July 18, 2022

MEMORANDUM FOR ERIN M. COLLINS
                NATIONAL TAXPAYER ADVOCATE

FROM: Douglas W. O'Donnell
                Deputy Commissioner for Services and Enforcement

                Jeffrey J. Tribiano
                Deputy Commissioner for Operations Support

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

This is our written response to the subject Taxpayer Advocate Directive (TAD) which supplements discussion with you and your staff. As you may be aware, in addition to taking multiple actions to address the inventory backlog, we continued efforts to increase electronic filing and pursue scanning technology solutions. As of June 25, 2022, taxpayers electronically filed 93.1 percent of individual income tax returns versus 92 percent at the same time last year. The IRS has also made it possible for taxpayers to electronically amend more tax forms further assisting taxpayers needing to make corrections and is continuing to expand options for electronic filing going forward.

Although the increases in e-filing have greatly reduced the volume of paper returns we receive in ordinary filing seasons over the past decades, we recognize that even the reduced volume is still significant. Every taxpayer is important to us. Therefore, we have pursued and continue to pursue a variety of options to gain efficiencies in processing paper filed returns. One such technology is 2-D barcoding. Several states have adopted 2-D barcoding, and we are in discussions with some of our state partners to learn from their experiences. At the same time, we have implemented several pilot programs to test barcoding and other technologies that may help us become more efficient. It is important to fully test these options before singling out, and perhaps

becoming overly reliant, on any one of them. Some of the pilot programs we are and have been testing include:

- **V-Coded Return Pilot.** A V-coded return is when the taxpayer used software to prepare the return, printed the return and mailed it to the IRS. Using a vendor, this pilot enables scanning and validation of V-coded Forms 1040 for submission using Modernized e-File (MeF). Our experience to date has been mixed and we continue to work with vendors to improve the likelihood of successful, error-free processing of tax returns.
- **Lockbox Scanning Service Pilot.** This pilot leverages our existing relationship with Treasury Department's Bureau of the Fiscal Service to scan Forms 940 and submit them using MeF. As a result of this pilot, the IRS will begin scanning and e-filing a portion of paper Forms 940 via MeF in August 2022. The goal is to accelerate this pilot and scan a larger portion of forms in filing season 2023, depending on pilot testing results and funding availability.
- **2-D Barcode Pilot.** This pilot used 2-D barcodes to intake data from Forms 8918 and Forms 8886. In December 2021, IRS released Form 8918 with 2-D barcodes. We intend to issue Form 8886 with 2-D barcodes in August 2022. The IRS received approximately 1,000 Forms 8918, of which 253 were on the old paper form and 637 on the new paper forms with 2-D barcodes. 78% of the 2-D barcoded paper forms that passed manual validation were fully readable with 100% accuracy, requiring close and ongoing scrutiny of only 22% of the forms. We are performing additional analysis to understand how to reduce the error rate. Before the IRS can consider using 2-D barcodes from Form 1040, we need to engage with the software industry to revise industry standards to align with how we intake and process data. The industry would have to agree to provide this code in printed forms prepared with their software. We will start that engagement soon, develop a plan and report back to you with the results.

In addition to scanning, we are making more forms available for e-filing. We are also reviewing administrative policies with a view towards expanding e-file eligibilities and to publish those changes to encourage greater adoption of e-filing. A multi-faceted approach is necessary to address the paper inventory that IRS receives yearly and to improve return processing for those due refunds as well as those who owe nothing or owe additional tax.

With respect to the actions directed in the TAD, we are modifying actions 1.a and 1.b. As stated above, we will engage with the software industry and report back to you with the results. We are revoking action 2. Our goal is to accelerate the V-coded pilot to scan tax year 2022 V-coded returns. We will not implement any single option until we are confident in the delivery of that option.