

ELECTRONIC TAX ADMINISTRATION ADVISORY COMMITTEE

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PREFACE

The Electronic Tax Administration Advisory Committee (ETAAC) was formed and authorized under the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98). ETAAC's primary charter is to provide input to the Internal Revenue Service (IRS) on the development and implementation of the IRS 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 reports annually to Congress concerning:

- IRS progress on reaching its goal to electronically receive 80% of tax and information returns;
- Legislative changes assisting the IRS in meeting the 80% goal;
- Status of the IRS strategic plan for electronic tax administration; and
- Effects of e-filing tax and information returns on small businesses and the self-employed.

As tax administration changes, so does the focus of ETAAC. In 2017, ETAAC will shift its focus to primarily addressing the serious problem of tax identity theft abuses, which threaten to erode the integrity of the tax system. In this report and in future reports, ETAAC will provide strategic and tactical recommendations on combating tax identity theft.

The IRS ensures ETAAC membership reflects broad experience and stakeholder perspectives, including representation from state departments of revenue, large tax preparation companies, solo tax practitioners, software companies, low-income and consumer advocacy groups, and business filers from the nonprofit and for-profit sectors. ETAAC member biographies are in Appendix A.

In conducting its assessments and formulating its recommendations, ETAAC relies on a variety of information sources. Most importantly, ETAAC participates in numerous discussions with IRS representatives. ETAAC also reviews several reports, including those from other advisory boards, the National Taxpayer Advocate, the Government Accountability Office (GAO), and the Treasury Inspector General for Tax Administration (TIGTA). The Committee is most grateful for their observations. Finally, on occasion, ETAAC seeks background insights from policy leaders, industry, and state departments of revenue. Using all of this information, ETAAC formulates its annual report, and the recommendations and opinions expressed in this report are solely those of ETAAC.

The IRS Oversight Board, also established pursuant to RRA 98, is responsible for, among other duties, the delivery of an annual report to the Director of Electronic Tax Administration (or other IRS delegate), and a similar report to Congress with respect to advancing electronic tax administration. The Oversight Board has provided valuable research and insights into taxpayer behavior and preferences, critical to effective tax administration strategies. Currently, the Oversight Board has suspended operations and will not resume operations or issue an annual report until it has enough members confirmed by the U.S. Senate to make up a quorum. ETAAC strongly recommends that the Senate accelerate confirmation of new Oversight Board members to allow the Oversight Board to continue its important work in tax administration.

Finally, ETAAC recognizes IRS employees and leadership for their continued efforts to administer an increasingly complex tax system, meet taxpayer service expectations, and successfully process billions of transactions and hundreds of millions of tax returns. The United States tax system could not operate without their dedication, commitment, and talent. IRS employees and managers have made themselves available during filing season and on many other occasions to brief ETAAC on a variety of issues and

initiatives, answer questions, and provide requested information, despite their demanding schedules. ETAAC appreciates their dedication, openness, and candor. Without the continuing and full support of IRS, ETAAC could not perform the job Congress has assigned to this Committee.

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

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EXECUTIVE SUMMARY

When Congress formed ETAAC in 1998, the big challenge in electronic tax administration was the adoption of e-filing. Congress set an e-file goal of 80% for all major return types. Since then, ETAAC has primarily focused on strategic recommendations to get the e-file rate to 80%. With this goal achieved, the IRS continues to implement further refinements to reach even higher e-file rates. Looking beyond the percentage of tax returns filed digitally, the IRS now faces other major electronic tax administration challenges:

1. The erosion of the tax system's integrity from the proliferation of tax identity theft, and
2. Inadequate levels of taxpayer service at the IRS caused by a customer-service model that does not adequately leverage digital service tools.

ETAAC believes that the IRS can make great strides toward solving these problems through innovation. In the past three years, ETAAC has focused its recommendations on addressing these big challenges.

In ETAAC's past two reports, the committee provided recommendations on how the IRS can modernize its taxpayer service model by incorporating digital capabilities. ETAAC made recommendations on removing barriers for taxpayers to authenticate their identities with the IRS, in an effort to combat the abuses of tax identity theft and Stolen Identity Refund Fraud (SIRF). In ETAAC's 2014 report, the committee recommended developing taxpayer and tax professional online accounts and suggested features that would help the IRS enhance its taxpayer service capabilities. In ETAAC's 2015 report, as the IRS was answering only 37.4% of its phone calls, ETAAC advocated for accelerating an adoptable, comprehensive online account and improving the digital experience on IRS.gov to improve taxpayer service levels.

In 2015, the IRS made pivotal changes to start addressing the two biggest challenges in tax administration. First, in June 2015, the Security Summit – a coalition of the IRS, the tax industry and state tax administrators – released its first recommendations on how to combat the abuses of tax identity theft and SIRF. Separately, the IRS introduced its vision of the future, called the Future State Initiative, and committed to modernizing and improving taxpayer service and compliance strategies. Both of these milestones mark the beginning of solutions that will better serve taxpayers and protect the integrity of the tax system.

Now that the IRS has a Future State strategy and a dedicated focus on combating the abuses of tax identity theft and SIRF, ETAAC's 2016 report addresses strategic initiatives and enhancements to both of these areas.

The following are summaries of ETAAC's observations on key issues and recommendations in this year's report:

1. E-FILE IS THE NORM FOR MOST MAJOR RETURNS, BUT THE IRS CAN MAKE IMPROVEMENTS.

For the 2016 filing season, ETAAC projects that 86.3% of individual taxpayers will e-file their returns with the IRS. All other major tax returns, with the exception of employment tax returns (Form 94x series), exceed an 80% e-file rate. The IRS is specifically focusing on Form 94x e-file growth. Pending budget and staffing availability for FY2018, the IRS plans to implement improvements that could include removing e-signature barriers. In past reports, ETAAC has identified e-signature as the main barrier to e-filing for the

Form 94x return series and has recommended simplification of this process, which is critical to achieving higher e-filing rates.

2. THE IRS HAS COMMITTED TO PRIOR ETAAC RECOMMENDATIONS IN ITS FUTURE STATE INITIATIVE, BUT WILL NEED TO WORK WITH INDUSTRY PARTNERS.

The IRS has made progress on specific areas of focus in ETAAC's 2015 report. Specifically:

- The IRS has published its plans to develop an adoptable digital taxpayer service strategy in its Future State Initiative.
- The IRS has and continues to make significant improvements to IRS.gov, the primary digital channel for taxpayer service resources.

In many recommendations in past reports, ETAAC has advocated for more IRS collaboration with external stakeholders to achieve better outcomes. ETAAC applauds the IRS for working with the tax industry and states in the Security Summit. In April 2016, in ETAAC's testimony before Congress, the committee advocated that the IRS engage more with industry partners to ensure that it achieves its Future State Initiative goals. For example, the IRS could engage the tax industry in developing and optimizing user adoption of taxpayer and tax professional online accounts.

3. CHANGES SHOULD BE MADE IN THE TAX ECOSYSTEM TO IMPROVE TAX ADMINISTRATION.

For improved efficiency and reduction of IRS and taxpayer burden, authentication of taxpayers, and verification and correction of tax returns, the tax ecosystem has to fundamentally change. ETAAC's 2016 report provides recommendations that would allow for better authentication of taxpayer identities and verification of taxpayer information before the IRS accepts returns and processes refunds.

In this year's report, the committee makes 11 recommendations on improvements to the tax ecosystem that will increase fraud prevention and detection, as well as compliance, including a voluntary registration process for taxpayers to authenticate their identities. ETAAC also makes recommendations to improve the accuracy, matching, and e-filing rates of information statements, with the ultimate goal of matching information statements to tax returns before issuing refunds.

4. TAXPAYERS AND TAX PROFESSIONALS NEED END-TO-END CAPABILITIES IN ONLINE ACCOUNTS.

In 2016, the IRS publicly committed to a Future State Initiative and digital service model that embraces technology for an improved taxpayer service experience, consistent with ETAAC's 2015 recommendations. The IRS Future State Initiative aligns with ETAAC's vision for taxpayers to:

- Fully understand their tax obligations,
- Have transparent access to their tax information and status with the IRS, and
- Effectively and securely interact with their tax administrator.

In this year's report, ETAAC provides five recommendations on how the IRS should further optimize the taxpayer experience. The IRS should examine and develop end-to-end digital capabilities to help taxpayers comply with their responsibilities and interact with the IRS before, during, and after filing.

2017 AND BEYOND

Starting with next year's report, ETAAC's focus will likely evolve to include making recommendations to address tax identity theft and Stolen Identity Refund Fraud.

PROGRESS TOWARD 80% E-FILE GOAL AND CONSIDERATIONS FOR THE FUTURE

One of ETAAC’s primary responsibilities, as defined in its charter, is to research, analyze, consider, and make recommendations on the IRS’ progress toward achieving its 80% e-file goal for major returns.¹ In keeping with historical analysis and reporting, ETAAC continues to calculate an Electronic Filing Index (EFI) for use in this report. The Index assesses the e-file rates of a defined set of major tax returns, including a methodology to project full-year e-file rates, based on season-to-date information for the main driver of electronic filing rates – the individual tax return. Appendix B contains details about the Index and ETAAC’s methodology.

In the 2016 filing season, while the IRS continues to make progress toward the 80% goal, year-over-year progress has slowed versus prior periods. Overall, ETAAC estimates a 78.0% EFI rate for all major return types in 2016.

Table 1: 2013 – 2016 Electronic Filing Index

| Electronic Filing Rate | 2013 | 2014 | 2015 | 2016 Projection |
|------------------------|-------|-------|-------|-----------------|
| EFI | 74.1% | 75.4% | 77.5% | 78.0% |

Sources: June 2015 ETAAC Annual Report to Congress for 2012-2015 rates; See Appendix B for calculation of 2016 projection.

Individual returns, which represent 76.8% of the 2016 filing season volume, continue to experience e-file growth, albeit at a slower pace than in prior years. This is understandable, given that the individual return e-file rate is rapidly approaching 90%. However, it also indicates that the rate of growth will likely be more gradual without IRS efforts to understand and address the remaining barriers to individual return e-filing.

Table 2: 2016 Projected Electronic Filing Index (EFI)

| 2016 Projections Type of Return | 2015 Estimated | | | 2016 Projection | | | Absolute Increase in Rate |
|--|----------------|-------------|-------|-----------------|-------------|-------|---------------------------|
| | Total | E-Filed | EFI | Total | E-Filed | EFI | |
| Individual (Forms 1040, 1040-A, and 1040-EZ) | 148,477,500 | 128,180,300 | 86.3% | 150,647,400 | 130,438,488 | 86.6% | 0.3% |
| Employment (Forms 94x) | 30,404,900 | 10,871,100 | 35.8% | 30,534,200 | 11,360,800 | 37.2% | 1.5% |
| Corp Income Tax (1120,1120-A,1120-S) | 6,891,400 | 4,942,700 | 71.7% | 6,976,800 | 5,170,300 | 74.1% | 2.4% |
| Partnership (Forms 1065/1065-B) | 3,842,800 | 2,963,400 | 77.1% | 3,903,500 | 3,081,500 | 78.9% | 1.8% |
| Fiduciary (Form 1041) | 3,238,800 | 2,396,300 | 74.0% | 3,257,900 | 2,419,100 | 74.3% | 0.3% |
| Exempt Organizations (Forms 990, 990-EZ) | 601,800 | 328,800 | 54.6% | 611,600 | 355,500 | 58.1% | 3.5% |
| Total | 193,457,200 | 149,682,600 | 77.4% | 195,931,400 | 152,825,688 | 78.0% | 0.6% |

Sources: 2015 estimates based on IRS Publication 6186 (Rev. 10-2015) and 2016 projections per EFI methodology, as defined in Appendix B.

Similar to prior-year results, the year-over-year comparisons in Table 2 provide a clear indication that the IRS’ greatest challenge to achieving an 80% goal across all major form types continues to be

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

employment tax returns (Form 94x series), with 19.2 million forms still filed on paper.² During the past seven filing seasons, the Form 94x series e-file rate has consistently seen the slowest or close-to-slowest growth of all major return types for reasons highlighted in past ETAAC reports.

During 2015, the IRS released a request for comments on ways to increase the electronic filing of employment tax returns. Consistent with prior ETAAC reports, the digital signature process was highlighted as a key barrier to increasing e-file rates across these returns. Subject to funding and resources, the IRS is looking to develop a Form 94x online signature PIN in FY2018.

INFORMATION RETURN REPORTS

Although information returns are not included in EFI calculations for major tax returns, ETAAC also tracks e-file rates for information returns. The e-file rate for the majority of information returns now exceeds the 80% threshold. Form 1099-MISC continues to be the only information return form type that has not achieved an 80% e-file rate. This is likely because of the number of small businesses that file few returns and thus find it more convenient to file via paper. As discussed in Recommendation 9, ETAAC is recommending that the IRS introduce a phased reduction of the threshold for mandatory electronic filing of Forms 1099-MISC from 250 forms to 20 forms. This will increase the e-filing rate of these forms in the future.

Table 3: Information Returns to Note

| Type of Return | 2016 Projections | | | 2015 Report EFI |
|----------------|------------------|------------|--------|-----------------|
| | Total | Paper | EFI | |
| Form 1099-MISC | 92,528,000 | 32,778,000 | 64.58% | 65.22% |

Source: 2016 Projections from IRS Publication 6961 (Rev. 07-2015), Table 1; 2015 Report EFI from 2015 ETAAC Annual Report to Congress

THE 80% E-FILE GOAL AND THE FUTURE

In 2016, the IRS has exceeded its 80% e-file goal for individual tax returns, for the fifth straight year. However, the EFI for all other major returns falls far short of the 80% threshold. Given the significant volume of Forms 94x, this trend will likely continue until the IRS implements a new electronic signature process for these returns.

As ETAAC highlighted in last year’s report, e-file is only one part of overall electronic tax administration. ETAAC has also looked to highlight and make recommendations around IRS progress in improving taxpayer service through digital tools. However, it is important to mention that with the benefits of technology and increased digital participation also come risks – namely cybersecurity and the challenges of tax identity theft and refund fraud. In the future, ETAAC will leverage its knowledge and expertise in electronic tax administration to help propose strategies for minimizing these threats while continuing to increase digital participation, including e-filing.

² See ETAAC’s 2014 Annual Report to Congress. Key Outcomes 1 and 3 reference the signature process as a barrier to increasing Form 94x series e-file rates.

ELECTRONIC TAX ADMINISTRATION (ETA) PROGRESS

ETAAC's responsibilities, as defined in its charter, include performing research and analysis, and making recommendations on IRS progress toward overall Electronic Tax Administration (ETA).

In last year's report, ETAAC provided data to measure IRS progress toward improving taxpayer service through digital channels. Specifically, ETAAC provided FY2013 IRS data to show the total number of measured taxpayer service actions for the year. The committee also created an ETA Index to calculate the percentage of measured taxpayer service actions that were performed by digital tools – that is, the digital-to-manual service ratio.

For FY2013, of the more than 710 million taxpayer service interactions quantified by the IRS, 66% were performed through digital tools. However, ETAAC noted that the ETA Index was skewed by the "Where's My Refund?" tool. If individual refund status inquiries submitted through the "Where's My Refund?" tool were excluded³, the ETA Index dropped to 43%.⁴ Those initial ETA progress measurements provided a baseline to measure future IRS progress toward its goal of providing taxpayers with more service through digital channels.

