

Electronic Tax Administration Advisory Committee

ANNUAL REPORT TO CONGRESS

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ETAAC ANNUAL REPORT TO CONGRESS, 2009

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ETAAC'S PURPOSE AND RESPONSIBILITIES

The Restructuring and Reform Act of 1998 (RRA 98) authorized the Electronic Tax Administration Advisory Committee (ETAAC) with the primary duty to provide feedback to the Internal Revenue Service (IRS) on electronic tax administration. As an ongoing public forum, ETAAC's responsibilities involve researching, analyzing and making recommendations on a wide range of electronic tax administration issues including the IRS' strategic plan, and progress thereon, for the electronic filing (e-filing) of tax and information returns.

RRA 98 requires that ETAAC annually report to Congress on the:

- (1) IRS' progress in meeting the goal to receive electronically 80% of tax and information returns;**
- (2) Status of the IRS' e-filing strategic plan;**
- (3) Legislative changes that would assist the IRS in meeting the 80% goal; and,**
- (4) Effects e-filing tax and information returns would have on small businesses and the self-employed.**

The IRS Oversight Board (Board), also established via RRA 98, has among its duties a similar 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' e-filing progress.

2009 ETAAC MEMBERS



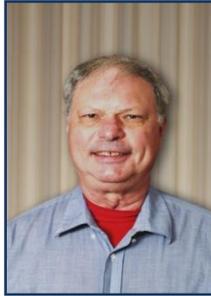
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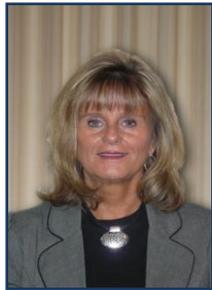
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EXECUTIVE SUMMARY

Summary of 2008/2009 Progress and Accomplishments

The IRS made significant progress increasing the e-file rate for individual returns, particularly in do-it-yourself online filing. Through the end of the 2009 primary filing season, this segment grew by 19% over the 2008 season. Preparer e-filed returns, on the other hand, were down by just less than one percent.

Strong gains are estimated for the 2009 calendar year for business e-file, while minimal gains are anticipated for employment returns, 1099-MISC returns and fiduciary returns. The 2009 calendar year overall e-file rate for all major form types is estimated at 59%. To reach the 80% goal, an estimated 57 million additional returns would need to be e-filed, including 16 million individual returns.

The IRS has also made progress in establishing the foundation to develop a new e-strategy. Principally, the Advancing e-file Study and progress towards an over-arching Enterprise E-Strategy indicate that the IRS is on the right path. In this report, ETAAC provides what it believes is a necessary framework to further an effective “electronic IRS”.

ETAAC’s 2008/2009 Recommendations

ETAAC is making ten recommendations in this 2008/2009 report to Congress that we believe are critical to achieving the Congressionally-mandated 80% electronic filing target. These recommendations focus on developing an electronic IRS whose services are strategically supported and trusted and are fast and easy to use. Public comments may be submitted to ETAAC@irs.gov.

In summary, the recommendations are:

1. Congress should enable the IRS to require preparers to e-file.

The single biggest opportunity to advance the 80% goal lies with a tax preparer requirement. ETAAC recommends that Congress provides the IRS with the authority to require an appropriate return threshold. And that the IRS starts with a threshold of 200 returns, which could result in 16 million additional e-filed returns. ETAAC proposes that implementation dovetail with the completion of Modernized e-file (MeF) for Form 1040.

2. Congress should fund, and the IRS should complete, the “four pillars” of its Modernization Program.

The IRS’ four priority modernization projects are not only critical to a better IRS but are the foundation for subsequent e-projects. The significant management capacity now devoted to managing these projects limits the IRS’ ability to take on significant new projects such as the advancement of the IRS’ e-strategy.

3. The Data Strategy project should be comprehensive.

The IRS should consider broadening its ongoing data strategy project to include national data standards to improve tax administration with the states and other stakeholders. Common functions such as authentication, e-signatures, data definitions and data interchange would benefit from a more standardized, national approach.

- 4. The IRS should modernize preparer e-services.**
Tax preparers represent the largest conduit for e-filed returns. They have long-established needs for electronic interaction with the IRS. The expansion and effectiveness of e-services should be supported as a strategic priority.
 - 5. The Electronic Services Strategy should be an enterprise priority.**
The right electronic services and products cannot be developed without holistic enterprise support and governance.
 - 6. The IRS and industry should collaborate on tax software standards.**
Taxpayers need to be protected by effective and efficiently administered standards. The IRS and industry should work closely to develop an effective, efficient oversight model that ensures software accuracy, security, privacy and reliability.
 - 7. The IRS should rebrand e-file.**
It has been more than 15 years since e-file was introduced at the national and state levels. Marketing objectives need to be reevaluated and emphasis given to taxpayer demographics that present the greatest opportunity to increase e-file.
 - 8. The IRS should develop an operational process for e-file rejects.** The e-file reject process can act as a deterrent to e-file for taxpayers and tax preparers. The IRS should work with industry to develop an efficient process for communicating, reducing and resolving reject issues.
 - 9. The IRS should renew the Free File Alliance agreement.**
The Free File Program is a basic entry point to the important, and quickly evolving, free e-file market. This contract renewal year presents an opportunity to continue the IRS' trend of making the program easier to use and understand.
 - 10. The IRS should ease the signature burden for information return sharing.**
The IRS currently requires signed taxpayer consent before it will share an information return with the appropriate state. ETAAC believes that existing federal/state data sharing agreements already permit this for e-filing and that the paper-based barrier should therefore be removed.
-

I. E-FILING PROGRESS

Since Congress established the 80% e-file goal ten years ago, ETAAC and the Board have advanced more than 100 recommendations for increasing e-file rates to the IRS and Congress. In working to meet the goal and in response to many of the recommendations, the IRS has invested significant effort and funding to move away from its historically entrenched paper-based environment.

