Electronic Tax Administration Advisory Committee

Annual Report to Congress

June 20, 2007

ETAAC ANNUAL REPORT TO CONGRESS, 2007

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PURPOSE OF THE ETAAC REPORT

The Restructuring and Reform Act of 1998 (RRA 98) created the Electronic Tax Administration Advisory Committee (ETAAC) for the purpose of providing feedback to the Internal Revenue Service (IRS) on the development and implementation of their electronic tax administration strategy. Specifically, ETAAC provides an ongoing public forum for the discussion of electronic tax issues, especially as it relates to the electronic filing (e-filing) of returns.

This annual report to Congress discusses the IRS' progress in furthering e-filing and makes recommendations on the IRS' electronic tax administration strategic plan. The IRS Oversight Board shares a similar reporting responsibility. The Board evaluates all that the IRS does from an electronic tax administration perspective to fully modernize the IRS. We encourage readers to review the Board's Electronic Filing 2006 Annual Report (February 2007) for additional insight.

OVERVIEW

Progress

In 1998 Congress established a goal for the IRS that, by 2007, 80 percent of all returns are filed electronically. Although the IRS is short of this goal, they are making significant progress and electronic filing continues to grow.

Based on trend data as of May 2007, the IRS expects that the percent of individual returns e-filed will increase to 58 percent, up from 54 percent last year. The 80 million projected e-filed returns will represent a nine percent volume increase over 2006. The e-filing of business returns will also increase, due in large part to mandates implemented in 2006.

IRS electronic services received strong praise from taxpayers. The redesigned IRS website, www.irs.gov, attracted more visitors and higher satisfaction rates from its visitors this year. Visits to its website are up ten percent and inquiries to its refund status application are up 22 percent. Online services including "Where's My Refund", calculators, employer identification number requests, transcript deliveries and various registrations are gaining popularity with both consumers and practitioners. These examples illustrate that the IRS is listening and responding to its stakeholders' needs.

While it is encouraging that the IRS has embraced e-filing and has been responsive to feedback on how to increase the e-file numbers, the IRS needs to do more beyond e-filing. In its 2006 Taxpayer Assistance Blueprint (Blueprint) that describes the five-year plan for taxpayer service, the IRS paints a broader vision for electronic tax administration that goes beyond just return filing. The Blueprint describes the types of interactions taxpayers have and recognizes that "e-government" efforts and services are vital to achieve the IRS' broader strategic goals. ETAAC commends the IRS for articulating its vision and initiating planning to reach their goals.

The IRS has also made progress in other areas, including:

- Implementing modernized e-file for partnership returns;
- Piloting the enhanced Electronic Federal Tax Payment System (EFTPS) that allows employers to pay both federal and state liabilities concurrently;
- Adopting multiple authentication methods to address critical security concerns; and,
- Helping develop standards for the XML Technical Standards Committee.

Trends

Today, more than 70 percent[1] of households have Internet access. Taxpayers who do not have access in their homes may have it in their workplaces or their local libraries. Americans are comfortable interacting electronically; and, we are seeing more and more people expressing a preference for electronic engagement via email and the Internet. Whether purchasing airline tickets, sending flowers, accessing service personnel or paying bills, electronic interactions and transactions are now mainstream. Consumers embrace technology because of convenience. This convenience factor is, perhaps, best illustrated by the fact that e-filing volume surged 35 percent in the last few days of the April 2007 tax filing season. The 24x7 availability offered by online tax preparation is undeniably a huge convenience factor for Americans who choose to wait until the last minute to file.

IRS Current State

The functionality that consumers expect in an electronic marketplace for financial transactions is not currently available in interactions with the IRS. For example, the ability for taxpayers to manage their accounts online, view information such as bills and notices, check the status of their correspondence and otherwise interact electronically with the IRS is largely only a vision today.

There is a tremendous amount of work remaining for the IRS to be able to deliver even the most basic electronic services. Several reasons account for this, including:

- Legacy systems that continue to divert precious resources;
- Priorities and funding that are moving targets and often not reconciled;
- An IRS organization that continues to embrace processes and cultural dynamics that were developed in a batch-oriented, paper environment; and,
- Project plans that are scoped to encompass the ultimate in functionality rather than being scoped in a way to leverage incremental improvements delivered in phases.

ETAAC Observations

In light of current trends and where the IRS is today, ETAAC believes that the IRS rapidly needs to address its stakeholders' increasing needs and expectations.

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[1] 2004 Nielsen//NetRatings survey (http://www.netratings.com/pr/pr_040318.pdf) and 2006 December Pew Survey, http://www.pewinternet.org/trends/User_Demo_4.26.07.htm

The Blueprint outlining the IRS' five-year strategic plan for taxpayer service recognizes that "the increased breadth and quality of services offered… have enabled the IRS to reach a larger audience in a more efficient and effective manner." The report also acknowledges that "there is still a need for greater efficiency and effectiveness in service delivery based on taxpayer needs and preferences."

With the above observations, ETAAC concludes that e-filing should no longer be ETAAC's sole focus, just as it should not be the IRS' sole focus. Though there are many opportunities for growing e-file that ETAAC will address, there are also opportunities in broader areas of electronic tax administration that warrant attention. Specifically, electronic administration and services will play an increasingly more important role in the IRS; and, ETAAC will offer recommendations in this area as well.

Therefore, this report is organized into two sections. The first section addresses recommendations for accelerating e-filing growth. The second section focuses on how the IRS can embrace and facilitate the delivery of services electronically. Common in both sections are recommendations to protect the integrity of the tax preparation and filing systems so that the public has confidence in their interactions with the IRS and their tax practitioners. As more and more taxpayers and practitioners rely upon electronic means for conducting business with the IRS, ensuring the integrity of the tax preparation and filing environment is vital.

