INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

WAGE & INVESTMENT
SUBGROUP REPORT

MARGARET A. ROARK, SUBGROUP CHAIR
JOAN LEVALLEY
DANIEL T. MOORE
ROBERT G. NATH
ROBERT A. WEINBERGER

NOVEMBER 15, 2007

WAGE & INVESTMENT
SUBGROUP REPORT

TABLE OF CONTENTS

INTRODUCTION/EXECUTIVE SUMMARY

ISSUES AND RECOMMENDATIONS

- **ISSUE 1: IRS Mail-Out Inserts**
- **ISSUE 2: EITC Communication Strategy**
- **ISSUE 3: EITC Return Preparer Strategy**

INTRODUCTION/EXECUTIVE SUMMARY

The IRSAC W&I Subgroup (hereafter "Subgroup") is comprised of a diverse group of tax professionals consisting of a certified public accountant (CPA), an attorney, an enrolled agent (EA), a certified payroll professional (CPP), and a representative from a national tax preparation firm. This group brings a broad range of experience and perspective from both tax preparers' and taxpayers' views. We have been honored to serve on the IRS Advisory Council and appreciate the opportunity to submit this report.

Since January of this year, the Subgroup has had the privilege of working with the professionals within the W&I Division and found them to be extremely helpful in providing the information and resources necessary to develop our report. The Subgroup has researched and is reporting on the following three issues:

1. <u>IRS Mail-Out Inserts</u> - The W&I Division asked IRSAC to assist in analyzing and reducing the volume of mail-out inserts sent to taxpayers, employers, and their representatives. Although some of the documents inserted with notices are required by law, we saw many opportunities to reduce the substantial volume of paper generated each year. Notices (with accompanying inserts) relating to the same tax account, but separate tax periods, should be combined to drastically reduce mailings. Representatives with powers of attorney should be provided the opportunity to elect not to receive inserts, and not default to the same inserts as the taxpayer receives. Due to the number of notices, forms, publications, and instructions that are encompassed by this request, we suggest an ongoing effort to review the criteria used for including inserts and pare them down to a more reasonable volume. We believe substantial monetary savings can be realized by

simply discontinuing all mailings of IRS forms to taxpayers who utilize commercial tax return preparation software, or by allowing the taxpayer to “opt out” of receiving paper forms.

2. EITC Communication Strategy - IRSAC was asked to assist in improving the communication strategy regarding the Earned Income Tax Credit (EITC) to increase the participation of eligible individuals. We recommend enhancement of the EITC Awareness Day by including additional stakeholders to increase the scope of participation. To focus on areas with the most EITC-eligible individuals, we recommend the IRS analyze non-participation by metropolitan area to target those efforts where they might be more productive. We suggest coordination with other assistance programs to ensure benefits for families who may not be aware of all available assistance, including non-tax-based programs. Since employers are the frontline contact for most workers, we further believe that encouraging employers to identify and educate employees on the EITC may result in increased participation from individuals who are currently unaware of the credit.
3. EITC Return Preparer Strategy - To improve the accuracy of Earned Income Tax Credit (EITC) returns, we recommend several steps to improve the qualifications and education of return preparers, while strengthening enforcement against fraud. Increased educational opportunities and development of qualified specialists in the context of testing and licensing all professional preparers would improve EITC claim accuracy.

The Subgroup considered a fourth issue relating to the electronic submission of IRS tax levy payments by employers using the Electronic Federal Tax Payment System

(EFTPS). The advantages of the IRS' receiving these payments electronically are obvious, but could have significant impact for larger employers who currently send payments to a number of IRS payment processing centers. We also believe the notifications (Form 668-W, *Notice on Levy of Wages, Salary, and Other Income,* and Form 668-D, *Release of Levy/Release of Property from Levy*) could be sent to employers electronically, which would reduce the turnaround time necessary to process such transactions. After we discussed this subject with W&I, a project manager was assigned from SB/SE Compliance, and this issue is currently in the conceptual/exploratory phase. We appreciate the interest IRS has taken in this subject and hope to continue to work with the Service as it addresses this issue.

Each issue contains specific recommendations. We hope that our effort to provide new ideas and suggestions for improvement are helpful to the IRS.