Since 1998 the percentage of tax and information returns e-filed has grown substantially. Tens of millions of returns have been converted from paper to e-filing over this short ten-year period. For example, the e-file rate for the Form 1040 return has increased from 20% in 1998 to 69% as of the end of the 2009 primary filing season. Close behind, Form 1099-MISC has reached the 62% mark, with more than 52 million e-filed returns in 2008.

The IRS' efforts benefited from an explosion in global Internet commerce, related cultural shifts where citizens now expect to conduct business and personal matters electronically, and actions by state departments of revenue¹. In the past ten years the world surpassed the first "one billion user" mark for Internet access. Various studies predict reaching the second billion mark by 2015. This shift has translated into exponential growth in use of the IRS website with access doubling to more than 200 million visits in a span of just a few years.

Despite the accelerating shift in the global mindset toward electronic or "e" business, millions of taxpayers, tax preparers and stakeholders are not conducting their tax-related business electronically. In fact, the IRS' ongoing Advancing e-file Study suggests that the high e-file adoption rate experienced over the last decade is now reaching a point of diminishing returns; paper-return filers are switching to e-file at a slower pace.

As the Board has confirmed, the IRS is a number of years away from attaining the 80% e-file rate. For all major form types that are subject to the goal, the IRS is estimated to end the 2009 calendar year at approximately 59%, a few percentage points higher than 2008, with the business e-file return types (Forms 1120 and 1065) showing the greatest gains.

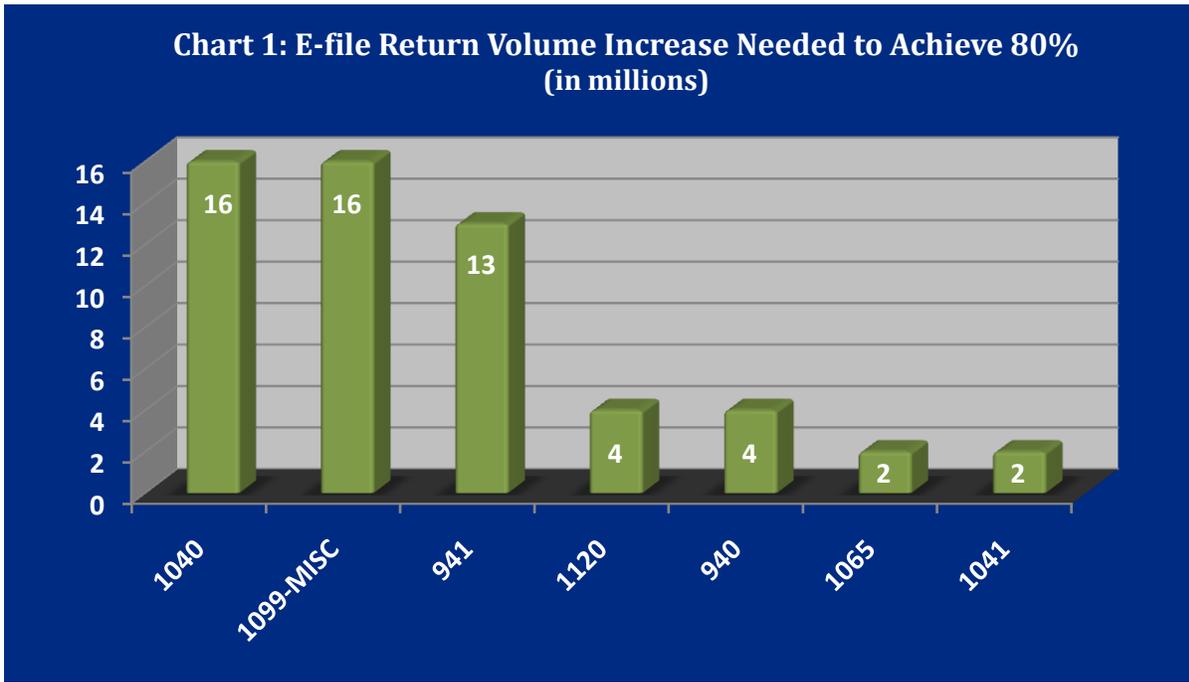
Closing the remaining 21 percentage point gap may represent the IRS' stiffest challenge yet.

To keep the vision and related emphasis centered, the Board has recommended extending the goal from its original 2007 target to 2012. Nonetheless, given the anticipated slow-down in e-file growth rates, closing the remaining 21 percentage point gap needed to achieve 80% may represent the IRS' stiffest e-file challenge yet. Notwithstanding this challenge, the IRS has achieved incremental e-file growth year-over-year and, through a fresh strategy, can position itself to further both the 80% goal and its electronic agenda.

Following are tables and charts depicting e-file highlights for the 2009 calendar year. Table 1 depicts the seven most significant tax and information return components of the 80% e-file goal. Chart 1 presents the number of additional returns (by category) that would have to be e-filed to meet the 80% goal. The gap is estimated to be approximately 57 million total returns, led by the Form 1040 and Form 1099-MISC with a 16 million e-filed return gap each.

¹ Successful implementation of state-level preparer e-file mandates for individual returns have contributed significantly to the e-file growth rate.

Table 1				
Estimated e-file Rate for Major Return Types²				
2009 CY				
(in millions)				
FORM	PAPER	E-File	TOTAL	PERCENTAGE OF TOTAL
1040	44	98	142 ³	69%
1099-MISC (partial mandate)	33	53	86	62%
941	18	5	23	22%
1120 (partial mandate)	5	2	7	27%
940	5	1	6	19%
1065 (partial mandate)	3	1	4	25%
1041	2	1	3	33%
TOTAL	110	161	271	59%



² Source: IRS Document 6186 – 2008 Update

³ Research, Analysis, and Statistics Tracking Report (RAS) update as of May 1, 2009.

There are other points of progress. For example, a strong pattern of e-file growth by self-preparers continues. The number of total do-it-yourself or “online” e-file returns increased 19% during the 2009 primary filing season. This year-over-year growth was boosted by a robust do-it-yourself e-file market, principally fueled by more free e-file offers outside of the Free File Alliance and the discontinuance of the e-file fee for desktop products.

