Most Cost-Effective Ways to Increase Forms 94X E-File

Before making any significant investments, IRS should conduct authoritative research comparable to the IRS's Advancing E-file Studies⁵³ to identify the range of options to increase Forms 94X e-file rates, including a study of:

- Perceived and actual benefits of Forms 94X e-filing from the tax filer's perspective;
- Perceived and actual barriers to electronic filing such as the Forms 94X e-file and EFTPS enrollment processes, the availability of low or no cost Forms 94X electronic filing in the marketplace, and the impact of separately charged Forms 94X e-file fees;
- Potential incentives for tax filers, software developers and service providers to adopt, promote or increase Forms 94X e-filing;
- The challenge and likelihood of changing actual tax filing behavior to adopt software solutions relative to the simplicity of manually preparing and filing Forms 94X;
- The cost, success and applicability of free online Forms 94X e-filing services currently offered by states revenue agencies; and,
- The range of potential technology or program options to increase Forms 94X e-file volumes, including an e-filing portal on www.irs.gov to enable employers to electronically file Forms 94X at no charge.⁵⁴

4.3.2 Detailed Assessment

4.3.2.1 Overview

We agree with the Oversight Board that increased e-filing of employment returns is a key challenge.⁵⁵ Unfortunately, as in other areas of e-file, there is no silver bullet, and any strategy must take into consideration many complex factors.⁵⁶ For example, in its Advancing E-file Studies commissioned by IRS, MITRE Corporation cautioned that *“Technology is secondary to motivating behavior. Even the most innovative technology will not help IRS achieve the 80% e-file goal unless it is grounded in a thorough*

52 For example, the 118 page Publication 3823 “Employment Tax e-file System Implementation and User Guide” should be reviewed. See <http://www.irs.gov/pub/irs-pdf/p3823.pdf>.

53 There may also be an opportunity to leverage the National Research Program to gain insights.

54 In its 2008 Report to Congress, ETAAC previously offered some potential approaches to create a free online filing solution for employers, i.e., IRS-developed, IRS-procured or a “Free File” like program.

55 IRS Oversight Board Electronic Filing 2010 Report, p. 31.

56 Advancing E-file Study Phase 2, p. 3 (“There is no silver bullet. An advancing e-file strategy must take into consideration many complex factors, and there is no quick fix or any single Option approach for IRS to convert remaining paper filers.”)

understanding of the intricacies of filer behavior — their motivators, concerns, and relative positions on the technology adoption curve.”⁵⁷

In 2008, ETAAC recommended increasing Form 941 e-file by deploying a free Internet-based application.⁵⁸ Subsequent ETAACs did not adopt and repeat this recommendation because of the need to gain a deeper understanding of employment tax filing requirements, filer behavior and needs, and available tools. IRS cannot afford to divert precious resources to develop and deploy a taxpayer-funded “free” employment return e-file portal that gets low usage.

ETAAC believes that the challenge of increasing employment return e-filing is significant. First, it is simple to prepare and file Forms 940/941 manually. Second, changing ingrained filing behaviors is hard. Third, any barriers, such as the registration process, will quickly blunt any decision to change filing modes. The end to end registration and filing process is being measured against the effort it takes to fill out a two page form and mail it. In fact, some software vendors report that e-file rates are low even when there is no separate fee for electronic filing. Finally, unlike individual returns, employment returns do not have a key driver of increased e-file – there is no refund.

IRS must study its full range of options. We hope our insights and recommendations better inform the discussion, and expect this area will receive attention in next year’s ETAAC report.

4.3.2.2 *IRS Employment Tax Returns*

Federal employment taxes filed with IRS⁵⁹ include income tax withholding, Social Security and Medicare tax withholding, and federal unemployment taxes. Payments are submitted to the Treasury Department through the Electronic Federal Tax Payment System (EFTPS).

The highest volume, most commonly filed federal employment tax returns are the Form 940 Employer's Annual Federal Unemployment Tax Return, and the Form 941 Employer's Quarterly Federal Tax Return (for withholding, Social Security and Medicare taxes). These two forms account for approximately 97% of all employment tax returns filed with IRS, and are the focus of this report.

Forms 94X differ from individual income tax returns in some important ways. First, they do not contain any individual taxpayer information. Second, Forms 94X are primarily a summary information return.⁶⁰ Each form is two pages, each with about twenty line items. The required information to populate the forms is typically generated by the employer’s payroll system. The “filing experience” for most employers is simply transcribing that payroll information onto the form, putting it in an envelope, and mailing it.

4.3.2.3 *Electronic Filing of IRS Employment Tax Returns – Current and Projected*

Employment returns have the largest unit gap to achieve 80% e-file – about 16 million returns, and only a 1% increase in overall Forms 94X e-file volumes – currently at 24%.

57 See Advancing E-file Study Phase 1 Report - Executive Summary Achieving the 80% E-file Goal Requires Partnering with Stakeholders on New Approaches to Motivate Paper Filers, MITRE Corporation, Sept. 30, 2008, p. 1.

58 ETAAC 2008 Annual Report to Congress, IRS Pub. 3415 (Rev. 6-2008), p. 8.

59 ETAAC is not considering wage and income reporting forms, such as Forms W-2 and W-3, which are already required to be electronically filed with SSA.

60 See <http://www.irs.gov/businesses/small/article/0,,id=99194,00.html> to access and view tax forms.

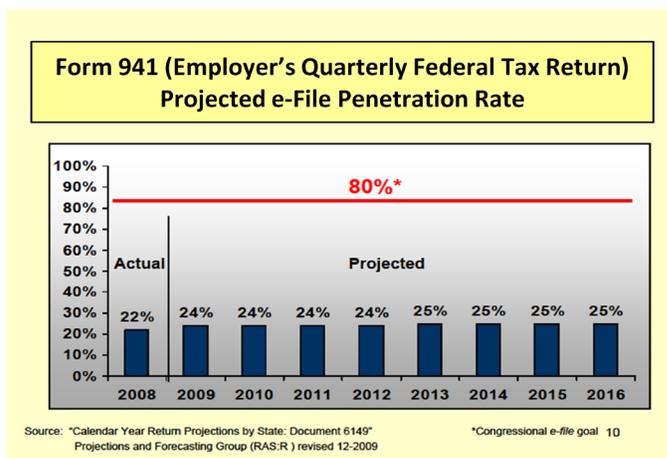
Table 8: 940 and 941 Filing Volumes

Type of Return	2010 Estimated			2011 Projection			2011 vs. 2010	
	Total	E-Filed	E-File Rate	Total	E-Filed	E-File Rate	E-File Unit Growth	Increase E-File Rate
Forms 940, 940-EZ and 940-PR	5,732,000	1,318,600	23%	5,786,600	1,397,400	24%	78,800	1%
Forms 941, 941-PR/SS	23,192,300	5,334,600	23%	23,195,000	5,493,700	24%	159,100	1%
Total	28,924,300	6,653,200	23%	28,981,600	6,891,100	24%	237,900	1%

Source: IRS Document 6186 (Rev. 10-2010) Table 2. Calendar Year Projections of the Number of Returns to be Filed with IRS (some data rounded)

Moreover, IRS does not expect any significant increase in Forms 94X e-file volumes through 2016.

Figure 1: Form 941 E-File Projection



4.3.2.4 Forms 94X E-File Must Increase for IRS to Achieve Its 80% E-File Goal

Employment returns are the largest pool of tax returns after individual returns, and increased e-file should deliver cost benefits to IRS. Current IRS processing costs for Forms 94X are approximately \$1.39 for a paper return and \$0.44 for an electronically filed return. Each one million return increase in Forms 94X electronic filing would deliver about \$1 million in annual operational savings to IRS, subject to the increased costs of any associated effort required to achieve that e-filing increase.

Additionally, the reality is that IRS cannot achieve its 80% e-file goal without a significant increase in Forms 94X e-file. For example, even if both individual and major business tax return e-filing achieved 85% e-file levels, IRS would have to more than double the current e-filing of Forms 94X to over 50% from its current rate of 24%.

4.3.2.5 ETAAC Survey of the Employment Return Filing Community

ETAAC members developed, conducted and analyzed a “pulse” survey over a two-week period to gain directional insights from the two main components of the employment tax return filing communities: in-house tax filers (employers that file employment returns on their own behalf) and employment tax service providers (payroll firms, accountants, tax preparers, bookkeepers and others that file employment returns for third parties).

The survey asked 28 questions relating to both demographics and community opinions of the Forms 94X filing environment, and was distributed with the cooperation of the NAEA, NATP, APA, AICPA, and the IRS Payroll Newsletter. ETAAC deeply appreciates their support. A total of 1,568 respondents participated in the survey, although not all respondents answered every applicable question.

The employment tax return filing community is highly fragmented, and different barriers and perceptions exist both between and within these groups based on the size of the entity, number of employees and/or clients, and the number of annual filings of Forms 94X. A summary view of the ETAAC survey responses from In-house Preparers and Service Providers is below.