ELECTRONIC FILING INITIATIVES

The IRS has made significant progress toward electronic filing and continues to deliver improvements and advancements each year. However, it will fall short of the 80 percent goal for 2007.

Tax Returns

As indicated in the following Chart 1, 49 percent of all tax returns are expected to be filed electronically in 2007, led by the 1040 series of income tax returns. Because the 1040 returns represent 76 percent of all tax returns received by the IRS, focusing on individual returns is strategically important.

Tax Return Projections for 2007

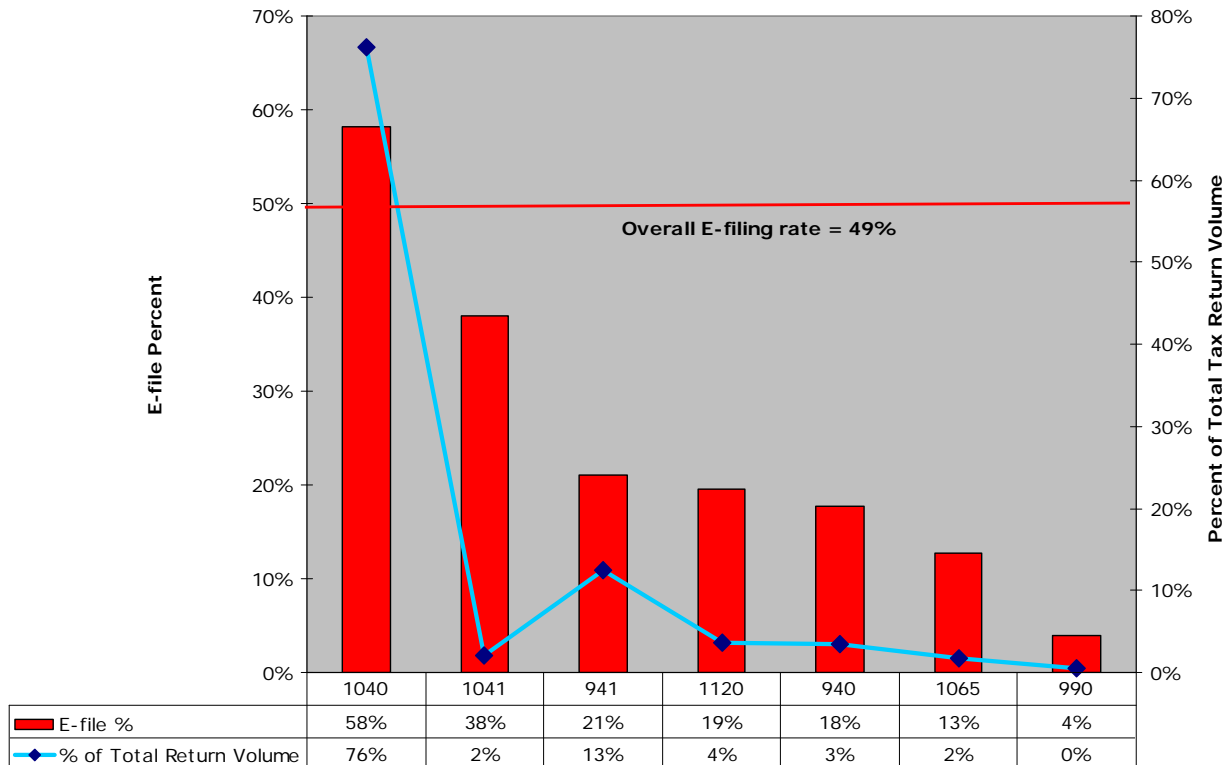|	1040	1041	941	1120	940	1065	990
■ E-file %	58%	38%	21%	19%	18%	13%	4%
◆ % of Total Return Volume	76%	2%	13%	4%	3%	2%	0%

Chart 1: Projected tax returns for 2007

Based on returns filed through May 2007, the IRS expects to receive 80 million 1040 type returns filed electronically. This represents 58 percent of all individual income tax returns and is four percentage points higher than the prior year. Overall, the IRS expects e-filing volume to increase nine percent year-over-year, which shows significant momentum.

The IRS saw significant growth among all types of individual filers. Among last minute tax filers, a group that traditionally sends in paper returns, the number of e-filed returns received in the last week of the regular season jumped 35 percent over the same week of the prior year. This increase occurred in an environment where the overall number of paper and electronic returns received during the same week rose only 12 percent. Balance due returns filed electronically surged 14 percent, this also from a group that traditionally files on paper. Self-prepared returns completed online also exceeded the average e-filing growth rate. This is great news because more than 90 percent of all online users e-file their return. This progress indicates that e-filing is catching on quickly with those who have previously resisted the e-filing trend.

Employment taxes returns (Forms 940 and 941) account for the most unit volume (16 percent) after 1040 returns and continue to show dismal rates of e-filing. For 2007 only 20 percent of these 29 million tax returns are expected to be e-filed. There is no mandate to file employment tax returns electronically, though there is a mandate to file Form W-2 electronically where the business submits 250 or more wage statements annually.

Business e-file volumes are also expected to increase this year. While reducing the asset threshold applicable to corporate mandates from $50 million to $10 million no doubt contributed to the increased numbers, mandated e-filers only accounted for 2.7 percent of all corporate returns. The majority of e-filed corporate returns were corporate taxpayers who voluntarily e-filed. Though the IRS infrastructure (modernized e-file platform) continues to mature for the business segment and the IRS continues to work closely with its private sector partners to make business electronic transactions more robust, the e-filing rate is still under 20 percent for most business returns. Because the mandates apply only to the largest business entities, the IRS continues to receive most business returns on paper.

Information Returns

Businesses are mandated to e-file information returns if they annually file 250 or more. The mandate is determined on a form-by-form basis. Since most information returns originate from very large filers, 98 percent of all information returns are received electronically by the IRS. See Chart 2 below and Appendix 1, Table 2.