Further notable points for the 2009 filing season and calendar year estimates are set out below.

Table 2		
2009 Filing Season⁴		
	YOY Volume Change⁵	YOY Growth %
Returns Processed Through CADE	+6,800,000	+26%
EFTPS Payments	+481,000	+1.5%
Website Visits	+27,000,000	+16%
Form 1040 Preparer e-filed Returns	-78,000	-0.1%
Form 1040 Online e-filed Returns	+4,900,000	+19%
Form 1040 Free File Alliance	-1,400,000	-31%
2009 Calendar Year Estimate⁶		
	YOY e-file Volume Change	YOY Growth %
Form 1120/1120S	+569,000	+43%
Form 1065	+212,000	+31%
Form 941	+119,000	+2%
Form 940	+63,000	+5%
Form 1099-MISC	+663,000	+1%
Form 1041	+25,000	+3%

⁴ IRS: Actual through April 15, 2008 and April 15, 2009

⁵ Caution should be given to YOY e-file changes due to unknown volume increases in 2008 attributable to economic stimulus returns that were not otherwise required to be filed during the 2009 filing season.

⁶ Source: IRS Document 6186 – 2008 Update
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II. ELECTRONIC TAX ADMINISTRATION STRATEGIC PLAN STATUS

Over the past year the IRS has undertaken two projects that will provide an excellent foundation for a fresh e-strategy: the Advancing e-file Study (Study) and the Enterprise E-Strategy project. Recommendations from the Study will be used in completing the Enterprise E-Strategy.

The Study, started in 2008, is an extensive analysis of (a) the IRS' current state of e-filing, (b) opportunities and alternatives for improvement, and (c) recommendations to achieve the 80% e-file goal. The Enterprise E-Strategy project focus includes (i) expanding the e-projects portfolio, (ii) identifying and developing common Web services that can be leveraged across all e-services, (iii) developing Web and data infrastructure to support the e-services portfolio, (iv) establishing governance to assess and prioritize e-services across the enterprise, and (v) applying standards and tools to ensure enterprise consistency in development and support.

Phase I of the Study was completed in September, 2008 and documented the many different factors in today's e-file environment– taxpayer behavior towards e-file, emerging practitioner and software developer roles and states' and other countries' approaches to e-file. Phase I confirmed that converting the remaining paper filers into e-filers will not be easy and that technology solutions are secondary to motivating taxpayer behavior. Also, the IRS must continue to rely on third party partners.⁷

The Advancing e-file Study is a critical step toward an effective e-strategy.

The rest of the Study will involve extensive research on options to increase e-filing focusing on the benefits, costs, feasibility of defined options, and strategy for meeting the 80% goal. The Study is estimated to be completed during the Fall of 2009. The Enterprise E-Strategy is subsequently scheduled to be complete by late 2009.

ETAAC supports the Study and commends the IRS for initiating such an extensive analysis. Assuming the quality of Phase I stays constant through the end of the project, the IRS will be in a good position to frame an effective approach to meet the 80% e-file goal.

In addition, the IRS has recently completed its IRS Strategic Plan 2009 - 2013. Central to the plan is the goal to improve services that will enable voluntary taxpayer compliance. The plan also includes a number of important strategic objectives that resonate throughout this report such as understanding taxpayer perspectives, improving processes and data flow, establishing third-party standards, and providing partners with the tools and information they need.

The IRS has approached its planning for electronic tax administration with seriousness and care. ETAAC is committed to supporting this process at both the tactical and strategic levels. Accordingly, the balance of this report outlines a suggested framework and recommendations to both advance the 80% e-file goal and, at a strategic level, move toward the vision of a holistic electronic interaction relationship between and among taxpayers, tax preparers, tax administrators, and the IRS.

⁷ Advancing E-File Study, Phase I Report, September 30, 2008, page 1
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III. E-STRATEGY FRAMEWORK

Progress toward the 80% e-file goal has historically been the major measuring stick for electronic tax administration success. Viewed at a strategic level, however, e-file growth in fact represents an important yet tactical *entry point* for creating and supporting a more robust electronic relationship between and among taxpayers, tax preparers and tax administrators.⁸

Pressure on the IRS to grow electronic interaction, finish modernization projects, and provide better customer service through technological innovation is very high.

The IRS is at a cross-road in electronic tax administration. Sustaining e-file growth in the face of tight budgets, limited management capacity, and related system constraints will be a major challenge. In the current economy, funding for both existing and new projects will be scarce for some time to come. Moreover, the information technology complexities associated with the largest tax administration function in the world are not conducive to quick implementation of new customer-driven technology solutions without extraordinary costs.

Establishing a comprehensive electronic IRS over the coming years is critical. E-file has largely been the entry point for taxpayers to interact electronically with the IRS and with government as a whole. However, electronic interaction beyond e-file is limited. While taxpayers and practitioners can pay electronically, deposit refunds electronically, check the status of refunds, and, if a tax preparer, gain access to certain taxpayer account information, a fuller array of electronic services defined by taxpayer demand is not available. The opportunity to understand needs and create a related interactive electronic experience beyond e-file is timely and has been a focus of past ETAAC recommendations.

Opportunity to shape a long-lasting, effective and interactive e-environment is timely.

To assist the IRS in developing its Enterprise E-Strategy – not just for e-file but for the next generation of electronic stakeholder interaction - ETAAC suggests a framework for establishing business objectives and related strategies. The framework also provides suggestions to meet the 80% e-file goal as quickly as possible.

⁸ Terms such as “electronic interaction”, “electronic experience”, “electronic IRS”, or “e-enabled” are used throughout the report. They are interchangeable and refer to any electronic interaction with the IRS whether e-filing, e-paying, electronically sharing data, using Web-based electronic services, etc.

A. Business Objectives

ETAAC fully embraces the foundational electronic tax administration vision articulated by the Board in its January 2009 Annual Report to Congress:

“The electronic filing of tax returns is part of a broader range of electronic tax administration (ETA) activities which are the foundation for a modernized Internal Revenue Service (IRS) that provides secure, convenient, timely and accurate services to taxpayers and tax professionals and the IRS employees who serve them. The full vision for ETA is to make electronic interactions among taxpayers, tax practitioners, and the IRS the norm. It remains the means by which the IRS can evolve into a truly modern organization that can deliver world-class quality and service.”

