Electronic Tax Administration Advisory Committee

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ETAAC'S PURPOSE AND RESPONSIBILITIES

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 the 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.

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 (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 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 Board and ETAAC have concurred in many opinions and recommendations on the IRS' progress in the areas of electronic filing and electronic tax administration.

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

EXECUTIVE SUMMARY

OVERVIEW

At the outset, ETAAC would like to recognize the employees and leadership of the Internal Revenue Service. Year in and year out, IRS employees and leaders 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.

This report is organized into the major Sections outlined below, which include the underlying details for our observations and recommendations. We hope that our observations, assessments and recommendations will enable Congress and IRS to make the best decisions possible in service to American taxpayers and our nation.

2009 ETAAC RECOMMENDATIONS – PROGRESS UPDATE (Section I)

As described in Section I, Congress and IRS have made considerable progress in several significant areas relating to recommendations in our 2009 Report. Most importantly, Congress and IRS have acted on authorizing and implementing a requirement that preparers[1] electronically file individual tax returns.

FILING SEASON 2010 -- PROGRESS IN ELECTRONIC FILING (Section II)

As described in Section II, the overall e-file rate for all major types of tax returns[2] is projected to reach approximately 59% for the 2010 filing season. To achieve the 80% goal for these types of returns, an estimated forty million additional returns need to be e-filed.[3] We continue to believe the biggest opportunity to increase electronic filing over the next two years remains in the area of individual income tax returns.

IRS continued to make steady progress advancing individual return electronic filing, which increased from about 69% of all individual returns to approximately 72% from 2009 to 2010.[4] Online filing by self-preparers using tax software continues to lead the way. Between January and May 2010, the number of electronically filed individual returns by taxpayers using computer software solutions grew by almost 8% over the comparable period in 2009. ETAAC expects consumer online filing to continue to grow, especially given the broad availability in the marketplace of free and low cost commercial tax preparation and electronic filing solutions including those offered under IRS' Free File Program.

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[1] As used in this report, "preparer" will be the generic term referring to both unenrolled tax preparers as well as tax practitioners (CPAs, attorneys and enrolled agents).

[2] In measuring progress against the 80% goal, IRS considers *major tax returns* to be returns filed by individuals, businesses, and tax exempt entities that account for income, expenses, and/or tax liabilities. IRS Strategic Plan 2009-2013, Pub. 3744 (4-2009) ("IRS Strategic Plan"). As used in this report, "*major types of tax returns*" refers to the most significant of those individual, employment, corporate, partnership, fiduciary and tax exempt tax returns.

[3] See Section II, Table 2.

[4] See Section II, Table 3. The electronic filing rate for the entire filing season (January – October) typically decreases slightly from the rate experienced as of April 15th because a greater percentage of returns filed after the primary filing deadline are on paper.

THE ENVIRONMENT AND CHALLENGES AHEAD (Section III)

As described in Section III, ETAAC believes that IRS is at, or certainly approaching, a *strategic inflection point* in performing its mission.[5] That point will be reflected principally by increased IRS responsibilities, reduced federal budgets, and heightened taxpayer expectations. In this emerging environment, ETAAC believes that IRS will be able to achieve its mission only if it collaborates with industry and other stakeholders to achieve the following key strategies in connection with electronic tax administration:

1. Continuously increasing the professionalism and capabilities of the electronic tax preparation and filing industry.
2. Delivering those taxpayer services that only government can provide.
3. Leveraging 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.

This effort will require the full support of all key stakeholders – Congress, Treasury, IRS, the electronic tax preparation and filing industry, and taxpayers.

2010 ETAAC RECOMMENDATIONS AND ASSESSMENTS (Section IV)

Section IV contains ETAAC's fully detailed 2010 recommendations and supporting assessments, which are organized around the *Key Success Indicators* (KSI) articulated in our 2009 Report and summarized below.

KSI 1: The electronic experience is a strategic priority for both the IRS and Congress.

1. <u>Business Systems Modernization & Modernized e-File (MeF)</u>. Congress should fund, and IRS should complete, IRS' Business Systems Modernization Program. IRS should collaborate with key stakeholders to review MeF performance during the 2010 filing season, and make any necessary adjustments to its implementation plan. IRS must complete these vital long-standing projects before beginning any new significant information technology projects.
2. <u>Preparer e-file Requirement</u>. ETAAC has offered several specific recommendations relating to the design and implementation of the requirement for preparers to electronically file individual tax returns (a "Preparer e-file Requirement"), and to mitigate associated implementation risks.
3. <u>Internet Strategy</u>. IRS should execute its Internet Strategy in a manner that ensures online projects will solve real customer problems that are aligned with IRS' strategic priorities and yield the highest "return on investment" for taxpayers, IRS, tax preparers and tax software companies.
4. <u>Innovation</u>. IRS must develop a robust partnership with the electronic tax preparation and filing industry to enable better services for taxpayers through increased collaborative innovation.
5. <u>Advancing *E-file* Study Phase 2</u>. Any options identified in IRS' Advancing *E-file* Study Phase 2 to increase electronic filing, and considered for implementation, must focus on IRS' core mission and competencies and be selected only after the completion of rigorous benefit-cost and "return on investment" analyses.

[5] 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.

KSI 2: The electronic experience is trusted.

6. Return Preparer Review. IRS must implement return preparer oversight and software industry standards in a manner that achieves the professionalization of the industry while not unnecessarily creating shortages or regulatory burdens that do not deliver corresponding public benefit.

7. Key Enablers. IRS must solve three challenges as key enablers for expanded electronic tax administration – IRS security, e-authentication and e-signature.

KSI 3: The electronic experience is easy and fast.

8. New Information Reporting. IRS must review its readiness to handle a significant increase in electronically filed information returns, and rigorously consider the full impact of accelerated information reporting on businesses and taxpayers.

9. E-file Rejects. IRS must continue to pursue a reduction of the most common electronic filing rejects.

I. 2009 ETAAC RECOMMENDATIONS – PROGRESS UPDATE

As summarized below, Congress and IRS have made considerable progress in addressing several areas relating to our 2009 recommendations.

1. Congress should enable the IRS to require preparers to e-file. In November, 2009, Congress acted on the single most important initiative that will enable IRS to achieve the 80% goal for electronic filing -- authorizing IRS to require preparers to electronically file returns pursuant to the Worker, Homeownership, and Business Assistance Act of 2009. IRS has begun engaging with stakeholders, including industry, to implement this legislation.

2. Congress should fund, and the IRS should complete, the "four pillars" of its Modernization Program. The IRS' four core Business Systems Modernization (BSM) projects remain the foundation for electronic tax administration. A continuing focus on, and completion of, these BSM projects is critical. Existing IRS management and technical resources are severely strained by these projects, and must not be further tasked with new IT programs until these foundational projects are completed. ETAAC is again reviewing this area and, in particular, the Modernized e-File (MeF) program in its 2010 recommendations.

3. The Data Strategy project should be comprehensive. The IRS should continue to consider how to broaden its ongoing data strategy project to include national data standards to improve tax administration with the states and other stakeholders. States depend on timely, high quality data in order to manage their tax systems. Additionally, the absence of common functions such as e-authentication, e-signatures, data definitions and data interchange continue to create barriers to the expansion of electronic interaction between federal and state tax agencies, taxpayers, preparers and the electronic tax industry.

4. The IRS should modernize preparer e-Services. Tax preparers continue to represent the largest originator of electronically filed tax returns – about 64% of all e-filed individual tax returns. Authorized IRS *e-file* Providers, principally Electronic Return Originators (EROs), rely heavily on IRS' e- Services suite of products.[6] ETAAC has serious concerns that the increase in approved EROs resulting from the IRS Preparer e-file Requirement will significantly increase demand for these services. As further discussed in several of our 2010 recommendations, IRS must carefully review and forecast the expected usage of preparer e-Services, and consider investing in these services as a strategic priority in support of the Preparer e-file Requirement.

5. The Electronic Services Strategy should be an enterprise priority. In our discussions with IRS, ETAAC has been encouraged by IRS' increased focus in this vital area. IRS is in the early stages of formulating its "Internet Strategy," which will enable a much more holistic, enterprise-wide management of this vital area. Additionally, IRS is engaged in a major procurement for managed services to make important improvements to IRS' web portals and related operations.[7] IRS intends to "*improve the IRS Web environment's efficiency, effectiveness, quality, and process maturity while satisfying growing demands for secure, reliable, timely, and customer-centric Web solutions*." ETAAC applauds this effort.

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[6] See e-Services - Online Tools for Tax Professionals (http://www.irs.gov/taxpros/article/0,,id=109646,00.html**)**

[7] "Managed Services for Internal Revenue Service (IRS) Enterprise Portals" (Solicitation # TIRNO-09-R-00051). https://www.fbo.gov/index?s=opportunity&mode=form&tab=core&id=70806d9f8d8c9bf3797d7107e1487d1a&_cview=0

6. The IRS and industry should collaborate on tax software standards. IRS has undertaken several steps in this important area. It has formed an ETAAC Software Subcommittee to obtain industry and state input regarding the electronic tax preparation and filing industry. Additionally, as previously recommended by the GAO, IRS commenced a Software Risk Assessment in 2009 that is focused on the security, privacy, accuracy and reliability of commercial software and related electronic filing systems.

7. The IRS should rebrand e-file. ETAAC has reviewed IRS' marketing plans for the IRS e-file Program. For the 2010 filing season, IRS had an improved focus on marketing electronic filing and Free File to key taxpayer segments -- as distinguished from its broader marketing efforts in past years. This focus should provide better results. As described in Section II, we encourage IRS (i) to increase its promotion of Free File (and Free File Fillable Forms) to taxpayers currently preparing their tax forms manually and filing on paper, and (ii) to work with industry to promote electronic filing to taxpayers who are preparing returns using tax software, but filing on paper. We believe these approaches are a good complement to the Preparer e-file Requirement.

8. The IRS should develop an operational process for e-file rejects. E-file rejects continue to be a source of frustration and extra work for IRS, preparers, software companies and taxpayers. The passage of tax laws with new, complex credits and deductions only increases this challenge by triggering the introduction of new "error codes," thereby increasing rejects and error processing exceptions. ETAAC continues to believe that IRS, states and industry must pursue improvements in this area, and is offering some additional suggestions to address this problem in its 2010 recommendations.

9. The IRS should renew the Free File Alliance agreement. ETAAC applauds IRS' five year renewal of the Free File program. This program's eligibility rules focus on providing critically important tax compliance services to low and middle income taxpayers ($57,000 AGI or less this year), and offer the broadest eligibility of any *free* IRS taxpayer assistance program. IRS has driven major improvements in the program over the past several years. Those improvements, coupled with the current eligibility criteria, strike the right balance between providing service to low/middle income taxpayers while preserving a healthy commercial marketplace that enables private innovation. ETAAC believes the program could be improved by increasing transparency and public awareness about state Free File services among eligible populations (about twenty states rely on the federal program as the basis for their free service programs). Free File accounts for about 3,000,000 returns annually[8] – the same number of returns prepared at Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites, without any IRS grants or funding.[9]

10. The IRS should ease the signature burden for information return sharing. The IRS previously required signed taxpayer consent before it would share an information return with the appropriate state. IRS has advised ETAAC that, pursuant to Tax Year 2010 Publication 1220, it plans to eliminate the previously required Form 6847 "Consent for Internal Revenue Service to Release Tax Information" to the states.

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[8] Free File usage is being affected by the heavy advertising of free commercial tax preparation and filing solutions, as well as the elimination of federal electronic filing fees on boxed software products. See IRS News IR-2009-23, March 13, 2009 (http://www.irs.gov/newsroom/article/0,,id=205255,00.html). ETAAC views these marketplace developments as positive because they are driving increased consumer electronic filing of individual returns at higher rates than preparers. See Section II, Table 3.

[9] During the 2009 filing season, VITA and TCE partners provided free federal tax return preparation and electronic filing to more than 3 million low and moderate income individuals with an adjusted gross income of $49,000 or lower. IRS awarded about $8 million in grants to support VITA for the 2010 filing season. See IRS News IR-2009-103, Nov. 10, 2009. http://www.irs.gov/newsroom/article/0,,id=215367,00.html

II. FILING SEASON 2010 -- PROGRESS IN ELECTRONIC FILING

IRS and industry continue to drive steady increases in electronic filing. IRS projects that the e-file rate for all *major types of tax returns*[10] will reach approximately 59% for the 2010 filing season, lead by an electronic filing rate of about 70% for individual returns.