Table 9: Forms 94X In-House Preparers Survey Data

Those that currently e-file...	Those that do <u>not</u> currently e-file...
<ul style="list-style-type: none"> Those using an “outsourced software solution” were 60% more likely to e-file Majority classified the cost of implementing their e-filing solution as “not costly at all” More likely to classify the cost of implementing their e-filing solution as “not costly at all” compared to their service provider counterparts Total number of employees generally had little effect on whether an in-house preparer e-filed, but there was a slight tendency for companies with fewer than 10 employees to file on paper 	<ul style="list-style-type: none"> Those that classified themselves as “government” disproportionately tended to not e-file Vast majority used “internally created solutions” Majority say they would be “much more inclined” to e-file if it could be done through EFTPS⁶¹ Most common responses for not currently e-filing were the “low volume of returns prepared,” “never considered, paper works fine” and “software doesn’t support e-filing”

Table 10: Forms 94X Service Providers Survey Data

Those that currently e-file...	Those that do not currently e-file...
<ul style="list-style-type: none"> Majority classified themselves as “Payroll Processor – Full Service” Those using an “outsourced software solution” were more likely to e-file Majority classified the cost of implementing their e-filing solution as “not costly at all” Those with 100 or more employees were much more likely to e-file, while those with 10 or fewer employees were more likely to file on paper Those with over 100 clients, or where their clients averaged over 100 employees, were twice as likely to e-file than those with fewer than 100 clients or where their clients averaged fewer than 10 employees 	<ul style="list-style-type: none"> Majority classified themselves as either “Bookkeeping and Accounting Office” or “Certified Public Accounting / CPA Firm” Tended to have fewer than 50 clients filing employment returns More likely to classify the cost of implementing their e-filing solution as “somewhat costly” compared to their in-house counterparts Majority say they would be “much more inclined” to e-file if it could be done through EFTPS Most common responses for not e-filing were “limited time to handle implementation/research move to electronic filing,” “IRS delivery options too complex,” and “software doesn’t support e-filing”

61 Payroll withholding constitutes a majority of payments through EFTPS, which is managed by Treasury. Previously, the EFTPS vendor developed a capability for federal agencies to e-file their Forms 94X through EFTPS in addition to submitting payments. As a result, federal agencies are not subject to the same complex registration, file format development and testing process, and security restrictions that IRS imposes on private industry for e-filing employment returns through IRS.

The ETAAC survey also asked the below questions, which provide some important insights into the barriers and incentives for e-filing employment returns.

Question: *What are the main reasons your firm/organization does not currently file more employment (94X series) returns electronically?* (Ordering below is based on highest percentage “In-house” responses, and includes the “Top 5” responses for both In-House and Service Providers).

Table 11: ETAAC Survey Question Summary #1

Answer	Responder Type	
	In-House	Provider
Low volume of returns prepared	24%	11%
Never considered, paper works fine	23%	8%
Use software but it does not provide an e-filing option	21%	15%
Do not use software to prepare the returns	19%	3%
Limited time to handle implementation/research move to e-file	18%	18%
IRS delivery options too complex	13%	15%
Different fed vs. state return systems/methods make it inefficient	8%	10%

Question: *For your firm/organization to start filing or increase the number of employment returns (94X series) filed electronically, how important are each of the following areas with respect to starting or increasing the number of returns e-filed?* (Ordering below is based on highest percentage “In-house” responses, and includes the “Top 5” responses for both In-House and Service Providers).

Table 12: ETAAC Survey Question Summary #2

Answer	Responder Type	
	In-House	Provider
Accuracy of data that is submitted	86%	77%
Accuracy of data coming out of systems (how payroll produced)	82%	72%
Ease of implementation	68%	78%
Simple method of delivering e-file data	62%	75%
Software used must offer e-file	58%	69%
Cost to implement must be low	53%	66%

Finally, the survey solicited a “fill-in the blank” response to the question “What is the single change that IRS could do to induce you to file more employment returns (94X series) electronically?”

There were about 940 narrative responses to this question, which required a manual review, interpretation and categorization. About 250 of those responses surrounded the theme of “provide a free online solution.” The other key themes getting high mention related to providing training on the Forms 94X electronic filing registration process and procedures, and making the overall employment return electronic filing process easier and more user friendly.

4.3.2.6 ETAAC's Summary Perspective

Increasing the electronic filing of Forms 94X will require that the entire end-to-end e-file registration, filing and payment process be incredibly easy and convenient – it is in competition with a simple form, a pencil, an envelope and a stamp.⁶²

ETAAC believes five key areas require focus, and is making recommendations to address them.

First, IRS must overcome numerous misunderstandings in the filer community about the availability and risks associated with employment return electronic filing. Many respondents were not aware that IRS accepted employment returns electronically, indicated a concern about increased liability if employment returns were e-filed, and were not aware of IRS support channels to assist the Forms 94X filer community in enrollment and filing.⁶³

Communicating with the tens of thousands of Form 94X in-house preparers that support small businesses will be especially challenging because they are unlikely to be members of any payroll or business organizations. Their current contact with IRS is likely limited to the receipt of the paper returns and filing instructions by mail. Any effort to increase the electronic filing of Forms 94X will require a strategy to engage this segment, which will be challenging.

Second, software and service providers must overcome the apparent lack of understanding by the Forms 94X filing community of the capabilities offered by its third party software, including the availability of electronic filing.

Third, the current enrollment process is perceived, and likely is, too cumbersome and time-consuming. It must be reviewed to identify improvements that will make it simpler and easier.

Fourth, ETAAC's survey was a first step to get directional insights into the employment return filing communities, and was not scientifically developed or conducted. More detailed research is required given the significant fragmentation and complexities of this filing community.⁶⁴

For example, many respondents referenced the attractiveness of free state employment tax filing capabilities and the EFTPS system for electronic payments. If the availability of low or no cost electronic filing is determined, in fact, to be a key barrier, then such solutions should be evaluated in the context of IRS overall challenges and opportunities. Although technological solutions likely play a role, ETAAC cautions against jumping to conclusions about their potential success. Any additional research should include an assessment of options, including rigorous consideration of all potential options to increase Forms 94X e-file in light of IRS' significant operational and modernization challenges. Taxpayers simply cannot afford a costly miss. Additional research can enable a more informed decision.

Finally, ETAAC believes that stakeholder collaboration is critical. IRS and industry must engage constructively to find the most appropriate, cost effective approaches to increase Forms 94X electronic

62 Something as basic as a poorly designed logon process that involves highly complex user names/passwords will cause relatively infrequent users to revert to a paper form, envelope and stamp – and generate calls to IRS.

63 IRS programs and resources promoting employment return e-file include: IRS SB/SE Division's Stakeholder Liaison Field engagement with the leadership of practitioner and industry partners; IRS Electronic Tax Administration presentations at the annual American Payroll Association conference; IRS' online Small Business Tax Workshop (See <http://www.irsvideos.gov/virtualworkshop/>); and, www.irs.gov information about IRS On-Line Filing Programs for employment taxes (<http://www.irs.gov/e-file/article/0,,id=97966,00.html>).

64 A good example of a detailed study of options is the work of MITRE on IRS' Advancing E-file Study Reports.

filing. One collaboration model would be to reinstate IRS “Request for Agreements” (RFA) program.⁶⁵ The RFA process could be used to “pilot” new ideas without the burden of permanently changing policy, unless and until IRS determined that it was the right thing to do. In effect, IRS could use the RFA process to generate creative proposals and to extend its sources of innovation at no expense to taxpayers.

65 RFA was a non-monetary program where, without any expenditure of procurement funds, IRS sought and received ideas to increase electronic filing. Companies could submit pilot proposals for IRS review. If accepted, IRS would cooperate to enable the submitting company to implement its pilot. If it worked, IRS made the opportunity more broadly available across the e-file community. If it failed, then IRS dropped it. There was limited risk or cost to IRS or taxpayers. Expedited processes for the development of “temporary policies” would be required to support rapid innovation and iteration.

KEY OUTCOME 3

Leverage the Capabilities and Diversity of the Electronic Tax Preparation and Filing Industry to Deliver Taxpayer Services that can be Better Met Through Private Sector Innovation

RECOMMENDATION 4: TAX FILING SIMPLIFICATION

IRS should begin engaging with industry to discuss the Commissioners' vision for accelerated information reporting and real time data matching, but defer any consideration of Simple Return.

Summary Recommendations

IRS should begin a consultative process with the tax preparation industry, financial institutions, the small and large business communities and ETAAC to discuss the vision and potential for Data Retrieval as it relates to taxpayer access to both prior and current year tax return data,⁶⁶ accompanied by a thorough public analysis of the Data Retrieval concept before any development work or funding commences.

IRS should defer further consideration of any return free proposal, including the Simple Return concept, unless and until the substance of the US tax code for individual taxpayers is radically simplified.⁶⁷

4.4.1 Detailed Recommendations

Data Retrieval and Simple Return are significant, complex undertakings that require rigorous analysis before being undertaken or funded. Either project would require significant funding, technical resources and management attention, and trade-offs in tax administration priorities for several years during a continuing period of fiscal crisis.

4.4.1.1 Data Retrieval

Consistent with the Commissioner's announcement,⁶⁸ IRS should, by October 1, 2011, begin a consultative process with the tax preparation industry, financial institutions, the small and large business communities and ETAAC to discuss the vision and potential for Data Retrieval as it relates to taxpayer access to both prior and current year tax return data. Specific discussion topics could include how to balance the long term objectives for the initiative with the range of systems and programmatic challenges facing IRS, the impact of existing and potential compliance obligations taxpayers and business, and the range of alternative approaches and most cost effective solutions to enable and achieve the vision.