The tax administration ecosystem includes diverse stakeholders - taxpayers, tax preparers, tax software providers and tax administrators. Like the Board, ETAAC envisions a future where a range of electronic services enables an interactive, accurate, and efficient relationship for all stakeholders and supports taxpayer self-compliance, the cornerstone of tax administration in the United States.

ETAAC believes that electronic services should support the following business objectives in an effective, e-enabled tax administration system:

<u>Table 3</u>
Business Objectives for Electronic Experience
1. Electronic filing and services are fully maximized.
2. The customer service needs of increasingly diverse taxpayers and tax preparers are fully addressed and understood.
3. The IRS and the tax preparation industry are full partners in reducing taxpayer burden in tax preparation, filing and paying.
4. Tax return processing and data collection are accurate and efficient.
5. Confidential taxpayer data is secure and private.
6. Tax data is shared in a controlled process among tax administrators and other stakeholders solely for the purposes of tax return preparation, processing, research, and compliance.

B. Key Success Indicators

ETAAC's recommendations are centered on three key success indicators that are critical to a fully enabled, effective and electronically interactive IRS. Meeting the three success indicators will help

The electronic experience should be the clearly right choice compared with paper and manual alternatives.

create an electronic environment in which (a) stakeholders resoundingly confirm that "the electronic experience is clearly the right choice" compared with paper and manual process alternatives, and (b) the IRS and Congress make the best, cost-beneficial decisions driven by customer and business need.

The Key Success Indicators (KSIs) are set forth in the following Table 4. Within each KSI are listed the outcomes that support the respective KSI.

Table 4

Key Success Indicators for Electronic Experience with IRS

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

1. Strategic direction is current and clear.
2. Necessary funding is provided to implement the strategic priorities.
3. Statutory and regulatory authority support and enable the strategic priorities.
4. IRS culture and actions demonstrate that successful end-to-end taxpayer experience is a top priority.

KSI 2 The electronic experience is trusted.

The IRS stakeholders -

1. Understand how the electronic interaction works;
2. Understand the benefits;
3. Know their electronic interaction is secure;
4. Know their privacy is protected; and,
5. Trust in the integrity of the end-to-end electronic experience.

KSI 3 The electronic experience is easy and fast.

1. End-to-end experience reflects the customer perspective and enables integrated services.
2. The electronic experience is significantly easier than the alternative experience.
3. Operational and compliance requirements are constantly balanced with ease-of-use.
4. Access and transaction speed mirrors best practices.
5. Resolution of problems or errors is expeditious.
6. Electronic information sharing and support services are timely.

C. Summary of Recommendations and Timeframes

Because ETAAC believes a fully e-enabled IRS is critical both to meeting the e-file goal and to being a world class tax administration agency, the majority of recommendations have a short-term horizon for implementation – one to three years. However, Recommendations 2 and 3 encompass implementing core business strategies and technology solutions which may necessitate a longer five year horizon. In addition, while all recommendations require IRS action, only Recommendations 1, 2 and 3 require action by Congress.

Table 5 summarizes the recommendations by time horizon and accountability.

Table 5				
ETAAC Recommendations Summary				
No.	Short-term	Long-term	Responsibility of Congress	Responsibility of IRS
1	■		Grant IRS authority to require tax preparers to e-file individual returns.	Establish preparer e-file requirement at 200 returns.
2		■	Fund and support the four pillars of modernization projects.	Complete the four pillars of modernization projects on schedule.
3		■	Support funding, as needed, for a broader Data Strategy project.	Expand Data Project plans to address national data standards.
4	■		Support funding, as needed, for improvements to e-Services.	Modernize e-Services for tax preparers.
5	■			Support e-strategy as an enterprise priority.
6	■			Collaborate to develop standards for tax preparation software.
7	■			Rebrand e-file marketing.
8	■			Develop an operational process for mitigating e-file rejects.
9	■			Renew Free File Alliance contract and seek improvements.
10	■			Eliminate paper waiver requirements for information return sharing.

1. Recommendation for Congress and the IRS

Congress should amend Internal Revenue Code Section 6001(e) to grant the IRS authority to require tax preparers to e-file individual, estate and trust tax returns.

The IRS should create a strategy to implement a Form 1040 e-file requirement for tax preparers who meet defined thresholds, specifically for those who file more than 200 individual, estate and trust returns, with a lower threshold possibly in the future.

ETAAC believes that the 80% e-file goal will not be reached in the near future without some level of practitioner-focused e-file requirement for Form 1040 individual returns. While the 80% goal covers all return types, the Form 1040 has the greatest potential to advance the goal significantly and, accordingly, should receive priority attention.

A 200-return requirement would move the e-file needle further than any effort to reach the 80% goal.

ETAAC's recommendation for e-filing requirements centers only on preparer-level individual returns. Success at the state level shows that preparer-level requirements can be established with minimal stakeholder burden. Nineteen states currently require some degree of preparer-based e-file requirements representing both large states with significant metropolitan centers and small, more rural, states⁹. Regardless of demographic characteristics, each successful implementation built on the experience of predecessor states. Thus, the IRS can draw from a wealth of experience in defining and implementing preparer requirements.

In its 2008 Report to Congress, ETAAC recommended that the threshold for imposing a practitioner e-filing requirement be the filing of 50 Form 1040 returns. After further review of preparer burden, return volumes associated with various preparer levels, and available cost savings data, ETAAC now believes that a threshold set at 200 returns would achieve significant savings while avoiding the imposition of undue burdens on small preparer offices¹⁰. Such an e-file threshold would result in approximately 16 million additional Form 1040 returns transmitted via e-file, saving approximately \$40 million in IRS manual paper processing costs. It would also push the Form 1040 e-file volume from today's 69% level to approximately 80% and move the overall e-file needle from 59% to 65%.