Reaching the overall Congressional 80% e-file goal will take several more years,[11] and there is no "silver bullet" in the form of a technology or other solution.[12] Success will require focus, perseverance and teamwork – every little bit will count whether it be completing the Modernized e-File system, improving e-file marketing or reducing rejects. Below are several electronic filing developments to set context for our 2010 recommendations.

KEY DEVELOPMENTS IN ELECTRONIC FILING & TRANSACTIONS

#1: Electronic filing continues to grow across all major types of tax returns, with the largest unit growth in individual returns and the highest growth rates in corporate returns.

Table 1: Estimated and Projected Calendar Year E-File Rates for Major Types of Tax Returns

	CY2009 (Millions)			CY2010 (Millions)			CY2009-2010	
TAX RETURNS	**Est. Total Returns**	**Est. # e-filed Returns**	**e-file Rate (%)**	**Proj. Total Returns**	**Proj. # e-filed Returns**	**e-file Rate (%)**	**Proj. e-file Unit Growth**	**Increase in e-file Rate (%)**
Individual (1040)	140.9	94.2	66.9%	138.5	97.5	70.4%	3,210,900	3.5%
Employment (940/941)	30.6	7.0	22.8%	30.8	7.1	23.1%	123,200	0.3%
Corporate (1120)	7.0	1.7	24.4%	7.0	2.1	29.7%	367,500	5.2%
Partnership (1065)	3.4	1.0	27.7%	3.8	1.1	30.2%	188,800	2.5%
Fiduciary (1041)	3.1	0.8	24.6%	3.1	0.8	25.0%	12,800	0.3%
Tax Exempt (990)	1.2	0.4	30.4%	1.3	0.4	33.5%	52,400	3.1%
TOTAL	186.3	105.0	56.4%	184.5	109.0	59.1%	3,955,600	2.7%

Source: IRS Document 6186 (Rev. 10/2009) Table 2. Total Number of Returns Filed by Type for United States (some data rounded).

IRS has projected the overall e-file rate for all major types of tax returns to reach approximately 59% for the 2010 filing season, with the electronic filing of individual returns showing the largest unit increase and corporate business returns showing the largest percentage increase. ETAAC remains optimistic about future e-file growth. First, IRS is implementing a requirement for tax preparers to electronically

[10] See footnote 2.

[11] For a comprehensive overview of electronic filing progress and trends, see IRS Oversight Board Electronic Filing 2009 Annual Report to Congress, January 2010, pp. 23-24 ("Board 2009 Electronic Filing Report"). ETAAC agrees with the Board's recommendation to extend the target date for reaching 80% to 2012 to create a tangible objective to help maintain institutional momentum.

[12] IRS Advancing E-file Study Phase 1 Report, September 30, 2008 (Case Number 08-1062), p. 1.

file individual tax returns. Second, the broad availability of no and low cost private industry solutions continue to move self-preparers away from manual preparation to electronic preparation.

#2: Increasing the electronic filing of employment tax returns is important, but IRS should focus initially on achieving increased electronic filing of individual tax returns.

Table 2: Biggest Opportunities for the Growth of Electronic Filing (Calendar Year 2010 projections)

TAX RETURNS	Proj. CY2010 Total Returns	Proj. CY2010 # e-filed Returns	CY2010 e-file Share (%)	"80% Goal" for each Return Type	"80% e-file Gap" for each Return Type (Note 1)
Individual (1040)	138,492,000	97,450,000	70.4%	110,793,600	13,343,600
Employment (940/941)	30,797,600	7,108,000	23.1%	24,638,080	17,530,080
Corporate (1120)	7,004,800	2,077,100	29.7%	5,603,840	3,526,740
Partnership (1065)	3,776,900	1,140,900	30.2%	3,021,520	1,880,620
Fiduciary (1041)	3,134,300	783,300	25.0%	2,507,440	1,724,140
Tax Exempt (990)	1,254,200	420,700	33.5%	1,003,360	582,660
TOTAL	184,459,800	108,980,000	59.1%	147,567,840	38,587,840

Source: IRS Document 6186 (Rev. 10/2009) Table 2. Total Number of Returns Filed by Type for United States.

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

To reach the 80% goal, ETAAC currently estimates that an additional forty million returns must be e-filed. After individual returns, the next largest source of tax return types is employment returns – primarily Forms 940 and 941. Currently, employment returns are projected to have an e-file rate of approximately 23%, and have the largest volume gap to achieve the 80% goal for that form type – about seventeen million returns. Individual returns require another thirteen million returns to reach an 80% e-file rate for individual returns. The number of employment and business returns required to achieve the 80% goal would decrease to the extent that electronic filing of individual returns exceeds its 80% goal, which ETAAC believes is feasible (See #4 below).

ETAAC agrees with the Board that IRS must begin to consider the root cause of low electronic filing rates for employment tax returns, and identify strategies to increase it. As noted by the Board, our 2008 Report contained a variety of ideas relating to increasing electronic filing of Form 941-- including one idea of deploying a free Internet-based application for employers to e-file their Form 941 returns.[13] Although this recommendation was made previously, the current ETAAC would like to study this area next year to better understand employment tax filer behavior and needs, and available tools. Our primary concern is that precious IRS resources could be consumed in building and deploying such a service, only to discover low usage. It is likely filers of employment returns are very different than filers of individual returns and, therefore, will require a different approach. In the meantime, ETAAC believes IRS' focus should remain primarily on driving the electronic filing of individual tax returns.

[13] See Board 2009 Electronic Filing Report, pp. 28-29.

#3: IRS experienced another year of growth in electronic filing of individual returns lead, again, by taxpayers electronically filing using consumer tax software.

Table 3: 2010 Primary Filing Season: Individual Income Tax Returns – Electronic vs. Paper

1040 Series Returns - Received by IRS	2009 Filing Season	2009 Paper vs. e-file Share	2010 Filing Season	2010 Paper vs. e-file Share	2009-2010 Change
PAPER-FILED	41,307,000	31.1%	36,615,000	28.0%	-11.4%
ELECTRONICALLY FILED		*Share of e-file*		*Share of e-file*	
Preparer	59,964,000	65.6%	60,212,000	64.0%	0.41%
Consumer	31,435,000	34.4%	33,858,000	36.0%	7.71%
Total EF	91,399,000	68.9%	94,070,000	72.0%	2.9%
TOTAL	132,706,000		130,685,000		-1.5%

Source: Table reflects data available from IRS ELF processing from January 2010 through approximately May 14, 2010 (Data Source ELF 1541). Full season e-file percentages are typically slightly lower.

As of mid-May, the percentage of individual returns that were electronically filed increased from approximately 69% in 2009 to approximately 72% in 2010.

Online filing by taxpayers using tax software continues to show the largest percentage increase. Through the end of the 2010 primary filing season, the consumer electronic filing segment grew by approximately 7.7% over the comparable 2009 period, despite a 1.5% reduction in overall total returns prepared and filed. Relative to returns electronically filed by preparers, the share of self-prepared electronically filed returns attributable to consumers using a computer continues to grow – from about 34% to 36% of all electronically filed returns.

Electronically filed individual returns by preparers, on the other hand, only slightly increased over last filing season – about 0.4% as noted above. However, we expect preparer-generated electronically filed individual returns to accelerate as IRS implements the Congressionally-authorized electronic filing requirement.

#4: IRS could achieve a 90% electronic filing rate for individual returns by focusing on (i) the successful implementation of the Preparer e-file Requirement, (ii) working with industry to encourage current V-Coders[14] to electronically file and, finally, (iii) finding new ways to drive faster adoption of computerized tax preparation by current "manual" taxpayers.

[14] A "V-Coder" is someone that prepares a return using software, but submits the return on paper.

Table 4a: Individual Income Tax Returns – Electronic Filing Rates by Preparation Methods

Preparation Method	# TY2008 Returns by Method	% Returns by Method	# TY2008 Returns e-filed by Method	% e-file Rates by Method
Preparer	82,800,000	60.0%	62,400,000	75.4%
Taxpayer Computer Self-Prepared	42,200,000	30.6%	32,200,000	76.3%
Taxpayer Manual Self-Prepared	13,000,000	9.4%	0	0.0%
Total Returns	138,000,000	100.0%	94,600,000	68.6%

Source: IRS Taxpayer Filing Attribute Report Tax Year 2008

Table 4b: Individual Income Tax Returns – Achieving "90%" e-file Rate

Preparation Method	% Returns by Method (based on TY2008 data)	Return Distribution by Method using CY2010 Data (Projected)	*Targeted e-file/Conversion Rates*	# e-filed Returns to Achieve 90% *Individual* Rate
Preparer	60.0%	83,095,200	95%	78,940,440
Taxpayer Computer Self-Prepared	30.6%	42,350,452	90%	38,115,407
Taxpayer Manual Self-Prepared	9.4%	13,046,348	55%	7,175,491
Total Returns		138,492,000		124,231,338

Sources: Preparation Methods for TY08 from IRS Taxpayer Filing Attribute Report Tax Year 2008; Total projected individual returns for CY2010 from IRS Document 6186 (Rev. 10/2009) Table 2 Total Number of Returns Filed by Type for United States.

Table 4c: Individual Income Tax Returns – Decline Rate for Taxpayer Manual Self-Prepared Returns

Preparation Method	TY 2006	TY 2007 (with Stimulus Rebate)	TY2008	Annual Growth Rate 2006-2008
Taxpayer Manual Self-Prepared	15,948,214	21,531,248	12,959,402	-9.4%

Sources: Preparation Methods for IRS Taxpayer Filing Attribute Report for Tax Years 2006, 2007 and 2008

The success of electronic filing is somewhat masked by the number of taxpayers who manually self-prepare their returns. The reality is that electronic filing by both preparers and taxpayers using computers is relatively high – about 76% each (See Table 4a). This figure reflects the results of the teamwork between IRS and industry to drive electronic filing of individual returns – but, we believe it can be higher.

ETAAC believes it is possible to achieve a 90% electronic filing rate for all *individual* returns by driving three key outcomes (See Table 4b):

- *Preparer-Generated Returns*. Increase the electronic filing of individual returns by preparers from approximately 75% to 95% by driving the implementation of the preparer requirement. As a side note, IRS' implementation of the preparer requirement could have a significant corresponding positive impact on the electronic filing volumes of business returns. Once a preparer experiences the benefits of electronically filing individual tax returns, it is likely they will also electronically file their clients' business tax returns.

- *Computer Self-Prepared Returns.* Increase the electronic filing of individual returns by taxpayers using computerized tax preparation from approximately 76% to 90% by (i) fostering a credible, financially healthy and competitive consumer tax software industry, and (ii) executing a targeted marketing effort to increase electronic filing by taxpayers who currently prepare their returns on computers but mail them instead of electronically filing. [15]
- *Manual Self-Prepared Returns.* Increase the electronic filing of individual returns by encouraging about one-half of the taxpayers currently manually preparing and mailing paper forms to adopt computerized tax preparation and electronic filing. These taxpayers *cannot* electronically file unless and until they adopt computerized tax preparation as the first step. IRS could accomplish this through various approaches including the targeted promotion of Free File and Free File Fillable Forms to manual self-preparers. (Of note, the usage of Free File Fillable Forms increased more than 8% through mid-May, 2010 over the comparable period for the 2009 filing season.) However, success will require a concerted effort. At the present pace, self-prepared manual returns are only decreasing at a rate of approximately 1.2 million returns per year. That rate needs to be at least doubled.

#5: Taxpayers continue to steadily adopt other electronic interactions with IRS.

Table 5: Other Electronic Interactions

Type Electronic Transaction	2009 Filing Season	2010 Filing Season	Year over Year Growth Rate
Electronic Payments	2,045,366	2,382,003	16.46%
Visits to IRS.gov	195,382,106	194,401,069	-0.50%
Refunds			
# Total Refunds	99,896,000	96,292,000	-3.61%
# Refunds Direct Deposited	69,577,000	70,332,000	1.09%
% Refunds Direct Deposited	69.6%	73.0%	4.87%

Source: Various IRS data sources through approximately May 1-13, 2010

Taxpayers continue to increase electronic interactions with IRS, including electronic payments and direct deposit of refunds. ETAAC suspects that the slight decrease in visits to www.irs.gov may be influenced by the reduction in individual tax filings this year.