Information Return Projections for 2007

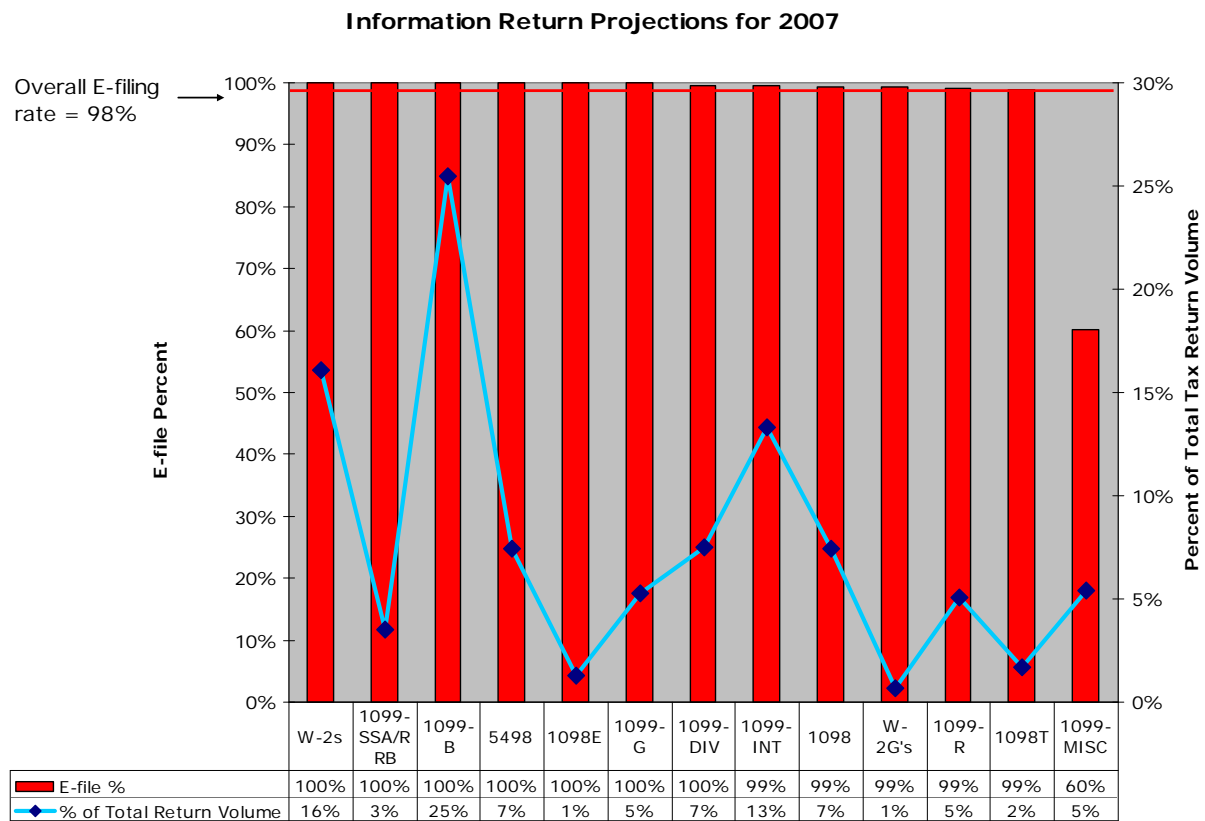|	W-2s	1099-SSA/RRB	1099-B	5498	1098E	1099-G	1099-DIV	1099-INT	1098	W-2G's	1099-R	1098T	1099-MISC
E-file %	100%	100%	100%	100%	100%	100%	100%	99%	99%	99%	99%	99%	60%
% of Total Return Volume	16%	3%	25%	7%	1%	5%	7%	13%	7%	1%	5%	2%	5%

Overall E-filing rate = 98%

Chart 2: Projected information returns for 2007

In spite of the perceived high e-file percentages in Chart 2, there are opportunities to increase substantially the number of electronically filed information returns. While much progress has

been made in the e-filing of information returns, more than 80 million additional returns could be received electronically with only a modest burden on businesses.

For example, the Social Security Administration (SSA) collects paper and electronic wage statements (Forms W-2) from filers and then transmits the data to the IRS electronically. That the SSA transcribes its paper forms into an electronic format before sending to the IRS explains why the IRS has a 100 percent e-filing rate for Forms W-2. In reality, the rate of e-filing to the SSA is 80 percent, leaving 47 million paper wage statements for the SSA to transcribe into digital format before transmitting to the IRS.

As another example, 32 million (or 40 percent) of the more than 81 million miscellaneous income statements (Forms 1099-MISC) are filed on paper. The paper filing rate is large because many businesses file fewer than 250 Form 1099-MISC returns and, therefore, are not mandated to e-file. In fact, most small businesses generate fewer than 10 miscellaneous income statements per year.

ETAAC Recommendations for Electronic Filing

Recommendation: Mandate that Practitioners e-file 1040 Returns

Previous ETAAC reports recommended mandates as a quick and relatively painless way to increase e-filing. The Government Accountability Office (GAO) supports this recommendation. ETAAC makes this recommendation again based on the following updated information.

In 2007, 57 million of the 136 million individual returns expected to be filed will be submitted on paper. Twenty-eight million of these paper returns will be prepared by a tax preparer on a computer and then mailed to the IRS. Research reported in the Blueprint indicates that taxpayers file paper returns not because they are opposed to electronic filing but because the preparer simply does not suggest e-filing as an alternative. In that professionally prepared returns represent 60 percent of all returns, a preparer mandate represents the single biggest opportunity for the IRS to increase e-filing rates for 1040 returns. In fact, if all 28 million of the above referenced returns were submitted electronically, the IRS would achieve the 80 percent goal for individual returns.