In establishing an e-file requirement, the IRS should consider:

- ***Implementation Timeframe***

If legislation enabling the IRS to require tax preparers to e-file was passed by June, 2010 and the IRS required e-file to be effective for returns required to be filed after December 31,

⁹ A threshold has been established at as few as 25 returns (New Mexico) and as high as 200 returns (Michigan).

¹⁰ Per General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals, Treasury Department, May 2009, the Administration is proposing a 100-return threshold for tax preparers, for tax returns required to be filed after December 31, 2010.

2011, stakeholders would have sufficient time to implement. The effective date would also coincide with scheduled completion of the 1040 MeF project.

- ***State Thresholds***

The IRS requirement should not supersede any existing state e-file requirements for threshold amounts. If a state has a lower threshold, that threshold should continue to apply.

- ***Penalties and Opt-Out Provisions***

To have the needed clout, the IRS should have the authority to implement penalties for those practitioners who do not comply with the e-file requirement. However, penalties might be waived in the first transition year and for good cause thereafter. Opt-out provisions should be considered for any taxpayer client who does not wish to e-file and for any preparer who can demonstrate a hardship to comply.

- ***E-file Working Group***

The IRS should create an IRS/Industry Practitioner 1040 e-file Working Group (i.e. tax preparer and tax software/transmitter representation) to provide input in developing, implementing, and communicating a roll out plan for the Form 1040 e-file requirement. The plan should be completed by January 2011 and should specify low volume forms to be excluded from the e-file requirement.

- ***Communication and Education***

The roll out plan should include a communication and education plan to help those who will need to assimilate the requirement into their businesses. The communication and education plan should involve every component of the e-file stakeholder spectrum and exploit appropriate communication and outreach channels. In addition to face-to-face interaction in public forums, these might include self-help tutorials that assist tax preparers in getting started with their applications, understanding their responsibilities and integrating e-file into their business models.

2. Recommendation for Congress and the IRS

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

The four multi-year projects that make up the Modernization Program are the foundation of a robust electronic experience for taxpayers, tax professionals and tax administrators. As the IRS and oversight entities have acknowledged, “[s]uccessful implementation of these four ‘pillars’ is essential to the support of all tax administration activities and is critical to the long-term success of the Modernization Program.”¹¹

The four pillars and how they support the Modernization Program are:

¹¹ “Implementing the Data Strategy Will Make System and Application Development More Efficient and Effective,” Report of the Treasury Inspector General for Tax Administration, February 19, 2009, Reference Number: 2009-20-022, page 1.

- **Modernized e-file (MeF)** – provides a more efficient and flexible platform for electronic filing that will enable the IRS to deliver better service for internal and external customers and stakeholders.
- **Customer Account Data Engine (CADE)** - replaces the IRS Individual Master File, the IRS’ venerable but cumbersome 1970s-era database that serves as the official repository of individual taxpayer information, and will provide faster return processing and postings.
- **Account Management Services (AMS)** - modernizes how the IRS manages taxpayer account information, enabling service enhancements such as real-time access and data management.
- **Data Strategy** – establishes a comprehensive plan for data collection, consolidation, storage and distribution.

The IRS has limited management capacity to oversee complex system projects beyond the

The Four Pillars must be completed to free up management capacity for e-Projects.

completion of these four projects. In fact, IRS’ current management capacity to complete even these critical four projects is severely tested. General Accountability Office (GAO)¹² and Treasury Inspector General for Tax Administration (TIGTA)¹³ reports have identified IRS systems modernization as an area of risk and vulnerability. The

Board’s most recent annual report found system modernization to be one of two “systemic weaknesses” at IRS. The report also stated, “It is time for the IRS, the Administration, and Congress to agree upon a plan to complete the IRS’ program of technology modernization and transition to a program that allows for steady evolutionary management of its technology systems.”

In sum, ETAAC agrees that the four pillars projects must be completed before IRS management resources can be freed up to manage and implement other projects that advance the strategic agenda for electronic services.

3. Recommendation for Congress and the IRS

Congress and the IRS should support the Data Strategy project - both as a catalyst and as an opportunity to develop a truly comprehensive data strategy that enables a robust electronic tax administration experience.

The Data Strategy will be a comprehensive plan for data collection, consolidation, storage and distribution. This modest description belies the project’s criticality and potential implications for the future of tax administration.

Serving well over a hundred million taxpayers, the IRS is one of the world’s largest and most complex managers of electronic information or data. Virtually every tax administration function involves data management. The continuing absence of an effective data strategy – the infrastructure, roadmap and rule book of data management - will hobble and ultimately block

¹² GAO report: Business Systems Modernization: Internal Revenue Service’s Fiscal Year 2009 Expenditure Plan, March 2009 (GAO-09-281).

¹³ TIGTA memo to Treasury Secretary Paulson, Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2009, October 15, 2008.

the IRS' efforts to modernize and deliver enhanced services to taxpayers and other stakeholders.

ETAAC recognizes the importance of the Data Strategy project as currently constituted – and the progress that has been made - and wants to ensure that the project delivers a truly comprehensive data strategy. Accordingly, ETAAC urges the IRS to consider the following matters and either include them in the Data Strategy project or otherwise address them in a coordinated manner:

- ***Collaboration with Outside Stakeholders***

While the IRS is the largest and most important user of U.S. taxpayer data, it is not the only user. The IRS routinely exchanges tax-related data with state revenue departments and other federal agencies, with tax preparers and taxpayers through tax preparation software

Collaborating on national data standards is critical to effective tax administration.

and with third party service providers such as banks and brokerage firms. These exchanges, which benefit the IRS as well as outside stakeholders, require extensive operational coordination and technical cooperation. The IRS' existing advisory structure

could be leveraged for outside stakeholder input into the development of data-related standards, policies and procedures (see section on Data Governance, below). For example, the IRS should work with the states to speed up transmittal of information return data so that states would not have to have separate filing requirements.