ETAAC's 2015 report noted that the committee can't determine whether the IRS had optimized its manual-to-digital service ratio, because the IRS has not yet set initial goals for each taxpayer service category/segment. We recommended that the IRS work with Congress to establish digital service delivery goals to accurately measure progress.⁵

While the IRS quantified common taxpayer service interactions that formed baselines for the ETA Index, the IRS did not measure taxpayer interactions from compliance activity, such as responding to an IRS notice or audit. ETAAC and the IRS agreed that future ETAAC reports should expand to measure the impact of IRS digital compliance capabilities on IRS and taxpayer burden and compliance.

ETAAC originally intended to provide the ETA Index measurement every year, to expand public knowledge of how the IRS is using digital tools to deliver high-quality and timely service to taxpayers and to enforce compliance.⁶ The committee also intended to change these measurements as the IRS developed new metrics, to best provide a clear picture of IRS ETA progress. Presently, however, the IRS can't provide current measurements of total and electronic taxpayer service interactions as presented in last year's report. As such, ETAAC will not be reporting on ETA progress in this year's report.

³ For FY2013, 94% of these inquiries were completed through the digital "Where's My Refund?" application on IRS.gov and its mobile application, versus calling or visiting the IRS.

⁴ In 2015, ETAAC specifically excluded individual refund status inquiries from the ETA Index to better illustrate scenarios in which taxpayers require assistance or must complete a transaction. Taxpayers use the "Where's My Refund?" application broadly and conveniently to track their refund status. The accessibility and financial incentive related to this digital tool may have prompted heavy use of the application. Consider that almost 110 million individual taxpayers received a refund in 2013, but the IRS received more than 325 million inquiries requesting information on when taxpayers would receive their refunds. The digital tool has made it easier for taxpayers to make multiple inquiries, and skews the ETA Index measurement.

⁵ See the 2015 ETAAC report, Recommendations 2 and 8, in which ETAAC recommends that the IRS develop further metrics and goals to better measure its progress toward digital taxpayer service and compliance, and taxpayer adoption of digital tools.

⁶ ETAAC's charter specifically states that the committee is the public forum for discussion on reaching the IRS' electronic filing goals. As such, ETAAC will continue to make recommendations to increase the e-file rate in its annual report to Congress. However, ETAAC's charter has a broader purpose and scope that includes providing continued input into the development and implementation of the IRS' organizational strategy for electronic tax administration. In Objective 5 of the IRS Strategic Plan for 2014-2017, the IRS provides five critical strategies to invest in electronic tax administration capabilities that are essential to protecting taxpayer data and supporting taxpayers, partners and IRS business needs. (See IRS Strategic Plan 2014-2017, Objective 5, on pages 20-21, at <http://www.irs.gov/pub/irs-pdf/p3744.pdf>).

IRS FUTURE STATE INITIATIVE: NEW MEASUREMENTS

The IRS is formulating new goals and measurements that will define the optimal taxpayer service mix. In the IRS Future State Initiative, the IRS declared that it is developing enterprise goals to assess progress. Several taxpayer service metrics and goals include:

- Percentage of compliance issues resolved within one year of filing
- Percentage of self-assisted account actions completed by taxpayers
- Percentage of tax account interactions resolved through the most efficient channel
- Percentage of taxpayers with reoccurring compliance issues

The IRS has not identified the targeted goals for each of these metrics. As the IRS continues to refine its digital goals and measurements, ETAAC encourages the IRS to share these goals. ETAAC also encourages future committees to provide insight into IRS progress toward reaching its goals.

PROGRESS TOWARD 2015 RECOMMENDATIONS

During the past year, the IRS has taken several important steps to implement ETAAC's recommendations in its 2015 Annual Report to Congress.

In the 2015 report, ETAAC recommended that the IRS accelerate its digital strategy to meet taxpayer service needs, especially the growing taxpayer expectation for digital service. ETAAC provided recommendations to the IRS on how to encourage taxpayer adoption of digital service via online accounts. ETAAC also recommended specific improvements to IRS.gov to allow taxpayers to better understand their tax obligations.

ACCELERATING AN ADOPTABLE, DIGITAL TAXPAYER SERVICE STRATEGY

In January 2016, the IRS announced its Future State Initiative. The Future State Initiative is a strategic IRS plan to design, develop, and implement approaches to tax administration that are more proactive, accessible, and interactive.⁷ A foundational component of the IRS Future State vision is the development of online accounts that will allow taxpayers and their tax professionals to securely log in, get information about their tax account, and interact with the IRS as needed. ETAAC applauds the IRS for strategically planning its investment priorities to develop online accounts, consistent with ETAAC's 2014 and 2015 recommendations.

In January 2016, the IRS also began to develop goals for its Future State Initiative projects, including percentage goals for account interactions resolved through the most efficient channel, and percentage goals for taxpayers' self-assisted account actions. Although the IRS has not yet published these goals, this analytic approach shows progress toward ETAAC's recommendation that the IRS create, use and publish meaningful metrics that illustrate the effects of its digital investments and adoption of digital tools.

As a part of its Future State strategy, the IRS also plans to be more transparent with its stakeholders. It plans to provide investment prioritization and a development roadmap in its future strategic plans and budgeting. ETAAC applauds the IRS for these first steps that are consistent with the committee's 2015 recommendations. We also encourage the IRS to continue to be transparent with all stakeholders, including Congress and the tax industry, to gain buy-in on its Future State strategy.

IMPROVING IRS.GOV

ETAAC's 2015 report recommended that the IRS improve its website experience as part of a digital-first taxpayer service strategy. Specifically, ETAAC recommended that the IRS improve search and navigation, as well as content quality.

In 2015, the IRS made several significant improvements to IRS.gov, including improved search and content upgrades. The IRS rolled out new search capabilities that enabled users to find forms easier and faster. To date, data shows that users are now able to find forms with half the search effort.⁸

⁷ The IRS Future State Initiative is described in detail at <https://www.irs.gov/uac/Newsroom/Future-State-Initiative>. In its 2015 report, ETAAC recommended that the IRS accelerate a digital-first taxpayer service strategy in which taxpayers adopt comprehensive accounts that serve their needs, in lieu of contacting the IRS by phone or paper. ETAAC wants to emphasize that a digital-first strategy does not mean "digital-only." A digital-first strategy would serve taxpayers who prefer digital services and also create capacity for other channels to serve taxpayers by phone, paper, or in person.

⁸ IRS analysis using Google Analytics, forms search comparison new vs. old (12/1/2015-2/29/2016).

In 2016, the IRS has continued to enhance search efforts to provide more relevant search results. Users of a beta-site search were 20% less likely to need follow-up searches or query revisions.⁹

The IRS also created small teams of web content specialists who improved key IRS.gov pages that taxpayers visited the most, including pages on payments, filing, refunds, notices, foreign language, and credits and deductions. After the IRS improved the credits and deductions pages, visitor behavior indicated greater focus; better engagement with credits-related guidance, forms, topics, and publications; and a reduction in the use of help pages and search.¹⁰

The IRS needs to build on these improvements by fully testing and implementing more effective content management systems and improving overall governance to support a new publishing model. This will help ensure that all content is organized and written in easily understood plain language. The IRS also has to make IRS.gov more user-friendly by allowing users to more easily consume information on mobile devices through responsive design. This will allow the IRS to reach users who rely on smartphones as their primary access to online information. An improved IRS.gov will play a crucial role in the Future State service model.

TAX IDENTITY THEFT PROGRESS

In past reports and in public testimony, ETAAC has emphasized the need for the IRS to strategically address the growing abuses of tax identity theft. In 2015, the IRS formed the Security Summit, a coalition of IRS, state, and industry leaders, in an effort to combat the abuses of tax identity theft and Stolen Identity Refund Fraud. This collaboration between the IRS and important industry stakeholders is a big step in the right direction for effectively addressing this major challenge in tax administration.

COLLABORATING WITH INDUSTRY AND GOVERNMENT STAKEHOLDERS

In 2015 and in prior reports, ETAAC has recommended that the IRS work with industry and government partners to solve tax administration challenges, such as improving taxpayer service. The Future State Initiative is an example of where the IRS must collaborate with industry and partners.

Industry partners can help the IRS design a more modern taxpayer service experience to achieve taxpayer adoption of the IRS digital service strategies. Consistent with ETAAC's 2015 recommendation describing New York State's success with implementing online tax accounts, the IRS should also proactively engage and collaborate with state departments of revenue to find and execute the best solutions. Finally, IRS transparency with Congress, including the proposed benefits of each major development milestone, will foster accountability and trust among government stakeholders in the IRS' long-term strategy.

PRIOR REPORT RECOMMENDATIONS

In 2016, the IRS has made advancements in several key areas that ETAAC addressed in reports before 2015.

E-FILING OBSTACLES FOR EMPLOYMENT TAX RETURNS

In its 2014 report, ETAAC recommended that the IRS implement initiatives to remove barriers to e-filing for small businesses, to increase the electronic filing of employment tax returns (Form 94x series). Such

⁹ IRS analysis using Google Analytics, based on Top 100 queries, ranked by site search volume (2/1/2016-2/29/2016).

¹⁰ IRS analysis using Google Analytics, Credits and Deductions section activity, (1/30/2014-4/15/2014, 1/20/2015-4/15/2015).

initiatives included improving the e-signature method, taxpayer outreach, industry engagement, and review and update of published materials on IRS.gov.

Since February 2014, the IRS has been developing a strategy for increasing the volume of electronic returns filed by business taxpayers, including employment tax returns. In the past year, the IRS concluded that the e-signature process is a major barrier to e-filing Forms 94x, consistent with ETAAC's findings in its 2014 report. As a solution to this issue, the IRS has proposed a Form 94x online signature personal identification number (PIN). This solution has been proposed for development in FY2018.

The IRS is also exploring a free or low-cost option for e-filing Forms 94x. The IRS has engaged the Bureau of Fiscal Services to explore conducting a study on whether it is feasible to allow for the e-filing of employment tax returns on the EFTPS platform.

The Form 94x series remains the biggest opportunity for e-file rate improvement. The IRS has incorporated Form 94x improvements and other e-file opportunities as part of its overall Future State strategy.

CONSOLIDATED AUTHENTICATION PROCESS

In 2014, ETAAC recommended that the IRS implement one IRS-issued PIN as the authentication component of an e-signature. ETAAC also recommended that the IRS expand a better, standardized authentication mechanism to all form types requiring an electronic signature.

Related to these previous authentication recommendations, the IRS is developing an enterprise-wide authentication strategy for all IRS interactions, which it plans to finalize later in FY2016. The IRS is also collaborating with the Security Summit on this strategy.

EMERGING ENVIRONMENT AND CHALLENGES

The environment in which the IRS performs its role as the nation's tax administrator is constantly evolving. In 1998, the IRS' primary electronic tax administration challenge was to encourage taxpayers to file their tax returns electronically. During the past 18 years, ETAAC has made many recommendations to improve e-filing and to increase the e-file rate to 80% for all major tax return types. The IRS has implemented many of these recommendations and other efficiencies to bring the e-file rate for individual taxpayers beyond the 80% goal set by Congress in 1998.

The IRS will continue to make improvements to bring the individual e-file rate to 90%.¹¹ The IRS will also consider additional substantive changes to increase overall e-filing rates, including improving the employment tax return filing process, allowing for the e-filing of amended returns, and removing other barriers for all return filers.

While the IRS has achieved success in e-filing, the past six years have exposed two new large-scale challenges in electronic tax administration:

- Combating refund fraud and other abuses born from the proliferation of tax identity theft, and
- Transforming the agency to better serve taxpayers and promote compliance through use of electronic or digital interactions with taxpayers.

Evolving taxpayer preferences, technology-driven customer service, reduced funding, and an increasingly complex tax code to administer have exerted pressure on the IRS to change the way it does business. Now, the IRS must find solutions for fulfilling its mission with the resources available.

ETAAC has made recommendations to Congress and the IRS to transform taxpayer service and compliance through effective electronic tax administration. To accomplish this transformation, the IRS, Congress and other stakeholders must understand and evaluate how the following critical environmental factors will affect tax administration now and in the years ahead.

TAX IDENTITY THEFT PROLIFERATION

More than 80% of all tax filers receive a refund, averaging almost \$3,000, and they are not required to authenticate their identities before filing. The IRS can't validate income and withholding information from third-party sources at the time of filing. Add to that the expectation that the IRS will send refunds within 21 days. This is the ideal environment for Stolen Identity Refund Fraud (SIRF).

Tax identity theft, and corresponding SIRF, is compromising the integrity of our tax system. Each year, the U.S. Treasury loses billions of dollars to SIRF. The IRS is working to combat this problem, but millions of taxpayers are still affected every year. Thousands of IRS employees are working on SIRF cases when they could otherwise be redirected to improve taxpayer service or compliance.

In 2015, IRS Commissioner John Koskinen formed the Security Summit, a coalition of representatives from the IRS, state tax agencies, and private industry, such as software vendors, to provide recommendations to the IRS to combat SIRF for the next filing season and the future. The Security

¹¹ The IRS Strategic Plan for 2014-2017 sets a performance goal for e-filing of individual returns at 90%. See. <https://www.irs.gov/pub/irs-pdf/p3744.pdf>

Summit made several recommendations for the 2016 filing season that can be viewed at <https://www.irs.gov/uac/Newsroom/Security-Summit-2015>.

In future reports, ETAAC will evolve its focus and efforts to finding solutions that combat SIRF and other abuses born from tax identity theft.

The following tables report the latest data on tax identity theft volume and burden, taken from the Government Accountability Office (GAO) and other government resources, as of April 13, 2016.¹²

Table 4: Tax identity theft volume for TS2014

| Volume measure for each tax season (TS) | TS2014 |
|---|---------------|
| Number of identified Stolen Identity Refund Fraud (SIRF) return filing attempts ¹³ | 4.9 million |
| Number of SIRF returns stopped before issuing refunds (%) | 3.6 million |
| Money lost to SIRF | \$3.1 billion |
| Number of new employment-related tax identity theft cases | unknown |

Table 5: Tax identity theft burden for FY2014

| Burden measurements (by FY) | FY2014 |
|--|---------------------------|
| IRS employees assigned to tax identity theft cases | >3,000 |
| Taxpayer Advocate Service tax identity theft cases | 57,929 ¹⁴ |
| Calls to IRS tax identity theft toll-free help line | unknown ¹⁵ |
| Average time for SIRF return refund to be reissued ¹⁶ | 312 days |
| Number of Identity Protection Personal Identification Numbers (IP PINs) issued | 1.2 million ¹⁷ |

This data provides a baseline of the current impact of tax identity theft on taxpayers and the IRS. As ETAAC focuses more on solutions to address the abuses of tax identity theft, volume and burden data should reflect the impact of these solutions.

THE FUTURE STATE INITIATIVE AND MODERNIZING TAXPAYER SERVICE

Notwithstanding electronic filing, the IRS is still mired in a manual taxpayer service delivery model that relies on interactions using people, paper, and phones to serve taxpayers. The IRS understands the need to move from the current model to create more efficient, scalable service and compliance delivery models for the taxpayers who prefer them. This approach is not only necessary to increase service and compliance levels at the IRS, but it is also what consumers are increasingly demanding of all service providers.

