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IRS HEARING ON "REAL-TIME TAX SYSTEM"
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Commissioner Shulman, Deputy Commissioners Miller and Tucker, thank you for the opportunity to testify before you today on the Real-Time Tax System Initiative.

My name is Bernie McKay and I am the Chief Public Policy Officer of Intuit.

Intuit is a leading provider of tax, financial management and online banking solutions for consumers, small and mid-sized businesses, accountants and financial institutions. Some of our most recognized consumer financial products are TurboTax, Quicken, QuickBooks and, more recently, Mint.com. We were founded more than 25 years ago with a focus on using technology to help consumers manage their personal finances. Then, and now, the core mission of the Corporation is to provide products, services and tools that improve our customers' financial lives so profoundly that they cannot imagine going back to the old way of doing things.

Overview

According to the Commissioner's proposal, the vision of the proposed Real-Time Tax system is to resolve the issue of "after the fact" corrections, errors or even fraud. The proposed system would enable IRS to verify the wage and income information in real-time, and then highlight mismatches (either purposeful or unintentional) so that the taxpayer may correct these changes before return filing or enable the IRS to stop fraudulent refunds before they issue.

Intuit agrees that increasing return completeness and accuracy is an important objective, and agrees in principle with the benefit of verifying information in real-time. Such verification could further reduce errors and fraud. However, the government does not have unlimited resources to implement such a system, nor do the small businesses of this country who must report financial information that is integral to tax return preparation.

Indeed, we already saw the results of the impact to the national small business community when changed 1099 reporting requirements were enacted as part of the Affordable Care Act of 2009, which led just one year later to congressional repeal of those new reporting obligations in 2010. Indeed, the Small Business Administration and the President called for the repeal. Taking that very recent experience as instructive, we believe it is important to seek out alternative implementation models here that could achieve the end policy objective of the Real-Time proposal without adding cost and other burdens to the taxpayer, the public treasury and the commercial sector.

In addition, the long public debate over whether the Government should reduce or even remove the role of the taxpayer from the preparation and submission of tax returns has unfortunately muddied the water on discussions about strategies to improve the timeliness of tax return validation. That kind of long-term proposal for expansion and change in the role of the Internal Revenue Service is not what the Commissioner has put forward in these hearings, focusing instead on adoption of what he has described as a "real-time" tax system. However, a broader long-term strategy continues to be advocated by others, where the changes necessary to achieve up-front validation of returns would be treated as a building block and gateway to a more sweeping and fundamental change in the American tax system down the road.

Illustratively, just last week, the Office of the Taxpayer Advocate filed its Annual Report to Congress. Within its pages, a long-term strategic framework was described and advocated that projected an evolution in taxation over time that begins with enabling real-time return validation and ends with a pre-completed tax return eventually delivered by Government.[1] This kind of incremental strategy has likewise been advanced by some in academia in various advocacy pieces published over the last decade.

An income tax system based on vesting effectively all aspects of the process of taxation centrally in the government -- borrowing on European models of taxation, both historically and up through the present time – would represent an historical departure for this country. Significantly, such an outcome can either be enabled or avoided through the strategies and choices we make today. Moreover, thoughtful planning and decisions made now can also avoid adding complexity to the public discourse around consideration of important initiatives like "Real-Time Tax".

In many respects, the American model of Voluntary Compliance is built on a basic philosophical foundation about the relationship of taxing authorities to the citizenry that goes all the way back to the earliest days of the founding of the Republic. The consistency of that philosophy of governance from then to now is a tribute to enlightened leadership in the political systems of our government over time. The citizen-centric differences between the American system of taxation, and the central government taxation models of our European brethren, do not represent flaws in our approach, but strengths. Tax reform and tax simplification are universally agreed as being needed and overdue for our country, but changing the American Voluntary Compliance model of the relationship of the citizen to the Government would not be such reform. Improving the tax system we've got, and retaining the engagement of the citizen in that system, are important priorities to retain on the pathway to reform.

I hope today to focus on potential solutions to achieve the Commissioner's specific proposal to improve the functioning of our tax system, and to enable government and industry to work together collaboratively to help make the nation's tax system better for years to come.