- ***National Data Definitions***

ETAAC envisions a future in which the IRS, its partners and outside stakeholders collaboratively develop, implement and manage successive generations of increasingly sophisticated electronic taxpayer service and/or compliance applications. Regardless of which entity takes the development lead on a particular project – the IRS in some cases, outside organizations in others – every new application would involve accessing, sharing, and managing tax-related data. Developing and maintaining a common language and rule-set for the use, exchange and management of tax-related data – commonly known as “data definitions” – is vital to the future of tax administration.

As the largest and most important user of tax data, the IRS is uniquely positioned to take a leadership role, including common oversight of identity and access management functions and registration processes embedded in many enterprise services. The IRS should establish and oversee, in consultation with the states and other outside stakeholders, a formal process to develop and publish national definitions for tax-related data.

- ***Data Governance***

A comprehensive data strategy will require an appropriate governance structure. The Data Strategy project, as currently defined, does not appear to address enterprise-level governance. An enterprise level governance structure must also have the necessary authority and tools to coordinate data-related policies at both the organizational and national levels.

ETAAC also believes that the IRS should consider working with stakeholders to develop national standards in authentication and e-signatures. ETAAC is not proposing that these be included as a part of the Data Strategy but should be addressed and governed in a coordinated, enterprise-based manner.

- ***National Authentication Standards***

Enhanced on-line services require a marked expansion of taxpayer and/or stakeholder (e.g. software vendors or third party service providers) access to on-line IRS taxpayer information. This, in turn, requires a secure authenticating process for user identities and management of authorizations. Due to increasing integration of federal and state-level tax administration, the IRS and state revenue departments should share standards for registration and authentication to the maximum extent possible. The IRS should work closely with those states¹⁴ which have already deployed or are developing authentication systems, building on the successful IRS/state collaboration in establishing XML standards for MeF.

- ***National E-Signatures Standards***

An easy, consistent and secure e-signature solution is critical to the expansion of e-filing and development of e-services. Ideally, the e-signature solution would be portable and could be re-used as an authentication method across appropriate online transactions and in interactions with strategic partners. To the extent possible, this e-signature solution should be compatible with general state-level e-signature requirements.

4. Recommendation for IRS

IRS should develop a plan to modernize the preparer e-Services program, including administration of the Electronic Return Originator function.

The IRS must modernize and increase the efficiency, product lines and functionality of e-Services and related processes. The preparer e-file requirement provides an opportune time for such modernization.

As tax preparers change their business models to embrace tax administration law and policy, the supporting electronic interaction must be easily available.¹⁵ The IRS faces upcoming challenges with respect to end-of-life support of the current software platform for e-Services.

Moving e-Services to another software application platform requires priority funding.

Regardless of the platform the IRS selects, emphasis should be placed on enhanced preparer

Tax preparers should be availed of self-service tools that make their interaction with the IRS easy and convenient.

incentive products that include features such as electronic response to a CP-2000 notice or notices that are currently resolved only by paper¹⁶ or phone, increased functionality and usability for existing services, efficiency that does not constrain capacity during peak times and e-mail and other electronic media capability with e-Help desk support.

¹⁴ The IRS should also examine what other countries have learned. For example, Canada's "Secure Channel Project" will provide valuable lessons learned from problems they encountered in implementation.

¹⁵ The recently completed "Findings From The 2009 e-Services Customer Satisfaction Study", Russell Research, March 2009, found that two primary areas of opportunity to improve e-Services concerned making it easier to use and making more preparers aware of the service.

¹⁶ Id. Preparers indicated high interest in receiving e-Notices.

As the IRS formulates its plans, they should also consider the following:

- ***Operational Electronic Submission***

As part of a robust electronic environment, basic operational transactions should be required to be completed electronically, such as applications to participate in the IRS e-file program. Fingerprint cards and credentials should also be submitted electronically, particularly as many police stations, which have been the primary source for fingerprint cards, no longer fingerprint on paper cards. Circular 230 tax practitioners should be able to upload credential submissions electronically.

- ***Background and Credit Checks***

As recommended in its 2008 Report to Congress, ETAAC continues to support a background and credit check for each person seeking to participate in the IRS e-file program who does not present evidence of professional status in lieu of fingerprint verification. This would give the public a greater sense that they have “trusted” partners within the e-file program. The checks could be outsourced with applicants paying fees to cover both functions.

5. Recommendation for IRS

The IRS should support e-strategy development and implementation as an enterprise priority.

Within the past year, the IRS has focused on completing its core Modernization Program commitments and addressing the important infrastructure and engineering needs associated with these priorities. In the midst of this, however, it has ceased working on major Web applications where the right technical environment was not certain or where a clear taxpayer need has not been established¹⁷.

An effective plan for electronic services must be carried out in an organizationally collaborative environment and focus on the top priorities of governance, identifying customer need, project prioritization and supporting information technology.

The IRS’ e-strategy will not be effective unless it is supported and governed as an enterprise.

Anything short of this will further inhibit progress toward a comprehensive electronic IRS.

- ***Enterprise Governance***

Governance must be a cornerstone of the Enterprise E-Strategy. A formal structure is needed to help assess and prioritize e-service requests, align capacity with organizational goals, leverage existing assets and help support effective investment planning that focuses on “greatest value to the customer”. The E-Strategy governance should also specifically cover identity management and data administration. Creating an enterprise Project Management Office within Electronic Tax Administration and Refundable Credits (ETARC) may be an appropriate functional starting point.

¹⁷ “Initial Efforts to Develop a New Web-based Portal Environment Were Not Successful”, TIGTA, May 19, 2009, Ref. 2009-20-079.

- ***Taxpayer and Tax Preparer Need***

Clearly defined business needs are essential to technological innovation. While the Advancing e-file Study represents an important step forward in understanding taxpayer and tax preparer needs and related e-file solutions, a similar but enterprise-wide needs-assessment and feasibility analysis would help document the potential for expanded taxpayer electronic interaction with the IRS. Assessing need from an enterprise perspective will help define the greatest taxpayer and tax preparer need among all business functions. Understanding those needs and their relative magnitude will facilitate building the right applications in the most cost-beneficial way.