In the last year two additional states have implemented state e-filing mandates, bringing the total number of states with mandates to 14. Discussions with state leaders and practitioners indicate that mandates have generated little negative feedback. Perhaps it is because states have taken into account reasonableness standards and exceptions with mandates. For example, some states have established volume thresholds and customer opt-outs to accommodate hardships or other burdens. As a result of these accommodations and, perhaps, overall ease of compliance, no states to our knowledge have imposed penalties for noncompliance.

ETAAC believes reasonableness standards and exceptions should be considered for federal mandates. For example, ETAAC suggests practitioner mandates for those filing more than 50 individual returns in a year. This could then provide a national standard for all states to adopt, thus improving consistency between federal and state tax administration.

If mandates are imposed, the IRS must provide extensive communication and training to practitioners and then listen and respond to their concerns. This is critical not just in the first year but in subsequent years as well.

ETAAC does not want mandates to become a substitute for making electronic filing more convenient and attractive. Rather, ETAAC suggests that Congress repeal the prohibition against preparer mandates and grant the IRS the discretion to implement such mandates at a time that is appropriate.

Recommendation: Modify e-filing Thresholds for Business Tax Returns

Today business tax returns are subject to mandates. The greatest opportunity to increase e-filing rates for business tax returns lies in the thresholds at which businesses must adopt electronic filing. ETAAC recommends the following adjustments to existing thresholds:

- Corporation tax returns – Lower the e-filing threshold to include corporations with assets less than $10 million. Alternatively, corporations should be required to e-file the tax return if they are already required to e-file other returns such as information returns. However, this recommendation must take into account the benefits and the potential burdens imposed on the business to comply. The IRS must also assess the impact other recent changes such as reducing the asset threshold from $50 million to $10 million have had on its stakeholders before imposing new ones.

- Partnership returns – Lower the threshold from 100 partners to 10 partners.

Recommendation: Mandate e-filing for Employment Tax Returns

There is no e-filing mandate for Forms 940/941 even though these forms represent 16 percent of all tax returns submitted. ETAAC recommends that businesses that are required to e-file their tax or information returns also be mandated to e-file their employment tax returns. The same should apply to excise tax returns. The compliance burden should be modest since affected businesses are already submitting other information electronically to the IRS.

Recommendation: Modify e-filing Thresholds for Information Returns

Although the vast majority of information returns are received electronically, about 100 million returns are still paper filed. The thresholds overlook large segments of filers such as those who file fewer than 250 information returns of any one form. ETAAC makes the following recommendations:

- Form W-2 wage statements – The SSA still receives 47 million wage statements on paper. Simply lowering the e-filing mandate from 250 to ten W-2 statements would achieve significant gains. The burden on small businesses should be modest since the SSA provides a website to file wage statements at no charge. Capturing more wage statements electronically would enable the SSA to forward more accurate information to the IRS in a timelier manner. As a result, the IRS could more accurately match wage information to tax returns earlier in the filing process. This would also mitigate erroneous taxpayer notices and fraudulent returns.

- Form 1099-MISC miscellaneous income statements (Forms 1099-MISC) – As previously noted in this report, 32 million of these 81 million documents are filed on paper. As a result, ETAAC recommends reducing the threshold for the mandate over time. The real opportunity for significantly increasing e-filing lies with those businesses that file fewer than 10 statements. Because there is no SSA equivalent for small businesses to file Form 1099-MISC on-line, ETAAC recommends that the IRS develop an on-line process to upload data electronically for this purpose. Again, taxpayer costs and burdens must be considered in the adoption of any new thresholds.

Recommendation: Invest in Marketing the Free File Program

The Free File program is a free federal tax preparation and e-filing program for eligible taxpayers developed through a partnership between the IRS and private sector tax software companies. Free File enables 70 percent of all taxpayers – or 95 million taxpayers – to take advantage of the free offer.

Free File continues to provide taxpayers with valuable free e-filing services. In response to complaints in 2006, Free File participants made changes to the program this year that provided greater pricing transparency to free and fee-based services, eliminated refund anticipation loans and enhanced usability. As a result, customer user satisfaction in 2007 was at an all-time high.

However, in its second year following its renegotiated agreement with the IRS – that reduced the number of eligible taxpayers from 130 million to 95 million – tax returns filed through Free File dropped one percent to 4 million[2]. This reduction in volume, while due in some part to fewer eligible taxpayers, is also a consequence of very limited marketing by the IRS.

The GAO recently released a report titled "Taxpayer Service, State Experiences Indicate IRS Would Face Challenges Developing an Internet Filing System with Net Benefits". The report, combined with the lack of growth in the Free File program, has fueled a political debate over the most appropriate free e-file solution to pursue. Given the considerable investment that would be required by an IRS Internet filing solution that might produce marginal benefits, combined with substantial infrastructure investment required by the IRS on many other fronts – not the least of which is connected to our findings contained in the second part of this report – we suggest that Congress proceed with caution in compelling the IRS to provide its own Internet filing portal. A more effective and prudent use of resources at this time would suggest more investment in growing participation within the Free File program.

To this point, ETAAC recommends that the IRS invest more to market the Free File program and to assess the reasons why more taxpayers do not take advantage of the program's services.

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[2] Despite the lack of growth in Free File, the number of free returns offered by software companies outside of the purview of Free File appears to be on the rise, creating its own competitive model within the tax preparation software industry. While the IRS has no way of tracking the effectiveness of this model on overall e-file growth for do-it-yourself filers, this appears to be an emerging trend that warrants observation.

Recommendation: Reduce Electronic Filing Rejections

Almost 80 million returns are expected to be filed electronically this year, but the number could have been much higher if it were not for rejected returns. Historically, about nine percent of the electronically submitted returns are rejected because of validation checks or social security number mismatches.