¹² ETAAC made several requests to the IRS to quantify the volume of tax identity theft and its burden on taxpayers and the IRS. The IRS was not able to provide this data and directed ETAAC to GAO reports that quantify the effects of tax identity theft. The GAO has provided volume and burden data for 2013 and 2014 returns. See <http://www.gao.gov/assets/670/667965.pdf> and <http://www.gao.gov/assets/680/676493.pdf>, respectively. In 2014, the GAO provided a comprehensive list of initiatives that the IRS implemented to combat tax identity theft. However, the GAO did not provide the measured effect that each initiative had on the volume of tax identity theft and the burden on taxpayers and IRS resources.

¹³ These amounts do not include undetected tax identity theft returns. See GAO report at <http://www.gao.gov/products/GAO-16-589T?>

¹⁴ See <http://www.taxpayeradvocate.irs.gov/2013-Annual-Report/downloads/Case-Advocacy.pdf>.

¹⁵ The IRS has not provided data for 2014. However, for the first 2½ months of the 2016 filing season (January 1 to March 19, 2016), the IRS received 1.1 million calls to its toll-free tax identity theft hotline. See <http://www.gao.gov/assets/680/676493.pdf>.

¹⁶ https://www.treasury.gov/tigta/congress/congress_04192016.pdf.

¹⁷ The IRS reported that 2.7 million IP PINs were issued two years later, in 2016.

In 2016, and consistent with ETAAC's 2015 recommendations, the IRS publicly committed to all of its stakeholders to a Future State service model that embraces technology for digital taxpayer service. In February 2016, the IRS released its initial version of its Future State Initiative¹⁸, outlining how it will achieve its strategic service and compliance goals through a more modern IRS.

ETAAC applauds this important first public step but emphasizes that the IRS needs to develop tangible goals and timelines for execution to effectively deliver on its plans. Looking ahead, the IRS will need to stay committed to its digital taxpayer service plans according to a defined roadmap and in coordination with important stakeholders.

For the IRS to achieve its Future State vision, ETAAC is concerned about the IRS' capability to attract and hire the appropriate information technology talent that will allow the IRS to build important Future State projects. Right now, the IRS has lost streamlined critical pay authority, which allows the IRS to hire candidates faster and compensate them competitively. On April 18, 2016, the Joint Committee on Taxation¹⁹ proposed reinstating critical pay authority for designated information technology positions, through 2021. ETAAC agrees with this proposal and urges Congress to reinstate this authority for IT positions, so the IRS can attract, hire, and retain important IT positions.

RELATIONSHIP BETWEEN THE IRS AND CONGRESS

One of the greatest challenges to tax administration is building collaboration and closing the communication gap between Congress and the IRS. The strained relationship between the IRS and Congress in recent years calls for greater transparency and collaboration.

To overcome this challenge, the IRS will also need to quantify goals related to each of its important strategic initiatives and hold itself accountable for meeting these goals.²⁰ If the IRS is transparent about its plans and better aligns its strategic priorities to its budget, the IRS will build trust with Congress and taxpayers.

RESPONSIBILITIES, BUDGET, AND PRIORITIES

The IRS continues to be challenged to increase its efficiency and rethink how it administers the nation's tax laws. During the past several years, this challenge has included increased workloads²¹ without appropriations for additional resources. To relieve some of this pressure, in 2015, Congress funded the IRS with \$290 million to develop authentication techniques, improve the identification and prevention of refund fraud and identity theft, and improve service on taxpayer phone lines. During the 2016 filing season, the IRS reported a 73% level of service, compared with 37.4% during the previous year.

¹⁸ See <https://www.irs.gov/uac/Newsroom/IRS-Future-State>. This Future State Initiative released in February 2016 is not the final plan. The IRS is still working on important elements of the plan, including measurements and goals to meet the plan's objectives.

¹⁹ Joint Committee on Taxation, *Description of the Chairman's First Modification to the Chairman's Mark of a Bill to Prevent Identity Theft and Tax Refund Fraud* (JCX-27-16), April 18, 2016. This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

²⁰ The six strategic themes of the IRS Future State Initiative are: Improve voluntary compliance through better tools, service, and information; Understand noncompliance and develop strategies to change behavior; Leverage and collaborate with critical stakeholders; Cultivate a high-performing, flexible, skilled, and diverse workforce; Use data analytics to select high-value work to deter noncompliance, with constant data feedback to improve operational efficiency and effectiveness; and Make the IRS a more efficient, effective and agile organization.

²¹ The IRS does not have specific funding to implement the Patient Protection and Affordable Care Act, the Small Business Health Care Tax Credit, third-party collection, passport limits, TS2017 refundable credit legislation, FATCA, and other changes to the tax code.

Budget reductions during the past five years have resulted in reduced enforcement efforts, such as audits and underreporter notices. The amount of taxes owed to the U.S. Treasury is at an all-time high, in excess of \$400 billion.²²

What remains unknown is the long-term effect of reduced service and enforcement activity on voluntary compliance and tax collection. The IRS completed the last in-depth Tax Gap study based on 2006 returns, indicating that 83.1% of taxes were voluntarily filed, reported, and paid. ETAAC recommends that the IRS complete a more current tax gap measurement and assessment to shed light on the effects of reduced enforcement and taxpayer service on voluntary compliance.²³

When focusing on strategic priorities, the IRS should build on the positive taxpayer behaviors that encourage voluntary compliance while keeping pressure on noncompliance through audit. However, it is not realistic for the IRS to “audit its way out of the tax gap.”²⁴ As such, the IRS should find the correct balance between compliance enforcement and taxpayer service in achieving voluntary compliance.

These are four major environmental challenges facing the IRS and its ability to administer the nation’s tax laws. ETAAC recognizes that the IRS is facing many other tax- and non-tax-related environmental challenges, such as increasing globalization, new legislative requirements, and a changing cybersecurity landscape. As such, the IRS is continually confronting new and diverse challenges. In this report, ETAAC’s recommendations respond to the four major challenges listed above, and in future years, ETAAC will continue to analyze current and emerging environmental factors to shape its recommendations.

²² This amount refers to the IRS’ overall accounts receivable balance. See <https://www.treasury.gov/tigta/auditreports/2016reports/201630004fr.html>

²³ In April 2016, the IRS restated the tax gap for tax years 2008-2010: <https://www.irs.gov/PUP/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>. However, this estimate doesn’t reflect the long-term effects of reduced resources on the tax gap, because the IRS experienced continued budget reductions starting in 2010. To truly understand the long-term effects of reduced budgets on overall compliance, the IRS needs to study tax years after 2010. It should be noted that overall tax collection for 2015 was the highest on record. ETAAC understands that this may be due to a variety of circumstances, including an improved economy. As such, the IRS needs to specifically measure the overall compliance rate to determine whether reduced compliance enforcement has a specific effect on this rate.

²⁴ See the testimony of former IRS Deputy Commissioner for Services and Enforcement Steven Miller to the House Committee on Oversight and Government Reform, on April 19, 2012, at <https://oversight.house.gov/wp-content/uploads/2012/04/4-19-12-Miller-Testimony.pdf>.

ETAAC 2016 RECOMMENDATIONS

The following is a complete listing of ETAAC's 2015 key outcomes and recommendations:

Key Outcome 1: Improved tax compliance and greater fraud prevention and detection through changes to the tax ecosystem.

Recommendation 1: The IRS should provide a voluntary registration process for tax filers to authenticate their identities.

Recommendation 2: The IRS should release refunds only after the IRS can reasonably verify taxpayers and their withholding.

Recommendation 3: The IRS should require payers to collect a certified Taxpayer Identification Number (TIN) from all contractors receiving payments subject to Form 1099-MISC reporting for non-employee compensation.

Recommendation 4: The IRS should expand access to TIN-matching functionality beyond information returns where payments are subject to backup withholding.

Recommendation 5: The IRS should remove barriers to adoption of TIN-matching functionality to facilitate increased use of the application.

Recommendation 6: The IRS should add an indicator to Forms 1099 allowing payers to flag payments made to presumed U.S. persons subject to backup withholding, so as to exclude these information returns from B Notices.

Recommendation 7: The IRS should automatically issue penalty notices for all missing or incorrect TINs and require proof that the payee was TIN-matched as part of any reasonable cause rationale for penalty abatement.

Recommendation 8: Given recent regulatory changes, the IRS should ensure that information return filing systems can successfully accommodate increased filing volumes in reduced timeframes.

Recommendation 9: The IRS should introduce a phased reduction of the threshold for mandatory electronic filing of Forms 1099-MISC from 250 forms to 20 forms.

Recommendation 10: Congress should fund the IRS specifically to compile information returns in a manner that allows real-time matching of tax returns to information returns on file.

Recommendation 11: Congress should provide the IRS with the authority to question and correct returns that do not match information returns.

Key Outcome 2: Taxpayers leverage online information and tools to better understand and comply with their tax responsibilities before, during, and after filing.

Recommendation 12: The IRS should provide taxpayers with secure online access to view and understand their tax information, tax obligations, and compliance status with the IRS.

Recommendation 13: The IRS should provide event-driven notifications related to IRS account actions to help taxpayers comply.

Recommendation 14: In addition to enabling online accounts that provide taxpayers with information and tools to help before and during filing, the IRS should add capabilities for taxpayers to interact with the IRS electronically for post-filing activity.

Recommendation 15: Taxpayers should be able to authorize third parties, such as tax professionals, Volunteer Income Tax Assistance (VITA) sites and tax software providers, to electronically receive tax account information as part of the tax preparation process.

Recommendation 16: The IRS should provide tax professionals who complete an enhanced Annual Filing Season Program and certified VITA volunteers with the same level of authorized access to taxpayers' online tax information that Circular 230 tax professionals receive.

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

KEY OUTCOME 1

POLICY AND PROCEDURAL CHANGES TO THE TAX SYSTEM ARE REQUIRED TO IMPROVE THE INTEGRITY OF THE TAX SYSTEM.

Key Outcome 1: Improved tax compliance and greater fraud prevention and detection through changes to the tax ecosystem.

Recommendations for this outcome:

Recommendation 1: The IRS should provide a voluntary registration process for tax filers to authenticate their identities.

Recommendation 2: The IRS should release refunds only after the IRS can reasonably verify taxpayers and their withholding.

Recommendation 3: The IRS should require payers to collect a certified Taxpayer Identification Number (TIN) from all contractors receiving payments subject to Form 1099-MISC reporting for non-employee compensation.

Recommendation 4: The IRS should expand access to TIN-matching functionality beyond information returns where payments are subject to backup withholding.

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Recommendation 11: Congress should provide the IRS with the authority to question and correct returns that do not match information returns.

Background on Key Outcome 1

Identity theft and refund fraud are persistent and ever-evolving threats to the stability and integrity of the U.S. tax system.²⁵ While the IRS has rolled out initiatives designed to address these challenges, few represent as significant opportunities to combat these threats as authenticating taxpayers prior to filing and harnessing the potential power of existing third-party information return filings.

Information returns have long represented the bedrock of the U.S. tax system. These filings increase voluntary compliance and assist the IRS in verifying the accuracy of tax returns.²⁶

The IRS anticipates that more than 2.3 billion information returns will be filed in 2016.²⁷ This number includes two series of forms that millions of taxpayers receive every year:

- Form W-2 series for payroll reporting
- Form 1099 series, including Form 1099-MISC reporting of non-employee compensation

The IRS' existing technology is unable to fully leverage the information of these filings for the benefit of the taxpayer. Likewise, certain regulatory provisions prevent the IRS from fully realizing the potential benefits.

This key outcome will discuss how Congress and the IRS can implement changes to the tax ecosystem and utilize information returns to combat fraud and fraudulent refund claims, and improve voluntary compliance.

Detailed recommendations

Recommendation 1: The IRS should provide a voluntary registration process for tax filers to authenticate their identities.

Detail on this recommendation:

For this recommendation, it's valuable to start by examining how most financial service companies interact with their customers to conduct business and provide customer service.

Financial service companies require their customers to register with them before conducting ongoing business. During the registration process, customers create an account and establish a relationship with their service provider. Online registration processes generally include two important elements:

- **First, customers authenticate their identities.** They get an account number and create security credentials, such as a user name, password, and additional security features to match their identity and appropriately authorize transactions.

²⁵ "Identity Theft an Ongoing Concern on the IRS Annual 'Dirty Dozen' List of Tax Scams to Avoid." Tax identity theft occurs when an individual intentionally uses the personal identifying information of another person to file a falsified tax return and obtain an unauthorized refund. See <https://www.irs.gov/uac/Newsroom/Identity-Theft-an-Ongoing-Concern-on-the-IRS-Annual-Dirty-Dozen-List-of-Tax-Scams-to-Avoid>. Refund fraud can also consist of inventing income to erroneously qualify for refundable credits, such as the Earned Income Tax Credit.

²⁶ When queried, 62% of the public indicated that information reporting has either a great deal of influence or somewhat of an influence on whether they honestly report and pay their taxes, according to the IRS Oversight Board 2014 Taxpayer Attitude Survey. Similarly, as per TAX REFUNDS - IRS Is Exploring Verification Improvements, but Needs to Better Manage Risks, GAO-13-515, Report to the Committee on Finance, U.S. Senate (June 2013), "An IRS study of individual tax compliance found that in tax year 2006, taxpayers accurately reported over 90 percent of income with substantial information reporting requirements, such as interest and dividend income. In contrast, the same study found taxpayers accurately reported only 44 percent of income subject to little or no information reporting, such as nonfarm sole proprietor income."

²⁷ IRS Publication 6961 (2015 update).

- **Then, businesses explain their terms and expectations to customers.** As customers set up their accounts, they have the opportunity to understand the terms and conditions by which transactions will occur between the business and the customer.

As a result of this registration and introduction process, customers now understand how to do business with the financial services firm. They also now have a means to validate future transactions.

Taxpayers do not have the same registration experience with the IRS

Tax filers don't formally register or receive any structured education on their tax obligations. Generally, the first time taxpayers start to understand their obligations and how to comply with them is when they first have a filing requirement.

New filers typically don't learn about their tax obligations from the IRS. Rather, a third party informs them of the requirement to properly withhold or make estimated tax payments and file a return. The third party is usually a new employer, a parent, or a tax professional.

In addition, because taxpayers don't formally register with the IRS, the IRS can't always authenticate taxpayers when they enter and exit the system, or have a new tax obligation. With unclear terms of engagement, taxpayers are left on their own to understand and comply with their tax obligations. They are also left wondering how to interact with the IRS if they need information or have a question.

The IRS should register, educate, and incentivize filers to enter the system

ETAAC recommends that the IRS set up a filer-registration process that would allow taxpayers to:

- Confirm their identity,
- Receive one or more security credentials to authenticate their identity during the tax-filing process,
- Understand their tax-filing and payment obligations, and
- File a return each year and conduct ongoing business with the IRS.

Taxpayers could complete the tax-filer registration process in different ways:

- New filers²⁸ could submit information to confirm their identity by setting up an online account or completing a first-time filing process.²⁹
- Existing filers could register online or submit their information during the tax-preparation process.
- Filers could also register by visiting an IRS taxpayer assistance center or an IRS-certified third-party service provider.³⁰

Taxpayer incentives to enter the system are important to encourage taxpayer registration. Taxpayers who register and authenticate their identities at filing would receive their refunds faster. Taxpayers who don't register would wait to receive a refund until the IRS could reasonably validate their identities by other means.

²⁸ The Form W-4 could provide information on tax-filing obligations, as well as how to register with the IRS.

²⁹ For example, the first-time filing process could include a special form that would register taxpayers, and/or an extended verification process that would allow the IRS to validate the taxpayer's identity.

³⁰ Authorized third-party service providers could include financial institutions, other government agencies, and tax and accounting firms.