- ***Supportable Architecture***

The third major planning priority is developing an information technology architecture that supports e-services growth without compromising performance or reliability. Identifying the right technical solutions and supporting infrastructure – from data utilities to Web architecture – should be an enterprise level function. This is perhaps the most dependent of the priorities, as sound technology choices are built on clearly defined business needs and an effective governance structure.

KSI 2 | THE ELECTRONIC EXPERIENCE IS TRUSTED BY IRS STAKEHOLDERS

6. Recommendation for IRS

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.

The percentage of individual income tax returns completed using a preparation software product is approaching 90%. In view of the fact that taxpayers and preparers have come to

Collaborating to establish the right standards for software services will be critical to protecting the e-file customer base.

depend on these products for computational accuracy as well as the security and privacy of their confidential information, the U.S. Government Accountability Office recently issued a report recommending that the IRS “assess the extent to which the reliance on tax software creates significant risks to tax administration, particularly in the areas of tax return accuracy, the security and privacy of taxpayer information,

and the reliability of electronic filing.”¹⁸

While it is cost and resource prohibitive for the IRS to provide total oversight and regulation of these products, the IRS should establish threshold standards and a related oversight model to support integrity in the important tax preparation software and e-file industry. An effective, efficient oversight model does not necessarily require direct IRS regulation. For example, IRS currently requires that third parties certify Free File Alliance member compliance with systems penetration testing requirements.

ETAAC has recommended in past reports that there should be greater oversight of tax preparers. The issue of tax software preparation oversight is an additional component to the larger “preparation oversight” issue. The IRS should consider that comprehensive and effective oversight of the tax software industry should be part of a larger oversight model for the entire tax preparation industry, including preparers.

IRS should consider collaborating with industry in the following areas:

- ***Clearer Security Standards***

IRS Revenue Procedure 2007-40 requires that all Authorized IRS *e-file* Providers have security systems based on the Gramm-Leach-Bliley (“GLBA”) and the FTC “Safeguards Rule.” However, the FTC Safeguards Rule does not set sufficiently clear security standards to protect taxpayer information. IRS should select from among several existing, recognized controls-based security standards to set for Authorized IRS e-file Providers. As just one illustration, IRS could require compliance with a global security standard – such as ISO 27002 – including periodic certification. Most importantly, ETAAC believes that an effective cyber-security standards strategy should not be technology prescriptive, because security threats evolve in days and weeks and technology must rapidly adapt to stay ahead of emerging threats.

¹⁸ GAO Report – Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risk – GAO-09-297, February 2009.

- ***Software Accuracy Standards***

ETAAC believes that IRS should work with industry and the states to determine the best approach for standards that would enhance the accuracy of tax software. Any such standards should avoid excessive rigidity, empower software developers to determine how best to meet their obligations, and anticipate the need to update tax software rapidly to reflect late-passed legislation.

Just as with security, any oversight model should focus on high-level requirements. The determination of “how” to meet standards should be left to the software developer. Compliance with those standards could be ensured through an oversight model relying on independent third party review.

7. Recommendation for IRS – Short-term:

IRS should review and update the e-file targeting, branding and marketing messages for taxpayers and tax preparers.

The IRS has historically focused its limited budget for marketing e-file on touting the traditional benefits of e-file – fast refund, accurate, and secure - to the different segments of the taxpayer and preparer demographic. In general, this generic marketing approach, from logo to core message, has been constant over the last 15 years. To a large extent, many states who co-brand the IRS’ marketing message, look, and feel have not changed marketing tactics either.

The IRS has set broad marketing objectives for the e-file program: increasing awareness of e-file

After 15 years of e-file operation, the IRS should consider re-branding.

and the Free File program; expanding e-file usage among taxpayer v-coders; increasing tax preparers’ e-file usage; and, increasing use of Free File among Hispanic, African American and young taxpayers. The IRS should leverage these ambitious goals as an opportunity to review and update its e-file targeting,

branding, and marketing messages.

As the IRS rethinks its e-file marketing approach, it should consider the following;

- ***Current Messages and Targets***

Narrowing its marketing to target those few segments that promise the greatest possibility of e-file “self adoption” will provide better return on the IRS limited marketing budget. ETAAC does not believe that non-participating tax preparers, the largest source of v-coders, will choose to e-file based on marketing. Instead, the marketing focus should be on more likely opportunities such as young taxpayers savvy in the use of electronic technology.

In addition to narrowing targets, it is important to assess how well the current core messages (“fast, easy and accurate”, and other variations) resonate with v-coders and non-e-filers. The e-file brand should be modernized and consistent in look, feel and conveyance of the e-file program’s core benefits. The refreshed branding should represent the outcome of the core message reassessment. Similar consideration should be given to rebranding the key state relationship to e-filing so that taxpayers easily associate e-filing benefits with both federal and state filing obligations.

- ***Data- Driven Assessment***

It is difficult to assess the results of the current marketing programs due to lack of data-driven methodology. Over the long-term, the IRS should step back from the current marketing approaches and, instead, conduct data-driven research to determine the most promising marketing approaches for future tax filing seasons.

- ***Leveraging Existing Relations***

The IRS should consider more closely engaging with IRS/Industry/State e-file working groups and organizations to formulate e-file marketing hypotheses and strategies. Working more consistently with the Council for Electronic Revenue Communication Advancement's (CERCA) e-file Working Group and the Federation of Tax Administrator's Free File Working Group would provide an opportunity to develop a strategic plan that enhances e-file and Free File marketing at both the national and state levels.

- ***Reduce Paper-Based Medium***

The IRS should explore eliminating the direct mailing of tax booklets to paper-file taxpayers while steering paper-filers online where they will see additional e-file information and services such as Free File. Some states are beginning to do this, and the IRS should collaborate with them to understand the costs and benefits.

- ***Target e-file Education to Tax Preparers***

The IRS should provide simpler, targeted materials on IRS.gov to make it easier for tax preparers to understand the benefits of electronic filing for their practices, how to adapt their business practices to gain the practice efficiencies that electronic filing delivers and how to best communicate the core e-file benefits to their clients. This should also include communicating greater awareness of the IRS' important e-Services function¹⁹.

