



OFFICE OF THE TAXPAYER ADVOCATE
WASHINGTON, DC 20224

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Completion Date: October 31, 2022

August 2, 2022

MEMORANDUM FOR CHARLES P. RETTIG
COMMISSIONER OF INTERNAL REVENUE

FROM: Erin M. Collins 
National Taxpayer Advocate

SUBJECT: Appeal of Taxpayer Advocate Directive 2022-1: Implement Scanning
Technology to Machine Read Paper Tax Returns and Address the Paper
Return Backlog

In accordance with IRC § 7803(c)(5)(B), I am writing to appeal the partial modification and partial rescission of Taxpayer Advocate Directive (TAD) 2022-1 by the Deputy Commissioners of the Internal Revenue Service.

Before I detail the reasons for my appeal, I want to acknowledge and thank the IRS employees in Submission Processing, the IRS employees working on the surge teams, and IRS management for their tireless efforts during the last three filing seasons aimed at overcoming the numerous challenges paper filings have presented. During my visits to the campuses, it was inspiring to observe the work ethic of the employees and local management. Although their daily efforts may not be observable to the public, they have worked diligently to confront the daunting and massive mountain of paper awaiting processing. That said, our taxpayers and employees deserve a 21st century tax administration that utilizes technology to meet the needs of the taxpaying public, notably by delivering timely tax refunds. I believe you wholeheartedly agree with this statement. As such, I was disappointed in the IRS's response to the TAD.

On March 29, I issued a Taxpayer Advocate Directive (TAD) to the Deputy Commissioners that directed them to implement scanning technology to machine read paper-filed tax returns. Specifically, my TAD directed them (1) to implement technology to automate the processing of paper-filed returns prepared with tax software (known as "v-coded" returns) by the start of the 2023 filing season and (2) to implement technology to automate the processing of handwritten paper returns by the start of the 2023 filing season if possible or, if not, by the start of the 2024 filing season.

On July 18, the Deputy Commissioners responded to my TAD.¹ The response said the IRS is testing several pilot programs, and its goal is to accelerate the “V-Coded Return Pilot” described in the response for 2022 returns filed in 2023. Notably, however, the response declined to make a commitment to implement scanning technology to machine read v-coded returns, and it expressly rejected implementing scanning technology to machine read handwritten returns. The response further stated the IRS would not implement any single option until it is confident in the delivery system. I fully agree the IRS should choose an efficient and reliable delivery system, but the IRS response did not provide specifics as to the IRS’s ongoing efforts, a timeline to apply a delivery system to process paper returns, or what percentage of 2022 returns it anticipates scanning. I appreciate the IRS’s efforts with the “Lockbox Scanning Service Pilot” and encourage moving forward with scanning returns. But that pilot involves returns with which the taxpayer is making a payment. Processing delays primarily harm taxpayers who are due refunds, and I would like to see the IRS prioritize the scanning of paper-filed *refund* returns.

Because of the magnitude of the IRS’s current return processing backlog and because the Deputy Commissioners’ response did not provide specific reasons for modifying or rescinding the directed actions in my TAD, I am appealing the TAD to you pursuant to IRC § 7803(c)(5)(B).

The reasons for implementing scanning technology are set out in detail in the TAD. Of particular note:

- Millions of taxpayers who filed paper tax returns and are entitled to refunds are still waiting far too long to receive them. Since the start of the pandemic, tens of millions of taxpayers have filed paper tax returns. About three-quarters of all individual income taxpayers receive refunds.² Processing delays, which have run as long as ten months or more, have translated directly into refund delays. These paper processing delays have caused inconvenience and frustration for all affected taxpayers and financial hardships for many, including low-income taxpayers waiting to receive Earned Income Tax Credit benefits. In sharp contrast to paper-filed returns, e-filed returns are processed within 21 days.
- As the IRS establishes its priorities for the 2023 filing season, I believe its most important objective must be to process all tax returns and pay all refunds promptly regardless of whether a tax return was e-filed or paper-filed.
- You and other IRS leaders have said you are aiming to process the backlog of paper-filed tax returns by the end of 2022. I certainly hope the IRS is successful. At this writing, however, there remains a significant imbalance between the number of paper-filed returns awaiting processing and the IRS’s processing pace. For 2022, the IRS has projected it will receive about 13.2 million Form 1040 paper-filed returns (including returns filed on

¹ IRC § 7803(c)(5)(A) provides that a Deputy Commissioner may modify, rescind, or ensure compliance with a TAD.