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[15] ETAAC believes that proposals to mandate that taxpayers who self-prepare their returns must e-file are less likely to be successful, as compared to initiatives to reduce or eliminate potential barriers, e.g., e-file rejects. Cost appears to be less of a barrier to consumer usage than in past years given the broad array of free and low cost commercial tax preparation and electronic filing solutions.

III. THE ENVIRONMENT AND CHALLENGES AHEAD

IRS Mission, Strategic Goals & Major Trends

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*."[16]

In support of this mission, the IRS Strategic Plan has a strategic goal to "*Improve service to make voluntary compliance easier,*" and includes several key objectives: (i) incorporating taxpayer perspectives to improve all service interactions; (ii) expediting and improving issue resolution across all interactions with taxpayers, making it easier to navigate the IRS; (iii) providing taxpayers with targeted, timely guidance and outreach; and, (iv) strengthening partnerships with tax practitioners, tax preparers, and other third parties in order to ensure effective tax administration.[17]

The IRS Strategic Plan also identifies six major trends affecting the IRS, which include: [18]

1. Increasing complexity of tax administration.
2. Growing human capital challenges.
3. Explosion in electronic data, online interactions, and related security risks.
4. Expanding role of tax practitioners and other third parties in the tax system.

All of the above trends have a significant effect on electronic tax administration. ETAAC would like to emphasize the impact of one of them, in particular, and identify one additional emerging trend.

Increasing Complexity of Tax Administration: Impact on Electronic Tax Industry

ETAAC believes that tax code complexity is straining our tax administration system. Many policy makers and observers have already reported this fact, including members of Congress and the GAO. In fact, the National Taxpayer Advocate's 2008 Annual Report to Congress stated that "*The largest source of compliance burdens for taxpayers – and the IRS – is the overwhelming complexity of the tax code.*"

Tax complexity creates a host of problems and challenges. It reduces citizen confidence in our tax system, creates unnecessary questions for taxpayers, and delays taxpayer refunds when tax returns are routed for error processing. [19]

But it is <u>not</u> just taxpayers and IRS who suffer from the impact of tax code complexity -- the entire tax preparation and filing industry is being overwhelmed by tax complexity. It creates systemic risk by challenging industry's ability to ensure the accuracy of its advice and software, and to provide systems that are highly reliable and secure.

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[16] IRS Strategic Plan, p. 5.

[17] IRS Strategic Plan, pp. 13-16.

[18] IRS Strategic Plan, pp. 9-11. The two trends not listed above are: "*Accelerating globalization*," and "*Accelerating change in business models*."

[19] "*…the current tax system is widely viewed as overly complex, thereby reducing the ability of individuals to understand and comply with the tax laws…Some experts who have written on transparency believe that the tax code's transparency has declined in recent years. Numerous tax provisions have made it more difficult for taxpayers to understand how their tax liability is calculated, the logic behind the tax laws, and what other taxpayers are required to pay.*" GAO Report: Understanding the Tax Reform Debate (GAO-05-1009SP), September, 2005.

At the same time, our tax return submission process goes beyond the instant objectives of compliance and revenue. Congress has traditionally leveraged 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. IRS' 2010 program to enable the purchase of US Savings Bonds using the tax refund is just one illustration of how direct citizen engagement in the tax return submission process can be leveraged to serve other national policy interests.[20]

Given the impact on *electronic tax administration*, ETAAC would like to add its voice to the bipartisan calls for real tax reform and simplification. We urge Congress to find ways to 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 improvement of the overall financial health of Americans through increased savings, greater financial literacy and better personal and family financial management. In that way, Congress can ensure that the tax system meets both its objectives – generating tax revenues and advancing important national policy interests to improve the economic health of taxpayers and the nation.

Emerging Reality: Increasing Fiscal Constraints

There's another trend not identified in IRS' Strategic Plan that will likely have an increasingly material adverse effect on IRS. It is a future of steadily shrinking federal budgets.

It is no secret that our federal government, actually all of our governments, are on unsustainable fiscal paths.[21] But the urgency of the situation is starting to gain increasing attention by leaders from both parties[22] as well as in the broader public policy arena.[23] GAO recently reported that, under certain budget simulations, by 2030 there will be little room for "all other spending," which consists of what most Americans think of as *government*, including national defense, homeland security, investment in highways and mass transit and alternative energy.[24]

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[20] Similarly, the Taxpayer Advocate has reflected on the role that tax preparation plays in personal financial management: " *… for many, many individuals, [preparing their taxes] is the only time that they ever really sit down and look at what happened to them financially over the last year. And maybe — I wouldn't want to lose that in a return-free system because I think that for the broader health of the country — the financial health of the country, that is an important ritual."* Tax Policy Center, April 11, 2005 (http://www.urban.org/publications/900807.html)

[21] GAO Report: State and Local Governments' Fiscal Outlook (GAO-10-358), March 2010 update.

[22] For example, the President recently appointed the members of a bi-partisan National Commission on Fiscal Responsibility and Reform. See http://www.whitehouse.gov/the-press-office/executive-order-national-commission-fiscal-responsibility-and-reform

[23] A recent Brookings Institution paper recently reported: " *The unsustainability of federal fiscal policy…has increased in importance and urgency in recent years…the medium-term projections have deteriorated significantly…the issues driving the long-term projections – in particular, the retirement of the baby boom and the aging of the population and the resulting pressure on Medicare and to some extent Social Security – which were several decades away in the 1980s, are now imminent…there are increasing questions about the rest of the world's appetite for U.S. debt…many countries around the world and many of the 50 states also face daunting fiscal prospects," and, looking ahead, "…defense spending would fall dramatically and non-defense discretionary spending...would drop to its lowest share of GDP in the past 50 years."* Déjà Vu All Over Again: On the Dismal Prospects for the Federal Budget, Alan J. Auerbach and William G. Gale, April 2010, pp. 2 and 6 (http://www.brookings.edu/papers/2010/0429_budget_outlook_gale.aspx).

[24] GAO Report: The Federal Government's Long-Term Fiscal Outlook (GAO-10-468SP), January 2010 Update, p. 4.

It seems surprising that, in that environment, IRS could avoid reduced operating budgets in the coming years. Yet, despite an era of decreasing budgets, IRS will be expected to meet increasing taxpayer demands in a highly complex tax system – all at a time when IRS leadership is turning over and employees with critical skills will be increasingly difficult to acquire and retain.[25]

Strategic Inflection Point…Implications

If its assessment is accurate, ETAAC believes that IRS is at, or certainly quickly approaching, a *strategic inflection point*. The trends described by IRS and ETAAC above have several implications for electronic tax administration:

- IRS will likely have reduced funding and resources for its operations.
- IRS will be challenged by a loss of experienced executives, managers and technical personnel.
- IRS will be required to focus on its core mission and, particularly, on those things that only government can do well.
- IRS will be highly reliant on the electronic tax preparation and filing industry to serve taxpayers effectively.
- When making decisions, IRS will need to think about electronic tax administration as an *end-to-end ecosystem* that includes all the participants, including IRS and electronic tax preparation and filing industry.
- The expectations for the electronic tax preparation and filing industry will steadily increase -- all participants, whether they be tax preparers or tax technology companies, will be expected to meet high standards of performance and professionalism.
- IRS and industry will need to develop robust partnering skills.

The above trends and implications are the context through which ETAAC has developed its 2010 recommendations. They explain ETAAC's emphasis on increasing the professionalism of the tax preparation industry, ensuring that IRS focuses on its core mission, encouraging IRS to leverage industry innovation to solve taxpayer problems, and using electronic tax administration to address current IRS operating challenges.

Our nation needs a fair, robust, reliable electronic tax administration system now more than ever. All stakeholders in our electronic tax administration system – Congress, Treasury, IRS, industry and taxpayers – are key contributors to our success. The new 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.

[25] IRS Strategic Plan, p.9.

IV. 2010 ETAAC RECOMMENDATIONS AND ASSESSMENTS

ETAAC's 2010 recommendations are again organized around the three Key Success Indicators (KSIs) articulated in its 2009 Report.[26]

KSI 1: THE ELECTRONIC EXPERIENCE IS A STRATEGIC PRIORITY FOR BOTH THE IRS AND CONGRESS.

1. BUSINESS SYSTEMS MODERNIZATION & MODERNIZED E-FILE PROGRAM: RECOMMENDATION FOR CONGRESS AND IRS

Congress should fund, and the IRS must complete, the mission-critical four pillars of its Modernization Program before beginning any new significant information technology projects.

IRS should take several steps to ensure MeF will provide a stable, high performance electronic filing system that will have significant adoption by both states and industry:

- **Conduct a joint "lessons learned" review with state and industry stakeholders of MeF performance during the 2010 filing season.**
- **Identify and correct those significant performance deficiencies of the MeF system that contributed to the systems inability to deliver at the extremely high service levels demanded by tax filers and, particularly, by individual tax filers.**
- **Adopt a "24/7 operational mindset" around MeF operations, which includes having adequate support staffing, metrics, reporting systems and operating mechanisms to enable the overall system to deliver at the service levels demanded by tax filers and, particularly, by individual tax filers.**
- **Without compromising improved system performance in the 2011 filing season, consider expanding the number of 1040 forms/schedules available in 2011 or deferring the number of forms delivered in 2012.**
- **Understand and plan for the potential impact of a low level of state adoption of Form 1040 MeF due to adverse state fiscal and budget conditions.**

ETAAC ASSESSMENT

Business Systems Modernization Program

The foundation for electronic tax administration is the *four pillars* of IRS Business Systems Modernization Program (BSM), [27] which includes the following projects: Customer Account Data Engine (CADE), Modernized e-File (MeF) Program, Account Management Services (AMS), and the Data Strategy.[28] These projects directly enable important taxpayer benefits such as faster refund issuance, a more seamless and easier electronic filing experience, enhanced access to taxpayer information, and better customer service.

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[26] See 2009 ETAAC Annual Report to Congress, p. 13.

[27] TIGTA Report: Annual Assessment of the Business Systems Modernization Program (Ref. No. 2009-20-136), September 14, 2009.

[28] TIGTA Report: Implementing the Data Strategy Will Make System and Application Development More Efficient and Effective (Ref. No. 2009-20-022), February 19, 2009, p. 1.

Each of the BSM projects represents a significant and complex undertaking. Reports by the GAO[29] and TIGTA[30] have identified IRS systems modernization as an area of risk and vulnerability. The IRS Oversight Board's 2010 Annual Report again identified system modernization as one of two "systemic weaknesses" at IRS.[31]

ETAAC continues to believe that these foundational BSM projects must be completed before IRS management and technical resources can successfully manage and implement other projects that advance IRS' strategic agenda for electronic tax administration. Because of BSM's significance to electronic tax administration, ETAAC is restating its 2009 recommendation that Congress fund, and the IRS fully support, Business Systems Modernization.[32]

Modernized e-File (MeF) Program.

IRS has been working diligently to transition its electronic filing infrastructure to a modernized transaction-based platform to improve taxpayer service, drive adoption of e-filing and reduce costs.

<u>Background</u>. MeF is the replacement for IRS' current Legacy e-File system. MeF is a Web-based system that enables electronic filing of various tax returns including corporate, partnership, and individual tax returns. MeF will provide a more flexible electronic filing system that will enable IRS to receive and process returns in an Internet format, provide real-time processing of e-file acknowledgements, and streamline error detection.[33] Additionally, Form 1040 MeF enables several elements of new functionality including: attachment of supporting documents, year-round processing, electronic filing of amended individual income tax returns, improved error reject codes, and faster acknowledgments.

Filing Season 2010 marked IRS' implementation of the first phase of MeF system processing of individual tax returns, which commenced on February 17, 2010 and included Form 1040, Form 4868 (Extension), and 21 other Form 1040-related forms and schedules. IRS is planning to offer the same 23 forms in the 2011 filing season, and then significantly expand MeF coverage to include a total of approximately 148 forms by the 2012 filing season.[34]

Based on 2010 MeF system performance, some stakeholders have expressed the need to support more 1040 forms/schedules for the 2011 tax filing season instead of attempting to add so many forms for the 2012 filing season.[35] In fact, ETAAC has serious concerns about IRS' ability to develop and deliver a

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[29] GAO Report: 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).

[30] TIGTA Memo to Treasury Secretary Geithner, Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2010, October 15, 2009 ("TIGTA 2010 IRS Management & Performance Challenges").

[31] IRS Oversight Board Annual Report to Congress 2009, April 2010, p.4.