To enable this consultative process, IRS should conduct a thorough public analysis of the Data Retrieval concept before any development work or funding commences, including: (i) a clear statement of the taxpayer and IRS problems being solved, and clearly articulated measures of success; (ii) the identification of potential alternatives other than Data Retrieval that eliminate or mitigate the identified problem, such as the data retrieval capabilities already available to the public in the commercial

66 Specific discussion topics could include how to balance the long term objectives for the initiative with the range of systems and programmatic challenges facing IRS, the impact of existing and potential compliance obligations taxpayers and business, and the range of alternative approaches and most cost effective solutions to enable and achieve the vision.

67 Even now, many of the current prominent tax reform/simplification proposals include numerous credits, deductions and tax benefits (earned income, child, charitable deduction, mortgage and retirement). See *The Moment Of Truth: Report of the National Commission on Fiscal Responsibility and Reform*, December 2010, p. 31 (Fiscal Commission).

68 National Press Club, April 6, 2011. <http://www.irs.gov/newsroom/article/0,,id=238204,00.html> (Commissioner's Remarks).

marketplace, and (iii) the identification and a full, rigorous analysis of the burdens, risks, return on investment and benefit-cost for taxpayers, IRS and business consistent with all applicable statutory, regulatory and OMB obligations.⁶⁹

4.4.1.2 Simple Return

ETAAC recommends no further consideration of any return free proposal, including the Simple Return concept, unless and until the substance of the US tax code for individual taxpayers is radically simplified.

4.4.2 Detailed Assessment⁷⁰

4.4.2.1 Background: Data Retrieval and Simple Return

Commissioner Shulman recently articulated a “data retrieval” vision for tax processing, where accelerated current year third party information reports would be made accessible to taxpayers (and their professionals), and enable IRS to conduct “real time” information processing and return matching.⁷¹ Electronically filed returns lacking required information would be rejected.⁷² A related electronic tax administration concept called “Simple Return,” a model of return-free filing (or pre-filled returns), has also been proposed.⁷³

Both concepts relate to electronic tax administration, and their recent review by the President’s Economic Recovery Advisory Oversight Board (PERAB) makes them a timely subject for ETAAC’s consideration.⁷⁴ (Note: PERAB did not recommend or endorse specific options, but only provided an overview of their advantages and disadvantages.)

ETAAC has publicly called for substantive tax simplification,⁷⁵ and fully supports efforts to reduce taxpayer burden and increase tax return accuracy - so long as any proposed solution is objectively analyzed and demonstrated to deliver a positive benefit-cost, can be realistically implemented on time and budget, and will deliver on its promises without creating countervailing burdens or unacceptable tradeoffs. At this time, we need to move beyond the discussion of these proposals as high level concepts and, instead, conduct thorough data-driven analyses. In support of that effort, ETAAC is summarizing PERABs review of these concepts, and offering its perspective.

69 Risks include technology, schedule, resources, change management, security, privacy, data, integration, requirements and cost. See Report to Congress on the Benefits of the President’s E-Government Initiatives, FY11, Attachment “N” http://www.whitehouse.gov/sites/default/files/omb/assets/egov_docs/FY11_EGov_Benefits_Report_v2.pdf. OMB Circulars are accessible at http://www.whitehouse.gov/omb/circulars_default.

70 ETAAC has footnoted its summary review with several relevant assessments, and highly recommends their review.

71 Commissioner’s Remarks. See also Taxpayer Advocate Testimony, Senate Finance Committee, April 15, 2010 <http://finance.senate.gov/imo/media/doc/041510notest1.pdf> (Taxpayer Advocate Testimony)

72 It would need to be determined how “paper filed” returns would be handled.

73 "The Simple-Return: Reducing America’s Tax Burden through Return-Free Filing," by Austan Goolsbee (Hamilton Project, July 2006) http://www.brookings.edu/~media/Files/rc/papers/2006/07useconomics_goolsbee/%20200607goolsbee.pdf (Simple Return Proposal). For another perspective, see Policy Analysis of “Return-Free” Tax System by Robert A. Boisture, Albert G. Lauber and Holly O. Paz, Computer & Communications Industry Association, April 2006 at <http://www.ccia.net.org/CCLIA/files/ccLibraryFiles/Filename/000000000331/Return-Free-WP.pdf>

74 The Report on Tax Reform Options: Simplification, Compliance and Corporate Taxation, President’s Economic Recovery Advisory Board, August, 2010, pps. 41-44.

75 2010 ETAAC Annual Report to Congress (IRS Pub. 3415, Rev. 6-2010), p.9 (2010 ETAAC Report)

4.4.2.2 Data Retrieval

Context: Prior Year vs. Current Year Data Retrieval

To assist in understanding this discussion, ETAAC is characterizing two concepts of Data Retrieval – prior year and current year. Both prior year and current year data retrieval could occur in tandem, but present different operational requirements.

From ETAAC’s perspective, prior year data retrieval refers to the ability of IRS to make available, and taxpayers and tax preparers to retrieve, tax return information already in IRS’ possession without the need to accelerate information reporting by employers and financial institutions. Existing examples of this capability include IRS’ practitioner e-services (access to taxpayer transcripts) and the Department of Education’s Free Application for Federal Student Aid web site (access to taxpayer information into FAFSA student aid applications), which are referenced in more detail below. In fact, ETAAC has recommended the implementation of prior year data retrieval in prior Annual Reports to Congress.

On the other hand, ETAAC is characterizing current year data retrieval as the ability of IRS to make available, and taxpayers and tax preparers to retrieve, current tax filing season wage and investment information reports such as that found in Forms W-2 and 1099. Unlike prior year data retrieval, current year data retrieval requires the acceleration of information reporting.

PERAB - Identified Advantages & Disadvantages

PERAB identified data retrieval’s key benefits as time savings, a decrease in taxpayer frustration, and a reduction in transcription errors and other mistakes, which could help all taxpayers, not just those with simple tax returns.

PERAB also noted a number of disadvantages including: the risk of security breaches; higher taxpayer awareness of the relatively limited amount of information possessed by IRS; the need for additional resources for technology investments; and, the increased cost and difficulties of getting third-party data submitted and processed early enough to enable taxpayers to file their returns and obtain their refunds on their current schedule. Likewise, Commissioner Shulman recognized that “fundamental changes” would be required by the government and private sector in his April 6 remarks at the National Press Club.⁷⁶

ETAAC’s Perspective on Data Retrieval

Under its current processes, IRS begins to receive information reporting directly (1099) or from SSA (W2) in February, but does not begin to use the information until August or later.⁷⁷ Current year data retrieval seems to promise two key benefits: (i) more accurate, less burdensome taxpayer data entry enabled by information downloads from IRS’ databases, and (ii) reduced IRS error processing and inaccurate refund issuance associated with unreported income. Delivering these benefits requires overcoming some major challenges.

⁷⁶ Major rework of IRS systems, ability to load/match all reporting data sooner and in real-time, and need to push the private sector to deliver information returns earlier - in the face of budget constraints and IRS current production challenges.

⁷⁷ IRS uses include its “non-filer” and “automated underreporter” programs.

First, real time information matching cannot succeed unless any accelerated information reporting from the private sector to IRS is accurate. ETAAC's 2010 Report expressed serious concerns that it would not be accurate.⁷⁸

As background, the current deadline for delivering wage and financial information reports to taxpayers is January 31st. Then, information return filers must deliver those reports to SSA and IRS by March 31st for electronic filing. This two month period enables taxpayer review and identification, and issuer correction, of errors in those information returns before submission to IRS. ETAAC members with experience in this area (as issuers and processors) advised that error rates in these documents are material, which raises ETAAC concerns that the elimination of a suitable review period will reduce the accuracy of information reported to IRS.⁷⁹ A related challenge is that taxpayers are unlikely to conduct accelerated reviews of these documents. ETAAC members' experience is that taxpayers typically do not review these reports until they begin working on their returns. One indication of this taxpayer behavior is the current "end of season" rush for W2 and 1099 corrections associated with late season filers.

Inaccurate information reporting on IRS could have serious impacts, and must be carefully assessed. IRS would have to handle more information return corrections,⁸⁰ and taxpayer burden and anxiety could increase instead of decrease because of incorrect information report filings. IRS might also have to handle more amended tax returns to correct errors in previously filed returns. Finally, e-file rejects (and the volume of associated phone calls to IRS) might increase where taxpayers have filed a return with updated (accurate) information, but IRS databases have not yet been updated with corrected information, thus creating data mismatches.

Second, assuming the data accuracy challenge could be overcome, Congress would need to ensure that accelerating the information reporting timeframe would not place undue cost and other burdens on business, employers and financial institutions. Shortening the processing period from three months to one month is a significant workload increase, especially for small businesses. ETAAC's concerns about the practical business impact of such a change are heightened by Congress' recent statutory repeal of expanded 1099 reporting by businesses, which had been enacted just last year as part of the healthcare legislation. The legislative reversal resulted from the substantial concerns expressed by the small business community about the additional associated costs and burdens, which the President described as "an undue barrier to small business growth."⁸¹ Policy makers must avoid creating the same kind of costly business burden again, particularly on small business, without adequate study of its practical impact including a consideration of other potential opportunities.⁸²

Third, IRS already starts getting information reporting "in season" and is not using it. The Taxpayer Advocate illustrated the challenge when she testified that "*With tax returns arriving as early as January and the IRS not completing its Information Returns Master File for the year until around August, we would have to find a way to make up about six months' worth of time.*"⁸³ Before increasing the business burden by accelerating information reporting, IRS must demonstrate that it has the ability to receive, process, load and match information reporting with real time return submissions *using the data it*

78 2010 ETAAC Report, p. 32-33.