Registration would be a win-win for filers and the IRS

Tax-filer registration would accomplish two major goals: It would allow the IRS to confirm the identities of tax filers and provide an opportunity to educate taxpayers about a new, safe channel to communicate electronically with the IRS.

New filers could also benefit from this experience, because compliance with any requirement starts with a full understanding of the rules. If the IRS makes the rules transparent, it will be easier for taxpayers to *voluntarily* understand and comply with their requirements.

Taxpayer registration could also consolidate the many existing authentication and PIN processes into a single standard, which would alleviate taxpayer confusion and burden.

As ETAAC has recommended in the past, a registration process would provide an opportunity for the IRS to gain adoption of online accounts and encourage taxpayers to do business electronically and securely with IRS.

Recommendation 2: The IRS should release refunds only after the IRS can reasonably verify taxpayers and their withholding.

Detail on this recommendation:

The IRS issues more than 90% of refunds in less than 21 days.³¹ As mentioned previously, the IRS does not receive Form W-2 data or other information return data until after the filing season begins, and does not compile all such data for several months thereafter. As a result, the IRS frequently receives information returns too late to match tax return wage data against employer wage data prior to issuing refunds.

Industry analysts view this haste in issuing refunds as directly contributing to tax fraud and identity theft. “America is addicted to fast refunds. ... What we need from politicians is permission to process a return for a month or two before sending out a refund,” said Verenda Smith, an official at the Federation of Tax Administrators (FTA), in a *Wall Street Journal* article.³²

In 2015, Congress took an initial step in this direction with a new provision in the Consolidated Appropriations Act, 2016, P.L. 114-113, which allows the IRS to postpone until February 15 paying refund claims that are based on the Earned Income Tax Credit. This change becomes effective for the 2017 filing season. However, this change will do little to combat refund fraud where thieves claim refunds based on false Form W-2 withholding.

Some state tax authorities delayed refunds for the 2016 filing season, given concerns about tax fraud and identity theft. Illinois announced on January 4, 2016, that it did not anticipate issuing any refunds until March 1, 2016.³³ The press release announcing the delay specifically stated that “the decision

³¹ See <https://www.irs.gov/Refunds/Tax-Season-Refund-Frequently-Asked-Questions>, <https://www.irs.gov/Refunds/What-to-Expect-for-Refunds-This-Year>.

³² The Wall Street Journal, “Congress Starts Its Own TurboTax Probes,” by John D. McKinnon and Laura Saunders. Feb. 16, 2015, 7:20 p.m. ET.

³³ Fraud Prevention Measures to Delay Tax Refunds in 2016. State of Illinois press release, Jan. 4, 2016.

comes as fraud prevention efforts from last year's tax season illustrate the positive impact that additional delays and scrutiny have had in combating tax return fraud and identity theft."³⁴

Hawaii's Department of Taxation also indicated that it may delay certain refunds by as much as 16 weeks.³⁵ Utah's legislature passed a law prohibiting refunds before March 1, unless the employer and the employee had filed all required returns and forms by January 31.³⁶

FTA's Smith stated that state refund delays are "a clear trend," because the additional time allows tax authorities to match the various disparate sources of information they receive against taxpayer returns. This way, states can validate that they are issuing refunds to the appropriate taxpayers. Other states have followed this trend and are withholding refunds until they can reasonably identify taxpayers.³⁷

ETAAC recommends that the IRS adopt similar practices and delay refunds until it can reasonably verify taxpayers and their withholding. While there are positive and negative consequences of this plan, ETAAC views such a process as critical in guarding against fraud.

Recommendation 3: The IRS should require payers to collect a certified Taxpayer Identification Number (TIN) from all contractors receiving payments subject to Form 1099-MISC reporting for non-employee compensation.

Detail on this recommendation:

Payers making aggregate non-employee compensation payments of more than \$600 to certain parties as part of a trade or business must report these payments on a Form 1099-MISC each year. Before making any payments, the payer must collect a U.S. TIN for each vendor or apply 28% backup withholding.

Currently, the IRS doesn't require vendor-payment TINs to be certified, meaning that vendors don't have to provide their TINs on Form W-9 signed under the penalties of perjury.³⁸ Vendors can provide the TIN orally, included on an invoice, etc. However, given the potential for errors in this process, payers have significant name-TIN mismatches.

These gaps in data integrity prevent the IRS from timely and accurately matching Forms 1099-MISC against income. They also increase the risk that these information returns could be used for fraud or identity theft. Requiring a certified TIN for Form 1099-MISC payments would minimize this risk and increase compliance.

³⁴ Id.

³⁵ State of Hawaii Department of Taxation, Jan. 8, 2016. See <http://tax.hawaii.gov/>.

³⁶ Utah State Tax Commission, November 2015 Notice, New Annual Reconciliation Requirements.

³⁷ Wall Street Journal, "Congress Starts Its Own TurboTax Probes," by John D. McKinnon and Laura Saunders. Feb. 16, 2015, 7:20 p.m. ET. See also <http://www.dontmesswithtaxes.com/2016/01/state-tax-refunds-to-be-delayed-in-illinois-louisiana-utah-because-of-tax-identity-theft-procedures.html>.

³⁸ Form W-9, *Request for Taxpayer Identification Number and Certification* (Rev. December 2014). Instructions provide that with respect to Other Payments, "You must give your correct TIN, but you do not have to sign the certification unless you have been notified that you have previously given an incorrect TIN. "Other payments" include payments made in the course of the requester's trade or business for rents, royalties, goods (other than bills for merchandise), medical and health care services (including payments to corporations), payments to a nonemployee for services, payments made in settlement of payment card and third-party network transactions, payments to certain fishing boat crew members and fishermen, and gross proceeds paid to attorneys (including payments to corporations).

There is precedent for requiring a certified TIN for certain types of payments. For example, financial institutions must collect certified TINs before making interest payments.³⁹ Imposing this requirement would represent minimal incremental effort for payers, because collection of certified TINs is already an industry-accepted best practice.

Recommendation 4: The IRS should expand access to TIN-matching functionality beyond information returns where payments are subject to backup withholding.

Detail on this recommendation:

Payers are required to obtain the TINs of payees and include the TINs on information returns they file with the IRS and statements they furnish to recipients. The IRS validates the information returns it receives against tax returns. This matching process allows the IRS to verify the accuracy of tax returns and identify and stop tax refund fraud, including fraud resulting from identity theft.

The effectiveness of this validation and matching process are entirely dependent upon the integrity of the data – specifically that there must be a match between the name and the TIN. The IRS TIN-matching platform allows withholding agents to proactively validate the name and TIN combination in their records against information in IRS systems.⁴⁰

However, the IRS limits access to this system to information-return filers issuing Forms 1099 that are subject to backup withholding under Internal Revenue Code (IRC) Section 3406.⁴¹ This includes Forms 1099-B, 1099-DIV, 1099-INT, 1099-K, 1099-MISC, 1099-OID, and 1099-PATR.⁴²

The significant benefits of TIN-matching for the IRS and taxpayers justify expanding access to all information-return filers.⁴³ For the IRS, expanding access would mean improved data integrity and more efficient use of information returns to verify taxpayer returns and combat fraud. This would reduce correspondence with payers and filers, and drive administrative efficiencies.

For payers, expanded access to the TIN-matching system would allow them to resolve mismatches with payees before filing information returns. That would reduce penalties for filing information returns with incorrect TINs and eliminate correspondence with the IRS to establish reasonable cause.

ETAAC, therefore, recommends expanding access to TIN-matching functionality to any information returns that can trigger penalty notifications. This would increase data integrity and prevent fraud.⁴⁴

³⁹ See id. “[With respect to] Interest, dividend, broker, and barter exchange accounts opened after 1983 and broker accounts considered inactive during 1983. You must sign the certification or backup withholding will apply.” See also 26 U.S.C. §3406(a)(1).

⁴⁰ The IRS TIN-matching program permits payers to verify payee TINs required to be reported on information returns and payee statements. Before filing an information return, a participant may check the TIN furnished by the payee against the name/TIN combination contained in the IRS database maintained for the program. The IRS will inform the payer whether the name/ TIN combination furnished by the payee matches a name/TIN combination in the database. The purpose of the program is to help avoid TIN errors and reduce the number of backup withholding notices required under Section 3406(a)(1)(B) of the Internal Revenue Code. Rev. Proc. 2003-9 introduced the TIN-matching system used today as an expansion of a previous system that was restricted to federal agencies.

⁴¹ Publication 2108A (Rev. 1-2013).

⁴² Publication 1281 (Rev. 12-2014).

⁴³ The IRS rationale for requiring Congressional authorization to expand TIN-matching access appears to be that the program discloses return information that is subject to protection from unauthorized disclosure under Section 6103. Publication 2108A, section 4(2).

⁴⁴ Expansion of access to IRS TIN-matching functionality is a long-standing recommendation made by a number of advisory organizations. ETAAC previously addressed this in its 2012 annual report. The Information Reporting Program Advisory Committee (IRPAC) first recommended expansion of the TIN-matching program in 2002. The IRPAC Burden Reduction Subgroup, Emerging Compliance Issues Subgroup, and Employee Benefits and Payroll Subgroups also recommended expansion in 2013, and the topic was elevated to an IRPAC-wide issue in 2014. The

Continued

Recommendation 5: The IRS should remove barriers to adoption of TIN-matching functionality to facilitate increased use of the application.

Detail on this recommendation:

The IRS should review existing barriers to adoption for the TIN-matching system, including an overly cumbersome authentication scheme. The current TIN-matching registration process requires withholding agents to designate an employee to register for the service. That employee must provide personal information – including name, address, Social Security Number, and prior-year adjusted gross income, as reported on his or her individual tax return. Once the employee registers, it takes several days for the IRS to issue and mail the individual a personal identification number to finalize the registration process.

The requirement that employees provide detailed personal information, such as adjusted gross income, is a considerable barrier to getting withholding agents to register for the TIN-matching system. Similarly, the requirement represents an insurmountable barrier for U.S. withholding agents outside of the U.S., because their employees typically do not have U.S. TINs or file U.S. tax returns.

The IRS should allow access to the TIN-matching system only through a robust authentication system, and should look to leverage other existing authentication schemes, such as those for online account functionality.

Recommendation 6: The IRS should add an indicator to Forms 1099 allowing payers to flag payments made to presumed U.S. persons subject to backup withholding, so as to exclude these information returns from B Notices.⁴⁵

Detail on this recommendation:

Under current regulations, payments made to undocumented individuals must be presumed to be made to U.S. persons.⁴⁶ This generally means the payment is subject to 28% backup withholding and Form 1099 reporting.

For example, assume a U.S. financial institution maintains an account for a non-U.S. person currently documented with a valid Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals)*. That Form W-8 expires December 31, 2016. If the financial institution doesn't receive a new form, the financial institution must presume the account holder to be a U.S. person; complete 28% backup withholding on payments of fixed, determinable, annual, or periodic income; and complete Form 1099 reporting. Because this non-U.S. person does not have a U.S. TIN, the IRS will issue the financial institution a B Notice, despite the fact the financial institution is already correctly completing backup withholding and attempting to obtain an updated Form W-8. Such B Notices are erroneous and clog the system, which results in non-value-added work for

Department of Treasury has proposed expansion, and the National Taxpayer Advocate has recommended it, as well. In 2003 and 2004, Congress considered legislation to this effect, but couldn't reconcile differences between the House and Senate versions of the legislation.

⁴⁵ A "B Notice" is a CP2100 or CP2100A notice to payers that Forms 1099 have been filed with either missing TINs or incorrect name/TIN combinations. In response to a first B Notice, a payer is required to collect a certified Form W-9 from the payee within 15 days. In response to a second B Notice (e.g., the payer receives two B Notices within a three-year period for the same payee), the payer is required to collect a copy of a Social Security card from an individual or an IRS Letter 147C.

⁴⁶ §1.1441-1(b)(3)(ii)(B); §1.6049-5T(d)(2)(i).

payers and the IRS. This reduces resources that could otherwise be focused on combating identity theft and refund fraud.

Therefore, ETAAC recommends that the IRS implement an indicator on Forms 1099 allowing payers to flag these scenarios and therefore avoid B Notices. There is precedent for this. For tax year 2015, the IRS introduced a box on Forms 1099-MISC to designate that the payer had received a second B Notice for the account.⁴⁷ When payers check the box, the IRS will not send further communications related to the account.

Recommendation 7: The IRS should automatically issue penalty notices for all missing or incorrect TINs and require proof that the payee was TIN-matched as part of any reasonable cause rationale for penalty abatement.

Detail on this recommendation:

If a payer issues a Form 1099 or other information return statement with a missing U.S. TIN or an incorrect name-TIN combination, the IRS will issue a penalty under Section 6721 for failure to file a correct information return.⁴⁸ Currently, this penalty is generally \$260 per payee, with an annual cap of \$3,178,500 per payer.⁴⁹ While the IRS may abate these penalties based on reasonable cause, payers are frequently unclear about what exactly constitutes reasonable cause.

TIN-matching is currently an optional service available within IRS e-Services. However, the IRS and practitioners strongly encourage payers to use the system to proactively identify and correct name-TIN mismatches that would otherwise slow the IRS matching process.

Given the importance of data integrity in mitigating fraud and identity theft, the IRS should require proof of TIN-matching as part of any reasonable cause justification for penalty abatement – assuming that the IRS removes barriers to adoption, as discussed in Recommendation 5 above.

There is precedent for such an approach. For example, as part of the Foreign Account Tax Compliance Act (FATCA), the IRS requires U.S. withholding agents and participating foreign financial institutions to validate the Global Intermediary Identification Numbers of participating and registered deemed compliant foreign financial institutions on an annual basis.⁵⁰

Recommendation 8: Given recent regulatory changes, the IRS should ensure that information return filing systems can successfully accommodate increased filing volumes in reduced timeframes.

Detail on this recommendation:

The Protecting Americans from Tax Hikes (PATH) Act of 2015 accelerates the filing deadline for Forms W-2 and W-3, and Forms 1099-MISC reporting non-employee compensation. Starting in the 2017 filing season, these forms must be filed by January 31.⁵¹ That deadline is accelerated by 30 days for paper filers and 60 days for electronic filers versus current requirements. This change will mean that the IRS

⁴⁷ 2015 Instructions for Form 1099-MISC.

⁴⁸ 26 U.S. Code § 6721.

⁴⁹ Section 6721 itself prescribes a penalty of \$250 per return, with an annual cap of \$3,000,000 per payer; however, Rev. Proc. 2016-11 increased these amounts to adjust for inflation.⁵⁰ IRC Treas. Reg. 1.1471-3T(d)(4)(i); 1.1471-3T(e)(3)(i).

⁵⁰ IRC Treas. Reg. 1.1471-3T(d)(4)(i); 1.1471-3T(e)(3)(i).

⁵¹ The Protecting Americans from Tax Hikes (PATH) Act of 2015 as included in the Consolidated Appropriations Act, 2016 (P.L. 114-113).

will receive a significant amount of information earlier in the tax season; however, the IRS must be able to effectively consume this information to help prevent identity theft and refund fraud.

Currently, while submissions to the Filing Information Returns Electronically (FIRE) system peak during March and April, they are somewhat dispersed through the filing season. The accelerated January 31 deadline will create a similar peak in January and February, much earlier in the filing season. For the IRS to effectively manage this concentrated volume during January, ETAAC recommends that the IRS open FIRE at least one week earlier. ETAAC recognizes that this tactic alone will not meet the accelerated demand and that the IRS will need to implement other technology improvements to process information statements.

