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Virginia Department of Taxation
Craig M. Burns, Commissioner
January 25, 2012

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IRS's Real Time Tax System Initiative

Virginia is very much in favor of any initiative that can validate information when the return is filed and resolve reporting discrepancies up-front as compared to after-the-fact. We recognize this is a very large and complex issue to address and we commend Commissioner Shulman for decision to begin the process to address this.

We believe the IRS has already identified many of the concerns/issues that we would have (on page 10 of the PowerPoint provided to us):

- Timeline/deadlines for receiving the up-front information.
- Accuracy of the up-front information.
- Time/effort following up on missing or inaccurate up-front information.
- Impact on taxpayer when the inaccurate or missing information is not their mistake, and there is nothing they can do to resolve the discrepancy (i.e. employer reports W-2 information and they mis-keyed the employee's SSN when they submitted the information).
- Impacts to the current timeline/schedule for processing individual income tax returns, particularly if it shifts the issuance of refunds or collection of tax dues for states into the next fiscal year.

In addition:

- If the taxpayer feels they cannot use e-File without resolving the discrepancy first or they don't know how to resolve the discrepancy, we are very concerned that many will simply print the tax return from their software and mail it in instead of e-filing it, which could adversely affect our efforts to increase electronic filing.
- States have become dependent on the current Fed/State e-File program for the majority of their individual income tax returns. Any solution that does not integrate with (or build upon) the current modernized e-File Fed/State program would adversely affect States.
- Any solution that attempts to provide a Fed only solution such as the IRS's Fillable Forms/e-File program could adversely affect States and increases taxpayer burden by making them file separately with the IRS and their state.

In response to the IRS's General Questions and Specific Questions for Feedback:

- What are the best opportunities to evolve the tax system to be more real time in the short-, medium-, and long-term?

    - Short- to Medium-Term: Work with employers, issuers of 1099s, K-1s, etc., and SSA to determine how quickly income and deduction

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information could be received and processed?   What is the expected error rate (how many documents will be corrected and materiality)?   When should the majority of corrected documents be available?   Develop a time line.

Consider at what point you start to notify taxpaying public about the benefits of a real time system. Will the public accept a later filing period (for example can't start filing returns until February 15) vs. simplified requirements (for many it is easier to file)?

o   Medium- to Long-Term: Obtain state withholding from W-2s and other information returns.   The employers and other issuers of reporting documents would only have to report the information to one place (either IRS or SSA) but not states. As soon as the IRS processed the information they would transmit to the states in on standardized format.

Allow access to information available on-line to state taxing agencies. This will improve both taxpayer service and compliance.

o   Long-Term: For those individuals with less complex tax situations (Such as only salary/wage and interest income, standard deduction, etc.), could have ability to view income information on line, verify information is correct, answer a few questions, and elect to have system prepare and file tax return immediately. For some corrections, consider allowing taxpayer to accept or reject amended return on-line.   For less complex returns and straightforward modifications, why require taxpayer or preparer time to key information on return and submit, if can be computed on-line.

o   How can we most effectively structure our collection efforts to eliminate hassle for taxpayers, and reduce burden?

o   Provide a single point for the collection of information that is maintained in a central repository.

o   Provide taxpayers/tax preparers with an option to log into the master repository of information to review what you have on file for them before they file their return. If information is missing or inaccurate provide them

with online advice/steps on how to resolve the discrepancies before they are ready to file their return.

o What suggestions would participants offer on how to operate an up-front matching process? What should be the role of the taxpayer, the tax practitioner, and the software industry in resolving issues that arise? What tools could the IRS provide to support up-front issue resolution?

  o Need standardized matching criteria. For many individuals this is the SSN. However for those individuals that don't have a SSN, they must have an ITIN that is issued by the IRS and used on all forms. Employers and other issuers of reporting documents must report by using SSN or ITIN to both the taxpayer/recipient and IRS and state government, and in some cases they may need a process in place to validate the number.

  o Consideration should be given to prohibiting financing and similar institutions from paying income (like interest income) to taxpayers until valid SSN or ITIN provided. (I believe this is in place to some extent now.)

  o Work to make available a streamline on-line process for employers and other issuers of documents to validate ITINs and possibly SSNs. Of course we must balance protecting personnel information v. need to match up records quickly and accurately. Such an on-line application may only provide last four digits of a person's number. In other situations, may have "certified" vendors who have access to the program that will issue ITINs immediately once certain information is provided.

o In a scenario where the IRS moved substantially toward upfront matching, how would panelists envision the process working between the IRS, taxpayers, and practitioners to resolve issues up front, rather than months and years after the fact? What issues and concerns would panelist suggest that the IRS should consider?
  o There should be a process where the taxpayer and tax preparers can identify the issue with the return in real time.

- o Develop a process to ensure the tax preparers can act on the taxpayer's behalf. If the return is rejected, an email should be sent to both the taxpayer and tax preparers.

- o The taxpayer and tax preparers should be able to log into the IRS secured site and view their information returns.

- o Ensure this process does not delay the accelerated refund turnaround time most states have with electronic filed returns. This would cause a customer service nightmare.

- o Ensure the IRS has the capacity to handle rejected returns. Customer service call volumes could increase.

- o Several comments have raised questions about the interaction of the timing of tax return filings, and information return filings. To the extent that there are gaps, how would panelists suggest that these gaps could be narrowed over time?

  - o Work with SSA, employers, and issuers of information returns to streamline reporting process so the information can be submitted and processed faster.

  - o If we are able to narrow some of the gaps, there are real benefits, such as simplifying the filing process and more accurate returns. A taxpayer could log into an IRS secure site and view their information returns. Likewise the taxpayer could grant their preparer access to the same information. Viewing the source data will allow the taxpayer and preparer the opportunity to view the same information the IRS is using if the returns are rejected.

  - o As described in one of the documents for straight forward returns (W-2 income, 1099 interest, etc), it may be possible for the taxpayer to elect to have the federal (& maybe state) return calculated for them by just answering a few questions.

  - o Consider delaying or changing filing period to give the IRS chance to process W-2s and other information returns.

    a. Of course this will cause concern with those taxpayers that need their refunds quickly. To minimize this impact consider:

        1. Simplifying tax code so taxpayers can better estimate their liability, adjust their withholding and estimated payments accordingly, and reduce their refund.
        2. For refundable credits consider steps that can be taken to simplify credits, improve reporting process, etc.
        3. Is there some "unofficial" information that can be provided by employers and issuers in December (end of tax year) that can be used to validate returns?
        4. Consider prior year filing patterns (we do this in Virginia). If a taxpayer has a validated filing history and current year return information seems to coincide with filing history, may be able to process return with high comfort level.
        5. Consider other data sources to verify return data (like state DMV records or unemployment files) which may be available prior to the start of filing season.
        6. Publicizing in advance that the filing period will be changing and give taxpayers a chance to adjust their withholding and estimated payments accordingly.

o If filing season cannot be modified and if information returns and W-2s cannot be submitted and processed until April or later, the benefit of a Real Time system is reduced significantly since a large number of taxpayers file their returns in January, February and March.