79 Congress could delay the filing period. One important consideration would be the impact on taxpayer refunds, especially the impact on low income taxpayers who typically receive large refunds early in the filing season. See Taxpayer Advocate Testimony, p. 24.

80 Companies currently process corrections before IRS submission. Acceleration would require IRS processing of corrections.

81 See <http://www.whitehouse.gov/blog/2011/04/14/repealing-1099-reporting-requirement-big-win-small-business>

82 Extending 1099-MISC filing deadlines might help close the tax gap. See TAX GAP: IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements, January 2009 (GAO-09-238), p. 27.

83 Taxpayer Advocate Testimony, p. 24.

already has. Realistically, given that a very large number of returns are filed during the initial season filing peak ending in early February, how much of its current six month processing cycle can IRS eliminate – can it actually process, load and match the information fast enough to make a sufficient difference as balanced against the costs and burdens of current year data retrieval?

Additionally, these new processing requirements would require the design, development, testing, deployment, operation and maintenance by IRS of a real time interactive back-end processing system, in addition to a “taxpayer-facing” front-end system that provides secure data retrieval and increased customer support center resources to handle taxpayer inquiries.⁸⁴ This substantial work effort would have to occur during a time of significant systems modernization and security challenges for IRS, as reported by both TIGTA and GAO, as well as absorbing the work associated with IRS’ substantial role in implementing the new healthcare program.⁸⁵ Adding another major new systems design and implementation program to undertake the data retrieval strategy, with or without Simple Return, needs to be carefully analyzed regarding its practical impact on IRS resource capabilities and operating focus.

Even if current year data retrieval was judged able to deliver its aspirational benefits, Congress should consider whether data retrieval is the right thing to add to IRS’ already full plate, and likewise identify what will come off that plate. ETAAC, for one, would not defer IRS’ current tax system modernization projects in favor of current year data retrieval or diminish IRS’ focus on security. Taxpayers need to know quickly that their electronically filed return have been accepted (MeF), their refunds will issue quickly (CADE2), and that their questions can be answered by IRS call center agents with immediate access to current information (Account Management Services) – all in a secure environment. Delivering on the basics of taxpayer service must be central to IRS’ going forward strategy and resource allocations, and requires a dedicated, priority focus throughout the organization.

Finally, IRS should consider whether there are less challenging and less costly options to solve this problem. For example, IRS has already successfully deployed an IRS tax data sharing feature that enables Free Application for Federal Student Aid (FAFSA) applicants to import IRS tax information into their web browser, enabling the citizen to pre-fill their financial aid applications.⁸⁶ Additionally, IRS already makes taxpayer transcript information electronically available to practitioners through the e-services Transcript Delivery Service.

Given those proof points, ETAAC recommended last year that IRS provide *taxpayer* access to their *prior year* tax information.⁸⁷ How much benefit would that less burdensome capability provide relative to an accelerated information reporting model? Many taxpayers have the same employers and financial institution reporting “year-over-year.” How much automated underreporting is associated with information reporting from issuers included in prior year return data that could enable “taxpayer reminders” to ensure they identify information they might have otherwise missed?

84 Commissioner Shulman’s vision included taxpayers and their preparers “access[ing] that information, via the Web, and download[ing] it into their returns, using commercial tax software.” See Commissioner’s Remarks.

85 TIGTA Memo for Secretary Geithner, Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2011, October 15, 2010. Also see GAO HIGH-RISK SERIES: An Update, February 2011 (GAO-11-278).

86 Available information includes taxpayer name, filing status, AGI, taxes paid, type return, # exemptions, education credits, IRA deductions, and tax exempt interest income. Authentication relies on tax year, taxpayer name, SSN and date of birth. See Federal Student Aid – Datashare (FSA-D), Privacy Impact Assessment, November 12, 2009 at <http://www.irs.gov/pub/irs-pia/fsad-pia.pdf>. See TIGTA: “Federal Student Aid Datashare Application Was Successfully Deployed, but Improvements in Systems Development Disciplines Are Needed (Ref. No. 2010-20-099, dated Sept 3, 2010).

87 2010 ETAAC Report, p. 20.

Direct electronic data retrieval of personal financial information from original sources (payroll services, banks, brokers, etc.) by taxpayers and tax professionals preparing returns is available today through commercial software, enabling existing pre-population of much of a taxpayer's return. Conversely, electronic retrieval of data uniquely in the government's possession – such as prior year tax returns – is not available today for return preparation. With very difficult public expenditure choices looming in the years ahead, investment in new IRS capabilities should focus on meeting unmet needs and be clearly accretive to the continued modernization of the tax process, while carefully seeking to avoid costly investments to duplicate capabilities that already exist. Taxpayers need the best possible decision given the large investment any project would require, our fiscal crisis, and the current demands on IRS leadership and technical staff now and for the foreseeable future.

In conclusion, taxpayer access to their tax information and IRS “real time” matching have great promise in theory, and should be fully investigated. ETAAC agrees with Commissioner Shulman that it's time to start a dialogue with the business community. The foundation for that dialog is a clear understanding of the problem to be solved, the identification of all potential solutions, and a thorough analysis of their potential benefits, costs, risks and tradeoffs.

4.4.2.3 Simple Return

PERAB - Identified Advantages & Disadvantages

PERAB also considered Simple Return, which is modeled after the California ReadyReturn program where taxpayers with relatively simple returns have access to an online pre-filled return with information taken directly from employers, financial institutions and last year's return along with a preliminary calculation of tax liability. Taxpayers are responsible for making any necessary updates to their returns, such as adding self-employment income, and changing dependents.

PERAB identified that Simple Return's key benefits would be relieving taxpayers from the chore of filling in tax forms, and reducing the frustration and anxiety of taxpayers at tax time. (The PERAB Tax Reform Subcommittee was briefed on the projected benefits of Simple Return, as well as Data Retrieval, in a presentation entitled Using Technology to Simplify Filing by Professor Joseph Bankman of Stanford Law School.⁸⁸)

PERAB also noted a number of disadvantages including: little relief for taxpayers with complicated returns or business income, or low-income filers in complicated living arrangements; lack of an IRS computing infrastructure; absence of timely third-party information reports needed to pre-fill a return; need for considerable investment in technology and manpower; potential that a pre-filled return that omitted income, or misstated the return in a taxpayer's favor could reduce tax compliance and collections; difficulty or impossibility of adapting Simple Return to address all the special credits for low-income households; and, finally, even with technological improvements, the inability for many taxpayers to prepare returns as soon after the close of the year as they currently file their returns in order to obtain their tax refunds. (Additional analyses of Simple Return are found in “The Benefits and Costs of Implementing ‘Return Free’ Tax Filing in the U.S.” by Drs. Robert Litan of the Brookings Institution and Jeffrey Eisenach of Navigant Economics, and in “Should the Government Prepare Individual Income Tax

88 For a previous paper by Professor Bankman, of Stanford Law School, on “Using Technology to Simplify Filing,” see National Tax Journal, December, 2008 (http://www.americantaxpolicyinstitute.org/pdf/tech_conference/Bankman.pdf).

Returns?” by Dr. Joseph Cordes of George Washington University and Arlene Holen of the Technology Policy Institute.⁸⁹)

ETAAC’s Perspective on Simple Return

Accelerated information reporting and current year data retrieval are the essential foundation to enable Simple Return to be possible, so all the above considerations concerning Data Retrieval apply here as well. However, Simple Return raises additional considerations unique to its feature of presenting pre-filled tax returns to taxpayers.

First, our tax code must be radically simplified. Simple Return has been characterized as entailing *“nothing more than checking the numbers, signing the return, and then either sending a check or, more typically, receiving a refund.”*⁹⁰ To meet these expectations, Simple Return requires that IRS accurately calculate the taxpayer’s *taxable income* (net of any tax preferences such as exemptions and deductions) and their associated *tax liability* (net of any tax credits or other preferences).

The challenge for Simple Return occurs in the collision between complex tax laws and even more complicated taxpayer lives. Given the plethora of existing tax benefits (especially for the low/middle income taxpayers) and an increasingly complex society and economy, Simple Return does not relieve the taxpayer of needing to understand the intersection of the tax laws with their annually-changing personal lives in order to ensure their return is accurate and, importantly, that they are getting all the benefits they deserve. At the federal level, it is just not as simple as checking the numbers.

The reality is that Simple Return can only deliver on its promises of simplification and burden reduction if Congress purges most, if not all, of the existing individual socio-economic tax incentives like the Earned Income Tax Credit. The simplified system would likewise need to be unlinked from the ever-changing complexities of taxpayers’ daily lives, into which the government has little insight absent additional taxpayer reporting. Then, our tax code would need to remain “simple” long term.