ISSUES AND RECOMMENDATIONS

ISSUE ONE: IRS MAIL-OUT INSERTS

Executive Summary

The W&I Division asked IRSAC to assist in analyzing and reducing the volume of mail-out inserts sent to taxpayers, employers, and their representatives. Although some of the documents inserted with notices are required by law, we saw many opportunities to reduce the extremely large volume of paper generated each year. Notices (with accompanying inserts) relating to the same tax account, but separate tax periods, should be combined to drastically reduce mailings. Notices sent multiple times for the same issue need not duplicate each insert. Representatives with powers of attorney should be provided the opportunity to elect not to receive inserts, and not default to the same inserts as the taxpayer receives. Due to the number of notices, forms, publications, and instructions encompassed by this request, we suggest an ongoing effort to review the criteria used for including inserts and pare them down to a more reasonable volume. We believe substantial monetary savings can be realized by simply discontinuing all mailings of IRS forms to taxpayers who utilize commercial tax return preparation software, by allowing the taxpayer to "opt out" of receiving paper forms.

Background

The IRS mails (by regular or certified mail) over 70 different types of inserts (forms, publications, notices, and instructions) with correspondence it sends to taxpayers. This program encompasses about 220 million inserts and 175 million separate pieces of taxpayer correspondence each year. Included in this correspondence is a set of collection, inquiry, and refund notices that comprise about 190 million of the 220 million inserts.

The IRS organizes its "load plan" for these Individual Master File (IMF) and Business Master File (BMF) notices in seven groups, as follows:

Group Name	**Approximate Number of Notices/Year**
IMF Non Collection Balance Due Notices	7 million
IMF Refund Notices	11 million
IMF Even/Taxpayer Inquiry Notices	2 million
BMF Non Collection Balance Due Notices	5 million
BMF Refund Notices	3 million
BMF Even/Taxpayer Inquiry Notices	1 million
IMF/BMF Collection Notices	50 million (36 million in CP500 series)

The IRS tailors the inserts to the type of correspondence. For example, most balance due collection notices receive Pub. 1, *Your Rights as a Taxpayer,* and Notice 1212, *Automated Telephone Service*. Some inserts are required by law; the IRS includes others out of caution. Moreover, the IRS duplicates these inserts by mailing additional copies to taxpayer representatives when the taxpayer has filed a power of attorney. The IRS believes that the availability of all such inserts on the IRS website does not reduce the agency's perceived need to include them in hard copy mailings. Finally, in some cases, the IRS sends one letter and one corresponding set of inserts in one envelope for each of many tax periods, even though this practice unnecessarily increases the paperwork. An example of many is CP504, *Final Notice – Balance Due*, a collection notice the IRS sends to taxpayers for delinquent payroll and income taxes. The IRS sends a separate CP504 notice, enclosing Notice 1219B, *Notice of Potential Third Party Contact* and Pub. 594, *The IRS Collection Process*, by certified mail for *each delinquent period.* If all delinquent periods were stated on one form, the IRS could save substantial cost. Also, consolidating periods on one notice would reduce confusion for taxpayers who erroneously assume the multiple notices are duplicates. It is important to note that collection notices (of which CP504 is one example) account for about 75 percent of the total number of notices described in the above chart.

IRSAC believes that the most effective review of the notice and load plan will require a painstaking and time-consuming review of each notice and its associated publications, forms and instructions. Still, the IRS can take several immediate steps to start reducing the paperwork.

Recommendations

1. Consolidate tax periods in notices. Send *one* collection notice of each type for multiple periods where this is feasible. Insert only one set of publications, forms and instructions. For example, CP504 contains a three-page letter (which includes a window-envelope cover sheet), Notice 1219-B (1/3 page), Notice 1212 (1/3 page), Pub. 594, *The IRS Collection Process (*12 pages), and a return envelope. All delinquent periods can be aggregated in one letter with one set of inserts.
2. Where an insert is not legally required, the IRS should consider sending documents or inserts only once in the collection process. The IRS should also include in that mailing a prominently displayed list of forms, publications, and

other documents that may be relevant, and reference where to find them on the IRS Web site.