Recommendation 9: The IRS should introduce a phased reduction of the threshold for mandatory electronic filing of Forms 1099-MISC from 250 forms to 20 forms.

Detail on this recommendation:

Electronic filing of third-party information reports is essential for the IRS to quickly process data to identify potential fraud. In 2014, payers electronically filed only 65.3% of Forms 1099-MISC.⁵²

Currently, the IRS requires payers with more than 250 of a specific type of information return to file them electronically.⁵³ A separate 250 threshold applies for amended information returns.⁵⁴ Reducing this threshold to 20 returns would increase the IRS' ability to detect fraud and enhance compliance through earlier matching, while being sensitive to the needs of small businesses lacking the necessary resources (either human or financial) to file electronically.

The proposed 20-return threshold is based on a review of paper filings from 2007 to 2013. For filing season 2013, this would have effectively pushed at least 211,770 Form 1099-MISC filers from paper to electronic filing, representing more than 11.4 million payees.⁵⁵ This proposal is consistent with the Chairman's Mark of a Senate bill to prevent identity theft and tax refund fraud.⁵⁶

Requiring electronic filing of amended returns is consistent with this approach. The withholding agent initially filing the return already has access to the necessary tools to file electronically. Therefore, mandating that the withholding agent also electronically file the amendment will not represent an increased burden and will minimize the burden of scanning or otherwise manually entering this record. In addition, it would reduce the risk that the IRS will register multiple forms (at least one of which is incorrect) for the taxpayer, thus complicating refund-authentication efforts. ETAAC recognizes that it may be necessary to phase in this threshold reduction over several years to allow industry to adjust to these new thresholds.

⁵² IRS Publication 6961 (2015 Update). Form 1099-MISC filings are the primary concern, given the relatively low electronic filing rate and high volume – 92.5 million forms were filed in 2015. With the exception of the Form 1099-S, all other Forms 1099 have electronic filing rates equal to or above 98.5%. Forms 1099-S are not a significant issue, as annual volume is less than 3.5 million forms.

⁵³ See generally IRS Rev. Proc. 2011-40; IRS Pub. No. 1220, Specifications for Filing Forms 1097, 1098, 1099, 3921, 3922, 5498, 8935 and W2G Electronically.

⁵⁴ 2015 General Instructions for Certain Information Returns (Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G).

⁵⁵ Report of Paper Form 1096 Filers for Tax Year 2013. Because the category breakdown is from 10-24 returns, it is impossible to identify the specific number of filers impacted by the 20-return threshold.

⁵⁶ Joint Committee on Taxation, *Description of the Chairman's First Modification to the Chairman's Mark of a Bill to Prevent Identity Theft and Tax Refund Fraud*. (JCX-27-16), April 18, 2016. See www.ict.gov. The threshold would be reduced to 150 from 200 for 2020, to 100 from 150 for 2021, to 50 from 100 for 2022, and to 20 from 50 for subsequent years. This modification would be effective for returns with a due date after December 31, 2017.

There is recent precedent for lowering the electronic filing threshold. Regulations enacted under FATCA required that, effective January 1, 2014, financial institutions required to report payments made under Chapter 3 or 4 of the IRC must electronically file Forms 1042-S regardless of the number of forms filed versus the previously allowed threshold of 250 forms.⁵⁷

Finally, the IRS should explore and consider an electronic “fill in” and file functionality for small filers (those that issue fewer than 20 Forms 1099-MISC for a given calendar year). These small filers could create a user account and then complete and file Forms 1099-MISC online. The IRS could model this potential solution on SSA.gov’s functionality for e-filing Forms W-2.⁵⁸

In addition to reducing costs for small-business taxpayers and increasing electronic filing, this functionality would also allow small-business taxpayers to demonstrate their commitment to “green” initiatives. If developing such technology is burdensome for the IRS, the IRS should review the potential to allow information-reporting tax software providers to develop and offer the functionality.

Recommendation 10: Congress should fund the IRS specifically to compile information returns in a manner that allows real-time matching of tax returns to information returns on file.

Detail on this recommendation:

Historically, most information returns are not compiled by the IRS until after mid-April.⁵⁹ The IRS generally starts matching tax returns with information returns in July, with subsequent matches in February and May of the following year.⁶⁰

Over 90% of taxpayers file on or before April 15 each year. Each year, the earliest the IRS notifies taxpayers about any mismatches between information statements and their returns is in November. For the 2016 tax season, the IRS issued 90% of refunds in less than 21 days after taxpayers filed their returns. In the program’s current design, there is no possibility that the IRS can reconcile taxpayers’ information before paying out refunds.⁶¹

If the IRS could match information returns to taxpayer returns at or near the time of filing, the IRS could identify many of the returns that self-report withholding and earned income in order to fraudulently or erroneously claim large refunds and refundable credits. Importantly, the IRS could do this before, not after, sending a majority of refunds. To achieve this goal, the IRS must receive information returns, primarily Forms W-2 and 1099-MISC, as early as possible in the filing process *and* be able to match them to returns being filed.

⁵⁷ 2015 Instructions for Form 1042-S at 3.

⁵⁸ SSA Publication No. 05-10033. The Social Security Administration markets this to employers as a “free electronic filing option available for small businesses that allows you to prepare and submit up to 20 W-2s (per report) over a secure Internet service.” SSA.gov also points out that employers won’t have to buy paper forms, and that they will receive Forms W-2 for employees and employer records, as well as an electronic receipt that they can use as proof that they filed the forms on time.

⁵⁹ TAX REFUNDS - IRS Is Exploring Verification Improvements, but Needs to Better Manage Risks, GAO-13-515, Report to the Committee on Finance, U.S. Senate (June 2013).

⁶⁰ Id. The IRS’ Automated Underreporter (AUR) program matches information returns to tax returns and pursues discrepancies. The AUR program conducts matches in three phases, following a staggered schedule, in part to accommodate when it receives information returns and income tax returns. The IRS conducts its first match in July for income tax returns filed by April 15; the second match in February of the following year for income tax returns received between April 16 and Oct. 15; and the third match in May of the following year for income tax returns received after Oct. 15. According to the IRS, the first match is performed in July to allow for receipt of most information returns.

⁶¹ See <https://www.irs.gov/Refunds/Tax-Season-Refund-Frequently-Asked-Questions>, <https://www.irs.gov/Refunds/What-to-Expect-for-Refunds-This-Year>.

The IRS has taken steps to receive information returns earlier. As mentioned above, beginning with tax year 2016, Forms 1099-MISC reporting amounts in box 7 for non-employee compensation will be due by January 31.

However, the IRS is limited in its ability to fully accomplish this goal. A June 2013 report by the Government Accountability Office (GAO) stated that “IRS officials commented that matching dates are also affected by competing demands for the agency’s information technology resources.”⁶²

Given the important role that matching plays in combating tax fraud and identity theft, it is critical that the IRS develop the capability to compile information returns before taxpayers file their returns. The IRS should be able to use the compiled information returns to identify discrepancies before issuing the bulk of refunds. As such, ETAAC recommends that Congress fund the IRS specifically to allow for real-time matching of tax returns to information returns on file.

Recommendation 11: Congress should provide the IRS with the authority to question and correct returns that do not match information returns.

Detail on this recommendation:

Ultimately, with earlier submission of information returns and earlier IRS matching capabilities, the IRS needs to have the ability to leverage this matching process for more effective, front-loaded compliance.

As a general rule, when the IRS identifies an error on a taxpayer’s return that will result in an understatement of tax, the IRS must send the taxpayer a notice about the discrepancy and the proposed tax deficiency. The IRS provides the taxpayer with a report of the items to be adjusted; the tax, if any, reported on the original return; and the proposed adjustment from the IRS. The taxpayer then has 30 days to accept the proposed adjustment or request an administrative appeals conference with an Appeals Officer. If the taxpayer and the IRS can’t reach a resolution, the taxpayer can contest the additional tax assessment, without payment, through the U.S. Tax Court. Taken together, this process describes IRS deficiency procedures, which provide taxpayers with the right and ability to question additional tax assessments to their returns without having to pay the tax first.

Currently, the IRS can’t ultimately adjust a return without using deficiency procedures. If the IRS has a Form 1099 that a taxpayer has not reported on his or her return, the IRS can question the return only by auditing the taxpayer or using underreporter compliance procedures.

IRC Section 6213 (math error authority) limits the IRS from adjusting information-statement mismatches at filing.⁶³ ETAAC recommends that Congress modify Section 6213 to provide the IRS with expanded authority to ultimately adjust a return when the return does not match information returns; however, the IRS must give the taxpayer proper notice to agree with or override the proposed adjustment before the IRS can change the return.

⁶² TAX REFUNDS - IRS Is Exploring Verification Improvements, but Needs to Better Manage Risks, GAO-13-515, Report to the Committee on Finance, U.S. Senate (June 2013).

⁶³ The IRS has limited ability to correct a return at filing, called math error authority, under IRC Section 6213. Math error authority is limited to certain specific circumstances: an error in adding or subtracting on the return, an incorrect use of a table related to the return, inconsistent entries on the same return, omitted information that is required to substantiate an entry on the return, and an entry that claims a deduction or credit amount that is more than the statutory limit, where that limit is described as a specific monetary amount or as a percentage, ratio or fraction. Pub. L. No. 94-455, § 1206(b) (1976), enacting IRC § 6213(f)(2). See also IRC § 6213(g)(2).

For example, if a taxpayer fails to include a Form 1099-INT reporting interest income on his or her return, the IRS could prompt the taxpayer to correct the interest underreporting or provide an explanation before the IRS accepts the return.⁶⁴ The taxpayer could then correct the return or override the prompt by providing a reason for the discrepancy. If the IRS doesn't receive a response within a given reasonable timeframe, the IRS should have the authority to adjust the return based on the information returns in its possession.

When the IRS can perform real-time matching of returns against information returns, it only makes sense that the IRS should also be able to provide taxpayers with the opportunity to proactively comply and avoid unnecessary post-filing compliance enforcement. For the IRS, reconciling information returns against income at the time of filing will mean greater efficiency, reduced costs, and increased compliance as part of its efforts to minimize tax fraud and identity theft.

Conclusion

As refund fraud and tax identity theft grow more rampant, ETAAC recommends that the IRS examine large-scale changes to the tax ecosystem to combat these threats. One important change is a voluntary filer-registration process that would educate taxpayers and authenticate their identities, and provide the benefit of a streamlined refund process.

This key outcome also focuses on changes the IRS should make to its existing infrastructure that would bolster efforts to combat refund fraud and tax identity theft, along with streamlining filing to drive tax administration efficiencies.

The IRS should make several changes to its existing information return requirements, technology systems and procedures that will improve data integrity and reduce the risk of fraud and identity theft. Those include upgrading the FIRE system and enhancing and expanding access to IRS TIN-matching functionality.

The IRS should also establish additional requirements for payers, such as reducing the threshold for mandatory electronic filing of Forms 1099-MISC, requiring certified TINs from contractors receiving Forms 1099-MISC, and mandating TIN-matching for all information returns. In addition, the IRS should release refunds only after reasonably identifying taxpayers and their withholding.

Congress plays an important role in these recommendations. Congress should specifically fund IRS efforts to match tax returns to information returns on file before issuing the majority of refunds. In addition, Congress should expand the IRS' authority so it could question and adjust returns that do not match information returns. These changes would allow the IRS to identify mismatches earlier, increase taxpayer compliance, and minimize refund fraud and tax identity theft.

⁶⁴ To reduce burden, the IRS could prompt taxpayers for correction of amounts above a certain threshold.

KEY OUTCOME 2

THE IRS SHOULD CREATE AN END-TO-END DIGITAL TAXPAYER EXPERIENCE.

Key Outcome 2: Taxpayers leverage online information and tools to better understand and comply with their tax responsibilities before, during, and after filing.

Recommendations for this outcome:

Recommendation 12: The IRS should provide taxpayers with secure online access to view and understand their tax information, tax obligations, and compliance status with the IRS.

Recommendation 13: The IRS should provide event-driven notifications related to IRS account actions to help taxpayers comply.

Recommendation 14: In addition to enabling online accounts that provide taxpayers with information and tools to help before and during filing, the IRS should add capabilities for taxpayers to interact with the IRS electronically for post-filing activity.

Recommendation 15: Taxpayers should be able to authorize third parties, such as tax professionals, Volunteer Income Tax Assistance (VITA) sites and tax software providers, to electronically receive tax account information as part of the tax preparation process.

Recommendation 16: The IRS should provide tax professionals who complete an enhanced Annual Filing Season Program and certified VITA volunteers with the same level of authorized access to taxpayers' online tax information that Circular 230 tax professionals receive.

Background on Key Outcome 2

In its 2014 report to Congress, ETAAC emphasized the importance of creating online accounts for efficient and transparent communication between taxpayers and the IRS. The committee recommended that the IRS commit to modernizing electronic taxpayer service and compliance interaction capabilities.

In its 2015 report to Congress, ETAAC recommended that the IRS accelerate development of online capabilities to improve taxpayer service. The IRS had not yet committed to modernizing its taxpayer service platform; however, because of the IRS' 37.4% level of service⁶⁵ during the 2015 filing season, ETAAC reinforced its previous recommendations with a heightened sense of urgency. The 2015 report emphasized the need for the IRS to launch a comprehensive taxpayer online account with increased taxpayer security and authentication. ETAAC also provided strategies for rapid development and user adoption of these accounts.

Now, in 2016, the IRS has publicly committed to all of its stakeholders to a Future State service model that embraces technology for digital taxpayer service, consistent with ETAAC's 2015

⁶⁵ The level of service measures the percentage of phone calls the IRS answers.

recommendations. The IRS has committed to building a comprehensive online account to serve taxpayers.

In this key outcome, ETAAC will provide recommendations on how the IRS should further optimize the taxpayer experience through development of end-to-end capabilities to help taxpayers comply with their responsibilities and interact with the IRS before, during, and after filing.

ETAAC re-emphasizes the importance of leveraging third parties that contribute significantly to taxpayer service and compliance, and, as such, the committee makes recommendations on how the IRS can better achieve its mission through these third-party channels.

The Future State of the IRS

On February 22, 2016, the IRS released its vision for the Future State of the IRS. Specifically, in its Future State Initiative, the IRS outlined a taxpayer service model that leverages technology to enhance the entire taxpayer experience.⁶⁶ The model envisions the IRS meeting the needs of taxpayers and the tax community in an effective and efficient manner.

A critical component to the Future State service model is virtual taxpayer assistance, which centers on a taxpayer online account. In this account, taxpayers will be able to:

- Access and understand their account information.
- Set alerts and reminders.
- Correct return errors.
- Perform other self-service functions and interact with the IRS.

The IRS estimates that it will launch a taxpayer online account in late 2016. The initial release of taxpayer online accounts will allow taxpayers to authenticate their identities, access prior-year tax information, and perform limited payment functions. Over the next five years, the IRS plans to iteratively add more account information and self-service capabilities.⁶⁷

Transparency and trust lead to compliance

The IRS Future State service model must build trust with taxpayers to promote voluntary compliance. Each year, taxpayers share much of their personal and financial information with the IRS, but the IRS does not share much information with taxpayers. For most taxpayers, accessing and understanding their tax information at the IRS is a mystery.