The need for significant tax simplification as a prerequisite to a return free tax system is well recognized. The Treasury Department recognized this fact in 2005, at a time when our tax code was even simpler.⁹¹ Fortunately, many are advocating substantive tax reform. For example, subsequent to the PERAB report, the President’s bipartisan Commission on Fiscal Responsibility and Deficit Reduction concluded its year-long deliberations about deficit reduction and tax reform, and issued detailed recommendations for significant tax simplification. Although no specific tax filing simplification recommendations such as Simple Return or data retrieval were made, the Commission viewed that *“Simplifying the code will dramatically reduce the cost and burden of tax preparation and compliance.”*⁹²

The challenge facing a “return free” system’s ability to deal with, for example, individual tax credits is well documented. For example, the inability of Britain’s “Pay As You Earn” (PAYE) return-free system to accurately determine eligibility of targeted tax credits led to creation of a parallel filing requirement, with forms and instruction booklets closely resembling our own 1040.⁹³ The lesson of the British experience, that a return-free system may require additional filings to ensure accuracy or to enable tax

89 A copy of Litan-Eisenach’s March 2010 Report and letter submission to the Fiscal Commission is at <http://www.naviganteconomics.com/docs/LitanEisenachCavesDeficitCommissionLetterwithAttachment093010.pdf>. A copy of Cordes-Holen’s Report is at <http://www.techpolicyinstitute.org/publications/type/1.html>.

90 Simple Return Proposal, p. 5.

91 Report to Congress on Return-Free Tax Systems: Tax Simplification Is a Prerequisite, Treasury Department, Jan. 2003, p. 2.

92 Fiscal Commission, p. 28.

93 See HMRC’s “Getting your tax credits claim form right” at <http://www.hmrc.gov.uk/forms/tc600-notes.pdf>.

benefits delivery, raises practical questions about whether a system like Simple Return can deliver on its promise of taxpayer burden reduction and still provide the necessary level of flexibility our tax system needs. Given the far greater number of refundable and other targeted tax credits and incentives in the American system, the ability of IRS to deliver an accurate pre-prepared return could be a substantial challenge. When combined with the year-to-year dynamics of changing employment, physical relocation, and changing individual and family circumstances in American society, the challenges facing such a system to achieve accurate outcomes multiplies over that of other societies such as Britain.⁹⁴

Additionally, many of the tax expenditures in the law today are intended by Congress to incentivize particular taxpayer economic behaviors, such as gaining additional education. Congress would have to assess the impact of Simple Return on its policy objectives to incent those behaviors. Reducing or eliminating the taxpayer's involvement or awareness in the process of delivering such incentives would appear to work at cross-purposes to the intent of those provisions at the most basic level.⁹⁵

Second, Simple Return requires not just the new data retrieval systems (described above), but also an online tax preparation system. Unless it reverts to a paper process, Simple Return would require that IRS develop, deploy, operate and maintain a robust, real time, online tax processing system, which would be much more challenging than creating an application programming interface that enables taxpayers to "download" their tax data. If Simple Return achieved the volume of usage⁹⁶ some have suggested, then it would need to be able to handle potentially hundreds of thousands of concurrent users at filing peaks. IRS must also budget for frequent "technology refreshes," which are occurring on shorter and shorter cycle times as technology changes accelerate. The past stagnation of IRS systems could not continue to be characteristic of IRS technology resources.⁹⁷ Additionally, IRS would need highly skilled IT staff, as well as more technically capable call center staff to handle the high volume of tax, technical and operational online tax processing questions than in the past, if for no other reason than the significant expansion of IRS direct service to the taxpayer that the concept represents. Any problems or errors in creating and delivering such pre-prepared returns would cause such call center traffic to grow dramatically.

Third, any additional burdens for taxpayers, business and other stakeholders must be considered. Simple Return's promise is that it will significantly reduce taxpayer burden, although those estimates must be updated.⁹⁸ To ensure the Simple Return is accurate, one suggestion was to modify Form W-4, currently used to set employee withholding allowance. That approach would place increased burden on employers (to answer more employee questions, process Form W-4s more frequently, and file them with IRS), taxpayers (to prepare the expanded form), and IRS (to process forms they don't currently receive).⁹⁹ Any new burdens must be included in the evaluation of the overall burden calculation and resource planning, and carefully monitored. As noted above, the realities of small business concerns

94 For discussion of foreign return-free tax administration models, see Statement by M. Brostek, Senate Finance Comm., Apr. 12, 2011 (Preliminary Information on Selected Foreign Practices That May Provide Useful Insights, GAO11-540T).

95 "While [pre-populated returns] certainly would reduce the time [spent] on tax return preparation, it also makes them less aware of what the tax law is." Senator O. Hatch, Senate Finance hearings on Best Practices in Tax Administration, April 12, 2011.

96 The Simple Return Proposal estimated 40% of 140M taxpayers could be eligible for the program after full implementation.

97 See Commissioner's Remarks ("In all honesty, there was an under-investment in IRS technology over the past 20 years which left us in a very deep hole.")

98 The Simple Return Proposal was based on TY2004 data. A recent IRS paper entitled "Individual Taxpayer Compliance Burden: The Role of Assisted Methods in Taxpayer Response to Increasing Complexity," by IRS Office of Research noted compliance costs may have decreased from 2000 to 2007 (despite increased federal tax complexity) because of increased technology-assisted compliance methods and productivity. See <http://www.irs.gov/pub/irs-soi/10rpresconindtax.pdf>

99 Another approach was to mail a postcard to the IRS, which would require manual handling. If IRS determined to use an online system to collect this information, an assessment of additional development work and operational costs is required.

about new, repetitive or expanded reporting requirements has already been demonstrated in the legislative decision to repeal the new 1099 reporting.

Finally, Simple Return requires a rigorous benefit-cost assessment. Given our fiscal crisis, one critical element is a realistic estimate of the number of taxpayer who would actually use Simple Return, not just how many “could use it.” The only comparable for usage seems to be ReadyReturn. California has approximately 15,000,000 personal taxpayers, of which about 2,000,000 are eligible to use ReadyReturn given the program’s limitations.¹⁰⁰ After a sizable increase in usage in its second year, ReadyReturn taxpayer adoption was between 60,000-65,000 users for each of the 2009 and 2010 filing seasons¹⁰¹ - about ½ of one percent of California’s total personal taxpayer population and three percent of the ReadyReturn-eligible population. The high praise directed toward the ReadyReturn program as a success must be tested with an objective analysis of its consistently low adoption rate by California taxpayers. Simply put, before IRS pursued a Simple Return concept, any forecasts of actual usage would need to be carefully analyzed and well understood. Similarly, any benefit-cost analysis would require the calculation of the “cost per return” based on the total life cycle costs of the system, fully accounting for all direct and indirect costs, including its development, deployment, annual operation, maintenance and ongoing service provisioning. In an era of extremely difficult budget choices, Congress would need to determine whether Simple Return’s actual usage levels of, for example, ½ of one percent of all federal individual taxpayers, would be a sufficient return on investment, or to understand why IRS believed Simple Return usage would be significantly more than California’s ReadyReturn experience.

4.4.2.4 *Additional Considerations for Data Retrieval and Simple Return*

There are several other considerations relating to the Data Retrieval and Simple Return proposals.

First, would there be sufficient current and continued future funding for these programs and related operations relative to other investment needs and opportunities?

Second, would the tradeoffs be worth it if IRS proposed “self-funding” these projects by cutting spending in other areas of its budget? Are those service reductions or halted modernization efforts the right cuts to make?

Third, for Simple Return, should IRS prepare tax returns, and are the risks of failures of a centralized national filing system acceptable? GAO previously identified the service disruptions of the UK and Canada’s electronic tax systems.¹⁰² More recently, the UK has been dealing with the fallout of the government’s effort to correct ten years of PAYE system miscalculations of citizens’ tax liability, and its associated efforts to recover the significant shortfalls in taxpayer payments resulting from those errors.¹⁰³

100 See http://www.ftb.ca.gov/aboutFTB/press/2011/Release_01.shtml and http://www.ftb.ca.gov/readyReturn/faq_about.shtml#Q2

101 In its second year, ReadyReturn usage jumped from ~10,000 to 60,000 taxpayers. Over past two filing seasons, annual ReadyReturn usage has stabilized between 60-65,000. The 2009 jump appears to relate in large part to a one-time shift of users from California’s i-File system called CalFile to ReadyReturn.

102 GAO Tax Software Report, p. 18.

103 See <http://www.bbc.co.uk/news/uk-11186397> (Six million people in UK have overpaid or underpaid tax.);

http://www.thisismoney.co.uk/tax/income/article.html?in_article_id=513900&in_page_id=77 (Tax fiasco worsens with 18m more errors).

Fourth, would a Simple Return system enable Congress to deliver the targeted socio-economic or stimulus policy benefits customarily delivered through our tax system¹⁰⁴ or, if unable to do so, would Congress be inclined to eliminate such economic policy methods from the tax system going forward?

Finally, would a Simple Return system disengage taxpayers from their civic duties¹⁰⁵ or adversely impact their financial capability?¹⁰⁶

104 Richard Highfield, Senior Tax Administration Advisor with OECD noted that “At first glance, the return-free feature of the UK system appears highly attractive given that it avoids the compliance costs associated with end-year tax returns and the administrative costs of processing them. However...the PAYE arrangements...lack the flexibility needed to effectively accommodate some Government policy demands...Somewhat perversely, these new procedures require claimants to file something akin to a tax return to support their claim.” Commentary to Chapter 12, Administration and Compliance (by J. Shaw, J. Slemrod & J. Whiting), p. 1181. See <http://www.ifs.org.uk/mirrleesreview/dimensions/ch12.pdf>.