Core Advantages of Real-Time Tax System As Proposed

- **DATA VERIFICATION IN REAL-TIME**

As it has been proposed and refined over the last year, there are some distinct advantages of a system that does real-time verification of data. If it were to work as suggested, the Real-Time Tax System could "fix" the after the fact system that the IRS currently operates. This

[1] National Taxpayer Advocate 2011 Report to Congress, issued January 2012, pg. 17 and Footnote 11.

may be about data that is simply entered incorrectly or incompletely – or in the alternative, may be data that is fraudulent. The current process of verification used with the Automated Underreporter Program (AUR) is not timely, taking months for IRS to centrally gather and prepare the information and then compare that information with the taxpayers' information. Even then, according to TIGTA, manual intervention and review of the return is required in almost all cases before notices are sent to taxpayers. Often, in fact, the taxpayers are sent their refund checks before the IRS could contact them to correct the information.

The Commissioner explained in discussing this proposal that if done right, "We would have more accurate returns and deal with many more problems up-front."[2] Handling the problems "up-front" would correct taxpayer information to ensure that they are getting the refund that they deserve. Additionally, it can eliminate both taxpayer and IRS burden of following up on a return months or even years after the return was filed – ensuring that both the taxpayer and the IRS receive the money that is due to them.

But what may perhaps be most important, this initiative could be a boon to the accuracy and completeness while providing another tool to reduce fraud. Stopping inaccurate returns from going through, and catching them before the inaccurate refund check is actually issued, would be a significant evolution in tax administration, improving the functioning of the US tax system in a fundamental way.

Key Considerations Essential to Success of Strategy

Despite the advantages of this concept, however, there could complications that impact the potential for success of the current proposal, depending upon how it is implemented.

- **POTENTIAL BURDEN TO CONSUMERS AND MAIN STREET**

There is a potential for significant impact to the taxpayers and small businesses depending on the implementation strategy employed to realize the Real-Time vision.

From a Silicon Valley technology industry perspective, all of our products and services are developed and continually updated by customer-driven innovation – where the customer is the central component of how we make decisions on our products and services, their features and functionality, their quality and accuracy, and just as importantly, their usability. Depending upon how it is implemented, the current Real-Time Tax system proposal could create a larger burden to the consumer than one might assume at first blush.

In a TIGTA report on the Automated Underreporter Notice (AUR) process, TIGTA highlights a number of problems with the current AUR, a process designed to encourage taxpayers to report all of their income. For example, TIGTA's evaluation of the CP 2000 notice provided during the AUR process determined that taxpayers were actually confused by the notices and that some notices included inaccurate information resulting in over-assessment or at times, under-assessment of taxes.[3]

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[2] Commissioner Shulman's Speech at the CERCA Fall Meeting, OCTOBER 12, 2011.
[3] TIGTA 2008 Report on Automated Underreporter Notices, pg. 6.

If the IRS were to move forward with the Real-Time Tax concept, as proposed, and expedite the amount of information provided to the IRS, there is a significant potential that this information will continue to be inaccurate.

In fact, the Office of the National Taxpayer Advocate has the same concerns. In its recently issued Annual Report to Congress, the Advocate's Office writes that proposals to acquire more information earlier are beneficial to "simply identify data discrepancies"; however, due to budget constraints, the IRS may not have the resources to "assist taxpayers who respond properly" and consequently, "cannot implement or expand the use of such a program without adverse taxpayer impact."[4] The report also raises concerns about over-reliance on automation in data matching as a process that can compound complications created by errors in third party data reporting, to the disadvantage of the taxpayer and to the assumptions around the accuracy of their return.[5]

Accelerating third party reporting is often a core element of discussions around up-front return validation. However, creating new small business costs and burdens through accelerated reporting requirements as part of implementation of a Real-Time Tax strategy should be approached with great care. In the recent case of the changes to 1099 business reporting that were included in the Affordable Care Act in 2009, the costs and burdens to small business of those new requirements were extensively documented during that policy debate by groups such as the National Federation of Independent Business and the US Chamber of Commerce, among others. The repeal of the provisions by Congress in 2010, and the President's signature on that statutory change provide a case study worthy of any proposal that recommends changes in financial reporting requirements that could create additional costs and burdens for small businesses across the United States.