Although most filers are able to successfully retransmit their return after correcting their error, more than 20 percent never try to e-file again. Consequently, an estimated 1.8 million taxpayers who intended to e-file are defeated and end up putting their return in the mail. While the numbers may not seem big, addressing this issue puts an additional one to two percentage points on the electronic filing scoreboard for the IRS—all with very little effort or incremental cost.

The Treasury Inspector General for Tax Administration (TIGTA) said in a new audit (2007-40-079) that the tax return validation controls ensure that errors are corrected before processing and benefit taxpayers by providing immediate notification of any error requiring correction. The audit noted that the IRS has approved modifications to certain error conditions for the duplicate use of a Social Security number and suggested the agency "could apply the same approach to a number of the more than 600 error conditions."

ETAAC recommends that the IRS evaluate its more than 600 validation controls with the goal of increasing e-filing rates while also mitigating erroneously filed returns. In pursuit of this goal, ETAAC encourages the IRS to collaborate with software developers to explore ways to further reduce controllable rejects.

Recommendation: Tighten ERO Suitability Standards and Oversight Processes

Tax practitioners account for 60 percent of all tax returns filed and for 70 percent of all e-filed tax returns. It is vital that the IRS have in place a rigorous process to ensure that only those e-file applicants (electronic return originators or EROs) who truly meet IRS standards are issued an electronic filing identification number (EFIN). Further, it is even more critical to the integrity of the e-file system that preparers who file fraudulent returns be quickly identified and removed from the system. ETAAC believes that the vast majority of tax preparers aid in reducing fraudulent returns and are an important part of the revenue protection process. There are, however, preparers who are responsible for various fraud schemes, and we believe that there are steps in the EFIN application and ERO oversight processes that can be improved, resulting in a significant reduction of paid preparer fraud.

ETAAC recommends the following changes:

> **Tighten Electronic Return Originator (ERO) Suitability Standards**
> - Conduct criminal background checks - Today only 25 percent of non-exempt ERO applicants (this excludes Certified Public Accountants, Enrolled Agents and attorneys) have a criminal background check conducted on the principal of the business. The IRS estimates that the screening eliminates from one to three percent of all applicants. Furthermore, the screening process has improved substantially so that results are available to the IRS within 20 minutes of the submission of an electronic fingerprint. As a result of the relatively high rejection rate and the rapid speed by which results can be

obtained, ETAAC recommends conducting criminal background checks for all non-exempt ERO applicants. At a cost of approximately $300,000, this may be a small price to pay for greater integrity to the filing system. Alternatively, an EFIN application fee may be imposed to defray this cost.

- Reinstate credit reporting - The IRS discontinued the use of credit reporting on ERO principals in the early 1990s. ETAAC recommends that the IRS consider re-instituting credit reporting and using the results to qualify applicants for program participation. For example, those who have significant negative personal credit profiles should be denied participation. Significant negative personal credit profiles may include applicants with state tax liens, no positive credit history, recent bankruptcy or material current delinquent obligations. The process will require some automation and the development of some empirically derived or judgmental rules, but we believe the IRS has the capability to support both of these process challenges.

- Ensure citizenship or residency requirements are met - The principal of an EFIN applicant must be a U.S. citizen or a permanent U.S. resident. The IRS today has processes in place to check this, and we recommend that this process be periodically validated. Further, the IRS should build a process with SSA to eliminate applicants with social security numbers that are issued for work purposes only.

- Require registration of preparers - Today there is no registration or licensing of individual tax preparers. The IRS and industry have no way to track or monitor individual preparers. Therefore, ETAAC recommends that each individual preparer be required to register with the IRS, pass the IRS suitability standards and attach an individual identification number to each return they prepare. These requirements should be phased in over time to mitigate implementation issues. An application fee may be imposed to defray the costs to implement this recommendation.

Improve ERO Oversight and Program Management
- Centralize oversight of EROs into one operating division - Today there is no cohesive strategy or single point of contact for managing EROs. Responsibility is shared among Electronic Tax Administration, Wage & Investment, Small Business/Self-Employed, and Criminal Investigation. Based on experience of ETAAC members with the business, it is apparent that a tax preparer who commits fraud is able to do so with little to no fear of the consequences. ETAAC recommends that IRS centralize oversight of EROs into one operating division, including all functions from EFIN application to enforcement of regulations.

- Aggressively pursue fraudulent tax return preparers - IRS oversight of EROs yields few suspensions or prosecutions. During the period of 2001-2005, an average of 32 EROs per year was suspended through the e-file monitoring program[3]. During a more recent period, Criminal Investigation (CI) initiated on average 217 investigations a year that led to an average of 106 convictions per year. Additionally, 3,356 EROs were suspended or

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[3] National Taxpayer Advocate, *2005 Annual Report to Congress*, (January, 2006) 232, table 1.12.3.

expelled in 2006 for tax compliance issues and assessment of preparer penalties, as well as suspensions recommended by CI relating to active criminal investigations. Based on these results, ETAAC recommends that the IRS increase oversight over EROs and promptly remove preparers who have been identified with filing fraudulent returns or violating e-file rules.

- Increase oversight - Increased oversight will allow the IRS to identify more preparers who are filing fraudulent returns and to suspend promptly the related EROs from participation in IRS e-file. The IRS is creating a new e-file rule that will preclude appeals if the suspension is based on an active IRS criminal investigation, as long as the CI case is still open. This presents an opportunity for the IRS to step up its compliance efforts. ETAAC supports implementation of this rule.

ELECTRONIC TAX SERVICES AND ADMINISTRATION

Overview of Tax eServices and Administration

Electronic tax administration is fundamental to a world-class revenue agency and voluntary compliance. However, the IRS cannot fully stop the paper flow until all taxpayers can be efficiently and timely served via technology. This requires a shift from a narrow e-file focus to a broader electronic tax administration focus.

