

**Statement of James R. White,
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(GAO)**

Thank you for inviting me to serve on today's panel and the opportunity to contribute to the discussion about developing a real-time tax system as the Internal Revenue Service (IRS) continues its effort to determine what steps would need to be taken to implement such a system. A real-time tax system in which IRS has the capability to compare information on tax returns to information submitted by third parties before issuing refunds could have enormous benefits to both taxpayers and IRS. The benefits include correcting overclaimed refunds before they are issued, holding up refunds if returns are selected for audit, avoiding penalties and interest, and increasing refunds for taxpayers in cases where they failed to claim tax benefits for which they are eligible.

The IRS Commissioner has acknowledged implementing a real-time tax system would require a fundamental shift in how IRS conducts its business and would likely need to take place over a significant period of time. While we agree that implementing a real-time tax system would be a long-term endeavor, in recent reports we have identified a number of short-term steps that IRS should take. Generally, these steps would either expand current prerefund compliance checks or help lay a foundation for the long-term.

These steps would have immediate benefits:

- Pursue areas where additional math error authority (MEA) could be obtained from Congress to automatically identify and correct errors particularly in cases where third-party information is required to claim a benefit. IRS needs approval from Congress to use MEA to make adjustments to tax returns without initiating an audit. We have identified three specific areas where IRS could use MEA but does not have it. These would enable IRS to (1) ensure taxpayers do not claim credits or deductions in excess of lifetime limits using prior year tax return information, (2) verify taxpayers' compliance with the limit on the number of years Hope tax credits can be claimed, and (3) identify and correct returns with certain ineligible Individual Retirement Account contributions.¹ Further, we have suggested to Congress that IRS be granted broader discretion to use MEA, with appropriate safeguards for taxpayers.² One recent successful expansion of MEA involved the First-Time Homebuyer Tax Credit.³
- Determine whether altering some existing processes would allow IRS to detect potential noncompliance and avoid costly audits before issuing refunds. For example, regarding the adoption tax credit, we recently recommended and IRS agreed to study whether a simpler process could be employed in cases where taxpayers did not submit required documentation with their tax return. Rather than initiating an audit, we recommended

¹ GAO: *2011 Tax Filing: IRS Dealt with Challenges to Date but Needs Additional Authority to Verify Compliance* GAO-11-481 (Washington, D.C. Mar. 29, 2011); *2009 Tax Filing Season: IRS Met Many 2009 Goals, but Telephone Access Remained Low, and Taxpayer Service and Enforcement Could Be Improved* GAO-10-225 (Washington, D.C.: Dec. 10, 2009); *Tax Administration: IRS's 2008 Filing Season Generally Successful Despite Challenges, although IRS Could Expand Enforcement during Returns Processing*, GAO-09-146 (Washington, D.C.: Dec. 12, 2008).

² GAO: *Recovery Act: IRS Quickly Implemented Tax Provisions, but Reporting and Enforcement Improvements Are Needed*, GAO-10-349 (Washington, D.C.: Feb. 10, 2010).

³ GAO: *Tax Refunds: Enhanced Prerefund Compliance Checks Could Yield Significant Benefits*, GAO-11-691T (Washington, D.C.: May 25, 2011).

that IRS immediately request the documentation from the taxpayer, and if provided, run the return through initial screening again.⁴ Doing so would give taxpayers a chance to provide required documentation before being subjected to audits that are costly and time consuming for both taxpayers and IRS.

- Determine whether some existing forms should be altered to make verifying compliance easier.⁵ For example, we recommended that IRS revise Form 1098 to require third parties to provide information on the address of a home securing a mortgage to help detect mortgage interest noncompliance and to help identify noncompliance related to rental real estate. Further, we reported that IRS should revise Form 982 and 1099-C to segregate the total dollar amount of forgiven mortgage debt.
- Expand transcription of information from paper returns. To avoid disadvantaging e-filers, IRS only uses data in its automated compliance checks if the data is computerized for both e-filed and paper returns. This limits the amount of data available for prerefund compliance checks.⁶
- Implement modernized systems, including the Customer Account Data Engine 2 (CADE2) and Modernized E-filing (MeF), which should allow IRS to process returns faster and conduct prerefund compliance checks in real-time.⁷ Without such systems, significant expansion of prerefund compliance checks will not be possible.

In addition to the above, we know from our past work that certain steps, including strategic planning and research, can lay a foundation for long-term success. While we have not recommended them, the following are some examples of steps that IRS may wish to consider:

- Develop a strategy that describes IRS's vision for pursuing real-time matching in more detail. Such a strategy could include a list of objectives or desired capabilities, a list of topics requiring further research, a business case describing benefits and costs, a discussion of any impacts on taxpayer rights, a discussion of risks, a schedule of milestones, and a schedule of needed budgetary resources.⁸ The plan would likely be general and high-level initially with a focus on understanding the feasible alternatives. We would expect it to evolve and add detail over time and become more focused on implementation.
- Research the range of effects on taxpayers. In addition to limiting penalties and interest associated with errors, prerefund checks might help IRS detect failures to claim tax benefits for which taxpayers are eligible. Thus MEA and other prerefund checks may

⁴ GAO, *Adoption Tax Credit: IRS Can Reduce Audits and Refund Delays*, GAO-12-98 (Washington, D.C.: Oct. 20, 2011).

⁵ GAO, *Home Mortgage Interest Deduction: Despite Challenges Presented by Complex Tax Rules, IRS Could Enhance Enforcement and Guidance*, GAO-09-769 (Washington, D.C.: July 29, 2009), and *Tax Gap: Actions That Could Improve Rental Real Estate Reporting Compliance*, GAO-08-956 (Washington, D.C.: Aug. 28, 2008).

⁶ GAO, *E-Filing Tax Returns: Penalty Authority and Digitizing More Paper Return Data Could Increase Benefits*, GAO-12-33 (Washington, D.C.: Oct. 5, 2011).

⁷ GAO, *Taxpayer Account Strategy: IRS Should Finish Defining Benefits and Improve Cost Estimates*, GAO-11-168 (Washington, D.C.: Mar. 24, 2011), and *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others*, GAO-11-111 (Washington, D.C.: Dec. 16, 2010).

⁸ GAO-11-168.

result in higher refunds. Describe how taxpayer rights, such as appeal rights, would be ensured.

- Research issues such as the accuracy of the roughly 2.7 billion information and withholding documents submitted to IRS in 2010, whether third parties could file them earlier, and how early in the year IRS could be ready to do more prerefund checking.
- Research which business processes and information systems would need to be modified or developed to allow IRS to conduct matches during returns processing.
- Research how and to what extent paid preparer regulation and commercial tax software could be leveraged to make additional prerefund checking possible.⁹
- Research the best practices by states that have moved in the direction of a real-time tax system.

The above steps are not meant to be an exhaustive list. Rather, they are actions that should help move IRS in the direction of a more real-time tax system. We believe such a move could benefit taxpayers and, in an era of tight agency budgets, make tax administration less costly.

This concludes my statement. I would be happy to answer questions.

⁹ GAO-11-691T and GAO, *Tax Administration: Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risks*, GAO-09-297 (Washington, D.C.: Feb. 25, 2009).