Indeed, the recent Electronic Tax Administration Advisory Committee's (ETAAC) Annual Report to Congress highlighted this issue and the potential effect it may have on small businesses and small main street banks and credit unions. As ETAAC reported:

> "Shortening the processing period from three months to one month is a significant workload increase, especially for small businesses. ETAAC's concerns about the practical business impact of such a change are heightened by Congress' recent statutory repeal of expanded 1099 reporting by businesses, which had been enacted just last year as part of the healthcare legislation. The legislative reversal resulted from the substantial concerns expressed by the small business community about the additional associated costs and burdens, which the President described as "an undue barrier to small business growth." Policy makers must avoid creating the same kind of costly business burden again, particularly on small business, without adequate study of its practical impact including a consideration of other potential opportunities."[6]

Therefore, the IRS should ensure that its current processes are corrected, and that it has the resources necessary to accelerate and operate the new processes during the filing season, and to implement the technology systems needed for a Real-Time Tax System. Most

[4] National Taxpayer Advocate 2011 Report to Congress, issued January 2012, pg. 8.
[5] National Taxpayer Advocate 2011 Report to Congress, issued January 2012, pg. 4.
[6] ETAAC Report to Congress, 2011, pg. 38.

importantly, the IRS must ensure that the eventual plan does not create new costs or burdens for individual taxpayers or small businesses that are reporting data. These kinds of basic considerations should be central to the adoption of any particular implementation vision.

- **TECHNOLOGY**

Ironically, technology is another potential complexity that could be a disadvantage to the proposal depending on the chosen implementation strategy.

Technological innovations are happening daily within the private sector because we have the mission focus and innovation-driven culture to allow our employees to take some of their work time to brainstorm on what can be done better, on creatively solving difficult problems and challenges, and then to acquire rapidly the cutting edge technologies required to achieve and implement the innovations this strategy produces. However, the government is usually at a significant disadvantage in this area due to its limited funding, annual budgeting, procurement processes, staffing limitations and its multiplicity of competing critical public priorities. Driving an innovation culture takes strategy, commitment and resources. In addition to investing more in technology above and beyond the annual funding, which is focused on central, core modernization efforts, government would need to increase its staffing by orders of magnitude and also receive additional investment funding to give "innovation time" to its staffers, so they're given the opportunity to innovate, develop technologies, and creatively solve problems, on how an idea like the Real-Time Tax System might best be accomplished.

For example, some years ago the private sector developed an Open Standard for the secure electronic transfer of financial information known as OFX. In turn, companies then developed software solutions which enabled consumers to electronically draw their financial data directly from its original sources and instantly utilize that information to complete financial forms, transactions and other essential data-driven uses. One major application of modern Software-as-a-Service, or SaaS, that utilizes this financial data innovation, is the electronic pre-population of tax returns. As a result, this has already been taking place at the command of the taxpayer for some years now as they annually prepare their own income tax returns utilizing modern software tools, and electronically file them. Such simplification and improvement of tax compliance is being achieved with applied technology today, without creating a central national financial data repository that could be highly vulnerable to hacking, disruption and international cybercrime. Instead, it is an innovative capability already invented and delivered in the competitive marketplace that goes directly to the widely dispersed and distributed original sources of financial data. The data is securely accessible to its owner in order to reduce taxpayer compliance burden, speed the time involved in return preparation and increase the accuracy and completeness of returns. Again, this is being done right now as we speak.

As it considers strategies for the real-time validation of data in tax returns, IRS should explore solutions and technologies that would not require extraordinary investment, or reinventing the wheel, or creating vulnerable new central database targets. Rather, the government could instead choose to leverage the investments and innovations of the private sector by utilizing data matching strategies that draw on the same original data sources that today are already used to electronically prepopulate returns in the first place. A collaborative effort with the private sector to explore creative, low investment solutions that could achieve upfront data validation from original sources as returns are received is a solution path that could make a great deal of sense in an era where government does not have access to unlimited resources, and agencies have a myriad of competing critical priorities which must somehow all be achieved successfully in each budget year.