105 Dr. Eric Toder, Urban Institute, raised similar considerations about return free systems for the President’s Advisory Panel on Federal Tax Reform on May 17, 2005. See http://www.taxpolicycenter.org/UploadedPDF/900816_Toder_051705.pdf

106 The National Taxpayer Advocate noted that “for many, many individuals, [tax time] is the only time that they ever really sit down and look at what happened to them financially over the last year...for...the financial health of the country, that is an important ritual.” See <http://www.urban.org/publications/900807.html>

RECOMMENDATION 5: IRS/INDUSTRY COLLABORATION AND PARTNERSHIP

IRS should increase and focus its collaboration with electronic tax administration stakeholders to drive efficiency, lower cost and improve taxpayer service.

Summary Recommendations

IRS should take three key steps to increase the productivity of its existing electronic tax industry and state partnering activities: (i) formalize an electronic tax administration Issue Resolution Operating Process, (ii) create an electronic tax administration Issue Resolution Steering Committee, and (iii) identify specific electronic tax administration Issue Resolution Projects.

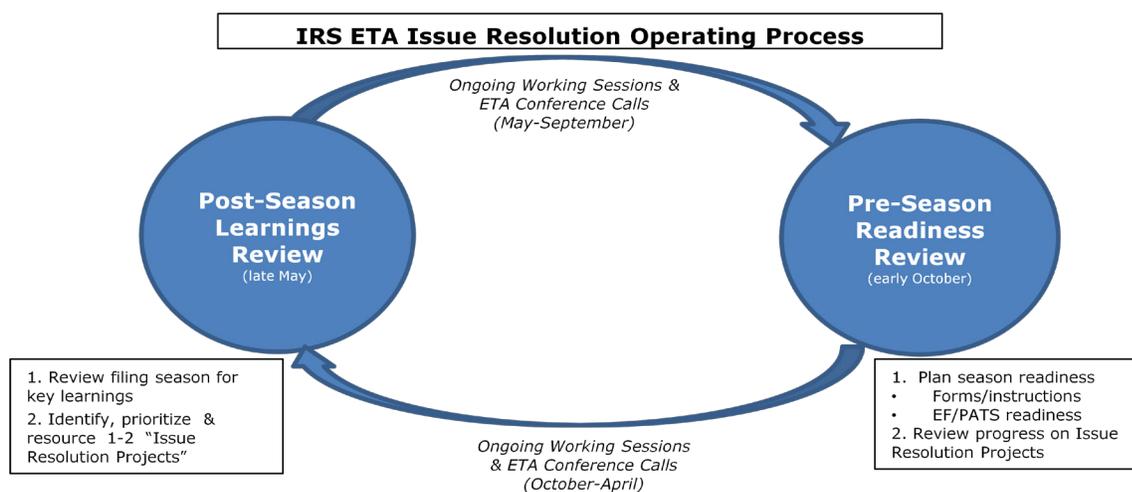
4.5.1 Detailed Recommendations

Consistent with the IRS Strategic Plan's direction to create "issue resolution teams,"¹⁰⁷ ETAAC recommends that IRS take the following three actions to increase the productivity of its existing electronic tax industry and state partnering activities.

4.5.1.1 ETA Issue Resolution Operating Process

IRS ETA should reframe its existing industry conferences and other meetings into a cohesive issue resolution operating process that enables two-way communications and focuses on identifying and resolving issues affecting the taxpayer's electronic tax experience. (See Figure 2)

Figure 2: IRS/Industry Issue Resolution Operating Process Illustration



¹⁰⁷ IRS Strategic Plan, p. 16. (Reported creation of "issue resolution teams" as part of IRS' industry partnership strategy).

4.5.1.2 *ETA Issue Resolution Steering Committee*

To drive this process, IRS ETA should form an Issue Resolution Steering Committee consisting of representatives from IRS, states and the electronic tax industry not later than October 31, 2011. This Committee should be a hands-on working group with specific actionable deliverables, and not just a deliberative body that focuses on discussing issues.

4.5.1.3 *ETA Issue Resolution Projects*

The Steering Committee should identify and prioritize a list of projects requiring actionable recommendations (details in ETAAC Assessment), such as:

- Reducing the most common e-file rejects.
- Finding a replacement solution for the current AGI/PIN.
- Identifying actions that software developers can take to assist IRS in increasing overall tax return accuracy.
- Providing filing season electronic filing information to states, industry and other tax administration stakeholders.
- Providing IRS with electronic tax industry feedback on any potential authentication solutions with respect to likely adoption or usage by taxpayers and preparers.
- Reducing the need for taxpayers to contact either IRS or the electronic tax industry.
- Providing IRS with electronic tax industry feedback on any potential online or mobile solutions with respect to likely adoption or usage by taxpayers and preparers.
- Identifying potential collaborative technology projects.

4.5.2 Detailed Assessment

4.5.2.1 *IRS has an Announced Strategic Priority to Partner with the Electronic Tax Industry*

The IRS Strategic Plan for 2009-2013 observes that third parties, including software companies, provide almost 90% of individual taxpayers with their first line of interaction with IRS and, additionally, that taxpayers will have an easier time complying with their obligations if these third parties can provide more accurate, complete, and timely advice.

The Strategic Plan also set a specific goal to strengthen partnerships with third parties to ensure effective tax administration and make voluntary compliance easier - including the creation of “*dedicated issue resolution teams.*” ETAAC believes that IRS can increase the productivity of its existing industry and state partnership activities by moving beyond an engagement model principally focused on communications to, instead, one focused on both communications and collaboration – all in service to solving important taxpayer problems associated with electronic tax administration.

4.5.2.2 *IRS and Industry are Currently Executing Elements of an Electronic Tax Partnership*

Electronic tax administration is a *dynamic, end-to-end system* that includes several participants, including Congress, IRS, preparers, states, and the electronic tax preparation and filing industry. The decisions and actions of any one participant impacts the tax administration system, both upstream and downstream.

IRS and the electronic tax industry recognize these interdependencies, and currently work together in several ways. For example, IRS has a dedicated IRS relationships management team focused on communicating with the electronic tax industry. IRS has also implemented the following regular

communications sessions to engage with industry that supplements other types of written communications such as QuickAlerts:

- *ETA Software Developers Conference.* IRS holds an annual Software Developers Conference, usually in June, to communicate and facilitate discussions concerning IRS and industry issues related to tax software development and delivery.
- *ETA Pre-filing Season Conference.* IRS holds an annual Pre-filing Season Conference, usually in September, to communicate and facilitate discussions concerning planned developments and potential issues for the upcoming tax processing season.
- *Periodic ETA/Electronic Tax Industry Calls.* ETA holds periodic conference calls to update the electronic tax industry stakeholders concerning current developments and operational issues, e.g., MeF, forms release, etc., usually monthly.

In addition to these regular communications sessions, IRS consults on an *ad hoc* basis with the electronic tax industry to gain insights or solve specific problems, e.g., IRS formed a Software Developers Working Group to focus on leveraging software to enhance EITC due diligence.

Another recent illustration of significant IRS/state/industry collaboration was the ETAAC Software Subcommittee. In a little over a year of dedicated effort, the Subcommittee's Security Working Group reviewed IRS' current security requirements for Authorized IRS e-file Providers, the security environment, existing security frameworks, and commonly used assessment and oversight models and, then, developed specific recommendations for enhancements to the security practices of the digital infrastructure of the IRS Authorized e-file Provider community. The Subcommittee's Accuracy Working Group also made recommendations concerning actions to improve the accuracy of returns prepared using software. The recommendations of these Working Groups are being reported out in this Annual Report to Congress. (See Recommendation 1)

4.5.2.3 *The Pressure and Need for More Effective Partnering is Growing with Increased Taxpayers Expectations and the Outlook for Decreased Government Funding*

Recently, President Obama signed Executive Order 13571 directing all government agencies and departments to better serve the public by using information technology and best practices from the private sector to improve services and reduce costs. The order stated that "Government managers must learn from what is working in the private sector and apply these best practices to deliver services better, faster and at lower cost." Jeffrey Zients, the federal chief performance officer, identified IRS as a good example of a government organization that is modernizing its customer transactions and taxpayer service practices.¹⁰⁸

The need for the sharing and adopting best practices between government and the private sector is increasing. In last year's Annual Report to Congress, ETAAC expressed its opinion that IRS is at a *strategic inflection point*, which is being driven by factors such as: budget pressures, and likely reductions, for IRS; loss of key talent as experienced IRS employees and managers retire - and, in some cases, are not replaced; rapid technological changes as new computing and communications devices - such as smart phones and tablets - are launched; and, rapidly increasing consumer (i.e., taxpayer) expectations for better, faster service - driven in large part by technological changes and consumer experiences outside of the tax environment.

108 BNA Daily Tax Report, April 28, 2011, Tax Administration: IRS Cited as Model as President Issues Order Encouraging Private Sector Practices

These developments have significant implications for electronic tax administration, including:

- IRS will have less funding and resources.
- IRS will have a less experienced workforce.
- IRS will need to “do more with less,” which will require a tight focus on its core mission and, in particular, on those things that are uniquely government roles such as tax return processing and examinations.
- IRS will become increasingly reliant on the electronic tax preparation and filing industry to serve taxpayers effectively which, as an aside, will drive heightened expectations and performance standards for the electronic tax preparation and filing industry.

