Electronic Tax Administration Advisory Committee

Annual Report to Congress

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ETAAC Annual Report to Congress – 2003

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Executive Summary

Overview

The National Commission on Restructuring the IRS issued a report in 1997 defining ***A Vision for a New IRS***. In 1998, much of that vision was codified into law in the IRS Restructuring and Reform Act of 1998 (RRA 98). The Act established the following goals for the IRS:

- Paperless filing should be the preferred and most convenient means of filing federal tax and information returns;
- The Internal Revenue Service should set goals to have at least 80 percent of all returns filed electronically by 2007 and all returns that are prepared on a computer filed electronically by 2003, and;
- The Internal Revenue Service should cooperate with the private sector to encourage competition to increase electronic filing (e-filing).

The legislation further required that the IRS establish an advisory group, with an assignment to report to Congress annually on:

- The progress of the IRS in meeting RRA 98 goals;
- The status of the strategic plan to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing;
- The legislative changes necessary to assist the IRS in meeting those goals; and
- The effects on small businesses and the self-employed of electronically filing tax and information returns.

To fulfill this charge, the Electronic Tax Administration Advisory Committee (ETAAC) was created in 1998 by the IRS Electronic Tax Administration (ETA). Over the past few years, the IRS has made considerable progress toward achieving the goals identified above. The IRS ETA should be commended for bringing focus, energy and creativity to the effort. Electronic tax administration is now considered an important component of the strategic plans of each of the IRS Operating Divisions.

Still, the IRS faces formidable challenges in meeting the aggressive goals set forth in RRA 98. When those goals were first articulated, opportunities for electronic filing and service delivery were more limited than they are today. Initial efforts focused on expanding the availability of electronic filing, particularly for individuals. This included creating electronic versions of forms and schedules in the Form 1040 family, as well as offering free-style practitioner notes, electronic signatures, credit card payments and electronic funds withdrawal options. Additional electronic services identified as important benefits to the tax professional community, such as Electronic Account Resolution and Electronic Transcript Delivery, are being developed to provide practitioner incentives for e-filing.

Individual e-Filing

As of June 27, 2003, 52.2 million individual tax returns had been e-filed during the 2003 filing season, amounting to 42.1% of total returns filed. That represents an increase of 5.8 million (12.5%) e-filed returns compared to the total returns e-filed during the same period in 2002 (46.4 million). This rate of growth falls somewhat short of projections for this season, although electronically filed returns will be accepted through October 15, so e-file participation is expected to grow to 52.6 million e-filed returns for the 2003 filing season. Overall, the trend is clearly toward lower annual growth rates in e-filing than was experienced in the early years of the program. At the current rate of increase, the IRS will not achieve 80% e-filing by 2007 and has not reached the goal of 100% e-filing of computer-prepared returns by 2003.

To improve the growth rate, the IRS will need to overcome barriers to adoption of e-filing that include a continued preference by taxpayers and certain segments of tax practitioners for paper filing, lack of awareness of e-filing and how to do it and concern about privacy, security and the role of third parties in the process. Some of these barriers can be addressed through education and marketing of the advantages of e-filing, such as faster refunds, electronic receipts that offer proof of filing, convenience, accuracy and reduced likelihood of receiving a notice from the IRS. Others need to be addressed through structural changes, such as modernizing the 1040 e-file system to provide more value to taxpayers and tax practitioners.

The segment of taxpayers and tax practitioners who prepare returns on computer but file them on paper offer the greatest potential for rapid conversion of a large number of taxpayers to e-filing. In particular, we recommend continued aggressive marketing and the early implementation of a broad range of e-services for practitioners as an incentive to e-file the estimated 30 million returns that this group prepares on computer but files on paper.

This past filing season saw the introduction of a significant new development in the availability of no-charge online filing -- the Free File Alliance. The 30 million taxpayers who prepare their own returns by hand and file them on paper are the primary target audience for this initiative. Free File offers no-charge on-line filing to a subset of these taxpayers through a consortium of private-sector providers. Of the 11.8 million electronic returns filed online as of the end of June, 2.7 million were prepared and transmitted using Free File. Continued penetration of this market segment depends on increasing awareness of the Free File Alliance opportunity, ensuring that the offerings deliver real value to customers and facilitating access to the Internet.