[32] We are encouraged that the President's requested budget for the BSM program is in line with funding levels the Board has previously advocated. IRS Oversight Board FY2011 IRS Budget Recommendation, Special Report, March 2010, p. 3 ("Board FY2011 IRS Budget Report").

[33] Board 2009 Electronic Filing Report, p. 31.

[34] Modernized e-File (MeF) Update presented by IRS ETA Development Services Division to ETAAC, May 4, 2009.

[35] One way of handling this expansion would be to add forms support to MeF in two groups -- commonly used 1040 forms/schedules for tax year 2010 (tax filing season 2011) and all remaining 1040 forms/schedules for tax year 2011 (tax filing season 2012).

stable, high performance Form 1040 MeF system in 2012 based on a plan that assumes the addition of over 100 forms between the 2011 and 2012 filing seasons.

2010 Filing Season. ETAAC supported the IRS strategy for the 2010 filing season, which focused on gaining knowledge and identifying improvements for the Form 1040 MeF system for 2011. IRS developed a "volume management plan" that limited the number of individual tax returns transmitted through MeF to 30 million with a planned maximum of 241,000 tax returns transmitted per hour. The plan envisioned that the remaining e-filed tax returns would be processed through the Legacy e-File system.[36]

State Participation. Over the past five years, all member states of the Federation of Tax Administrators (FTA)[37] have been given the opportunity to participate in the MeF program. Participating states commit to jointly developing and maintaining MeF standards through TIGERS,[38] and obtaining the necessary funding to implement MeF. All states currently participating in IRS' Legacy e-file system have been made aware that they must implement MeF because of the planned termination of the Legacy system after the full implementation of Form 1040 MeF, which is currently planned for the 2012 filing season.

ETAAC Pulse Survey. MeF implementation requires a coordinated team effort between IRS, the states and the electronic tax preparation and filing industry. To better understand the current state of MeF, ETAAC conducted a short "pulse survey" of both states and industry stakeholders to solicit comments on MeF and identify what, if any, concerns existed.[39]

First, several stakeholders made positive comments about IRS efforts to engage and communicate with them timely on this project. These responses reflect IRS' efforts to actively work with internal and external stakeholders on MeF.

Second, state and industry stakeholders reported the following principal concerns (listed in order of the number of responses):

- Performance: delayed or missing acknowledgments, slow processing speeds, inability to perform on "filing deadlines," and MeF platform instability (18 respondents)
- Coverage: IRS' or stakeholders' ability to expand successfully the coverage of 1040 forms and schedules as currently planned to a total of 148 forms by the 2012 filing season (8 respondents)

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[36] TIGTA has reported concerns about the low volume of tax returns being received and processed by MeF and the erroneous rejecting of tax returns. TIGTA noted that "…*In comparison [to business returns], individual tax returns involve many more issues resulting in more complex programming and system requirements*." TIGTA also reported that, as of March 5, 2010, 24 percent of the tax returns transmitted to the MeF system had been rejected, which is consistent with the feedback received by ETAAC in its pulse survey. TIGTA Report: Interim Results of the 2010 Filing Season (Reference Number: 2010-41-047), March 31, 2010 ("TIGTA 2010 Season Interim Report").

[37] FTA provides services to state tax administrators, including research and information exchange, training, intergovernmental and interstate coordination, and representation of state administrator interests before federal policymakers.

[38] "The "Tax Information Group For EC Requirements Standardization" has been chartered to discuss matters relating to business standards and practices surrounding national tax data formatting and transfer, and develops and maintains tax electronic technical format standards for a variety of tax filing and other related government electronic reporting or data exchange applications.

[39] In April 2010, ETAAC received responses from 14 states and 4 industry members relating to: (i) MeF platform stability to handle a high volume of returns, speed of acknowledgments, etc.; (ii) MeF ability to increase significantly the number of 1040 forms/schedules supported between 2010 and 2012; and, (iii) the impact of the economic downturn and increasingly constrained budgets on stakeholders' ability to meet IRS MeF rollout schedule.

- Participation: inability of states and industry to receive 1040 returns in through the MeF program due to economic and financial constraints (6 respondents)

Other concerns mentioned by respondents included: increased "timeout" issues as transmission volumes increased, connectivity and retrieval failures, frequent system down time (and lack of notice), lack of MeF platform stability and capacity, form/schema changes after the start of tax season (or issuance of schema changes without adequate notice), slow servers (e.g., "*over 4 hours to pull down partnership returns*"), problems dealing with acknowledgments ("*if IRS encounters a duplicate or an error, they stop processing and send the whole batch back*"), slow response to operating issues, lack of sufficient IRS contacts to handle MeF questions, the need to maintain dual systems during the transition from Legacy to MeF, and IRS termination of Legacy support before all states convert to MeF.

Looking Ahead to Filing Seasons 2011 and 2012. IRS' specific objective for this filing season was to identify MeF operating issues, and capture additional information from lessons learned. Based on stakeholder experience, the overall performance of the MeF system and processes are not yet proven, mature and consistent as with the Legacy system. As a result, stakeholders currently have low confidence in MeF's ability to consistently deliver in a high volume production environment.

As IRS may have expected, the MeF system requires significant improvement before it can assume full processing responsibilities for Form 1040 returns. IRS is well aware of the importance of "customer" adoption to the success of the MeF project. To achieve that adoption, MeF must reflect high availability – 99% or higher. Customers cannot be exposed to continuing issues associated with time-outs, connectivity losses and retrieval failures, especially during high volume periods.

In that regard, several stakeholders provided specific recommendations for improving MeF operations including increasing batch and acknowledgement 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,[40] providing better handling of no-entry fields, keeping EDI and MeF tax data requirements consistent to avoid the burden and the challenges of supporting both MeF and EDI during the transition period, and providing increased transparency into general MeF performance, metrics and stability and how the IRS, states and industry are tracking towards 1040 MeF implementation goals.

We believe IRS made a sound decision in taking a "launch and learn" approach with Form 1040 MeF system for the 2010 filing season. Now is the time for IRS to review, with the active input of state and industry stakeholders, the performance of MeF during the 2010 filing season, and determine a game plan to ensure the success of a high performing, highly available MeF system.

2. PREPARER E-FILE REQUIREMENT: RECOMMENDATION FOR IRS

To enable the successful implementation of the Preparer e-file Requirement, IRS should approach this initiative during the first few years of implementation primarily as a "change management" effort that requires extensive, ongoing, two-way communication and not primarily as a compliance or enforcement effort.[41]

[40] States, in particular, have expressed the importance of establishing MeF system lock-down dates during which system updates or enhancements cannot be made. The MeF system must be operational and available for high volume due dates, and IRS should not request states to bring their systems down during the day.

[41] Several states with a Preparer e-file Requirement identified taking this approach as a significant lesson learned for a successful implementation.

IRS should consider taking the following approach in designing and implementing the Preparer e-file Requirement to ensure a smooth, successful implementation:

- **Continue to assign Electronic Return Originator (ERO) and Electronic Filing Identification Number (EFIN) status at the firm/office[42] level, which corresponds with State e-file requirements and enables firms to retain ultimate responsibility for ensuring their tax preparers adhere to the requirement.**
- **Track e-file volumes at the firm level for purposes of monitoring compliance.**
- **Apply the e-file requirement only (i) to preparers filing individual (1040 family) income tax returns, and (ii) to those forms that are permitted to be e-filed.**
- **Phase-in the requirement over a three year period based on the firm's prior year filing volume measured through the preceding primary filing season (i.e. April 15th), which ETAAC believes will enable small business tax practices to embrace electronic filing as part of their business model:**
  - **2011 Filing Season: 100 Returns**
  - **2012 Filing Season: 50 Returns**
  - **2013 Filing Season: 10 Returns**
- **Provide taxpayers with the right to "opt-out" of having their Form 1040 returns electronically filed and, in compelling cases, firms with the ability to apply for a "hardship waiver" under certain limited circumstances.**
- **Focus the early stages of "enforcement" on educating and collaborating with preparers in implementing the e-file requirement.**

IRS should take the following approach to mitigate the risks associated with implementing the new e-file requirement:

- **Communicate early and often with all industry stakeholders, including preparers, taxpayers, software developers/transmitters, industry groups, media and State Departments of Revenue. All stakeholders must understand and address the impact of the e-file requirement on tax preparation and filing software, individual business practices, and increased e-file volume for states.**
- **Focus on the "critical few" priorities that will have the greatest impact on a successful short-term implementation of the Preparer e-file Requirement, as IRS will face technical, systems, operational and administrative challenges in meeting its aggressive 2011 implementation target.**

ETAAC ASSESSMENT

ETAAC applauds the implementation of an electronic filing requirement for tax preparers, and has the below recommendations.[43]

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[42] "Firm" refers to the business entity providing tax preparation and electronic filing services, e.g., sole proprietor, corporation or partnership. "Office" refers to a separate fixed location from which a firm is submitting electronically filed tax returns.

[43] This requirement was passed into law pursuant to the Worker, Homeownership, and Business Assistance Act of 2009, which was signed by the President on November 6, 2009. The law applies to individual income tax returns (any return of the tax imposed by subtitle A on individuals, estates, or trusts) prepared by a tax return preparer,

Administration. IRS e-file rules require that a firm participating in the IRS e-file program to obtain a separate EFIN for each of its offices.[44] Then, each tax preparer in a specified office e-files returns under that office's EFIN, supplemented with other preparer identifying information such as name and TIN/EIN.

Currently, all states with a Preparer e-file Requirement designate the "firm" as the mandated entity. As a result, every tax preparer in the firm must e-file if that firm meets the mandate threshold and is required to e-file.

A change from the current IRS approach by requiring that each individual tax preparer obtain an EFIN would create a significant burden for many key stakeholders. Similar burdens would be created if IRS measured compliance at the "office level" by attempting to link individual preparer e-file volumes to their location (or EFIN). Due to the heavy seasonal aspects of tax preparation, companies with seasonal employees would have significant new administrative burdens managing tax preparers associated with any single office's EFINs. This would be particularly challenging for large employers/operations where tax preparers may work in several different offices over the course of a season.

ETAAC recommends that the IRS preparer requirement be measured at the firm level. This would be consistent with the approach of the states that have a Preparer e-file Requirement, and avoid the complications described above. Once it achieves the required threshold in any year, a firm should continue to be required to e-file all 1040/individual returns (unless opt-out/hardship below). Firms should be responsible for ensuring their associated tax preparers participate in the e-file requirement.

Coverage and Disqualifications. The new federal legislation applies to preparers filing individual, estate or trust returns after December 31, 2010. At the same time, IRS current Legacy e-File system accepted only 755,918 estate and trust returns in 2007. Modernized e-File will not be fully in effect for the 1040 family until tax filing season 2012 and, currently, is not planned to include estate and trust returns. We believe any IRS regulations implementing the new federal legislation should apply only to return preparers filing individual (1040 family) income tax returns. IRS forms that are not e-fileable should be excluded from any "count" to determine whether a given firm/preparer is covered by the requirement (e.g. 1040NR).

IRS should disqualify applicants who have adverse criminal records that are identified during IRS/FBI background checks where the offense raises questions about the applicant's trust, integrity or overall suitability. On the other hand, a relatively minor offense that occurred years before that does not reflect adversely on an applicant's integrity should not necessarily exclude a person from the program. To ensure consistent decisions and avoid unnecessary disqualifications, IRS should provide clear guidance concerning the types of offenses and other factors that affect an applicant's qualifications for the Authorized IRS *e-file* Provider program.

Phase-In of Requirement. ETAAC recommends a three year phase-in of the requirement based on the firm's prior year filing volume measured through the preceding primary filing season (i.e. April 15th) starting with 100 returns for filing season 2011, 50 returns for filing season 2012, and 10 returns for filing season 2013. As an alternative, IRS could provide a phase-in over two years, starting with a threshold of 100 for filing season 2011 and 10 for filing season 2012. We believe the implementation time period and related volume targets should be selected based on IRS' ability to process new ERO applications, complete background and suitability checks and process unusual cases. Qualified

except with respect to any calendar year where the preparer reasonably expects to file 10 or fewer individual income tax returns.

[44] IRS *e-file* Application and Participation (IRS Pub 3112).

preparers should not be in a position where they have filed an application, but IRS has not had sufficient time to process and approve it.