In this emerging environment, IRS needs to find new ways to innovate and develop creative solutions to serve taxpayers at the levels that taxpayers (and policy makers) expect. In fact, IRS should consider the electronic tax industry resources as a source of “non-paid consultants” who have a vested interest in serving taxpayers effectively and enabling their compliance.

4.5.2.4 IRS Should Lead the Effort to Drive and Accelerate Improvements in Electronic Tax Administration
ETAAC does not believe that IRS’ and industry’s current level of engagement and problem-solving is sufficient to meet the scope and speed of the challenges facing IRS and electronic tax administration. ETAAC believes that IRS can take three actions to increase the productivity of its existing industry and state partnership activities by moving beyond a model focused more on communications to, instead, one focused on both communications and collaboration.

First, IRS should create a cohesive Issue Resolution Operating Process that enables and drives the identification and successful resolution of electronic tax administration issues affecting taxpayers. For example, IRS would create a Post-Season Learnings Review and a Pre-Season Readiness Review, which could take the place of IRS’ current Software Developer’s Conference and Pre-Filing Season Conference, respectively. In addition to reviewing past season performance and issues impacting the upcoming filing season, IRS and industry could also set and drive joint operational priorities to resolve electronic tax administration issues. As described below, this operating process could be driven by a joint steering committee focusing on the resolution of a prioritized list of issues.

Second, IRS should create a team to identify, prioritize and drive improvements in electronic tax administration – ETAAC proposes the creation of an Issue Resolution Steering Committee with the following attributes:

- Purpose. The Steering Committee should be a hands-on working group with specific actionable deliverables, and not just a deliberative body that focuses on discussing issues.
- Membership: The Steering Committee should be a small team consisting of not more than ~12-15 persons representing:
 - IRS: ETA, Accounts Management, Submissions Processing, MITS, Refund Crimes, Data Strategy Program Office and/or Online Services.
 - States: E-file, Accounts Management, Submissions Processing, Refund Crimes, and/or Online Services.
 - Electronic Tax Industry: Consumer and professional electronic tax companies.
- Working Groups. As necessary, the Steering Committee should form working groups, which may require the addition of specialized IRS, state and electronic tax industry resources based on the nature of the issues being considered.
- Leadership: The Steering Committee should have one co-leader designated from each of IRS and the electronic tax industry.

- Meeting Frequency: The Steering Committee should meet not less than monthly (and likely more often), usually in the form of conference calls and online meetings.
- Regular Reporting. The Steering Committee should create and publish a regular scorecard to report on its progress.
- Expenses. Each member (or his/her employer) would cover any travel or other expenses.
- Sunsetting. IRS should set a one year assessment window, after which IRS would terminate the Steering Committee if it determined that the purpose of the Steering Committee was not being achieved.

IRS will need to determine and assess the impact of any compliance requirements that might apply to such an effort, such as FACA. There are other approaches for soliciting potential improvements in tax administration or feedback on issues. For example, IRS could solicit “Industry proposals” from an industry trade group on tax administration issues that could be discussed by joint IRS-industry panels at open forums such as the IRS Software Developers Conference.

Third, IRS and its stakeholders need to go beyond discussion, and move to a place of focus, accountability and actionable recommendations. IRS, states and industry should identify and prioritize specific “Issue Resolution Projects”, which could include the following:

1. Reduce the most common e-file rejects: Currently, IRS has an initial e-file error reject level of about 15%-20%, which may be the single biggest opportunity to enable e-file growth given the implementation of the preparer e-file mandate. GAO reports that only fifteen error codes account for 85% of rejects received by taxpayers. The top codes should be evaluated, and practical solutions identified to reduce or eliminate them.
2. Find a replacement solution for the current AGI/PIN: The current AGI/PIN model for individual tax filers is unacceptably complex. It should be replaced with a more effective approach that is not a barrier to e-filing while providing reasonable assurance of identity.
3. Identify actions that software developers can take to assist IRS in increasing overall tax return accuracy: IRS and the software development community should take targeted actions to enhance return accuracy by identifying areas where software can increase taxpayer compliance (See Recommendation 1).
4. Create an established process to share in-season e-file information. IRS needs to implement the consistent, periodic (daily and weekly) reporting of IRS e-file data during the filing season to ensure that states and industry have the essential insights that enable adequate planning for the capacity and availability of critical IT systems and taxpayer (customer) support resources.¹⁰⁹
5. Provide IRS with the electronic tax industry feedback on any potential authentication solutions with respect to likely adoption or usage by taxpayers and preparers: A method of taxpayer authentication is essential to providing taxpayer access to their information. IRS has been evaluating authentication approaches for several years. It is essential that IRS solicit and consider the electronic tax industry’s unique insights and input on solutions that will (or will not) meet the needs of taxpayers.
6. Reduce the need for taxpayers to contact either IRS or the electronic tax industry: Both IRS and the electronic tax industry have significant contact volumes with taxpayers. Typically, those taxpayers contact both IRS and industry. Yet, there is no significant collaboration between IRS

¹⁰⁹ In-season e-file information is essential to ensure the reliability and availability of electronic tax industry operations, which rely on the insights from a steady flow of IRS tax season operational and electronic filing data.

and the electronic tax industry to identify the source of call volume or develop common messages.

7. Provide IRS with the electronic tax industry feedback on any potential online or mobile solutions with respect to likely adoption or usage by taxpayers and preparers: IRS should be consulting with the electronic tax industry to identify the most valuable taxpayer and tax professional electronic solutions. The electronic tax industry serves, directly or indirectly, about 90% of all taxpayers, and has unique insights into the usage behaviors and needs of taxpayers and tax preparers.
8. Identify potential collaborative technology projects: IRS and the electronic tax industry should identify opportunities to conduct targeted non-monetary pilots to pilot innovative new “connected offerings” under a re-implemented Request for Agreement process.

Additionally, at some point in the future , IRS should work with the electronic tax industry to refine its existing electronic tax administration “partnering strategy,” which could include: IRS and industry’s common vision for an electronic tax administration partnership; the respective roles of IRS and electronic tax preparation industry in electronic tax administration;¹¹⁰ the standards of performance and service level agreements required for each of IRS and the electronic tax industry; and, IRS and electronic tax industry actions that can increase their individual and collective capabilities.

Our nation needs a fair, robust, reliable electronic tax administration system now more than ever. All stakeholders in our highly interdependent electronic tax administration system – Congress, Treasury, IRS, industry and taxpayers – are key contributors to our success. The roles, capabilities and operating processes required by IRS and industry, in support of a robust electronic tax administration system will take years to develop. We need to start now, and move more quickly to drive continuous improvement.

110 The IRS Oversight Board recognized the need for role clarity in its FY2011 IRS Budget Recommendation Special Report, March 2010, p. 27 (“Tax intermediaries have many roles in the interaction between taxpayers and the IRS...Better understanding and differentiating among these roles and their evolution will help the IRS develop and maintain more effective tax intermediary strategies. This ongoing research will support IRS partnerships with tax intermediaries to provide more effective tax administration.”)

APPENDIX A: ETAAC MEMBERS

Leann Boswell - Ms. Boswell of Van Meter, IA, is an executive officer II for the Iowa Department of Revenue. She is responsible for the e-file Service Unit. Ms. Boswell led the development of e-file & Pay, for business tax electronic file and payment applications, reaching a voluntary adoption level of 97 per cent. She also facilitates e-file & Pay enhancements and problem resolution. Ms. Boswell earned a BS in Business Management and participates on a national committee to increase Free File participation.

Sean Brennan - Mr. Brennan of West Chester, PA, is president of Brennan & Associates and Brennan and Company, CPA, PC. He is a CPA e-filing both individual and business tax returns and has taught various courses the college level for 14 years. He earned a BS in Accounting from St. Joseph's University and a MBA in Economics and Finance from West Chester University. Mr. Brennan is a member of the American Institute of Certified Public Accountants (AICPA).

Alice Burnett - Ms. Burnett of Lawrenceville, GA, is the owner and president of Burnett and Associates, LLC., which offers support to both public and private sector clients, primarily covering programs that contain a financial component. Previously, Ms. Burnett held a senior manager level position in a major financial institution for over 20 years, and was a manager for the implementation and operation of the Electronic Federal Tax Payment System (EFTPS). Her certifications include Project Management Professional (PMP), BAI Certified Risk Professional in Operations, Certified Supplier Manager, Certified Disadvantaged Business (DBE) in Georgia, and Six Sigma Green Belt. She is also a member of the Project Management Institute (PMI), American Management Association (AMA), and American Society for Quality (ASQ).

Jean-Philippe Choudhry - Mr. Choudhry of Calabasas, CA, is the Chief Process Officer for 1099 Pro, Inc. He is responsible for developing and defining processes to meet IRS' and states' requirements for filing information returns. Reporting methods range from web based desktop software and enterprise solutions. Each year, 1099 Pro e-files hundreds of millions of information returns for their clients using the IRS FIRE system. Mr. Choudhry is a member of the American Payroll Association (APA).