Many taxpayers need access to the IRS for information and assistance. The IRS Oversight Board's most recent study on taxpayer attitudes reported that 43% of taxpayers need to interact with the IRS outside of filing a tax return.⁶⁸ The same study reported that 9% of taxpayers deal with the IRS after they file, as the result of a notice. Importantly, the IRS Oversight Board reported that taxpayers are increasingly looking for digital or electronic access to this information.⁶⁹

⁶⁶ See <https://www.irs.gov/uac/Newsroom/Future-State-Initiative>.

⁶⁷ See the description of the IRS Concept of Operations, which includes a five-year plan to implement digital taxpayer service tools, at http://taxpayeradvocate.irs.gov/Media/Default/Documents/2015ARC/ARC15_Volume1_MSP_01_Taxpayer-Service.pdf.

⁶⁸ See <https://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20Taxpayer%20Attitude%20Survey%202014.pdf>. These needs include obtaining and understanding tax account information, interpreting tax rules that apply to taxpayers' particular circumstances, making and processing payments, and interacting with the IRS on compliance issues, such as notices and compliance enforcement activity.

⁶⁹ <https://www.treasury.gov/IRSOB/reports/Documents/IRSOB%20Taxpayer%20Attitude%20Survey%202014.pdf>.

The IRS Future State descriptions of taxpayer experiences reflect this reality. The Future State taxpayer segment vignettes demonstrate how all types of taxpayers could have increased transparency through secure online accounts.⁷⁰ This ideal taxpayer experience allows taxpayers to have real-time access to their tax information and status with the IRS, fully understand their tax obligations, and effectively and securely interact with their tax administrator. In today's digital environment, taxpayers expect the IRS to deliver these capabilities online.

IRS limitations on promoting voluntary compliance

An IRS taxpayer online account should not only provide taxpayers with better access to their tax information, but it should also help taxpayers proactively comply. Preventing noncompliance before filing tax returns is much more effective than detecting and resolving noncompliance. Currently, the IRS has few capabilities to prevent noncompliance. The IRS is generally limited to rejecting e-filed returns due to certain errors⁷¹, or sending "soft notices"⁷² to taxpayers to flag potential noncompliance.

The IRS' ability to reject a tax return is limited.⁷³ It includes detecting duplicate and incorrect use of Taxpayer Identification Numbers (TINs). However, if taxpayers don't accurately or completely report their tax return line items, the IRS can take few preventative measures to stop the misreporting at the time of tax return filing.⁷⁴ Prevention capabilities are also hindered by the IRS' look-back compliance system⁷⁵ that can't match third-party information statements to tax returns for accuracy during the filing process.⁷⁶ In Key Outcome 1, ETAAC discusses the importance of verifying tax return data before accepting a filed return.

Because the IRS can't leverage third-party information to validate tax returns at the time of filing, the IRS is limited to enforcing compliance after filing. The IRS sends notices⁷⁷ and uses employees to examine tax returns and collect from taxpayers. This includes compliance investigations, such as audits

⁷⁰ The IRS released vignettes that described the taxpayer experience of the future for four taxpayer segments: an individual taxpayer, a small business owner, a government entity, and a large business taxpayer. All of these segments expected and valued transparency from the IRS. See <https://www.irs.gov/uac/Newsroom/Future-State-and-IRS-Activities>

⁷¹ There are several reasons why a tax return may be rejected. One of the most common reasons is incorrect prior-year adjusted gross income that's required for an electronic signature. Other common errors include misspelled names and incorrect Social Security Numbers or birth dates. The IRS can also reject a return if the Employer Identification Number reported on Form W-2 does not match data in the e-file database.

⁷² Soft notices explain the potential noncompliance to taxpayers and ask them to correct the issue, usually by filing an amended return.

⁷³ Congress gives the IRS authority to analyze a return for accuracy before accepting the return under Section 6213 of the Internal Revenue Code (referred to as math error authority). However, current math error authority is specific and restrictive under Section 6213(g)(2) and does not include the ability to analyze returns for correct reporting of income and deductions on a tax return.

⁷⁴ For example, if the IRS receives information from the Center for Medicare and Medicaid Services that the taxpayer received more advance premium tax credit than he or she reported on the return, the IRS must accept the return and use discrepancy procedures to assess and collect additional taxes. Deficiency procedures require the IRS to propose any additional tax and allow the taxpayer to contest the proposed tax prior to payment. For several years, the president has proposed that the IRS be granted "correctable error authority," which would allow the IRS to adjust returns when the IRS has information from government databases that doesn't match items reported on tax returns. When the IRS identifies the error, it would adjust the return, send the taxpayer a notice, and ask the taxpayer to contact the IRS within 60 days to reverse the correction, if necessary.

⁷⁵ For more on the look-back tax compliance structure and the real-time tax system, see the June 2013 GAO study on the real-time tax system, at <http://www.gao.gov/assets/660/655020.pdf>.

⁷⁶ Currently, the IRS receives information statements according to various timelines and compiles them after most tax returns are filed. Oversight groups, such as the IRS Oversight Board and the Treasury Inspector General for Tax Administration, have suggested that information statements should be filed earlier and/or that the start of filing season should be delayed. That way, the IRS could verify taxpayers and their income by matching tax returns to information statements before issuing refunds.

⁷⁷ According to the IRS Office of Taxpayer Correspondence, in 2014, the IRS issued approximately 178 million notices to taxpayers.

and underreporter notices⁷⁸, to correct noncompliance. However, the IRS' compliance-personnel capacity restricts the number of notices and investigations that the IRS can pursue with potentially noncompliant taxpayers.⁷⁹

To illustrate the IRS' current limitations in preventing and correcting noncompliance, one only needs to look deeper into the IRS underreporter program. In tax year 2013, individuals filed 147.9 million tax returns, all of which the IRS processed when filed. However, after filing, the IRS found 27.6 million returns (18.5%) that did not report all income when matched with information statements. With its reduced staff levels, the IRS sent only 3.7 million CP2000 underreporter notices (13% of the discrepant returns) to these taxpayers in fiscal year 2014.⁸⁰ The IRS didn't notify the remaining 23.9 million taxpayers, including those with potentially significant tax liabilities, about their possible noncompliance. This failure to notify taxpayers of potential noncompliance can leave the door open to future noncompliance.⁸¹

As the 2014 CP2000 underreporter program demonstrates, under the IRS' current approach, it can't send each taxpayer a notice about potential noncompliance or provide the attention and resolution each taxpayer would need.

This limited phone- and paper-based service approach does not leverage third-party taxpayer information and limits the IRS' ability to help taxpayers voluntarily comply. A more scalable approach requires upfront matching (see Recommendation 10) and online accounts, in which taxpayers would receive notifications related to IRS account actions and compliance requirements, including specific information on areas where they may be out of compliance.

The IRS must enable compliance through third parties

In the past two ETAAC reports to Congress, the committee has highlighted the importance of tax professionals to tax compliance.⁸² Most taxpayers use tax professionals, and almost all tax returns are filed with tax software. It stands to reason that the IRS should partner with tax professionals and the tax software industry to help taxpayers comply.

In the current IRS online account strategy, tax professionals will eventually be authorized to view their clients' accounts and help with compliance issues. However, the IRS roadmap doesn't define when the IRS will build tax professional accounts, potentially leaving significant gaps in the taxpayer experience by failing to enable this large and important tax service and compliance channel.

⁷⁸ The IRS sends CP2000 notices, or underreporter inquiries, to taxpayers about seven months after they file a return. This notice proposes changes to tax returns because information reported on the returns didn't match information statements on file with the IRS from employers and other payers. The IRS sends CP2000 notices after filing because the IRS collects and validates third-party information returns after filing.

⁷⁹ In April 19, 2012, testimony to Congress, former IRS Deputy Commissioner for Services and Enforcement Steven Miller told the House Committee on Oversight and Government Reform that the IRS does not have the resources to "audit its way out of the tax gap." Effectively, this means that the IRS must rely on preventative and other methods to foster voluntary compliance. See <https://oversight.house.gov/wp-content/uploads/2012/04/4-19-12-Miller-Testimony.pdf>.

⁸⁰ See the tax year filing season population for individuals at <https://www.irs.gov/uac/Dec-26-2014>. The IRS provided data on information statement mismatches and CP2000 notices from the Campus Operation Business Results report and IFS Functional Area Code 7E.

⁸¹ Notifying taxpayers about discrepancies has yielded positive compliance results for the IRS. For 2014, the IRS sent a limited number of soft notices to taxpayers requesting that they review their returns for accuracy and consider filing an amended return, if needed. Out of the 27,593 notices sent, the IRS received 11,344 responses from taxpayers and more than \$4 million in additional tax payments.

⁸² See Key Outcome 4 from the 2014 ETAAC report to Congress, and Key Outcome 3 from the 2015 ETAAC report to Congress.

As recommended in the past two annual reports, ETAAC believes it is critical for the IRS to release tax professional accounts in parallel with, or worst case, soon after the release of taxpayer accounts. Doing so will enable tax professionals to help taxpayers understand their tax obligations and comply with their responsibilities.

It's also imperative that the IRS continue to partner with the tax software industry to identify sources of information that the IRS should make available for taxpayers and tax professionals to help taxpayers comply. Right now, taxpayers and tax professionals can't receive account information when they are preparing a tax return – the time when they need information the most.⁸³

The Future State: Online accounts are a key component of an overall taxpayer service and compliance strategy

The IRS Future State service model enables technology as a part of a holistic taxpayer service experience. The Future State service model embraces digital solutions to allow the IRS to maximize service delivery across multiple channels of service (phone, walk-in centers, and online). It creates options to serve all taxpayers the way they want to be served.

By creating comprehensive digital capabilities for taxpayers and tax professionals to use before, during and after filing, the IRS can meet the growing digital service expectations of taxpayers and ensure that human-interaction capacity is available for taxpayers who need and prefer in-person assistance.

Detailed recommendations

Recommendation 12: The IRS should provide taxpayers with secure online access to view and understand their tax information, tax obligations, and compliance status with the IRS.

Detail on this recommendation:

In the past two ETAAC reports to Congress, the committee has made specific recommendations on the information the IRS should include in a taxpayer online account. Transparency of tax account information and tax rules represent an important first step for taxpayers to understand their tax obligations. Before taxpayers can be expected to effectively comply, they must understand what the IRS expects from them.

Importantly, taxpayers also need to know where they stand with the IRS. Today, taxpayers assume that they are in good standing with their tax obligations until the IRS sends them a notice. Within an online account, the IRS could alert taxpayers to potential noncompliance⁸⁴, and give them options to look into the issue and correct it, if necessary.

For taxpayers who aren't in compliance (meaning, they have a reporting, payment, or filing issue), the IRS could give them information and options to get back into compliance. For example, if a taxpayer owes the IRS an unpaid balance, the IRS could explain payment options within the taxpayer's online

⁸³ In tax season 2015, the IRS piloted a program to transfer "Where's My Refund?" data to tax software using the third-party designee section of the tax return and a consent from the taxpayer. The IRS expanded this pilot for the 2016 filing season; it is available to provide refund information for up to 250,000 taxpayers.

⁸⁴ For example, the IRS could alert taxpayers when they have missed a scheduled estimated tax payment or defaulted on an installment agreement because they owe an additional balance or missed an installment payment.

account. The online account would also allow the taxpayer to establish payment agreements to get back in good standing.

Recommendation 13: The IRS should provide event-driven notifications related to IRS account actions to help taxpayers comply.

Detail on this recommendation:

Digital, event-driven notifications are the norm today in many taxpayers' personal lives. Customers can set up alerts for many situations – when products are delivered, payments have posted, or someone opens a door in their home. Currently, taxpayers don't have any way to monitor their IRS account activity, such as return filings, payments posting, or IRS requests for more information related to compliance activity or other opportunities from which they may benefit.

As part of a taxpayer online account, the IRS should offer event-based notifications for activity updates. To enhance voluntary compliance, the IRS should also offer taxpayers the option to set up alerts, notifications, and communications based on their profile and filing characteristics. Many of these alerts could notify taxpayers when compliance deadlines are approaching, allowing for better proactive voluntary compliance.

Customized, event-driven notifications and alerts can help taxpayers understand their status, obligations, and potential or existing noncompliance items. Here are some examples:

- The IRS could notify taxpayers when a return has been filed and accepted under their TIN. This notification would let taxpayers know when to expect their refunds – or alert them that they could be a victim of tax identity theft.⁸⁵
- When the IRS receives third-party information statements, taxpayers could receive information about the requirement to file a return.
- If the IRS doesn't receive a return by the deadline, the IRS could quickly intervene to bring the taxpayer into compliance. Taxpayers could set up a "reminder to file" notice each year to prevent future noncompliance.⁸⁶
- Taxpayers could receive notifications when the IRS receives a payment or issues a refund.
- Self-employed taxpayers could set up reminders to pay their estimated taxes each quarter.
- Taxpayers could receive compliance notifications, including common post-filing notices, such as monthly installment agreement payment reminders or notifications of an audit or underreporter inquiry.
- Taxpayers could receive guidance tailored to their profile and information that reflects relevant life stages or transitions.⁸⁷

⁸⁵ Alabama and Georgia are innovating new techniques for residents who set up taxpayer accounts with the state revenue agencies. Once taxpayers create an account, they can opt in to receive an alert if the state accepts a return filed with their SSN. If taxpayers receive an alert but haven't filed yet, they can contact the agency, which will then stop the fraudulent return before issuing the refund.

⁸⁶ Taken from the Taxpayer Advocate Service 2014 Annual Report to Congress, Most Serious Problem #11 at <http://www.taxpayeradvocate.irs.gov/Media/Default/Documents/2014-Annual-Report/WORKLOAD-SELECTION-The-IRS-Does-Not-Sufficiently-Incorporate-the-Findings-of.pdf>.

⁸⁷ Examples include child- and dependent-related information, such as tax credits, 529 savings accounts, and eligibility of income-based entitlement programs; education information, such as Free Application for Federal Student Aid form completion, understanding tuition tax forms from institutions, and appropriate use of the American Opportunity Credit, the Lifetime Learning Credit, and Pell grants; healthcare information, including how to enroll in health care under the Patient Protection and Affordable Care Act, qualification for the premium tax credit and advance premium tax credit, and information on penalties and exemptions for people without adequate coverage; income information, including prompting eligible taxpayers to claim the Earned Income Tax Credit, particularly if they received it last year (transcript *Continued*)

- The IRS could work with employers and other external partners to ensure that they provide newly employed taxpayers with information about their filing and payment obligations. The information could include a link to an IRS online account with a withholding calculator and forms to update with the employer, if necessary.

Recommendation 14: In addition to enabling online accounts that provide taxpayers with information and tools to help before and during filing, the IRS should add capabilities for taxpayers to interact with the IRS electronically for post-filing activity.

Detail on this recommendation:

Every year, millions of taxpayers have to interact with the IRS for a compliance issue. Compliance data shows the large numbers of taxpayers with compliance activity each year.

Table 6: Compliance activity in 2014

| Compliance issue | Number of taxpayers in 2014 ⁸⁸ |
|--|---|
| Examinations (mail, office and field audits) | 1.4 million |
| CP2000 underreporter notices | 3.7 million |
| Delinquent return investigations (new) | 1.6 million |
| Penalty assessments | 29.5 million |
| Taxpayers who owe the IRS | 18.7 million |
| Math error notices | 1.7 million |

Right now, the IRS corresponds with taxpayers by letter or phone⁸⁹ for virtually all of the above compliance issues.⁹⁰ In 2014, the IRS sent more than 178 million notices⁹¹, many of which involved the issues listed in Table 4, to taxpayers and their representatives.⁹² For taxpayers, these letter-based compliance-enforcement interactions can mean long resolution times and unclear outcomes.