Taxpayer Opt-Outs and Preparer Hardship Waivers. Taxpayers should be provided with the right to "opt-out" from having their personal Form 1040 return electronically filed, which would be consistent with the practices of most states.[45] Tax preparers should also be able to "opt-out" their client from filing returns under certain circumstances, such as where their software does not allow e-filing of a particular form in a taxpayer's return or IRS doesn't support e-file for a particular form such as 1040NR.[46] IRS should develop a special "Opt-Out" form (such as California did with its Preparer e-file Requirement) for preparers to document (and retain) opt-outs for their clients.

For a period of time, IRS should also consider providing a "hardship waiver" to preparers under certain limited circumstances. Any waivers should be time bound and subject to review/renewal. Because it is not possible to identify all appropriate hardships, IRS should retain full discretion to determine and allow waivers.

Enforcement. Although many states have the authority to charge penalties (anywhere from $5 - $100) for each return qualifying for e-file that does not meet the opt-out provisions, few currently do so. One state advised ETAAC that it is enough that they "*have the hammer*" of an enforcement penalty, although they have employed a less aggressive enforcement approach in early years by using soft notices, calls and occasionally an office visit. Most states have emphasized that in the early stages of the requirement, compliance should be effected primarily through practitioner and taxpayer education programs and not through any sanctions. We believe IRS should focus on education and a collaborative approach to the Preparer e-file Requirement implementation, even if it is eventually authorized to penalize non-compliant preparers.

Education of Tax Preparers, Taxpayers, and other Third Parties with Interest. Education of tax preparers is paramount to the requirement's success. For affiliated tax preparers, the tax preparer organizations will be of significant value (e.g., American Institute of Certified Public Accountants, National Association of Enrolled Agents, and National Association of Tax Professionals). For unaffiliated tax preparers, the IRS should use a variety of communication channels to ensure clear understanding of the requirement and who is subject to it, including IRS Tax Forums, www.irs.gov,[47] and letters to individual tax preparers subject to the requirement. Professional tax software companies may also provide a communications channel for preparers.

IRS should also solicit feedback from industry members and professional groups about the most effective education/information and communications methods for various groups of stakeholders. ETAAC believes that IRS' transition and educational plan can ease the impact on affected stakeholders by: (i) assisting tax preparers in understanding the value of e-file and the costs that will be diminished by adopting e-file into their business practices, (ii) communicating early and often with all stakeholders

[45] All but one of the current twenty-three states requiring preparers to e-file provides taxpayers the right to "opt-out" from having their personal returns electronically filed by a tax preparer.

[46] IRS and all stakeholders should collaborate to identify the most commonly e-filed forms to ensure that software companies are focused on the highest *return-on-investment* forms, as opposed to IRS just requiring that all e-fileable individual forms must be supported.

[47] IRS is already making broad use of www.irs.gov and other Internet resources, such as www.youtube.com. See the IRS video on "How to become an Authorized e-file Provider" presented by the Director of IRS Electronic Tax Administration and Refundable Credits at http://www.youtube.com/watch?v=MnZgjpVGZDw.

including tax preparers, software developers, and electronic transmitters,[48] and (iii) continuing to leverage www.irs.gov to communicate to preparers.

3. INTERNET STRATEGY: RECOMMENDATION FOR IRS

IRS' Internet Strategy should be implemented through a rigorous process that ensures any online service will solve real customer problems that are aligned with IRS' strategic priorities and yield the highest "return on investment" for taxpayers, IRS, tax preparers and software companies with a potential focus on:

- **Reducing existing IRS call volumes and associated costs, and improving taxpayer service, by answering existing taxpayer questions more effectively through the Internet.**
- **Improving IRS online services for preparers and the electronic tax preparation and filing industry.**
- **Extending to taxpayers those IRS online services that are currently available only to preparers.**

ETAAC ASSESSMENT

ETAAC believes that an IRS e-strategy should be guided by the concept of "*electronic government*" as defined by the E-Government Act of 2002,[49] with a particular focus on using the Internet and other technologies to "*enhance the access to and delivery of Government information and services to the public."*

In preparation for this report, IRS Electronic Tax Administration (ETA) briefed ETAAC on the early stages of IRS' Internet Strategy. We agree with IRS' improved focus by recharacterizing its E-Strategy" as an Internet Strategy. ETAAC also commends IRS on some of its recent online offerings on www.irs.gov, namely "*Where's My Refund*" and "*Request Electronic Filing PIN*." Both of these services reflect the kinds of innovative, carefully targeted services that solve important customer problems.

Going forward, ETAAC believes there are three critical points that IRS must consider in executing its Internet Strategy.

First, IRS must make decisions about developing and providing Internet-based services based on a rigorous evaluation process to ensure that *real customer problems* are being solved and that its limited resources are being used to their best advantage:

1. There must be a clear understanding and identification of the *customer segment(s)* being served, and the *customer problem(s)* being solved.
2. The targeted customer segment and problem must be *solved well* on the Internet, and not require the adoption of new behaviors or tasks that the customer segment does not currently perform (for example, it cannot be a task that a taxpayer "should perform" but, instead, one that the taxpayer already performs).[50]

[48] It is vital for stakeholders to understand the mandatory elements for the requirement in case there are changes to business practices, software features or IT systems. Software developers and transmitters, in particular, are already working on tax year 2010 product features, and usually go into a "code freeze" in the early fall in order to complete testing of their products before late year release to customers.

[49] E-Government Act of 2002 (Public Law No: 107-347).

[50] In ETAAC member experience, services that attempt to change consumer behaviors, or create new ones, are almost always doomed to failure. These are the typically represented by failed projects where customers "said" they wanted the service but, in fact, don't use it when it becomes available because it really wasn't a "job" they

3. The new service must be clearly aligned with and support the accomplishment of an important IRS strategic goal or objective that relates to IRS' core mission.
4. Success must be defined in advance, along with clear metrics.
5. There must be a clear understanding of project risks, and an articulated risk mitigation strategy.[51]
6. The project must reflect the "best use" of IRS' limited resources, which includes a determination of whether the subject services could or should be offered by private industry instead of by government[52] and, if by government, then IRS must:
    i. Conduct a rigorous analysis of the project's return on investment and benefit/cost,[53] and,
    ii. Be explicit about the tradeoffs it is making – that is, by doing *this* project, IRS is choosing not to do *that* project.

Second, IRS' Internet Strategy should focus not just on taxpayers, but also consider those persons who serve taxpayers. Currently, about 90% of all taxpayers have already demonstrated their preference to use professional preparers or consumer tax software to learn about their tax obligations, and prepare and file their taxes. IRS should consider how it can get additional "leverage" (one-to-many) by enabling preparers and software companies to better serve taxpayers.

Third, ETAAC believes that the IRS should focus on solving three broad *customer problems* that are directly related to electronic tax administration:

- *Reduce existing IRS call volumes and associated costs and improve taxpayer service by answering existing taxpayer questions more effectively through the Internet*. IRS is faced with a monumental customer service challenge. As of March 6, 2010, IRS Customer Account Services had already answered over 8,500,000 taxpayer calls while delivering an overall level of service of about 74%.[54] IRS understands that it must do more to provide self-serve options through www.irs.gov where taxpayers can find the answers to their questions. However, building effective online customer service capabilities goes far beyond just posting FAQs. IRS should find opportunities to work collaboratively with states and the electronic tax preparation and filing

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were performing before. Professor Clayton M. Christensen of Harvard Business School, author of The Innovator's Solution, has characterized this inherent risk as the "da*nger of asking customers to change jobs*."

[51]Office of Management and Budget (OMB) has identified those e-government risks as: technology and technical obsolescence, project schedule and resources, organizational and change management, strategic, security, privacy, data, integration, cost, project management, acquisition and procurement, contract management, feasibility, systems reliability, changing priorities, and dependencies and interoperability between this and other investments. See Attachment "N" to Report to Congress on Benefits of the E-Government Initiatives Fiscal Year 2010 **(**http://www.whitehouse.gov/omb/assets/egov_docs/FY10_E-Gov_Benefits_Report.pdf)

[52] The Office of Management and Budget (OMB) has issued guidance on federal policy concerning the reliance on the private sector for commercial services. See OMB Circular No. A-76 (Revised), Performance of Commercial Activities, May 29, 2003. Also see "The Role of Government in a Digital Age," by Joseph E. Stiglitz, Peter R. Orszag & Jonathan M. Orszag, and commissioned the Computer & Communications Industry Association, October 2000, in which Nobel Laureate Stiglitz and current OMB Director Orszag articulated principles for government provision of goods and services in a digital economy. See http://www.ccianet.org/CCIA/files/ccLibraryFiles/Filename/000000000086/govtcomp_report.pdf

[53] See OMB Circular A-94 for Guidelines on Benefit-Cost Analysis of Federal Programs.

[54] TIGTA 2010 Season Interim Report.

industry to share best practices to improve the capability of the overall tax eco-system to answer taxpayer questions quickly and accurately.

- *Improve IRS online services that enable preparers and the electronic tax preparation and filing industry*. Providing enhanced online services to preparers enables them to better serve taxpayers in a manner that has a multiplying effect because a single preparer likely serves a hundred or more taxpayers. One area of focus should be IRS' current professional "e-Services" suite, which is quite dated. These services need to be revitalized, especially given the increased load they will be under as IRS registers hundreds of thousands of new preparers and requires them to become EROs.
- *Extend IRS online services that are currently available only to preparers to taxpayers as well*. Innovative advances with technology and the Internet have already enabled third party tax-related data -- such as W-2's and 1099's -- to be available from primary sources for instant download into tax software today directly from their original sources. On the other hand, an authorized preparer has online access via IRS to a taxpayer's prior year tax information, while taxpayers themselves do not have similar access. However, neither the preparer nor the taxpayer can electronically import this type of information into the commonly used software. ETAAC believes that information uniquely in the government's possession, such as prior year tax information,[55] should be electronically available to both taxpayers and preparers, which would speed and simplify return preparation and increase return accuracy. Likewise, if a Debt Indicator (DI) is provided in connection with a return, then IRS should also provide explanatory information about the nature of the refund offset. (We understand that the IRS is already considering this enhancement to the DI). These types of ideas are consistent with President Obama's goals for an "open government" that encourages transparency and collaboration.

4. COLLABORATIVE INNOVATION: RECOMMENDATION FOR IRS

Create new partnerships between IRS and the tax preparation industry that will deliver better service to taxpayers through increased collaborative innovation. This initiative could include the reintroduction of the "Request for Agreement" program to actively encourage the development of new and innovative ideas for achieving public interest objectives and IRS' strategic goals and objectives.

ETAAC ASSESSMENT

Meeting Customer Expectations

The speed and quality of the "customer experiences" in a 24/7 electronic world is creating heightened expectations for better service and for solutions that are tailored to specific customer needs. Given IRS' challenges and core responsibilities outlined above, ETAAC does not believe that IRS can be successful meeting these heightened expectations in an environment of constrained resources by going it alone. Instead, ETAAC believes that IRS must do two things to meet the increasing demands and expectations of its customers in electronic tax administration:

- Develop a clear partnership strategy for the electronic tax preparation and filing industry

[55] IRS must carefully consider whether to make income-related information available to taxpayers in a manner that discloses, for example, the limited income information reported to IRS. ETAAC believes that such disclosures could negatively impact tax compliance because of taxpayers deciding not to report additional non-reported income on their tax returns. Also, many commercial companies are already electronically importing W-2 and 1099 information from the primary sources much faster than IRS could obtain such data.

- Leverage innovation through collaborative efforts with private industry

Electronic Tax Community Partnership Strategy

One of IRS' strategic objectives is to "*Strengthen partnerships with tax practitioners, tax preparers, and other third parties in order to ensure effective tax administration*."[56] ETAAC believes this strategic objective is essential to the future of electronic tax administration.

Notably, IRS has undertaken several partnership engagements with the electronic tax preparation and filing community, including providing preparer online e-Services, engaging in regular communications, and implementing various working groups to improve tax administration. ETAAC believes these types of activities reflect important elements of a partnership but, in and of themselves, do not constitute a "top down" partnership strategy.

The first step in developing a more cohesive partnership strategy is to set clearly defined outcomes for electronic tax administration, and being clear about the respective roles and responsibilities of IRS and the electronic tax community. Once those are determined, IRS can work with the electronic tax community to determine the most effective strategies to deliver those outcomes and, then, identify how IRS can best organize itself to execute against them. A good starting point would be to adopt the Board's recommendation to conduct research to better understand and differentiate the roles of tax intermediaries.[57]

Leveraging Innovation Through Public/Private Partnerships

Apple Computer is recognized as a premier innovation company. Certainly, the iPhone reflects tremendous innovation, but that's not the half of it. Many of the innovative applications being offered through the iPhone are not being created by Apple. Instead, third party developers are creating new iPhone applications at an incredible pace – at NO cost to Apple, and at a huge benefit to consumers.[58]

IRS faces the same decision that Apple did. IRS could choose to build all customer-facing applications itself. ETAAC believes that such an approach will neither be implemented quickly enough to meet taxpayers' needs nor deliver at the necessary service levels that taxpayers expect.