ETAAC recognizes that the IRS faces cultural and organizational challenges to full acceptance, use and development of electronic services (eServices). Some of these challenges, such as taxpayer access to computers and computer literacy, relate to individual taxpayers who act on their own behalf. These barriers cannot be fully controlled by the IRS nor should the IRS be charged with removing them. Other challenges can be influenced by the IRS in partnership with third party tax practitioners and software developers. These barriers and actions to eliminate them need to be addressed by the IRS.

The IRS also faces challenges from within its own organization. Implementing a strategy that meets ever changing taxpayer needs and expectations requires a "change oriented mindset" throughout the IRS. The IRS must take the necessary steps to build, drive and sustain an "e-world" culture within its organization.

Progress on eServices

ETAAC acknowledges the IRS for its significant progress in articulating its tax services strategy. The IRS has made gains in restructuring its organization, tax systems, and service delivery channels to enhance electronic filing and payments. The IRS has also made progress in providing taxpayers and their representatives with electronic access to information and services that assist with preparing, filing, reporting, and otherwise meeting tax related obligations.

Usage of the IRS' preferred method of service delivery, www.irs.gov, has increased substantially over the past four years. For example:

- Visits to www.irs.gov have almost doubled since 2003 to nearly 200 million in 2006, yet the volume of contacts to the website help desk has dropped;
- Visits to popular online services such as "Where's My Refund" and the Employer Identification Number requestor more than doubled during the same period; and,
- Usage of the Transcript Delivery System, a popular eServices function for tax professionals, increased from ten thousand in its first year (2004) to more than one million in 2006.

The IRS continues to provide more services and products for individual taxpayers through its online service delivery channels, particularly with respect to giving taxpayers access to their own information. In 2008 the IRS plans to enable taxpayers, through its Internet Customer Account Services (ICAS) project, to authenticate and register for online service access, view account information and make online payments. The expansion plans for ICAS in 2009 include granting individual taxpayers the online ability to change their address, submit disclosure authorizations, determine account payoff amounts, submit an extension to file and view current and prior tax returns.

The IRS' Comprehensive eServices Vision

In its 2003 report ETAAC described a vision for the IRS that included an integrated approach to electronic service delivery. The vision incorporated all stakeholders– the IRS, taxpayers, tax practitioners, software developers, third party information providers and other government institutions– and articulated an eServices framework where all components would work together to reduce the tax administration burden.

The IRS' recently released Blueprint provides a comprehensive analysis of taxpayer service delivery. Prominent in its theme is "electronic interaction enablement" facilitated by an IRS that is an "interactive and fully integrated, online tax administration agency" with the capability "for any exchange or transaction that occurs face-to-face, over the phone, or in writing to be completed electronically."

The Blueprint identified eight gaps between the current state and where the IRS needs to be. ETAAC supports the IRS' need to address these gaps. Four of the gaps are particularly important in developing a comprehensive eServices vision:

- Website Management – A governance structure for policy, project priority, and funding decisions;
- End-to-End Portal and Application Monitoring – A process to ensure 24x7 service availability;
- Online Support Tools – More online services and tools to meet a broad scope of service needs, e.g. answers to tax law questions, resolution of account issues and optimal application usability; and,
- Authentication for Account-Related Tools – An authentication process that allows users to sign-on one time and access multiple services.

Along with the explosive growth in Internet usage have come high user expectations for services, functionality and availability. Internet users now typically expect access to their own information and services so that their needs are met quickly and conveniently, 24 hours a day. These expectations are no less so in terms of electronic tax administration and the taxpayer experience.

ETAAC Recommendations for Tax eServices and Administration

Recommendation: Deliver eServices that Meet End Users' Needs

ETAAC endorses the electronic recommendations set out in the Blueprint and encourages the IRS to move quickly to execution. ETAAC recommends that the IRS expand its eServices vision and supporting implementation plans to incorporate contemporary and futuristic online services. The vision and strategy should provide and support an "end-to-end" service model based upon feedback from unique customer segments— third party providers, businesses, and individual taxpayers who are acting on their own behalf. For example, a spectrum of services might begin with an information website and increase in complexity through e-file, online access to information and ultimately to full interactivity among the customer, the IRS and other governmental agencies.

With respect to individuals acting on their own behalf, IRS resources may best be used to enhance services from the beginning of the spectrum, the informational website, through online access to individual information. On the other hand, third party providers will have needs and expectations that move further along the spectrum to include special interactive services unique to their circumstances. Business taxpayers may be expecting something in between.

In considering a spectrum of tax eServices, not all will be expected nor extensively used by each customer segment. The IRS must define its vision, strategy, priorities and implementation plans based on user feedback and a clear understanding of target segment needs.

It is important for the IRS to recognize that as they migrate to more eServices, their resources will likely be pulled in many directions. Just as it is critically important that they prioritize their projects, they must also be willing to discontinue services that no longer play a vital role. Deciding what to discontinue should be just as important as deciding in what to invest.

Described below are four examples of how the IRS can better deliver eServices.

Example 1: Accessing and Using Data
EService delivery should be expanded to allow taxpayers to use their tax preparation software to import information into their tax returns. While this model already exists for some software products with respect to importing information from employers, payroll reporting agents and financial institutions, no such ability exists for the unique information that the IRS has.

The importance of synchronizing taxpayer information that the IRS has with the tax preparation process extends not just to the ease and convenience of completing the return but also to the accuracy of the return. As a result, this would produce fewer taxpayer notices and subsequent

contacts with the IRS. For example, importing estimated tax payment information would significantly reduce return errors typically associated with estimated tax payment discrepancies.