¹⁹ Id. Russell Research Study, March 2009.
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8. Recommendation for IRS

The IRS should establish a permanent operational process to review and improve its current e-filing practices and procedures with respect to rejects.

Improving the reject process so that it is not onerous to taxpayers, tax preparers, software providers and, indirectly, states has been an issue for a number of years. While the IRS has made progress on an ad hoc basis, addressing the e-file/paper reject parity issue must be a permanent, structured process. ETAAC believes the IRS can make short-term changes to their reject criteria processes that will provide closer parity between paper and e-file filing methods.

The IRS should consider the following in developing a reject process.

- ***Leverage Industry and State Expertise***

IRS should create an IRS/Stakeholder e-file Operations Working Group (i.e. tax preparers, tax software/transmitter organizations and the states) to review current electronic filing

A structured process is needed to plan for and mitigate e-file rejects.

error codes/rejects and related electronic filing processes and practices. Working with this group, the IRS would be in a better position to define and implement an ongoing process for reject error code resolution. The analysis should consider reporting, resolution and bilateral communication

with regard to error code reject problems. For example, consideration should be given to developing:

- Thorough review of new rejects and utilization of the software community to test criteria and provide feedback;
- Defined 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;
- A communication portal for stakeholders on issues, potential timelines for resolution and actual resolution; and,
- An effective global e-signature strategy to prevent rejects for incorrect PIN signatures. E-signature standards between the IRS and states are disparate. Working toward the establishment of national standards that meet government and industry needs will enable efficiencies for all. See Recommendation 3.
- In the near-term, the current IRS e-signature standard for e-filed returns that requires the use of prior year AGI (or prior year PIN) should be re-examined to (a) determine negative impact on taxpayers, tax preparers, software developers and the IRS, and (b) explore viable alternatives.

9. Recommendation for IRS

IRS should renew the Free File Alliance program and continue making improvements to the program that increase benefits and build taxpayer confidence.

Free File gives 70% of all individual taxpayers the ability to use free online tax preparation and e-filing services from commercially available, full-featured interview based tax software. Free File has accounted for 27 million tax returns since 2003 - at no cost to the government. The program was recognized in May 2009 by the Software & Information Industry Association with an award for innovation in public service. Taxpayer use of the Free File Alliance increased 20% in 2008 but dropped by just over 31% in 2009 to approximately 3,200,000 returns²⁰. The IRS attributed the decrease in volumes to a number of factors, including national advertising of other free online tax preparation and the elimination of electronic filing fees by some software providers.

The evolution of Free File has resulted in setting foundational standards for online tax preparation services. In particular, the IRS has set high security, privacy and other standards in the Free File program that could be applied outside of the program. In 2009, Free File launched a new “Fillable Forms” service which enables all taxpayers – regardless of income – to enter federal tax data and e-file their federal tax return directly to the IRS for free. Fillable Forms also includes broad forms coverage, automated calculations and data flows with and between forms. The Free File program is currently scheduled to expire in October, 2009.

The Free File Alliance has established an important free model that drives more competitive choices for taxpayers.

ETAAC recommends that the Free File Alliance agreement be extended. The IRS should consider the following reforms to the Free File program to ensure it continues to set the “gold standard” for the tax software preparation industry and earns public respect and confidence:

- Renew and extend the existing Free File Agreement for a sufficiently long period of time, at least three to five years, to (a) ensure program availability for taxpayers, (b) enable states participating in Free File to plan and budget resources knowing that Free File will be available as a core taxpayer service program, (c) enable IRS to focus on its current Modernization Program, and (d) reassure private industry that the program is stable which will, in turn, encourage continued investment and innovation.
- Evaluate taxpayer need with respect to increasing the number of baseline forms that must be offered through Free File members. And, continue to provide Fillable Forms with any improvements determined necessary by IRS and the Free File Alliance.
- Provide greater transparency on IRS.gov about the availability and cost of state preparation and e-filing options in the Free File program.
- Where appropriate, move to third party certification to validate Free File Alliance member compliance with the Free File program’s Standards of Practice rather than primarily relying on member self-certification, such as in the areas of security, disclosures, site functionality, marketing practices, and forms coverage.

²⁰ By comparison, the Voluntary Income Tax Assistance (VITA) program prepares about the same number of e-filed returns.

- Continue encouraging VITA sites to leverage their staff, facilities and resources by offering access to the Free File program as an alternative "self-help" or "assisted service" model. This would increase Free File and e-filing volumes and would ease demands on VITA sites. The IRS' new Publication 4743, No Cost Filing Options, represents good progress towards this end.
- Investigate the harmonization of public eligibility standards for all IRS-sponsored free taxpayer services which would create a single standard, regardless of the manner of tax preparation, and make it easier for taxpayers to understand the availability of these services.

10. Recommendation for IRS

The IRS should eliminate the need to print, sign and mail in waivers from taxpayers prior to sharing information return data with the states.

The IRS estimates that they will receive approximately 61 million information returns on paper in 2009. The IRS should ensure that information return filers transitioning from paper to electronic filing encounter as few barriers as possible. By keeping the transition to e-filing simple and promoting its benefits, the IRS can expect that more information returns will be filed electronically.

A major benefit of e-filing information returns is the Combined Federal/State Filing Program. The program allows filers of certain information returns to satisfy state filing requirements by simply filing with the IRS. The IRS then forwards these information returns to the participating states.

The Combined Federal/State Filing Program is a major benefit offered to e-filers. However, a significant barrier to the program is Form 6847 (Consent for Internal Revenue Service to Release Tax Information). Form 6847 must be printed, signed and mailed by each filer wanting to participate in the program. The form gives the IRS the filer's permission to release tax information to the states. ETAAC believes that this information release can be satisfied under existing IRS/state agreements and does not warrant the consent of every single filer. Eliminating the

Eliminating an unnecessary paper step will go far to encourage greater use of the fed/state information return filing program.

requirement to submit a separate paper form will allow for more streamlined filing and movement to an all-electronic process for filing required information returns.