3. Cease sending any inserts to Circular 230 representatives unless they ask to receive them. Modify Form 2848, *Power of Attorney and Declaration of Representative*, as needed for this purpose. Discontinue sending the more routine, collection-specific notices (where such notices are not legally required) to such representatives by certified mail. W&I should consider delivering notices to these representatives via e-services and a secure mailbox.
4. Because the volume of inserts and publications is so enormous, the task of analyzing all such documents will take considerable time. The IRS should continue working with tax practitioners and IRSAC on this issue, focusing on major notices, until the system has been streamlined. In response to the IRS' request for assistance, Subgroup members have begun to keep better track in their own practices regarding notices received, so they can make specific recommendations to improve the process.
5. The IRS should also continue its own review of all notices, publications, and forms to ensure they are as compact and efficient as possible. This means simplifying the notice language and arranging the text so that the notice takes up fewer pages. Pub. 1, *Your Rights as a Taxpayer*, is an excellent example of efficiency in an IRS publication.
6. Non-insert paper forms (*e.g.*, Forms 941, 1120, 1040) also represent a substantial investment of resources. The IRS should develop ways to eliminate mailing the hard copy versions of these forms when appropriate. For example, the IRS now

identifies returns generated by commercial return preparation software. The IRS could use these data to eliminate mailing hard copy forms, as it does with e-file notifications. Likewise, the IRS should consider a "check the box" insert on Forms 1040, 1120, and 941 to allow the filer to opt out of receiving mailed forms in the future. The IRS currently sends a postcard to taxpayers whose returns were filed by a paid preparer that indicates the forms will no longer be mailed to the taxpayer and advises how to get the forms if needed.

7. To reduce the cost of printing and mailing, notices should be printed on lightweight paper in gray scale (or eliminated) whenever possible. Communications printed in full-color on glossy paper should be used less often.

ISSUE TWO: EITC COMMUNICATION STRATEGY

Executive Summary

IRSAC was asked to assist in improving the communication strategy regarding the Earned Income Tax Credit (EITC) to increase the participation of eligible individuals. The IRS has made significant efforts to reach out to communities and individuals, but we have some recommendations that may enhance its current marketing campaign. We recommend enhancement of the EITC Awareness Day by including additional stakeholders to increase the scope of participation. To focus on areas with the most EITC-eligible individuals, we recommend the IRS analyze non-participation by metropolitan area to target those efforts where they might be more productive. We suggest coordination with other assistance programs to raise awareness of the EITC for families who may not be aware of all available assistance, including non-tax based programs. Since employers are the frontline contact for most workers, encouraging employers to identify and educate employees on the EITC may result in further participation from individuals who are currently unaware of the credit.

Background

Participation in the EITC ranges from 75-85 percent, which is high compared with non-tax programs such as Food Stamps or the State Children's Health Insurance Program (SCHIP). Studies show the highest level of EITC nonparticipation is among potential claimants without children, the limited English proficient, rural residents, and non-traditional families. Substantial effort and funding have been devoted to reaching out and educating potential EITC tax filers through media campaigns, direct marketing, stakeholder partnerships, and Web-based services. However, some EITC-eligible populations remain underserved.

Recommendations

1. Continue and enhance EITC Awareness Day. The 2007 EITC Awareness Day was a success. A concentrated effort to increase the awareness of the tax credit should be continued through national and local media. In addition to partnering with non-profit and community groups, the IRS should include paid preparer organizations, trade groups and large tax firms since 70 percent of EITC claimants use professional preparers to complete their tax returns.
2. Continue to partner with social service agencies and non-profits that provide services to non-participants, and provide EITC awareness kits, including flyers and brochures that provide information on the credit. The information should

direct taxpayers to IRS Taxpayer Assistance Centers, paid preparers, or VITA sites for tax preparation assistance.

3. Develop and publicize estimates by zip code of eligible workers who aren't claiming the EITC and the estimated dollars they are missing. This effort could drive local media coverage, as well as motivate local officials and community groups (who view EITC funds as indirect economic development assistance) to aid in enlisting eligible workers to apply for the EITC. The localized data can be the basis for a targeted marketing campaign.
4. Encourage employers to notify potentially eligible employees who may fall into the EITC income requirements. The IRS should create an EITC awareness poster and include this with Form 940, *Employers Annual Federal Unemployment (FUTA) Tax Return*, when it is mailed to employers in January. California has just passed legislation encouraging employers to notify potentially eligible employees of the EITC.
5. Partner with administrators of other public assistance programs to make benefit recipients aware of underutilized programs for which they may qualify. Similarly, we know that while EITC benefits are utilized at about a 75-85 percent rate, Food Stamp and SCHIP programs only reach 50-66 percent of those eligible. It is worth exploring whether EITC recipients could be given information to determine eligibility for these programs (which can bring as much as $9,000 more to a family's income) and whether participants in those programs could be notified about their possible EITC eligibility.