IRS should take a different approach. IRS should identify its core assets – namely its internal tax processing capabilities, its tax knowledge and the unique taxpayer information it has in its databases – and find ways to enable taxpayers and the electronic tax industry to leverage those assets in support of IRS' strategy to provide better taxpayer services and easier voluntary compliance.

One good example would be providing taxpayers and tax professionals with the ability to import IRS prior year tax return information into their tax preparation or accounting software. Currently, IRS e-Services Transcript Delivery Service allows tax professionals to access prior year information. Instead, IRS could build an Application Programming Interface (API) to enable taxpayers or tax professionals to

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[56] IRS Strategic Plan, p. 16.

[57] "*Tax intermediaries have many roles in the interaction between taxpayers and the IRS, such as assisting taxpayers in meeting obligations and receiving benefits, assisting the IRS by transmitting information, and challenging the IRS in an adversarial role. 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*." Board FY2011 IRS Budget Report, p. 27.

[58] See the offerings available at the Phone App Store (http://www.apple.com/iphone/apps-for-iphone/).

import that same data securely into their tax preparation or accounting software. That's just one example.

There are other examples in the federal government. The White House Chief Technology Officer, Aneesh Chopra, recently provided a presentation that included a description of how the US Postal Service provides APIs to verify addresses, calculate rates and more.[59] Mr. Chopra has also touted the Sunlight Foundation,[60] which organized "Apps for America" -- a program that uses independent developers to create services using government information to increase transparency and accountability.[61]

Where should IRS start? ETAAC recommends that IRS go "back to the future" by reinstating an IRS program that existed in the late 1990's – the so-called "Request for Agreements" (RFA) program.

The RFA program was a non-monetary program where, without any expenditure of procurement funds, IRS sought and received ideas to increase electronic filing. Private companies or non-profits could submit pilot proposals for IRS review. If accepted, IRS would cooperate with the company to enable the submitting company to implement its pilot proposal. If it worked, the IRS rolled out the opportunity more broadly across the Authorized IRS *e-file* Provider community. If it failed, the IRS dropped it. In effect, there was little to no risk to the IRS or taxpayers, and no expenditure of limited procurement dollars. Expedited processes for the development of "temporary policies" will be required to support rapid innovation and iteration.

ETAAC believes that 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 create a developer network and to extend its sources of innovation.

5. ADVANCING E-FILE STUDY PHASE 2 REPORT: RECOMMENDATION FOR IRS

Any options for increasing electronic filing contemplated in IRS' Advancing *E-file* Study Phase 2 must be evaluated with (i) a clear recognition of IRS' most important responsibilities, core competencies and significant challenges, and (ii) be based on a prioritization process that includes a rigorous benefit-cost analysis and "return on investment" calculation.

ETAAC ASSESSMENT

The Advancing *E-file* Studies provide a strong foundation for discussions concerning options to increase electronic filing. ETAAC commends the IRS Electronic Tax Administration's initiative in commencing this effort. The Phase 1 Study is an excellent resource for the current research in this area. ETAAC believes that the Phase 2 Study can build on that body of available knowledge, and provide essential insights into potential key options that may affect the adoption of electronic filing.

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[59] *Aneesh Chopra*, U.S. Chief Technology Officer & Associate Director for Technology, White House Office of Science & Technology Policy presentation at The American Council for Technology (ACT) - Industry Advisory Council (IAC), July 2009. See www.actgov.org/knowledgebank/.../Chopra%20Presentation.ppt (slide 14) (9 companies offer integration services with USPS data, and 25 companies sell products that rely on open USPS data – all of which provided consumers with more tools).

[60] See http://voices.washingtonpost.com/federal-eye/2009/07/chopra.html. The Sunlight Foundation is a non-profit organization that focuses on the digitization of government data and the creation of tools and Web sites to make that data easily accessible for all citizens. http://sunlightfoundation.com/about/

[61] Last summer, the Foundation announced three finalists that had developed applications leveraging government information to provide increased interaction, transparency and accountability. See http://blog.sunlightfoundation.com/2009/08/24/apps-for-america-the-finalists/.

Although the Phase 2 Study has not yet been released, ETAAC would like to offer some insights based on the Phase 1 Study results and the Phase 2 Study guidance. Most importantly, ETAAC believes that any decisions about options to increase electronic filing must be made with a clear understanding of IRS' most significant challenges, its most important responsibilities and core competencies, the associated risks, and the related benefit-cost and return on investment.

IRS Challenges

IRS faces tremendous challenges. As reported by TIGTA on October 15, 2009,[62] the most serious management and performance challenges confronting the IRS in order of priority are: Modernization; Security; Tax Compliance Initiatives; Implementing Tax Law Changes; Providing Quality Taxpayer Service Operations; Human Capital; Erroneous and Improper Payments and Credits; Globalization; Taxpayer Protection and Rights; and, Leveraging Data to Improve Program Effectiveness and Reduce Costs.

Considering just one of IRS' key challenges, ETAAC expressed its concerns about IRS' human capital in its 2009 Report, when it stated: *"The significant management capacity now devoted to managing these [Modernization] projects limits the IRS' ability to take on significant new projects such as the advancement of the IRS' e-strategy."* This challenge was reinforced by TIGTA's report that more than half of the IRS's employees and managers have reached age 50, and 39 percent of IRS executives are currently eligible for retirement. TIGTA also noted that the Modernization Program has experienced significant and frequent turnover of high-level IRS and Program executives, and that the above challenges are supplemented by two additional issues – *tax law complexity* and *healthcare reform legislation*.

Significantly, several of the challenges identified by TIGTA directly impact, or would be exacerbated by undertaking, some of the options identified in the Phase 1 Study. ETAAC believes that IRS management, employees, and resources must remain focused on delivering on IRS' core mission and finishing its most important priorities.

IRS Core Competencies

The Phase 2 Study must consider IRS' core competencies. For example, some of the options being considered in the Phase 2 Study include IRS developing, maintaining and operating 24/7 online *Software-as-a-Service* (SaaS) tax preparation services. ETAAC is not in favor of IRS pursuing these options. IRS has neither the resources nor the competencies of a SaaS provider to assume responsibility for managing the design, testing, operation, maintenance, and updating of around-the-clock direct e-file or online tax preparation services, whether forms or interview-based software.

IRS Risks

Ignoring any policy questions as to whether the IRS should be both the tax collector and the tax preparer in a voluntary compliance self-assessment tax system, any evaluation of IRS online systems must contemplate the IRS "brand" and "political" risk associated with any systems failures or errors. As evidenced by repeated nationwide government tax systems failures in both Canada and the United Kingdom reported by GAO,[63] there are serious risks of operational failures (including security breaches) associated with an IRS direct e-file or online tax preparation system. ETAAC believes that any failures,

[62] TIGTA 2010 IRS Management & Performance Challenges.

[63] GAO Report: Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risk (GAO-09-297), February 2009, p. 18 ("GAO Tax Software Report").

breaches or errors in IRS online systems will adversely affect taxpayer confidence in the IRS, and potentially in the broader federal government.[64]

Benefit-Cost and Return on Investment

The Phase 2 Study should also contain a total overall cost analysis of any possible options, but particularly those that involve significant investments, such as the IRS' development and operation of direct e-file or tax preparation services. Those analyses should include any software and systems life cycle and annual recurring investment costs. Additionally, if the federal Free File program were terminated as a result of its actions, IRS must also consider the costs that would be imposed on the approximately twenty states that currently rely on the federal Free File Program as the foundation for their state Free File programs.

ETAAC recommends that the Phase 2 Study use a metric that enables an apples-to-apples comparison of the benefit-cost or return-on-investment of any given option. For example, ETAAC believes one efficiency metric would be the "*total overall cost per net e-filed return*." That is, how much will it cost taxpayers to obtain each incremental e-filed return that IRS would otherwise not have received.

Finally, the Phase 2 Study must ensure that any supporting research is rigorously conducted and that it accurately reflects any commercial business practices.

KSI 2: THE ELECTRONIC EXPERIENCE IS TRUSTED.

6. TAX PREPARER OVERSIGHT: RECOMMENDATION FOR IRS

IRS must implement the new Return Preparer Review Program requirements in a manner that does not unnecessarily, adversely affect having an adequate supply of qualified Authorized IRS *e-file* Providers by:

- **Continuing to communicate early and often with all industry stakeholders, including preparers, taxpayers, software developers/transmitters, industry groups, media and State Departments of Revenue concerning the new preparer registration, testing, and education requirements.**
- **Ensuring available, affordable approaches for preparers to comply with the new requirements.**
- **Enforcing compliance both directly and indirectly, including a multi-year taxpayer public awareness program about the importance of only using registered, qualified preparers.**
- **Encouraging states to adopt the new IRS standards as the foundation for any state tax preparation industry standards to the maximum extent possible to avoid the creation of conflicting state standards, which could unnecessarily, adversely impact Authorized IRS *e-file* Providers engaged in a multi-state practice.**

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[64] Web site postings concerning one state revenue department's online filing system being "down" at the April filing deadline reflect the not surprising level of taxpayer reaction and frustration: "*It's April 14, the day before taxes are due, and the [state] e-file site has been down for at least four hours…Unbelievable…What a debacle! Heads had better roll for whatever is allowing this to happen,"* and *"Web File System Is Full…the system is processing at full capacity, and is unable to accept additional users at this time…Riiiiggght. What do they expect? It's ridiculous to not have sufficient resources at this time of the year."*
http://www.fatwallet.com/forums/finance/823106

IRS should continue to work with the tax preparation industry and states to identify and address identified risks associated with the dependence of tax administration on consumer and commercial tax preparation software,[65] including the establishment of any industry standards and certification models.

ETAAC ASSESSMENT

Background

Almost 90% of all taxpayers currently choose to rely on the tax preparation industry to assist them in the preparation and filing of their returns, whether through preparers or using consumer tax preparation software. Accordingly, taxpayer and government confidence in electronic tax administration is premised on their confidence in the tax preparation industry.

ETAAC believes that the *professionalization* of the tax preparation industry is foundational to ensuring that confidence. In support of that objective, ETAAC has previously recommended increased IRS standards and oversight for the tax preparation industry – both for preparers[66] and for the electronic tax preparation and filing community.[67]

Over the past year, IRS has aggressively pursued that objective by completing and issuing in December 2009 its Preparer Oversight Review,[68] which includes the below key elements.

> *Preparer Oversight.* The key elements of IRS' proposed preparer oversight effort include registration, competency testing, continuing education, compliance checks, ethical standards, and ongoing evaluation and enforcement. [69]
>
> *Electronic Tax Preparation and Filing Industry Review and Oversight.* An evaluation of the risks associated with the dependence of tax administration on consumer and commercial tax preparation software, and the possibility of establishing industry standards.

ETAAC would like to comment on both areas.

Preparer Oversight

ETAAC supports IRS' efforts to ensure that all preparers meet high standards of professionalism, which we believe strengthens electronic tax administration. However, government and taxpayers must realize that the full positive impact of the new preparer requirements will take several years to achieve given its phased implementation. This effort will be a journey, and we believe there are a few key areas to consider.

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[65] The term "tax software" is often used to refer to the electronic tax preparation and filing industry, which includes both (i) public and not-for-profit *software developers* that create tax preparation software and tax software utilities for consumers and preparers, and (ii) the transmitters who receive returns electronically from clients, batch them, and then transmit the data to the IRS. Transmitters operate a substantial technology infrastructure, including the application software, data center and customer service operations required to electronically receive, process, transmit, acknowledge and resubmit tax returns with the tax agencies.

[66] See 2007 ETAAC Annual Report to Congress, p. 10, and 2008 ETAAC Annual Report to Congress, p. 16.

[67] See 2009 ETAAC Annual Report to Congress, p. 22.

[68] IRS Return Preparer Review, Pub. 4832 (Rev. 12-2009) ("IRS Return Preparer Review").