Similarly, taxpayers should be able to seamlessly access and use their data that, while housed within other government agencies, feed into the over-arching tax administration structure, e.g. employment taxes, sales and use taxes, business and individual income taxes. "End-to-end" data access and functionality extend to the "taxpayer folder". The taxpayer folder is envisioned as a comprehensive repository of one's information where the taxpayer could view his or her information, change it, interact with the IRS, conduct account-specific research, file, pay and authorize others to do the same. The taxpayer folder could encompass a "My IRS" type of service customizable based on individual taxpayer preferences.

Example 2: Interactive Account Resolution
In the private sector consumers expect to be able to settle account issues online, whether involving health care, creditor and banking services or retail and service industry accounts. In the Blueprint, the IRS identified IRS notices as the top reason taxpayers called the IRS. The ability to receive or view notices online, understand the notice and related account issues and resolve matters electronically are significant opportunities to ease taxpayer and IRS burden.

It is critical that viewing notices and resolving underlying account problems online not simply mirror the troublesome readability and comprehension issues that exist with paper notices. For interactive online account resolution to be effective, the notice process itself must first be examined and reengineered to reflect best practice usability standards.

Example 3: Online Services for all Taxpayer Segments
The thrust of the IRS' eServices plans is aimed at individuals, and, indeed, it should be since individuals comprise the largest volume of users. Eventually, however, businesses and other taxpayer segments should also have access to the same types of electronic services. Justifications that apply to individuals for online services apply the same to businesses.

Example 4: Efficient Authentication and Registration
The foundation for the delivery of any eService is an effective and usable identity management system. To assure that more taxpayers come to rely on the IRS for service through electronic channels, the first experience must be positive. With respect to eServices, that experience will most likely involve the authentication and registration process. While both the Blueprint study and ICAS plans call for an effective identity and access management process for online services, the importance of an authentication process that is easy to use, applied consistently and appropriately, and balanced in terms of identification and security requirements cannot be stressed enough. Given that most taxpayers are not repeat users of online services and are likely expecting immediate access to information, the process should be reasonable and flexible in terms of balancing security, privacy and ease of use.

Recommendation: Develop Effective Information Technology Strategies

In a competitive market, those that do not stay current with the latest technology soon fall behind and lose their place in the market. IRS technology should enable taxpayers to easily comply with tax laws while providing significant IRS efficiency in managing the volumes of data received.

The IRS systems must be viewed as mission critical components of its business. This requires funding to create new systems as well as to maintain and improve them year after year so they do not become legacy systems.

With funding a constant factor in the decision to implement new systems or make improvements to existing ones, the IRS needs to take a different approach to system development, support and management. As each new system is scoped and implemented, the IRS must plan for the long term support, operation, improvements and continued funding on that system. The Filing Information Returns Electronically (FIRE) project is an example of a critical system that was built, put into place and then allowed to fall significantly behind architecturally as the information technology world moved forward. While FIRE has been able to keep up with huge volume increases over the years, ETAAC is concerned that costly updates may be needed soon to accommodate transactions not envisioned when the system was built and that downstream applications are not being maintained to process efficiently the information gathered by FIRE.

The modernized e-file system has become an integral part of tax filing, and this will prove especially so for the coming phases that affect personal income tax returns. The system must be maintained and kept technically current to maintain e-filing as a viable filing method available on a 24x7 basis. Tax preparers, software developers and states must be included in collaborative development efforts to ensure that the system works properly for all concerned. ETAAC is concerned that the resources, funding and systems to meet these expectations are not fully supported by the IRS or Congress.

The IRS' ability to implement the remaining, significant phases of modernized e-file on a timely basis will be critical to their ability to implement a broad spectrum of eServices. The more quickly that modernized e-file can be completed – and satisfactorily meet stakeholder needs – the easier it will be to justify funding other high priority projects.

The IRS' ability to successfully implement the huge undertaking of modernized e-file also has significant effects on its stakeholders. For example, the IRS' deliverables must be closely coordinated with software developers, states and others to ensure that deliverables, funding and priorities are coordinated and aligned—not just at the IRS but among all stakeholders. Any missed hand-offs will ripple throughout the tax ecosystem. The IRS must align its organization with the right people and processes to implement and manage these complex projects.

The IRS must also be sensitive to the importance of the interdependencies, maintenance and upgrades of non-mainframe and non-e-file applications. For example, if the W-2/941 Combined Annual Wage Reconciliation and Automated Under Reporter programs are not included in future modernization efforts, the IRS risks missing opportunities to address tax gap initiatives in their information matching programs.

By planning for incremental, scheduled releases, the IRS will have the opportunity to make technology changes as they become necessary, as well as to add new functionality in a timely manner. These incremental releases would be less expensive and would enable the IRS to be more responsive to user feedback not otherwise available with large-scale projects.

Recommendation: Address Taxpayer Barriers to e-filing

Though a majority of Americans have access to a computer and the Internet, the IRS faces significant challenges in convincing these taxpayers to adopt e-filing and eServices. The reasons vary but generally include concerns about privacy, security, the reliability of transactions, risk of audit and comfort with traditional paper filing.

ETAAC recommends that the IRS develop education and public relations initiatives with messages targeted to overcome these barriers.

- Privacy, security and reliability of electronic transactions. Transmitting sensitive, personal financial data increases the concerns of taxpayers who already do not trust IRS technology or government in general. The integrity of both the IRS and its systems is critical to changing the behavior of these taxpayers and creating loyalty to eServices solutions.

- Risk of audit. There is a strong perception among many paper filers that e-filing increases the chances of an audit. While we know that e-filed returns are twenty times more accurate than paper ones, the IRS needs to address the audit concerns for this taxpayer segment.

- Comfort with status quo. Comfort with traditional paper filing overrides perceived benefits to e-filing for many individual taxpayers who are computer savvy or who have balances due. They need a reason to change. In some situations the tax preparer is not encouraging e-filing. In others, a once a year event does not provide the momentum for an eServices mindset. Again targeted messages and enhanced eServices that deliver real benefits are critical to change the behaviors of this group.