² See IRS, 2021 Filing Season Statistics (week ending Dec. 3, 2021) (showing that 129.8 million out of 168.5 million processed individual income tax returns, or 77 percent, resulted in refunds), <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-december-3-2021>.

extension between now and October 15).³ The IRS has also projected it will receive 4.2 million amended individual income tax returns,⁴ and millions of business tax returns. As of July 1, 2022, the total tax return paper processing backlog stood at 17.4 million, with millions of additional individual and business returns still expected to be filed this year.⁵

Focusing just on Forms 1040, the IRS carried a backlog of 4.7 million paper-filed Forms 1040 from 2021 to 2022,⁶ and it was not able to complete the processing of these returns until late June of 2022.⁷ Thus, it took almost half a year for the IRS to process 4.7 million paper Forms 1040. To get current on its inventory by the end of the year, it will have to process the 13.2 million paper-filed Forms 1040 it is projected to receive in 2022 – nearly three times as many returns as it was able to process during the first half of the year. Put differently, the IRS will have to process an average of about 525,000 Form 1040 paper returns per week. As of July 15, the IRS had processed a weekly average of paper-filed Forms 1040 over the prior four weeks of just 295,000.

- The fact that IRS employees must keystroke all transcribed digits from millions of paper returns into IRS systems is inefficient and delays the payment of refunds to paper filers even in normal times. While the IRS says it issues refunds to e-filers within 21 days, it has often issued refunds claimed on e-filed returns in ten days or less, while paper filers normally must wait 4-6 weeks to receive their refunds. Last year, paper Forms 1040 took as long as 10 months to be processed. Many taxpayers who file paper returns would prefer to e-file but are prevented from doing so by IRS systems (*e.g.*, they must file a form the IRS doesn't accept for e-filing or the IRS has rejected their return for e-filing because it broke a business rule). Even outside the context of the pandemic, paper filers should not have to wait so much longer than e-filers to receive their refunds.
- Scanning technology would save money. In my TAD, I have detailed the IRS's history of considering but not proceeding with scanning technology. Most recently, the IRS requested funding for 2-D barcoding in the President's FY 2017 budget but apparently did not implement 2-D barcoding because Congress did not appropriate the requested funding. I recognize the IRS must prioritize IT projects within its annual budget, but the amount requested for 2-D barcoding – \$8.4 million – is a small amount in the context of a budget that exceeded \$11 billion at that time.⁸ In my opinion, it would have generated an excellent return on investment.

³ IRS Pub. 6186, *Calendar Year Return Projections for the United States and IRS Campuses: 2021-2028*, at 7 (revised 11-2021), <https://www.irs.gov/pub/irs-pdf/p6186.pdf>.

⁴ *Id.* at 9.

⁵ IRS, Wage & Investment Division data (as of July 1, 2022).

⁶ See Treasury Inspector General for Tax Administration, Rep. No. 2022-40-035, *Interim Results of the 2022 Filing Season 1* (May 2022), www.treasury.gov/tigta/auditreports/2022reports/202240035fr.pdf.

⁷ IRS News Release, IR-2022-128, *IRS continues work on inventory of tax returns; original tax returns filed in 2021 to be completed this week* (June 21, 2022), <https://www.irs.gov/newsroom/irs-continues-work-on-inventory-of-tax-returns-original-tax-returns-filed-in-2021-to-be-completed-this-week>.