Here’s a picture of the taxpayer experience when interacting with the IRS on compliance issues:

The IRS initiates most compliance correspondence from IRS compliance campuses that interact with taxpayers by phone and mail. The compliance campuses also make final determinations, including appeals determinations.

look back); and retirement information, such as informing taxpayers about the Saver’s Credit or tax-advantaged retirement accounts for self-employed taxpayers.

⁸⁸ IRS Data Book for 2014, at <https://www.irs.gov/pub/irs-soi/14databk.pdf>. The IRS Office of Servicewide Penalties provided the total number of taxpayers who were assessed a penalty. The Director, IRS Collection Policy, provided the total number of taxpayers who owe a balance to the IRS.

⁸⁹ In localized compliance efforts, the IRS may interact with taxpayers by phone. However, the IRS conducts most compliance activity through IRS compliance campuses that issue notices and answer phones, but don’t place many outbound calls. Also, because of disclosure and privacy rules, IRS employees are prohibited from emailing taxpayers and their representatives.

⁹⁰ The only exception is the online payment agreement (OPA) tool, which allows taxpayers to enter into streamlined payment agreements to pay their taxes without directly interacting with an IRS employee.

⁹¹ Provided by the IRS Office of Taxpayer Correspondence. Also see TIGTA report, at <https://www.treasury.gov/tigta/auditreports/2015reports/201540063fr.pdf>.

⁹² A representative is a person who can advocate on behalf of a taxpayer. The IRS requires representatives to be licensed to practice before the IRS. Most representatives are CPAs, enrolled agents, and attorneys. In 2016, the IRS added another authorization level, called the Annual Filing Season Program (AFSP), which allows tax preparers who meet certain qualification requirements to have limited representation practice privileges before the IRS.

Generally, the IRS manages taxpayers' cases by a mass-processing function where no single IRS employee is assigned to a taxpayer's case. This unclear line of sight leaves taxpayers questioning how the IRS is handling their cases. Without visibility to IRS actions and the status of their case, taxpayers often contact the IRS repeatedly to understand how to respond, whether the IRS has received their responses, whether the IRS needs additional information, and what the IRS has determined about their case. This back-and-forth process can take months to complete.⁹³ Delays can also result in additional interest on proposed deficiencies.

Taxpayers can be surprised by the final IRS decision, because they may not be aware of the facts the IRS considered or how the IRS made the determination. Taxpayers who disagree with the outcome are left with little information to understand how the IRS made the determination, to decipher what appeal rights they have, and to understand how to request a redetermination of their case.

Much like the initial determination, the process behind any appeal or redetermination is also invisible to taxpayers, further eroding taxpayers' confidence that the IRS is assessing their case completely and fairly applying the law.

This lack of visibility and effective tools for taxpayers to interact with the IRS ultimately leads to an unnecessarily long compliance cycle that burdens the taxpayer and multiplies the costs of compliance for the IRS.

In addition to creating burden for taxpayers and their representatives, the current paper-and-phone compliance process is inefficient given the realities of today's digital communication capabilities. Compliance enforcement is the most costly line item in the IRS' annual budget. In 2014, compliance enforcement represented 44% of the overall IRS budget, with more than \$5 billion spent on examination, collection, and other investigative functions.⁹⁴ More than half of the 82,000 IRS employees are assigned to compliance enforcement.⁹⁵

Current state: two digital tools for compliance transactions

The IRS has two digital tools that help taxpayers complete post-filing compliance transactions:

- Direct Pay, which taxpayers can use to make payments on an IRS installment agreement; and
- The Online Payment Agreement (OPA) tool, which taxpayers can use to obtain a direct debit streamlined installment agreement without having to call or mail information to the IRS.⁹⁶

The OPA tool has benefits to taxpayers and the IRS, in the form of:

- Cost savings for the IRS: An OPA-initiated streamlined installment agreement costs the IRS about \$6 to complete, versus manually completed installment agreements, which cost an average of about \$84 across all other service channels.⁹⁷

⁹³ For example, according to the GAO, the IRS took 195 days, on average, to resolve a mail audit in 2013. Presumably, an online notification of audit and response/upload capability could decrease this cycle time significantly by streamlining the response, routing, and decision process. See the June 2014 GAO report on IRS Correspondence Audits at <http://www.gao.gov/assets/670/663840.pdf>.

⁹⁴ See IRS Budget in Brief, FY2015, which highlights the enacted FY2014 budget, at <https://www.irs.gov/PUP/newsroom/IRS%20FY%202015%20Budget%20in%20Brief.pdf>.

⁹⁵ In FY2014, the IRS allocated 42,805 of its 84,189 FTEs to enforcement.

⁹⁶ A streamlined installment agreement allows taxpayers to obtain payment terms of up to six years if taxpayers owe less than \$50,000. Streamlined installment agreements represent 86% of all IRS installment agreements granted in 2014.

- A better experience for taxpayers: Using OPA, taxpayers can complete their requests and get instant approval for a streamlined installment agreement within minutes; in contrast, a manual request by paper or phone can take months to finalize.⁹⁸

The IRS completes more than 3 million installment agreement requests through OPA every year. As the IRS has made the OPA tool more user-friendly, taxpayers' use of the tool increased 591% from 2011 to 2015.⁹⁹

However, these tools represent only a small subset of taxpayers' compliance needs. Other than OPA and Direct Pay, the IRS doesn't offer digital capabilities for taxpayers and their representatives to interact and complete compliance-related transactions.

The Future State: Online accounts with comprehensive tools to streamline post-filing compliance interactions

Streamlining compliance enforcement through digital tools and processes would allow the IRS to maximize its limited resources while providing a better taxpayer experience.¹⁰⁰

In its Future State plans, the IRS has proposed information and tools to help taxpayers interact with the IRS more effectively after filing. That includes a digital communications tool that would allow taxpayers and the IRS to correspond about compliance issues and complete certain actions.

The future online account should provide compliance tools to help taxpayers:

Respond to IRS notices. If taxpayers receive an IRS notice, they should be able to see the notice, receive a customized to-do list to resolve the issue, and upload documents, if needed.

Evaluate penalty assessments and request abatement. A penalty abatement request tool should prefill the penalty amount and type, explain the abatement rules available for each type of penalty, and provide a guided workflow for taxpayers to request abatement.¹⁰¹

Respond to correspondence audits and underreporter inquiries (CP2000 notices) using issue-specific templates. The IRS should streamline audit and CP2000 responses by allowing taxpayers to "self-audit" by completing issue-specific online questionnaires and attaching requested documentation to prove tax

⁹⁷ Currently, the OPA tool handles only streamlined installment agreements, which typically involve less interaction with taxpayers than the more complicated installment agreements typically handled by the IRS Collection field function and the Automated Collection System (ACS).

⁹⁸ When taxpayers manually set up a direct debit installment agreement, they must fax or mail a form to the IRS to set up the draft from a financial account. As a result, taxpayers often have to mail in payments for a month or two while the draft set-up is completed.

⁹⁹ In 2011, 49,614 installment agreements were completed via the OPA tool. In 2015, 339,585 agreements were completed using OPA. One major improvement to the tool occurred in March 2015, when the IRS moved the electronic authentication process outside of OPA to the IRS' e-authentication platform. As a result, the number of installment agreements completed via OPA increased from 80,158 in FY2014 to 339,585 in FY15.

¹⁰⁰ According to the Pew Research Center, in 2015, 84% of American adults use the Internet: See <http://www.pewinternet.org/2015/06/26/americans-internet-access-2000-2015/>.

¹⁰¹ The penalty abatement process is an example of how the IRS could achieve better voluntary compliance through specific automated tools. Currently, the IRS doesn't have a specific form or well-known format to request penalty abatement. For taxpayers who know how to request abatement with a written letter, the current process can take months. Furthermore, because there is no a defined format, taxpayers are left to interpret the rules and information needed. This often leads to IRS denials for penalty relief because taxpayers haven't received proper guidance on which facts to present. The IRS could fix this experience in an online account. The IRS could prompt taxpayers with reasonable cause questions that taxpayers could answer to get an immediate response to their request. The IRS can use its internal, automated Reasonable Cause Assistant tool to automate the decision-making and complete the entire abatement transaction in one session, from request to determination.

return items. For example, in a mail audit questioning the home office deduction, the IRS should ask questions related to the taxpayer's qualification for the deduction, and request receipts for expenses that the taxpayer could upload and explain online.

Self-correct minor adjustments to return errors.¹⁰² If a taxpayer receives a request for more information or completion of a form for the IRS to process his or her return (IRS Letter 12C), the online account should provide a response tool. The tool should provide a list of specific items for the taxpayer to attach with explanation, if needed. If there is a change to the return, the taxpayer should be able to adjust the return and approve the change online.

Set up collection agreements. The OPA tool allows taxpayers to set up collection agreements that do not require financial documentation. However, the IRS should also allow taxpayers to request other collection alternatives online, including those that require taxpayers to submit financial information, such as Collection Information Statements and living expenses documentation. A collection agreement tool should allow taxpayers to submit the requests with the required documentation and respond back to IRS requests for more information. The online tool should indicate the status of taxpayers' payment agreements and allow taxpayers to make adjustments to their agreements based on their financial circumstances.

Directly communicate with the IRS through messages and multimedia methods. The IRS should expand its communication channels to online chat, email, and video. The IRS should also provide taxpayers with specific contact information and direct phone numbers for their applicable compliance units if taxpayers need to speak with a person. The online account should also provide an audit trail of communication, including a timeline for taxpayers to respond. The IRS should send event-driven notifications to prompt taxpayers for a timely reply.

With these capabilities, taxpayers can better understand the determination that the IRS employee or compliance unit will make in their cases. They can reduce the amount of time to resolve tax issues or disputes through a streamlined communication process. The audit trail left by electronic interactions will provide clarity to the information the IRS considered, and increase accountability for the IRS and taxpayers. The IRS will also benefit from a streamlined, efficient process that will reduce costs.

Recommendation 15: Taxpayers should be able to authorize third parties, such as tax professionals, Volunteer Income Tax Assistance (VITA) sites and tax software providers, to electronically receive tax account information as part of the tax preparation process.

Detail on this recommendation:

Most taxpayers interact with the IRS only one time during the year: when they file a tax return. However, taxpayers and their tax professionals can't access tax account information when they need it

¹⁰² When the IRS detects a potential error on a return that's not a math error or a return reject, the IRS sends a paper notice. Then, the taxpayer and the IRS resolve the issue by phone, letter, or an amended return that the taxpayer or his or her representative files to correct the error. Many of these errors result in a refund freeze, sometimes for several weeks, until the issue is resolved. Ideally, in an online account, the IRS could electronically notify the taxpayer about the potential return error, and explain how to correct the error online. For example, suppose a taxpayer omits a required form needed to substantiate a tax return entry. The IRS could freeze the refund, electronically alert the taxpayer and ask him to access his online account. When the taxpayer logs in, he sees the specific return error and the steps to resolve it. He reviews his return, uploads the omitted form, provides an explanation, and agrees to a change on the return. For taxpayers who file electronically, this online account feature could reduce the error-correction process to days, rather than weeks. For the IRS, this electronic process would increase efficiency and eliminate many notices and paper-filed amended returns.

most, during the tax-preparation process. There is no mechanism in place that allows for authorized, secure transfer of taxpayer account information, including compliance status and activity, through tax preparation software.

Taxpayers should be allowed to authorize their tax software or tax professional¹⁰³ to access their tax account information from the IRS during the tax-preparation process. This type of secure data transfer would help taxpayers and their tax professionals prepare more accurate tax returns and manage tax compliance.

“Where’s My Refund?” API

The IRS and the tax software industry have collaborated to enable the first form of secure transfer of tax account information. In 2015, the IRS piloted the “Where’s My Refund?” application program interface¹⁰⁴ (WMR API), which allowed tax software programs to display taxpayers’ refund information with appropriate consents. The WMR API allowed taxpayers and tax preparers to see refund status without having to submit a request at IRS.gov.

Although IRS.gov already offers a tool to view refund status, the WMR API was a significant first step in the IRS-industry collaboration to share account information between IRS systems and third-party tax software. In the future, the IRS should enable more data transfers to tax software for account and compliance information that taxpayers can use before or after filing a return and receiving a refund.

The authorization obstacle

The current limits on third-party authorizations are a significant obstacle for the IRS to enable transfer of account and compliance information to software providers. In the WMR API, the IRS allowed taxpayers to complete a special consent to allow the IRS to send refund account information to commercial tax-preparation software. That consent is limited to refund information.

To allow software providers to receive taxpayers’ full account information, including prior-year return and account information, compliance activity and status, the IRS would need to create a mechanism for taxpayers to specifically authorize tax software providers with rights to receive this information.

One solution could be for the IRS to enable e-filing of Form 8821, *Tax information Authorization*.¹⁰⁵ Or, the IRS could expand the current capabilities of the tax return third-party designee¹⁰⁶ to provide an authorization mechanism for software providers to receive tax account information and transfer it to taxpayers and/or their authorized tax professionals during or after tax preparation.

¹⁰³ Tax software and tax professionals are the two most prominent service channels for tax preparation. More than 90% of all tax returns are prepared using commercial tax software, and a majority of tax returns are completed by a paid tax professional.

¹⁰⁴ An application program interface (API) allows a program or application to interact with another application or set of data. In the “Where’s My Refund?” API, the tax software program interacts with the IRS to display the status of a refund in the tax software program.

¹⁰⁵ The Form 8821, *Tax Information Authorization*, allows authorized third parties to request tax account information on behalf of a taxpayer and get copied on the taxpayer’s IRS notices for multiple years and forms. The Form 8821 stays in effect for seven years or until the taxpayer revokes it or the third party withdraws the authorization. Any third-party authorization solution would have to ensure that the taxpayer has, in fact, authorized the sharing of information.

¹⁰⁶ During the tax-preparation process, taxpayers can use the third-party designee assignment to authorize individuals or firms to receive their account information and help with the processing of their return through April 15 of the following year. The third-party designee is the only authorization the IRS enables as part of the tax-filing process.

ETAAC recommends that the IRS work with the tax software industry to authorize tax professionals and third-party tax software to receive more comprehensive information and share it appropriately with taxpayers. Taxpayers and tax professionals could use that information to file more accurate returns and to understand compliance status and actions. Better visibility to this information when taxpayers or tax professionals are most likely to interact with the IRS (at tax filing) would increase voluntary compliance.

Recommendation 16: The IRS should provide tax professionals who complete an enhanced Annual Filing Season Program and certified VITA volunteers with the same level of authorized access to taxpayers' online tax information that Circular 230 tax professionals receive.

Detail on this recommendation:

As presented in this and past ETAAC reports, most taxpayers rely on tax professionals to prepare their returns. Tax professionals also commonly help taxpayers who receive IRS notices or need to address compliance issues. Tax professionals are either governed under Circular 230¹⁰⁷ or they are noncertified (unenrolled).

Consistent with prior ETAAC reports, the committee emphasizes that the IRS should release online capabilities to tax practitioners immediately after releasing taxpayer online accounts. Fifty-seven percent of all taxpayers use a paid professional to prepare their taxes; immediately enabling tax professionals to help their clients with filing and compliance will have a significant impact on the majority of taxpayers.