Recommendation: Drive IRS Organizational and Cultural Changes

Today the IRS is primarily a batch oriented, paper-based organization - not unlike many information and transaction based industries in the private sector were in the past. Customer expectations and business economics required the private sector to reinvent itself to compete in a global, high tech economy.

The IRS and its employees must adapt to the changing environment by being proactive and move from gathering facts to implementing its strategy. The Blueprint clearly lays out an ambitious eServices strategy leveraging technology and the Internet. Delivering on the visions in the Blueprint requires people who embrace and are energized by change.

The IRS leadership team must recognize the cultural challenges and lead changes to enable its employees to succeed in an eServices world. This requires the IRS as a whole to take the difficult steps taken by the private sector to meet the expectations and needs of its customers including reengineering processes, investing in technology and training and hiring employees who embrace the challenges and changes in an eServices world.

Recommendation: Invest in the Highest Priority Projects

Delivering eServices using best practices for technology, people and processes requires an investment of time and money. The expectation is that the invested resources will reduce ongoing expenses, provide better taxpayer compliance and service, and meet ever increasing taxpayer expectations.

In an environment where there is rarely sufficient funding for every project, intelligent choices must be made to maximize investments. While ETAAC believes our recommendations merit funding because of the benefits they can potentially deliver, it is up to the IRS to prioritize among all of its projects. Once the IRS makes a commitment to a project, it is essential that controls be put in place to ensure accountability. ETAAC believes accountability is lacking in many projects.

On the other hand, and as mentioned elsewhere in this report, ETAAC recommends that the IRS prioritize which projects to discontinue. This is as important as it is to prioritize which projects to do.

Once expectations have been set with new services, Congress must give its full and continuing commitment to appropriations as long as the business case still exists. The risks of not doing so are too high. The IRS needs to have the resources to quickly introduce new services that align with taxpayer needs and preferences, and that are delivered through the electronic channels taxpayers prefer. Otherwise, the IRS risks losing the early adopters who helped promote its initial efforts in e-filing and who may help lead other taxpayers to embrace the future way of doing business with the IRS.

APPENDIX 1: TAX AND INFORMATION RETURN STATISTICS FOR 2007

Form Type	Form # or Series	Form Description	Annual Return Volume*	% of Total Volume	Returns E-filed*	% E-filed
Tax Returns	1040	Individual	136.32	76%	79.24	58%
	1041	Fiduciary	3.82	2%	1.45	38%
	941	Quarterly Payroll	22.39	13%	4.71	21%
	1120	Corporation	6.51	4%	1.27	19%
	940	Annual Unemployment	6.14	3%	1.09	18%
	1065	Partnership	3.05	2%	0.39	13%
	990	Exempt	0.86	0%	0.03	4%
Total	Totals		179.09	100%	88.18	49%

Table 1: Projected tax returns (* in millions) for 2007. Source, IRS SOI Documents 6961 and 6186.

Form Type	Form # or Series	Form Description	Annual Return Volume*	% of Total Volume	Returns E-filed*	% E-filed
Information Returns	W-2s	Wage Income	241.24	16%	241.24	100%
	1099-SSA/RRB	Social Security/RRB	52.44	3%	52.44	100%
	1099-B	Broker Proceeds	381.71	25%	381.65	100%
	5498	IRA Contribution Info	111.04	7%	111.01	100%
	1098E	Student Loan Interest Stmt	19.17	1%	19.16	100%
	1099-G	Government Payments	78.95	5%	78.89	100%
	1099-DIV	Dividend Income	112.36	7%	111.89	100%
	1099-INT	Interest Income	199.28	13%	198.22	99%
	1098	Mortgage Interest	111.38	7%	110.63	99%
	W-2G's	Gambling Income	10.00	1%	9.93	99%
	1099-R	Retirement Payments	75.72	5%	75.03	99%
	1098T	Tuition Payments Stmt	25.53	2%	25.22	99%
	1099-MISC	Miscellaneous Income	81.27	5%	48.91	60%
Total	Totals		1,500.09	100%	1,464.22	98%

Table 2: Projected tax returns (* in millions) for 2007. Source, IRS SOI Documents 6961 and 6186.

Chris Beach
Term: 11/13/2006 – 11/12/2009
Director, Filing Methods
State of California – Franchise Tax Board

Kevin Belden
Term: 9/19/2005 – 09/18/2008
Deputy Comptroller and CIO
NYS Office of the State Comptroller

Nora Daly
Term: 12/01/2004 – 11/30/2007
Senior Product Manager
Oracle USA

Larry Dreyer
Term: 9/19/2005 – 09/18/2008
Retired
Bank of America

Sharon Gray
Term: 11/13/2006 – 11/18/2009
Certified Public Accountant
Self-Employed

Tim Hubbs
Term: 11/13/2006 – 11/12/2009
President
Drake Software

James A. Huling
Term: 9/19/2005 – 09/18/2008
Senior Vice President
JP Morgan Chase

Linda Lueck
Term: 12/01/2004 – 11/30/2007
Owner, Lueck Accounting Service
Instructor, Western Technical College

Robert Meighan, ETAAC Chairman
Term: 9/19/2005 – 09/18/2008
Vice President, TurboTax
Intuit Inc.

Suzanne Moss
Term: 9/19/2005 – 09/18/2008
Director of Tax Technology
Verizon Communications

Joan Ruff
Term: 11/13/2006 – 11/12/2009
Attorney

Anthony Tullo
Term: 9/19/2005 – 09/18/2008
Director of Federal Compliance
Automatic Data Processing

Marquetta White
Term: 11/13/2006 – 11/12/2009
Assistant Director Taxpayer Services
Arizona Department of Revenue