<u>ISSUE THREE</u>: EITC RETURN PREPARER STRATEGY

<u>Executive Summary</u>

To improve the accuracy of Earned Income Tax Credit (EITC) returns, we recommend several steps to improve qualifications and education of return preparers, while strengthening enforcement against fraud. Increased educational opportunities and development of qualified specialists in the context of testing and licensing all professional preparers would improve EITC claim accuracy.

<u>Background</u>

The EITC remains a successful key federal anti-poverty program. In 2005, about 22 million low-income workers received EITC benefits averaging over $1,870 each. In 2006, benefits for a family with two or more children ranged as high as $4,536.

Participation levels are high relative to other programs that are not delivered through the tax system, and administrative costs are very low. However, the overclaim rate has been persistently high and since more than 70 percent of EITC claimants use professional or volunteer return preparers, the IRS has aimed compliance efforts at return preparers to reduce errors and fraud.

IRS efforts have clearly improved in recent years through better outreach, education, and enforcement and IRS management should be commended for its success. The EITC Assistant on the IRS Web site is also a helpful tool. However, the EITC program remains subject to close review because of the significant refund amounts that are paid to ineligible recipients, which triggers requirements of the Improper Payments Information Act of 2002 (IPIA).[1]

How can return preparers help improve accuracy? The vast majority of preparers are competent and honorable. However, the EITC is a particularly complex part of the tax code, leading to honest mistakes. A majority of errors relate to identifying qualified children, filing status, and misreported income. In some cases, preparers innocently report misinformation from their clients, and in some cases preparers are not asking the questions required to show due diligence. Unfortunately, there are also some unscrupulous preparers.

Recent audit reports have found shortcomings in the preparation of EITC returns by all segments of the tax preparation community—paid preparers, volunteers, and IRS employees.[2] While simplifying the EITC, which could ease compliance, is the responsibility of Congress, the IRS can hold tax preparers—paid and volunteer—to a higher standard of accountability.

To improve performance, we recommend several education and enforcement measures.

<u>Recommendations</u>

1. To improve the skill of third-party return preparers, the IRS should quickly implement any testing and certification mandate approved by Congress. Legislation for preparer licensing and continuing education has twice passed the Senate Finance Committee and once been approved by the full Senate in recent years.[3] Any testing program should include questions related to the EITC. The IRS should also consider a voluntary specialized test segment related to the EITC for preparers whose practices involve many low-income taxpayers so that they can be certified as having the skills needed to prepare those returns. If licensing is

enacted and EITC return preparers are certified, the IRS should promote use of those qualified preparers. The IRS should test whether vouchers or other financial incentives would be a cost-effective means of encouraging taxpayers to use certified EITC specialists. Every IRS-approved volunteer tax preparation site should be required to have at least one certified EITC specialist.

2. The IRS, in conjunction with tax practitioner groups and educators, should develop an online educational module to help train practitioners in preparing EITC returns and to improve their skills. Publishers of professional tax return preparation software should include similar EITC training materials in their software, or provide links to the online IRS training module. Completing the training module could be required of those tax professionals who prepare EITC returns. Use by volunteer preparers should be strongly encouraged. In addition, to supplement the six annual tax practitioner Nationwide Tax Forums sponsored by the IRS, consideration should be given to half-day workshops in major metropolitan areas at which IRS experts could educate tax practitioners on the EITC, on interview skills, and on other tax issues related to low-income taxpayers.