[69] IRS Fact Sheet FS-2010-1, January 2010 (http://www.irs.gov/newsroom/article/0,,id=217782,00.html)

Communications. To ensure a smooth implementation, IRS must aggressively communicate the new requirements in a way that will reach all tax preparers. This challenge should not be underestimated because, given the nature of our tax system, many tax preparers operate seasonal businesses and may not regularly engage with IRS outside of the tax filing season (January – April).

ETAAC believes that IRS should continue to leverage www.irs.gov as the authoritative source of information about the new requirements. However, IRS also needs a multi-channel communication strategy to make tax preparers aware of the new requirements. To that end, IRS must leverage other relationships that many tax preparers maintain, such as professional organizations, tax software companies, bank product providers and state revenue agencies.

Accessibility and Affordability. As currently contemplated, the cost of implementing the new requirements will fall principally on the tax preparer, as opposed to being funded through the IRS budget. This funding approach will likely result in somewhat higher tax preparation costs for taxpayers as some element of those costs will be passed along to taxpayers.

To reduce this impact, IRS should make compliance affordable by implementing a regulatory model that achieves the objectives of the new requirements at the lowest possible cost. ETAAC believes that accessibility is a key element of maintaining affordability.

- Registration and PTIN issuance must be accessible for the tax preparer. With upwards of 1,000,000 tax preparers expected to register, IRS must establish and meet service levels to ensure that PTINs are granted prior to the tax season.
- Testing must be accessible. Tax preparers must have clear guidance on the components of the tax code to be tested, and have access to low/no cost study materials. Although commercial services may provide some of these services on a "value-added" basis, IRS should also make basic materials available.
- Continuing education must be accessible. IRS should ensure that a competitive marketplace exists for qualified course providers to ensure that costs are low and services are broadly available.

Compliance and Enforcement. The Return Preparer Review Program requirements must include a robust enforcement strategy to ensure that non-compliant tax preparers are weeded out of the system. We agree with those observers, including the National Taxpayer Advocate,[70] who believe a two-prong approach is needed.

First, IRS needs to be funded with the necessary resources to investigate non-compliance and pursue offenders using a range of enforcement tools from issuing notification letters to suspending offenders from the Authorized IRS *e-file* Provider program to pursuing penalties in appropriate situations.

Second, compliance cannot be achieved solely based on IRS enforcement efforts. A multi-year public awareness campaign is required to ensure that taxpayers understand the new requirements and avoid using unregistered preparers. We support IRS' consideration of a portal where taxpayers can confirm the compliance status of tax preparers, just as consumers can use other existing government online databases to verify licensure of their dentists or contractors.

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[70] See Most Serious Problem #3, National Taxpayer Advocate, 2009 Annual Report to Congress, Volume 1, p. 41. (*"Increase Visibility. To adequately oversee preparers, the IRS must…[require] all individual preparers to obtain unique identifying numbers as well as conducting a public awareness campaign to inform the taxpaying public about any new preparer requirements." p. 46).*

Uniform Standard. IRS should allow states that choose to regulate tax preparers to piggyback on IRS' registration, testing, and continuing education requirements and compliance efforts. States intending to adopt new standards could leverage the IRS standards and processes entirely (much like many states do with IRS' e-file requirements), whereas states with previously established standards (in the absence of IRS standards) might revisit their rules and align them more closely with IRS'. The alignment of state and federal standards would minimize both the burden (and costs) on taxpayers, preparers, and states.

Electronic Tax Preparation and Filing Community Review and Oversight

ETAAC continues to believe that the four areas identified by the GAO -- security, privacy, accuracy and reliability -- represent the right, critical focus to ensure the integrity of electronic tax administration.[71] As ETAAC recommended in its 2009 Report, "*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,"* and identified two areas of particular focus -- security and accuracy.

Consistent with its 2009 recommendation, ETAAC supports IRS' announcement to "*establish a task force consisting of industry, government and other stakeholders to consider the risks associated with tax preparation software and to discuss the possibility of establishing industry standards."* [72]

ETAAC commends IRS for moving quickly in this area. Even before it issued its Return Preparer Review, IRS had created an ETAAC Software Subcommittee in late 2009 to study security and privacy policies for Authorized IRS *e-file* Providers. The ETAAC Software Subcommittee's initial focus is on security, and we expect the issuance of its findings and recommendations in the coming months. More recently, IRS has expanded the charter of the ETAAC Software Subcommittee to include studying and advising on other areas of tax software policy such as tax software product accuracy and reliability. ETAAC recommends that the Subcommittee create separate working groups for Security/Privacy and Accuracy/Reliability to pursue parallel paths in conducting any reviews and formulating any policy recommendations.

As stated in our 2009 Report, ETAAC continues to believe that any standards should, wherever possible, be selected from among existing, recognized controls-based standards, and that industry should be an active participant in the discussions concerning the identification of any such standards. ETAAC also previously cautioned that such standards should avoid excessive rigidity, and accommodate the fundamental differences between software targeted to different customer segments and user preferences. For example, professional tax software typically has some type of a worksheet or forms-based interface, not a question-and-answer interview format. Similarly, to address differences in user preferences, some consumer tax software interfaces are interview-based while others are forms-based. In a voluntary compliance tax system, standards should not inhibit tax preparers and taxpayers from having access to the types of tax software tools they prefer to use to fulfill their tax filing obligations.

ETAAC believes that an effective, efficient oversight model does not necessarily require direct IRS regulation. We also agree with the Board's observation that IRS should not attempt to take on any role that entails "certifying" the accuracy of commercial tax software,[73] whether such certification implies government-approved design or suggests a guarantee of usability, accuracy, security or otherwise.

Instead, industry compliance with any agreed upon standards can be ensured by using an oversight model relying on established independent third party reviews, such as third party assessments and SAS

[71] GAO Tax Software Report.

[72] IRS Return Preparer Review, p. 5.

[73] Board 2009 Electronic Filing Report, p. 37.

70[74] audits under applicable AICPA standards. At the same time, it is very important to recognize that it is in the industry's self-interest to meet high standards. Companies that fail to meet customer (whether consumer or professional) expectations face the risk of losing them in an extremely competitive industry that requires high annual customer satisfaction and retention levels.

IRS is already leveraging third party compliance reviews in the Free File Program and elsewhere. For example, all Free File members are subject to third party penetration and vulnerability tests under Payment Card Industry (PCI) Data Security Standards.[75] "Free File Fillable Forms" providers are subject to third party reviews under the AICPA "Agreed Upon Procedures" standard to ensure compliance with IRS specifications. And, finally, all online providers in the Authorized IRS *e-file* Provider program must have a third party review of their privacy practices.[76]

However, implementing software standards is only one "how" to facilitating the achievement of public policy goals for electronic tax administration. The reality is that our tax system has significant interdependencies between multiple stakeholders -- Congress, Treasury, IRS, the tax preparation industry and taxpayers. Therefore, the ability to achieve improvements in electronic tax administration are heavily influenced by policy and implementation decisions.

For example, some of the biggest contributors to tax inaccuracy in the tax preparation community are the increasing size and complexity of the tax code itself (identified as the "*most serious [taxpayer] problem*" in the Taxpayer Advocate's 2008 Report to Congress ,[77] and an area recommended for future research by the Board [78]), late passed legislation,[79] and the late release of government tax publications, instructions and forms.[80] This challenge is exacerbated by the increasing number of states that have

[74] "SAS 70" refers to AICPA Statement on Auditing Standard 70, "Report on the Processing of Transactions by Service Organizations," which sets professional standards for service auditors to audit and assess internal controls of a service organization.

[75] Payment Card Industry Data Security Standards. See https://www.pcisecuritystandards.org/security_standards/pci_dss.shtml

[76] See IRS *e-file* Security, Privacy and Business Standards Mandated as of January 1, 2010. http://www.irs.gov/e-file/article/0,,id=201195,00.html

[77] "*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. ETAAC believes the complexity of the Code presents just as serious a challenge to the tax preparation industry, which must interpret and apply the Code to serve their customers. Tax code complexity also challenges IRS' ability to write publications, instructions and forms that taxpayers can understand without making errors. TIGTA Report: Analyzing Taxpayer Errors Can Help to Improve Forms and Instructions (Reference Number: 2009-30-083), June 11, 2009, p. 1.

[78] Board FY2011 IRS Budget Report, p. 26. ETAAC agrees with the Board's view that tax system complexity is a major cause of noncompliance. An additional goal for any IRS research in this area could include understanding the adverse impact of tax system complexity on the electronic tax and filing community, which also directly impacts taxpayers.

[79] The adverse impact of late passed legislation, whether at the federal or state level, cannot be underestimated. For example, software developers experience a *double whammy*, 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.

[80] The release of tax publications, instructions and forms by IRS and state departments of revenue are, of course, impacted by late enacted tax legislation. However, the earliest possible release of those tax materials, even in

not adopted the tax benefits included in recent federal stimulus legislation, which substantially increases the complexity of determining state income tax liabilities that are often computed based on elements of the federal tax return.

The interdependencies of electronic tax administration are also illustrated with respect to the *reliability* of electronic tax industry operations, which rely on a steady flow of IRS tax season operational and electronic filing data. That data provides the electronic tax community with essential insights into filing season patterns and developments to enable it to prepare and adjust critical systems and business practices to handle anticipated tax filing volumes and rejects.

In conclusion, the successful administration of our electronic tax administration system requires a collaborative team effort between both government and industry in service to the American taxpayer.

7. KEY ENABLERS – SECURITY, E-AUTHENTICATION AND E-SIGNATURES: RECOMMENDATION FOR IRS

IRS must solve three key challenges as key enablers for expanded electronic tax administration – security, e-authentication and e-signature.

ETAAC ASSESSMENT

Security

Commissioner Shulman has made security a top priority for the IRS,[81] and the agency has continued to make steady progress in this area. However, GAO and TIGTA continue to report security vulnerabilities with IRS. [82] Most recently, GAO acknowledged the IRS' progress on security deficiencies, but noted that "*newly identified and the unresolved information security control weaknesses in key financial and tax processing systems continue to jeopardize the confidentiality, integrity, and availability of financial and sensitive taxpayer information*. "[83]

Security is a key enabler to achieving taxpayer trust and confidence in IRS' electronic tax services and, therefore, must be on solid ground before new interactive electronic services can be undertaken. ETAAC acknowledges that security is a hugely challenging area, and encourages IRS to continue to aggressively pursue those actions necessary to fully implement an agency wide information security program.[84]

e-Authentication

In its 2009 Report, ETAAC noted that a "*secure authenticating process for user identities and management of authorizations*" is a prerequisite to having enhanced IRS online services that leverage taxpayer information. ETAAC continues to believe that the IRS and state revenue departments should

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draft form, is critical to enabling tax software developers to have as much time as possible to analyze the implementation of tax law changes, and to code and test their products.

[81] See http://www.irs.gov/irs/article/0,,id=183721,00.html

[82] TIGTA Report: Federal Information Security Management Act Report for Fiscal Year 2008 (Reference Number: 2008-20-173), September 10, 2008. GAO Report: Information Security: IRS Needs to Continue to Address Significant Weaknesses (GAO-10-355), March 2010 ("GAO 2010 Information Security Report").

[83] GAO 2010 Information Security Report, Highlights.

[84] TIGTA Report: Additional Security is Needed for Access to the Registered User Portal (Ref. No. 2010-20-027), March 31, 2010, reported certain security-related issues with the Registered User Portal, which is the access point for IRS' e-Services suite of products. ETAAC believes that the identified problems are correctable with relatively modest effort by IRS.

share common authentication standards to the maximum extent possible. IRS should take a leadership position in creating consistent, universal e-authentication standards (policy and otherwise) that can be adopted by states.[85] Seamless electronic tax administration will be seriously hindered if we arrive at an end state of "fifty-one" different federal and state e-authentication standards and solutions.

IRS is making initial progress in this area with the development of its new Authentication Strategy. However, ETAAC understands that determining a robust, long term e-authentication solution is a challenging and sensitive undertaking that requires careful investigation and consideration. One of the biggest challenges appears to be *identity proofing.*[86] In pursuing its investigation, ETAAC encourages IRS to consider a variety of creative, but effective, approaches and solutions. For example, IRS could investigate using bank-issued credit and debit cards as a method for Identity Proofing. Such a solution might be implemented more quickly by using existing Payment Card Industry (PCI) capabilities. Similarly, IRS might investigate the approaches being taken by other federal agencies for an identity proofing approach. The IRS could also solicit industry and research institutions to suggest innovative, new approaches to this problem, or even use a public contest similar to the National Cybersecurity Awareness Campaign Challenge being conducted by the Department of Homeland Security.