Opening up access to more tax professionals

The current IRS platform that provides electronic tools to tax professionals (called e-Services¹⁰⁸) is limited to Circular 230 tax professionals. However, non-Circular 230 tax professionals make up more than half of all registered Preparer Tax Identification Number (PTIN) holders.¹⁰⁹

The IRS has not specifically indicated whether it will allow non-Circular 230 tax professionals to access the future tax professional online account. If the IRS stays consistent with its current e-Services model of allowing access only to Circular 230 tax professionals, the IRS will not be able to leverage the majority of tax professionals to help with taxpayer service.

Because most taxpayers who use a paid tax professional expect their professional to help when issues arise after filing¹¹⁰, the IRS should expand online account access to most tax professionals to meet taxpayer preferences. However, the IRS should do so under the standards of Circular 230.

¹⁰⁷ Circular 230 is the collection of regulations that govern practice before the IRS. Licensed tax professionals are governed by Circular 230. These professionals include CPAs, enrolled agents, attorneys, enrolled actuaries, and enrolled retirement plan specialists.

¹⁰⁸ IRS e-Services is available to licensed Circular 230 tax professionals. Currently, the only electronic tool available through e-Services is the IRS transcript delivery system, which allows tax professionals to access client transcripts.

¹⁰⁹ See <https://www.irs.gov/Tax-Professionals/Return-Preparer-Office-Federal-Tax-Return-Preparer-Statistics>. As of March 4, 2016, 41.3% of all PTIN holders (paid tax preparers) were licensed as attorneys, CPAs, enrolled agents, or enrolled actuaries and retirement specialists (289,117 out of the total 698,449 PTIN holders). An additional 58,651 tax preparers voluntarily entered the AFSP and have elected to be covered under Circular 230. The AFSP designation became effective on January 1, 2016, and allows tax preparers to help clients before the IRS, with limited representation rights.

¹¹⁰ The latest IRS data on the use of third-party designees on tax returns comes from the 2008 IRS return line-count data (see <https://www.irs.gov/pub/irs-soi/08inlinecount.pdf>). For 142 million individual returns filed for 2008, 82 million were filed by a tax professional. In 2008, 58 million returns (41% of all returns) had a third-party designation filed on the return. Presumably, most of these designees would be the tax professional who prepared the return, to allow the IRS to contact the paid professional for help in filing the return, if needed.

In 2016, the IRS implemented a new Circular 230 designation, the Annual Filing Season Program (AFSP).¹¹¹ The AFSP allows tax preparers with active PTINs who take 18 hours of continuing education from IRS-approved providers to consent to adhere to specific practice obligations under Circular 230. As a result, these tax professionals will be listed in a public IRS directory of tax return preparers and will have limited representation rights before the IRS.

Consistent with the National Taxpayer Advocate's concerns, the committee recommends that the IRS increase the threshold for AFSP certification. Tax professionals should be required to pass an annual competency exam, which would include testing knowledge of their obligations under Circular 230. Tax professionals should also be required to pass a background check that would give the IRS assurances about their legitimacy.

After the IRS enhances the AFSP program with additional competency and background testing, ETAAC recommends that the IRS provide AFSP tax professionals with access to tax professional online accounts. AFSP online account access would enable electronic tools for a broader tax professional population, and, as a result, improve service to more taxpayers. It would also help the IRS promote further adoption of the AFSP designation.

In addition to the AFSP program, the IRS should authorize its Volunteer Income Tax Assistance (VITA) volunteers to access IRS account information. VITA volunteers receive extensive tax and ethics training, and are required to pass a competency examination administered by the IRS.

Conclusion

Online accounts offer an innovative opportunity for the IRS to improve taxpayer service and compliance before, during, and after filing. Providing an end-to-end digital taxpayer experience will help taxpayers understand their obligations, information, and status with the IRS; prevent noncompliance; and allow taxpayers (and their associated tax professionals) to interact with the IRS when they need to address an issue. The entire approach would improve transparency between the IRS and taxpayers, improving trust and compliance.

The IRS should quickly enable a broad channel of tax professionals with online accounts that they can use to help their clients comply. Providing taxpayers and their authorized tax professionals with access to tax account information through tax software is also essential to enhancing voluntary compliance.

The IRS Future State service model enables technology as a part of an end-to-end taxpayer service and compliance strategy. ETAAC advocates that the IRS create online information and tools for taxpayers to better understand and comply with their tax responsibilities before, during, and after filing. Comprehensive digital solutions will also allow the IRS to maximize its limited resources, and create greater capacity to serve all taxpayers the way they want to be served.

¹¹¹ CPAs, attorneys and enrolled agents are Circular 230-licensed providers and can represent clients before the IRS for any year and form for which the taxpayer has authorized them. AFSP tax professionals are limited to representing taxpayers on examination and return-processing issues, but with certain restrictions. For instance, they can't agree to return adjustments or appeal unagreed issues.

APPENDIX A: ETAAC MEMBERS

Jim Buttonow – Mr. Buttonow, CPA, CITP, of Greensboro, NC, serves as the 2015-2016 ETAAC chairperson. Mr. Buttonow directs tax practice and procedure services and software for H&R Block. He regularly writes and instructs on IRS practice and procedure, compliance trends and post-filing practice efficiency strategies. For 19 years, Mr. Buttonow worked at the IRS, serving as a large case team audit coordinator for 15 years. Since 2006, Mr. Buttonow has also been in private practice. He earned a B.S. in Accounting from the University of South Florida.

Everard Lee Davenport – Mr. Davenport is Principal at Davenport Consulting and is based in Washington, DC. He works with nonprofit organizations, corporations, government agencies and Volunteer Income Tax Assistance (VITA) sites to create and deliver free income tax, financial empowerment and digital learning programs to underserved communities. Mr. Davenport has expertise in multi-partner program development, implementation and communications strategies, and is the architect of MyFreeTaxes.com. Recently, he served as Vice President, Programs at One Economy Corporation. Prior to that, he managed the nation's largest free low-income tax preparation network at the Food Bank of New York City. Mr. Davenport has a B.A. in Psychology from University of Texas at Austin and a M.S. in Urban Policy/Nonprofit Management from the New School in New York City.

Kevin A. Richards – Mr. Richards, of Springfield, IL, is the manager of the Electronic Commerce Division at the Illinois Department of Revenue. Richards, who is in his 25th year at the department, has managed the Electronic Commerce Division for the last 16 years. The Electronic Commerce Division is responsible for the development, marketing, implementation and management of electronic filing and payment programs at the department, including individual income tax and business tax applications. The Electronic Commerce Division also encompasses the Electronic Funds Transfer Office and all cash-management operations at the Illinois Department of Revenue. In fiscal year 2014, the Electronic Commerce Division oversaw the processing of more than 16 million electronic returns and payments totaling over \$36 billion in deposits. Mr. Richards earned a B.S. in Finance from Eastern Illinois University and an MBA from the University of Illinois-Springfield. Mr. Richards is also the president of the local chapter of the Association of Government Accountants.

Stephanie Salavejus – Ms. Salavejus, of Newport News, VA, is vice president with Peninsula Software (PenSoft). Ms. Salavejus is responsible for software solutions and product requirements for clients. She has 28 years of experience in electronic filing of tax reports and software development. Ms. Salavejus regularly speaks on tax administration topics related to payroll. She is also a member of the American Payroll Association and the National Association of Computerized Tax Processors.

Troy Thibodeau – Mr. Thibodeau, of Minneapolis, MN, is Chief Product Officer of Sovos Compliance, a software firm that helps businesses with Sales, Use, VAT and Information Returns processing. He is a former CPA with Price Waterhouse Coopers and has over 20 years of experience within the technology and finance industries. Mr. Thibodeau monitors international, federal and state regulatory rules, establishes technical direction of software development, and delivers operational and technical support to financial service and business firms around their tax reporting responsibilities. Certification includes Six Sigma, Green Belt. Mr. Thibodeau earned a B.S. in Accounting and International Business from University of Indiana and an MBA in Strategy and Marketing from the University of Minnesota.

Kelli Wooten – Ms. Wooten, of Boston, MA, serves as the 2015-2016 ETAAC vice chairperson. Ms. Wooten is a director with Markit | CTI Tax Solutions. She advises both multinational corporations and financial institutions on their compliance with information reporting and withholding rules such as the Foreign Account Tax Account Compliance Act (FATCA) and the Common Reporting Standard (CRS). Ms. Wooten supports clients in developing processes and procedures for completing and e-filing Forms 8966, 1042-S and 1099, as well as designing, testing, and implementing tax software solutions for tax due diligence, withholding, and information return reporting. Ms. Wooten is a frequent speaker and author on information reporting and withholding compliance. Ms. Wooten earned a B.S. in Accounting from The University of Tennessee, and a Juris Doctorate from the University of Cincinnati College of Law.

APPENDIX B: EFI ANALYTICAL METHODOLOGY

This Appendix explains ETAAC’s methodology for analyzing and projecting the Electronic Filing Index (EFI).

THE ELECTRONIC FILING INDEX

ETAAC has used several measures over the years to report and measure the electronic filing (e-file) rate. To create a consistent measure of this goal, standardize cross-year comparisons, and facilitate analysis, ETAAC developed the electronic filing index (referred to as EFI, or Index) for use in its annual report to Congress. The Index aggregates and assesses the electronic filing rates of a defined set of major tax returns and includes a methodology for projecting e-file rates based on season-to-date information about the main driver of electronic filing rates – the individual tax return.

The Index computes a specific electronic filing rate for each specified return family, as well as an overall composite rate representing the overall electronic filing rate for all major return families in the Index. Importantly, because certain information in IRS Publication 6186 (which is revised and published each fall) is estimated, ETAAC’s Index may shift slightly from year to year as IRS updates its estimates with actual filing season results.

RETURN FAMILIES

The Index is computed using IRS Publication 6186’s reported information for designated forms in six major return families:

Individual Income Tax

Forms 1040, 1040-A, and 1040-EZ

Employment Returns

Forms 940 and 940-PR, Forms 941 and 941-PR/SS

Corporation Income Tax

Forms 1120 and 1120-A Total Form 1120-S

Partnership

Forms 1065/1065-B

Exempt Organizations

Form 990
Form 990-EZ

Fiduciary

Form 1041

Substantiation for the continued use and accuracy of the EFI methodology can be seen in results from the 2015 filing season. ETAAC’s June 2015 report projected an e-file rate of 86.3% for the 2015 filing season for individual returns (Forms 1040, 1040-A, and 1040-EZ), and an EFI of 77.5% for all major returns. Based on IRS data for the 2015 filing season, published in October 2015, the actual e-file rate for individual returns was 86.3%, and the e-file rate for all major returns was 77.4%. Given the accuracy of the EFI methodology in projecting EFI rates, this 2016 ETAAC report uses the same projection methodology.

Table 7: 2015 EFI Projection vs. IRS Data

| 2015 IRS Data vs. EFI Projection | | | |
|--|-------|----------|----------|
| Type of Return | EFI | IRS Data | Variance |
| Individual (Forms 1040, 1040-A, and 1040-EZ) | 86.3% | 86.3% | 0.0% |
| Business (94x, 1120, 1065, 1041, 990 families) | 47.5% | 47.8% | 0.3% |
| All Major Returns | 77.5% | 77.4% | -0.1% |

Source: IRS Publication 6186 (Rev. 10-2015) Table 2 and June 2015 ETAAC Annual Report to Congress

ESTIMATING THE ELECTRONIC FILING RATE

As noted above, the current-year filing season data contained in IRS Publication 6186 is estimated. However, based on prior-year filing results and data for the season as of the time of publication, ETAAC can extrapolate and make reliable estimates for all of 2016. Therefore, ETAAC has modeled a projection methodology to forecast the current-year Index based on two components.

Component 1: Individual returns (Form 1040 series)

ETAAC projects total filing season e-file rates for individual returns by extrapolating current filing season year-to-date information into full-year estimates, based on how the individual return e-file rate has historically trended in the May-October period.

Based on this methodology, ETAAC estimates that the e-file rate for individual returns will be approximately 86.6% for the entire 2016 filing season, translating to an overall Index of 78.0% for all major return types for the 2016 filing season.

ETAAC follows a four-step process to project the full-year electronic filing rate for individual returns.

Step 1: Estimate the actual current year-to-date e-file rate.

Determine the current year-to-date e-file rate for individual returns, based on actual return filing information through April 22, 2016.

Table 8: Individual Income Tax Returns – Actual Through April 22, 2016

| Individual Income Tax Returns | 2016 filing season through 04/22/16 |
|-------------------------------|-------------------------------------|
| | Number of Returns |
| Total Filed | 136,528,000 |
| E-file | 122,546,000 |
| E-File % | 89.8% |

Source: Current- and prior-season filing statistics, as found at www.irs.gov/uac/2016-and-Prior-Year-Filing-Season-Statistics

Step 2: Estimate the historical e-file rate degradation through the remainder of the year.

Compare the e-file rate for the first four months of the year through end of April (primary filing season) with the actual e-file rate for the full-calendar-year filing season for 2014 and 2015. In both instances, the final e-file rate decreased approximately 3% after the initial April filing deadlines. The degradation rate during this period remains relatively steady from year to year. ETAAC will continue to monitor the degradation rate to note whether it has any significant year-to-year changes.

Table 9: Historical Partial-Season Data vs. Full-Season Data

| 2016 Projections | 2014 | | | 2015 | | | 2015 vs. 2014 |
|-------------------------------|-------------|-------------|--------|-------------|-------------|--------|---------------|
| | 4/25/2014 | 12/26/2014 | Change | 4/24/2015 | 12/25/2015 | Change | Change |
| Individual Income Tax Returns | | | | | | | |
| Total Receipts | 134,334,000 | 149,685,000 | 11.43% | 134,209,000 | 150,927,000 | 12.46% | 1.03% |
| E-File Receipts | 116,556,000 | 125,821,000 | 7.95% | 119,402,000 | 128,784,000 | 7.86% | -0.09% |
| E-File Rate | 86.77% | 84.06% | -2.71% | 88.97% | 85.33% | -3.64% | -0.93% |

Sources: Current- and prior-season filing statistics, as found at <http://www.irs.gov/uac/2016-and-Prior-Year-Filing-Season-Statistics>

ETAAC uses the average degradation rate experienced over the past two years to forecast degradation for the current year. The 2015 e-file rate degradation is forecast to be 3.2%.

Step 3: Project the full-year e-file rate for individual returns.

Subtract the e-file rate degradation from the actual current year-to-date e-file rate. Using an April 22, 2016, cutoff, the projected full-year e-file rate for the individual tax return family is 86.6%.

Table 10: 2016 Individual Electronic Filing Rate Projection

| Individual (Forms 1040, 1040-A, and 1040-EZ) | 2016 filing season through 04/22/16 | | |
|--|-------------------------------------|-----------------|-----------------|
| | Current | Projection Rate | 2016 Projection |
| Total Receipts | 136,528,000 | | |
| E-File Receipts | 122,546,000 | | |
| E-File Rate | 89.8% | -3.2% | 86.6% |

Sources: Current- and prior-season filing statistics, as found at <http://www.irs.gov/uac/2016-and-Prior-Year-Filing-Season-Statistics>

Step 4: Project the full-year e-file volume for individual returns.

Multiply the projected e-file rate by the IRS’ projected 2016 total individual return volume presented in IRS Publication 6186 – that is, 86.6% times 150,647,400 returns. Then, use this projected e-file return volume to calculate the overall Index rate for all major return types.

Component 2: Business returns (Forms 94x, 990, 1041, 1065, 1120)

ETAAC relies on IRS data estimates from IRS Publication 6186, which is published in the fall of each year, to calculate the EFI for all business return families of forms.

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