3. Treasury regulations set requirements to show preparer diligence in determining EITC eligibility and provide penalties for failure to comply. The requirements include: (a) completing Form 8867, *Paid Preparer's Earned Income Credit Checklist*; (b) retaining the EITC computation worksheet and other records; and (c) making reasonable inquiries to assure information is accurate and to probing further if information seems incorrect, incomplete, or inconsistent to ensure the

preparer does not know, or have reason to know, any information is incorrect.[4] Yet, at the same time, the IRS advises that the preparer is not supposed to audit his client. The IRS should provide guidance as to when preparers can rely on the representation of their clients and when further inquiry is appropriate. Consideration should also be given to adding questions to the EITC eligibility checklist—for example, "Do you have school records to support the child's residence?"

4. The IRS should continue to strengthen oversight efforts to identify preparers of multiple returns that are erroneous so that the IRS can make site visits, send letters suggesting continuing education, and monitor future performance. We support IRS efforts to improve selection methodology consistent with the best return on investment for the Return Preparer Program, the Questionable Refund Program, and the EITC Due Diligence Audit Program.[5] A "hotline" should be instituted so that the public can report incidents of preparers who file returns without signing them or e-file returns without a taxpayer's required Form W-2, as well as preparers who are required to be licensed who prepare returns without such a license. The IRS should be encouraged to utilize its statutory authority to pay monetary rewards to citizens who identify such preparer misconduct. This goal is not easy because many incompetent preparers lack a fixed location, operate on a cash basis, and relocate frequently, and we recognize that the IRS is generally short of sufficient enforcement personnel. But the IRS' efforts to halt return preparers who were filing fraudulent telephone excise tax refund claims in 2007 demonstrate that the agency can muster sufficient resources if management

makes the decision to intervene. A concerted and publicized enforcement effort, as part of a balanced overall program, could pay long-term dividends.

Overall, we found the IRS fully engaged in the challenges it faces with strong program leadership, but more can be done. We're very encouraged that the IRS has responded positively to our suggestions, and we look forward to monitoring its progress.

---

[1] The IPIA, P.L. 107-300, requires agencies to review their programs annually, identify those susceptible to significant erroneous payments, and develop corrective action plans for programs with high error rates. *See* Written Testimony of the Commissioner of Internal Revenue Service Mark Everson before the Senate Homeland Security and Governmental Affairs Committee Subcommittee on Federal Financial Management, Governmental Information And International Security, on "Reporting Improper Payments: A Report Card On Agencies' Progress," Mar. 9, 2006.

[2] Treasury's Inspector General for Tax Administration, for example, has noted that "taxpayers still have just a 1 in 2 chance of having their tax returns accurately prepared by VITA program volunteers." Testimony of J. Russell George, Treasury Inspector General for Tax Administration, providing a preliminary assessment of the 2007 tax filing season, before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate, May 9, 2007, pp. 3-4. *See also,* TIGTA, *Oversight and Accuracy of Tax Returns Continue to be Problems for the Volunteer Income Tax Assistance Program*, 2006-40-125, Aug. 31, 2006; TIGTA, *Improvements Are Needed to Ensure Tax Returns Are Correctly Prepared at Taxpayer Assistance Centers,* 2004-40-025, Dec. 2003; and Testimony of Michael Brostek, Governmental Accountability Office, before the Senate Finance Committee, "Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors," GAO-06-563T, April 6, 2006.

[3] *See,,e.g.,* S. 882, Tax Administration Good Government Act of 2004, 108th Congress, approved by the Senate Finance Committee Feb. 2, 2004 and substituted for H.R. 1528 by the full Senate May 19, 2004; S. 832, Taxpayer Protection and Assistance Act of 2005, 109th Congress; S.1321, Telephone Excise Tax Repeal and Taxpayer Protection and Assistance Act of 2006, 109th Congress, approved by the Senate Finance Committee Sept. 19, 2006; and S.1219, Taxpayer Protection and Assistance Act of 2007, 110th Congress. IRSAC's predecessor, the Commissioner's Advisory Group, twice recommended testing of unenrolled tax preparers.

[4] Treas. Reg. 1.6695-2. Any income tax preparer (defined in Reg. Sec. 301.7701) who prepares a return or claim for refund who fails to comply with the due diligence requirements concerning the eligibility for and the amount of an EITC shall pay a penalty of $100 for each failure.

[5] Treasury's Inspector General for Tax Administration has criticized IRS screening of preparers who originate e-filed returns. TIGTA, *Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program*, 2007-40-176, Sept. 19, 2007.