Ned Drinker - Mr. Drinker of Conshohocken, PA, is the tax manager of Oberthur Technologies of America Corporation. He is responsible for e-filing corporate returns, managing federal and state audits, and implementing state sales tax software. Mr. Drinker earned a BA in Economics from Hamilton College, a MBA from Temple University, and a Master of Taxation from Villanova University School of Law. He is a member of Tax Executives Institute.

David Olsen - Mr. Olsen of Kennesaw, GA, is a CPA and the director of product management for CCH Small Firm Services. He is responsible for product opportunity and enhancement planning for the ATX and Tax Wise product lines, covering tax, accounting and workflow software and other supporting products. Mr. Olsen also partners with business development functions to analyze and develop proposals for products and services used by the tax community. He earned a BA in Business from Houghton College and is a member of the American Institute of Certified Public Accountants (AICPA).

Paul Paeglis - Mr. Paeglis of Columbus, OH, is the former chief financial officer of Chase Tax Related Products at JP Morgan Chase Bank. He was responsible for managing all aspects of financial planning, reporting, and budgeting for the line of business. Mr. Paeglis also analyzed tax return filing trends and income tax refund repayment trends. He earned a BA in Business Administration from Saginaw Valley State University and a MBA in Finance from University of Michigan.

Phillip Poirier, Jr. - Mr. Poirier of San Diego, CA, is the 2010-2011 ETAAC Chair. Mr. Poirier is the vice president, government, of the consumer division at Intuit Inc. He is responsible for government initiatives relating to Intuit's consumer businesses (TurboTax, Quicken and Mint.com) and has extensive experience in business development, legal and regulatory compliance counsel and privacy/security matters in connection with electronic commerce initiatives.

Douglas Simon - Mr. Simon of Lincolnshire, IL, is president and founder of HS&A Payroll Services, Inc. He is responsible for a suite of tax compliance, payroll and retirement plan solutions. Mr. Simon works with a wide range of companies and oversees both tax filing and compliance operations. Mr. Simon earned a BS in Electrical Engineering from Northwestern University and a MBA from Depaul Kellstadt Graduate School of Business. He is a member of the American Payroll Association (APA) and the Independent Payroll Association Providers.

David Sullivan - Mr. Sullivan of East Greenwich, RI, is the Tax Administrator for the Rhode Island Division of Taxation. He is responsible for creating the E-government Unit to assist in enhancing and improving their interaction with customers using new technologies. He earned a BS in Accounting and Business Management from Lebanon Valley College and a MS in Taxation from Widener University. Prior memberships include Treasurer and President of the Northeastern State Tax Officials Association and Federation of Tax Administrators - Internal Revenue Service Tactical Advisory Group (FTA-IRS TAG).

Mark Steber - Mr. Steber of Sarasota, FL, is a CPA and the chief tax compliance officer for Jackson Hewitt Tax Service. He has over 23 years of experience in the tax industry and is responsible for the overall tax service delivery compliance. Mr. Steber establishes processes and procedures to ensure the accuracy of tax returns prepared in the Jackson Hewitt system and coordinates the monitoring of each office's compliance. He is a member of the American Institute of Certified Public Accountants (AICPA) and Alabama Society of Certified Public Accountants

TJ Turner - Mr. Turner of Sarasota, FL, is director of Income Tax Research for Vertex Inc. He is responsible for leading the software development and tax accuracy of vertex's corporate income tax product suite. Products include domestic and international corporate, partnership and insurance return preparation software, and income tax accounting software. Mr. Turner earned a BA in business Administration from Baldwin-Wallace College and is a graduate of the Thomas Jefferson School of Law.

Princess Vlandamir - Ms. Vlandamir of Dallas, TX, is a tax administrator/manager for S. Lee Riffe, P.C. CPA firm with a focus in tax support and client services. She is also a general partner/consultant with Vlandamir & Associates where she provides independent consulting services. During tax season, Ms. Vlandamir works with VITA as a site coordinator, tax preparer and trainer. She is a member of the American Institute of Certified Public Accountants (AICPA) and Texas Society of CPAs.

Harris Widmer - Mr. Widmer of Fargo, ND, is a CPA and partner in Widmer Roel PC. He provides tax, consulting, audit, and financial planning services to a wide variety of businesses and individual clients. Mr. Widmer earned a BA from Jamestown College. He is a member of the North Dakota Society of Certified Public Accountants, American Institute of Certified Public Accountants (AICPA), and National Association of State Oversight Boards of Accountancy.

APPENDIX B: EFI ANALYTICAL METHODOLOGY

This Appendix explains ETAAC's methodology for analyzing and projecting the Electronic Filing Index.

PART 1. ESTIMATING THE ELECTRONIC FILING RATE

The Electronic Filing Index

ETAAC has identified several different measures that have been used over the years to report and measure the electronic filing rate. To create a consistent measure of this goal, standardize cross-year comparisons, and to facilitate analysis, ETAAC has developed an electronic filing "Index" (EFI) for use in its Annual Report to Congress. The Index aggregates and assesses the electronic filing rates of a defined set of major tax returns, and includes a methodology for projecting 2011 e-file rates based on "season to date" information about the main driver of electronic filing rates – the individual tax return. The Index computes both a specific electronic filing rate for each specified return family, as well as an overall composite rate that represents the overall electronic filing rate for all major return families in the Index. Importantly, because certain information in IRS Document 6186 is estimated, ETAAC's Index may shift slightly from year to year as IRS updates its estimates with actual filing season results.

Return Families

The Index is computed using IRS Document 6186's reported information for designated forms in 6 major return families:

Individual Income Tax Forms 1040, 1040-A, and 1040-EZ	Employment Returns Forms 940, 940-EZ and 940-PR Forms 941, 941-PR/SS	Corporation Income Tax Forms 1120 and 1120-A Total Form 1120-S
Partnership Forms 1065/1065-B	Exempt Organizations Form 990 Form 990-EZ	Fiduciary Form 1041

Projected Electronic Filing Index

As noted above, the filing season 2011 data contained in IRS Document 6186 is estimated. However, based on actual filing season results, we know that the 2011 growth rates for individual return e-file exceeded IRS' original estimates. Therefore, ETAAC has modeled a projection methodology to forecast the current year Index based on two components.

First, ETAAC relies on IRS' estimates from Document 6186 all major return families other than individual returns. Second, ETAAC projects total filing season individual return e-file rates by extrapolating current filing season "year-to-date" information into "full year" estimates based on historical IRS trend data for the May-October time period. Part 2 (below) reflects that, at least for the past two years, the e-file rate for individual returns has decreased by about 3% between April and October because a larger percentage of returns filed in the extension period are on paper.

Based on this methodology, ETAAC estimated that the individual return e-filing rate will be approximately 77% for the entire filing season 2011, which translates into an overall Index for all major return types in filing season 2011 of 65.8%.

PART 2. PROJECTING THE FULL YEAR ELECTRONIC FILING INDEX FOR INDIVIDUAL RETURNS

ETAAC has a four step process for projecting the full year electronic filing rate for individual returns.

Step 1: Estimate the Actual Current “Year-To-Date” E-File Rate

Determine the current “year-to-date” e-file rate for individual returns based on actual return filing information through 4/30/11. (See Table 13)

Table 13: Individual Income Tax Returns – Actual Through 4/29/2011

Individual Income Tax Returns	2011 Through 4/29/11
	Number of Returns
Total	130,706,000
E-Filed	104,951,000
E-File Percentage	80.30%

Source: <http://www.irs.gov/newsroom/article/0,,id=239250,00.html>

Step 2: Estimate the Prior Year E-File Rate Degradation

Compare the year-to-date actual e-file rate through approximately 4/30 with the actual e-file rate for the complete tax filing season for both 2009 and 2010. In both instances, the final e-file rate decreased 2.98% during extension period between the April and October filing deadlines. (See Table 14) ETAAC will need to monitor the degradation rate as it could change year to year.

Table 14: Historical Partial Season vs. Full Season Data

Individual Income Tax Returns	2009			2010			2010 vs. 2009
	5/1/2009	12/31/2009	Change	4/30/2010	12/31/2010	Change	Change
Total Receipts	131,560,000	144,360,000	9.73%	129,268,000	142,449,000	10.20%	0.47%
E-File Receipts	90,935,000	95,478,000	5.00%	93,460,000	98,740,000	5.65%	0.65%
E-File Rate	69.12%	66.14%	-2.98%	72.30%	69.32%	-2.98%	0.00%

Source: <http://www.irs.gov/newsroom/article/0,,id=237561,00.html>

Step 3: Project the Full Year E-File Rate for Individual Returns

Subtract the e-file rate degradation from the actual current year-to-date e-file rate. Using a 4/30/2011 cutoff, the projected full year e-file rate for the individual tax return family is 77.31%.

Table 15: 2011 Individual Electronic Filing Rate Projection

Individual (Forms 1040, 1040-A, and 1040-EZ)	2011 Through 4/29/2011		
	Current	Projection Rate	2011 Projection
Total Receipts	130,706,000		
E-File Receipts	104,951,000		
E-File Rate	80.30%	-2.98%	77.31%

Source: <http://www.irs.gov/newsroom/article/0,,id=239250,00.html>

Step 4: Project the Full Year E-File Volume for Individual Returns

Multiply the projected e-file rate times the IRS’ projected 2011 total individual return volume presented in Document 6186 – that is, 77.3% times 141,122,600 returns. Then, use this projected return volume to calculate the overall Index rate for all major return types.

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