Leveraging private sector investment, innovation and invention, and applying it to public purpose, is a strategy alternative we recommend to IRS as a core principle of modern strategy for a high performing public sector organization.

- **"RETURN FREE"**

A shadow issue proposed by some advocates is the long-standing controversy and debate over the concept of having the central government revenue agency develop the capabilities to instantly prepare and complete tax returns for the citizen, either like the British Pay-As-You-Earn centralized government system operated on an "exact withholding" model, or the 'Return Free' model as commonly described here in policy debates in the US, or to model income taxation in similar ways to Local and County property and real estate taxation via 'Bill Presentment'. Advocates of these strategies have long cited the potential for increased revenue receipts that might be collected by redesigning the American income tax system. Some have also suggested that taxpayers might be delighted to have the burden of tax compliance removed from their lives by the government, replaced by a new central taxation function provided by the government itself.

However, any proposal that might be put forward for such fundamental changes in the American tax system would need to also include a deep understanding of whether it truly represents simplification, streamlining and improvement, or whether it has its own set of serious problems that must be honestly explored and weighed against claimed benefits.

The British experience is instructive about the realities of European models of taxation, and brings to mind the old adage that the grass is not always greener on the other side. Just one year ago, it was discovered that the income taxes of millions of British taxpayers had been miscalculated by government over the span of a decade. These public disclosures, and the difficult revenue true-up process that the government then pursued took place, produced a major national political scandal that damaged public confidence in the fairness of their own tax system, a system which policymakers observed had long ago become distant and disconnected from the people it was taxing due to their non-engagement in determining their own tax and financial affairs.

The Commissioner's Real-Time Tax initiative today does not propose a longer-term incremental plan such as the examples above. But if we are to heed author Steven Covey's famous advice to individuals and organizations, we must "begin with the end in mind." In this context, any plan implemented today needs to be examined and understood in terms of how it might meet its intended purpose, or be turned to different purposes by others in the future. Mr. Covey's wisdom would lead one to conclude that the implementation choices selected today need to be made with a thoughtful and careful eye to future outcomes.

Enduring Leadership and Strategic Vision

Fortunately for the American taxpayer, the Internal Revenue Service has taken a far different course than its counterparts on the other side of the Atlantic. As a result of enlightened leadership, over the last ten years a series of forward-thinking IRS leaders -- from Commissioner Rossotti to the present incumbent Commissioner Shulman -- have placed their continued faith in Voluntary Compliance, and chosen to leverage the investment and invention of the private sector to help improve and enhance the American taxation experience, and keep the citizenry engaged in the process of their own taxation.

The IRS has notably utilized a low cost strategy to deliver modern electronic tax simplicity and innovation to the American taxpayer through the IRS Free File program. This non-monetary public-private-partnership not only delivers leading edge electronic financial tools to the taxpayer, but it reinforces the need for citizen engagement in their tax affairs, and the individual citizenship responsibility for tax compliance that is inherent to our Voluntary Compliance system.

The IRS electronic filing strategy for more than a decade represented a highly innovative and efficient way of moving a nation forward and embracing significant change. In turn, the IRS Free File program was a further strategy to sharply drive electronic filing to increase tax return accuracy, while significantly decreasing return processing costs, all the while bridging the Digital Divide and helping the working poor in this country. The cost-effective value of leveraging private sector resources and applying them to public purpose is a strategic approach that can be applied to other critical objectives in this decade and produce new accomplishments comparable to the achievement of 80% individual e-filing over the past decade.

Conclusion

A wise man once said, “Mirror your **partner’s** dreams; the relationship will grow.” While at the time these words were written the author may not have been talking about a partnership between government and the private sector – this philosophy is nevertheless true for all partnerships. A *shared vision* – in this instance, accurate tax data verified in real-time – could increase the ability of the IRS to deliver at even higher levels of effectiveness in its core missions, but by working collaboratively with the private sector the benefits of such services could be achieved in the most cost effective and technologically advanced ways possible, realizing the power of data-driven innovation and the Internet.

In conclusion, I’d like to thank you again for the opportunity to testify before you today on this important issue. Intuit looks forward to continuing to work on this issue with you as you examine the inputs and concepts that you are gathering through your public engagement process on this proposal. Thank you.