However, in the short term, there may be opportunities to make existing authentication mechanisms easier for taxpayers without risking improper access to their information.[87] The harder it is for a taxpayer to use an online service, the less likely the service will be used and the more likely the taxpayer will just pick up the phone and call IRS.

First, ETAAC believes that taxpayers could benefit from having a single, consistent set of information required to access IRS online applications, where the nature of that information is sufficiently "secure" to prevent improper taxpayer access. For example, the authentication data IRS requires currently differ not only between services (such as between "*Where's My Refund*" and "*Did I receive a 2009 Economic Recovery Payment*?"), but also within the same service depending on whether the user is requesting the information over the automated phone service or online at www.irs.gov (such as the Electronic Filing PIN).

Certainly, the nature of some services could account for differences in the amount or character of data required to access and use them. On the other hand, it seems that IRS services could require the same authentication information for taxpayers, irrespective of whether the request is originated by telephone or over the Internet.

Second, IRS should also consider other authentication models, such as enabling taxpayers to obtain a single dedicated "customer number" that could be used to access <u>any</u> IRS online services along with a

[85] OMB has issued guidance on the implementation of e-authentication solutions in federal agencies. See *E-Authentication Guidance for Federal Agencies*, OMB Memorandum M-04-04, December 16, 2003.

[86] Identity Proofing is the process of providing sufficient information (e.g., identity history, credentials, documents) to a Personal Identity Verification (PIV) Registrar when attempting to establish an identity. A PIV Registrar is an entity that establishes and vouches for the identity of an Applicant to a PIV Issuer. The PIV Registrar authenticates the Applicant's identity by checking identity source documents and identity proofing, and ensures a proper background check has been completed, before the credential is issued. Personal Identity Verification (PIV) of Federal Employees and Contractors, Computer Security Division, Information Technology Laboratory National Institute of Standards and Technology (FIPS PUB 201-1, Change Notice 1), March 2006.

[87] "Ease" must be considered "end-to-end" – it includes the ability to understand what data is being requested (for example, many taxpayers do not understand the term *adjusted gross income*), the amount of data required, the time it takes to retrieve any required data, and the ease with which it can be entered. Each step creates complexity and, therefore, is a potential barrier to taxpayer usage.

self-assigned password or social security number. The issuance of that customer number would require the "one-time" use of personal information sufficient to provide high confidence that the person requesting that information is, in fact, the taxpayer. For example, the California Franchise Tax Board (FTB) enables taxpayers to obtain a "Customer Service Number" (CSN), which is effective for one year. CSN issuance requires the taxpayer to provide his or her SSN, last name and prior year AGI as the "shared secrets." Then, the taxpayer uses the combination of the taxpayer's CSN and SSN to ensure confidential and secure access to personal tax information available through FTB online services. The method of obtaining the CSN is similar to how a taxpayer obtains the federal Electronic Filing PIN, but the CSN supports the uses of a broader range of online applications.

e-Signatures

As with e-authentication, IRS should take a leadership position in creating consistent, universal e-signature standards (policy and otherwise) that can be adopted by states. Additionally, rather than starting fresh, IRS should gain insights to the maximum extent possible from other federal and state initiatives and guidance.[88] As ETAAC noted in its 2009 Report, an easy, consistent and secure e-signature solution is critical to the expansion of e-filing and development of online services. The existence of multiple federal (e.g., Self-Select PIN) and state signature solutions creates barriers to seamless electronic tax administration, and drives taxpayer contacts to IRS, state revenue agencies and industry -- at considerable cost.

KSI 3: THE ELECTRONIC EXPERIENCE IS EASY AND FAST.

8. INFORMATION REPORTING: RECOMMENDATION FOR IRS

IRS must evaluate its readiness and invest in the resources and systems required to handle a significant increase in electronically filed information returns required under recently passed federal legislation.

Any proposals to accelerate information reporting must fully consider the impact of acceleration on both businesses, especially small businesses that have limited resources, and taxpayers.

ETAAC ASSESSMENT

Increased Information Reporting

Information reporting represents a significant and growing source of returns that should be filed electronically with IRS. The recently enacted Patient Protection and Affordable Care Act ("Act") contained significant changes to 1099 information reporting obligations, including revenue raising provisions designed to drive greater tax compliance by increasing 1099 information reporting under the threat of increased penalties. Specifically, for payments made after December 31, 2011, companies will be required to furnish and file an information return for payments made to all for-profit companies regardless of corporate status. In addition, all payments for goods, materials, merchandise, supplies, and other property may need to be reported as well. Indications suggest that these changes will likely cause the 1099 reporting volume to increase significantly for most companies, as well as their associated B-Notices. Although the new requirements apply to payments made after December 31, 2011, affected filers will need to start making expensive changes, including implementing broadened W-9 solicitation

[88] For example, OMB has issued guidance on the implementation of e-signature solutions in federal agencies. See *Implementing the Electronic Signatures in Global and National Commerce Act*, OMB Memorandum M-00-15, September 25, 2000, and *Electronic Signatures: How to Mitigate the Risk of Commercial Managed Services*, OMB Memorandum M-05-05, December 20, 2004.

procedures, preparing for increased 1099 year-end printing, mailing, and filing obligations, and making necessary changes to their systems and processes to meet these new requirements. ETAAC also believes this situation raises serious questions about the ability of the FIRE system[89] to handle both increased electronic submissions, as well as increased company sign-ups.

Accelerated Information Reporting

On top of these new information reporting requirements, some stakeholders have called for accelerating existing reporting requirements. For example, the National Taxpayer Advocate has recommended that Congress direct the Treasury Department to study and report back on the administrative and legislative steps that would be required to enable the IRS to receive and process information reporting documents before IRS processes tax returns and issues refunds.[90] The perceived benefits of acceleration include a reduction in inadvertent taxpayer over-claims, the avoidance of fraudulent returns, enhanced benefits delivery, and the availability of reporting information to taxpayers whether for import into commercial software or to enable IRS' creation of "pre-populated" tax returns.

ETAAC Concerns – Increased Burden for Multiple Stakeholders

ETAAC has serious concerns about the challenges for all stakeholders of both significantly increasing the volume of electronically filed information returns while, potentially, significantly accelerating those reporting obligations.

First, the IRS must consider the effects of these new reporting requirements on paper filers that were originally under the 250 electronic filing requirement, and will now cross that threshold for the first time.

Second, the IRS must ensure that information return electronic filing and registration systems will be able to handle the additional volume. IRS must build and deliver the systems and processes so that it is ready to receive and process the huge volumes of new information returns called for under the Housing and Economic Recovery Act of 2008, where merchant acquiring banks and others will be required to report credit card and other electronic transactions beginning in 2011, as well as under the Patient Protection and Affordable Care Act.

Finally, the impact of new and accelerated information return processing would have a significant effect on both large and small companies alike. As it currently stands, many companies already struggle to meet the deadlines for processing and electronically filing these forms, and that burden is most sharply felt in small business (which will almost certainly not have dedicated, trained staff in this area). Shortening the information reporting timeframe will increase the strain on business resources, as well as on taxpayers, for several reasons:

- It will increase the amount of required reporting while shortening the reporting timeframe, which means most companies will be required to do more with the same resources.
- It will shorten the reporting timeframe, which will reduce the quality of information being reported to the IRS. Companies will have little or no time to receive feedback from their 1099 and W-2 recipients as to the form's accuracy, which will result in a larger number of inaccurate forms being filed with IRS.

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[89] The FIRE (Filing Information Returns Electronically) system is set up for financial institutions and others to file Forms 1042-S, 1098, 1099, 3921, 3922, 5498, 8027 and W-2G.

[90] Testimony of National Taxpayer Advocate Nina Olson before Senate Finance Committee April 15, 2010. See http://finance.senate.gov/imo/media/doc/041510notest1.pdf

- Once filed, any errors in information reports will result in more corrections being sent to the IRS for processing. Currently, companies can simply make changes to their records before the forms are filed. The introduction of accelerated reporting will require companies to have systems in place to process a large number of the more complicated IRS corrections that need to be filed. In turn, IRS will need increased staff, resources and systems to handle these corrections.
- Payee (taxpayer) burden and anxiety will increase because of incorrect information reports being filed with IRS. Prior to any acceleration, the majority of corrections would have been made before companies had filed with the IRS.
- Companies can be penalized for inaccurate information returns, including up to a $50 penalty (possibly $100/form) for each form filed incorrectly. The increased error rate could translate into a significant increase in financial penalties for companies, more likely smaller companies with limited staffing resources to handle their new obligations.
- The "pre-population" of returns based on incorrect information reporting will result in inaccurate tax returns that will lead to a larger number of amended tax returns needing to be filed with the additional associated burden that brings to both the taxpayer and the IRS.

9. ELECTRONIC FILING REJECT REDUCTION: RECOMMENDATION FOR IRS

Reduce the number of unnecessary common rejects by (i) implementing a permanent operational process to identify, review and track actions to reduce e-file rejects, and (ii) providing a tool that enables the validation of selected taxpayer identification information prior to electronic filing.

ETAAC ASSESSMENT

In its 2009 Report, ETAAC recommended that "*The IRS should establish a permanent operational process to review and improve its current e-filing practices and procedures with respect to 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. As we suggested last year, those actions include:

- Thoroughly reviewing new reject codes and utilizing the software community to test criteria and provide feedback,
- Defining escalation procedures for reporting and resolution to critical errors, especially during filing season,
- Ongoing analysis for the right degree of parity between paper and e-filed returns, and
- Providing a communication portal for stakeholders on issues, potential timelines for resolution and actual resolution.

Consistent with the views expressed in ETAAC's 2009 Report, GAO reported that "*IRS has the opportunity to improve service to millions of taxpayers and reduce its own costs by reducing electronic filing rejects and providing more automated services*."[91] 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. Significantly, out of the 600 possible error codes, GAO reported that only *fifteen* error codes accounted for *85 percent* of those received by taxpayers.[92]

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

[92] GAO 2010 Filing Season Report, Appendix II: Most Common Error Reject Codes in the 2009 Filing Season.

ETAAC acknowledges that IRS ETA has been working with the e-Submissions branch to implement a strategy to prevent and resolve errors causing rejects, which includes working with industry stakeholders to develop an action plan. However, based on the GAO insights, ETAAC continues to believe that attacking the underlying errors related to a narrow population of reject codes (or even a subset of them) could have a significant improvement in "first time" success of electronic filing. In evaluating the situation, ETAAC believes that the reject codes identified by GAO can broadly be categorized as follows:

- Taxpayer mismatching of data (for example, name spelling with IRS files or SSA records)[93]
- Previously-submitted taxpayer or dependent data, e.g., dependent Social Security Number[94]
- Other taxpayer mismatching of data (for example, prior-year PIN does not match)[95]

These common rejects could be reduced by providing self-assist options to preparers (or taxpayers using their own tax software) that enable the validation of selected information prior to electronic filing. Using an Application Programming Interface (API), ETAAC envisions that IRS could enable a preparer or taxpayer to have secure, online access to selected taxpayer data in an IRS data validation database. The system could be designed to limit the transmission of sensitive personally identifiable tax return information and, instead, issue only "binary" results associated with an error indication. If the validation were successful, the return could be electronically filed knowing that, at a minimum, some of the most common filing errors have been avoided. On the other hand, if the validation were unsuccessful, the professional and/or taxpayer could correct or confirm any relevant information before the return is resubmitted.

The IRS is currently utilizing a similar validation process within the Taxpayer Identification Number (TIN) matching program. IRS recognized a need for independent verification of select taxpayer information and the benefits from data authentication early in the tax process through the TIN matching process. TIN Matching is part of a suite of Internet-based pre-filing online services that allow "authorized payers" the opportunity to match 1099 payee information against IRS records prior to filing information returns. This process prevents many difficulties that would otherwise arise due to mismatched taxpayer data

ETAAC believes providing comparable verification functionality would provide several benefits, including:

- Avoiding or reducing the most common errors triggering 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.

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[93] Reject Codes 0500, 0501, 0502, 0503, 0504 - information on submitted tax return does not match IRS and/or SSA data in some fashion.

[94] Reject Codes 0506, 0507, 0510, 0515 - information on submitted tax return was already used on a previous filing in some fashion.

[95] Reject Codes 0522, 0523, 0535, 0680, - information on submitted tax return does not match other data within IRS system in some fashion.