⁸ Internal Revenue Service, *FY 2017 President's Budget - Congressional Budget Justification* 31, <https://home.treasury.gov/system/files/266/02-06.-IRS-FY-2017-CJ-1-22-16-v2-FINAL-CLEAN.pdf>.

Had the IRS leadership chosen to reallocate \$8.4 million to implement 2-D barcoding or other scanning technologies at that time, the investment would have paid for itself many times over in reduced costs for Submission Processing employees, who still are transcribing millions of returns digit by digit into IRS systems. Scanning technology would have prevented or substantially reduced the backlogs taxpayers have experienced over the last two years. It also would have substantially reduced or eliminated data transcription errors, which occurred on about 22 percent of transcribed returns, further burdening taxpayers and the IRS itself.⁹ As I noted in my TAD, 17 state tax agencies were using 2-D barcoding technology 22 years ago. The IRS should find a way to implement 2-D barcoding or other more effective scanning technology without further delay.

In closing, I want to clarify the directed actions set forth in my original TAD. In March, at the time I issued the TAD, my understanding was that 2-D barcoding could realistically be implemented in time for the 2023 filing season because (i) it is a tried-and-true technology in use for more than 20 years by many state tax agencies and (ii) tax return software companies have had significant experience converting return information into 2-D barcodes for the states over this time. It was also my understanding that optical character recognition (OCR) technology has advantages over 2-D barcoding, including the ability to scan handwritten returns, but it might take longer to test, refine, and implement. For that reason, my directive focused on 2-D barcoding, but I understand that tax return software companies must work with the IRS to place 2-D barcodes on returns and that whether they agree to do so may be outside the IRS's control.

I still believe my assumptions are correct. However, as I have told IRS officials repeatedly, I am agnostic as to which form of scanning technology is used. My goal is simply to substantially reduce or eliminate the challenges of processing paper-filed tax returns in an efficient and cost-effective manner and to provide timely refunds for all taxpayers – not just for taxpayers who file their returns electronically.

I will consider the IRS to have fully complied with Directed Action 1 if it implements technology that can machine read all v-coded returns by the start of the 2023 filing season, and I will consider the IRS to have fully complied with Directed Action 2 if it implements technology that can machine read handwritten returns by the start of the 2023 filing season or, if that is not feasible, by the start of the 2024 filing season.

Response and action dates

I ask that you respond to this TAD appeal by September 30, 2022, and state whether you plan to implement the directed actions, plan to implement alternative actions that will achieve the same objectives, or decline to take the directed actions. If you agree to implement the directed actions or alternative actions that will achieve the same objective, please specify the timeframe for doing so. If you need more time to respond, I will grant a reasonable request to extend the response deadline, but not beyond the 90-day limitation imposed by IRC § 7803(c)(5)(B).

⁹ IRS response to TAS information request (Sept. 16, 2021) (data through August 2021).

If you are complying with this TAD, I request that you provide a detailed plan to incorporate scanning technology for the 2023 filing season by October 31, 2022. If you modify or rescind this TAD, IRC § 7803(c)(5)(B) requires that you provide a written explanation of your reasons.

I look forward to working with you and your team. I welcome our continued dialogue on scanning technologies to best serve taxpayers and improve tax administration.

Attachments:

- Taxpayer Advocate Directive 2022-1: Implement Scanning Technology to Machine Read Paper Tax Returns and Address the Paper Return Backlog (March 29, 2022)
- Deputy Commissioners' Response to TAD 2022-1 (July 18, 2022)

cc: Douglas O'Donnell, Deputy Commissioner, Services and Enforcement
Jeff Tribiano, Deputy Commissioner, Operations Support
Kenneth Corbin, Commissioner, Wage & Investment Division
Nancy Sieger, Chief Information Officer
Bridget Roberts, Deputy National Taxpayer Advocate
Rosty Shiller, Division Counsel/Associate Chief Counsel (National Taxpayer Advocate Program)