Modernization of the 1040 e-file platform is critical to ensuring that the IRS can meet future e-file performance commitments, provide faster acknowledgments and improve services to self-filers and practitioners. The existing 1040 family e-filing platform was built in the mid-1980's. While it served the IRS well in the early years of e-filing, it is not capable of supporting the future volumes and required functionality of e-filing, including online, interactive e-filing services.

Business e-Filing

Overall, business return e-filing levels are relatively low and e-filing is not yet available for many business return forms. However, early IRS business e-file initiatives generally have been well received, particularly where the e-file process added value and didn't increase administrative burden or cost. While progress in business e-filing growth lags the progress being made with individual returns, the IRS is moving aggressively to make up ground, and has adopted a strategic approach to business e-filing and e-services that includes the development of modern new business return e-filing systems that should promote more rapid growth in the future. A plan is in place to roll out additional business e-filing products over the next few years through the Expanded Business Products Initiative.

ETAAC supports the development of a modern business e-file platform to support the expansion of business taxpayer e-filing, e-payment and e-services in the context of an overall strategy for improving services to business customers and their third-party representatives.

ETAAC also encourages the IRS to work with the business taxpayer community to develop guidance regarding electronic record keeping to complement electronic filing. Such an initiative would help both the IRS and business taxpayers to realize the benefits of end-to-end electronic tax administration.

Third-Party Tax Professionals

Tax practitioners prepare nearly 60% of all individual tax returns and more than 85% of all business tax returns, so they are a primary key to the success of e-filing. Some segments of the professional tax preparation community, primarily mass-market preparers who file 83% of their returns electronically, have adopted e-filing as their principle way of doing business. However, there were more than 30 million 1040 returns computer-prepared by practitioners but submitted on paper rather than e-filed.

Two over-riding themes emerge from surveys of tax practitioners who don't e-file. First, increased taxpayer demand for e-filing would encourage practitioner participation. Second, e-filing needs to be cost-effective for practitioners and to integrate well into their ongoing business processes. To address these themes, the IRS needs to continue to market e-filing aggressively to taxpayers who use paid preparers and to streamline the e-filing process as it relates to practitioners. Incentives and electronic services should be offered to offset the additional burdens and to add value for practitioners and taxpayers.

ETAAC encourages the IRS to quickly implement as wide a range of e-services as possible, making them available only to practitioners who e-file a significant quantity or proportion of eligible returns. If these services are made available exclusively to e-filers, and are provided in a timely fashion, they will provide a strong incentive for paper filers to convert.

ETAAC recommends that the IRS continue to work with the third-party tax professional community to identify and remove barriers to e-filing and to assist third-parties in the process of adopting new electronic business models.

Section 1: Progress Report–Filing Season 2003 Results for Individual e-Filing

Electronic filing during the 2003 filing season appears to be falling below projections. At the rate of increase experienced over the past few years, it seems clear that the IRS will not achieve the goal of 80% e-filing by 2007 and has fallen short of the goal to achieve 100% e-filing of computer-prepared returns by 2003. Attracting the first 50 million e-filers was relatively easy compared to what it will take to attract the next 60+ million required to meet the 2007 80% goal.

As reflected in Table A below, through June 27, 2003, filing season 2003 netted a 5.8 million increase in e-filed returns over the comparable period in 2002, for a total of 52.2 million e-filed returns. This represents a 12.5% increase this year over last. To establish a base of understanding for this Report, it's important to examine the trends within each electronic filing segment:

- On-line filing grew by 26.8%
- Practitioner e-filing increased 10.6%
- Tele-file use decreased by 4.8%

Table A: 2003 Individual e-Filing Season Comparative Results through June 27

	2002 Actual	2003 Actual	Change 2003 over 2002	% of 2003 Projection
Online	9.3 M	11.8 M	26.8% (+2.5 M)	87% (13.7 M)
Practitioner	32.9 M	36.4 M	10.6% (+3.5 M)	101% (36 M)
TeleFile	4.2 M	4.0 M	- 4.8% (-0.2 M)	100% (4.0 M)
Total	46.4 M	52.2 M	12.5% (+5.8 M)	97% (53.8 M)

Note: Totals and percentages may vary due to rounding.

Historical Trends: Individual Returns

Table B illustrates the historical growth in e-filing over the previous four years. The trend is clearly toward lower annual growth rates in e-filing than was experienced in the early years of the program, for two primary reasons. First, as the base of total filers and e-filers grows, the number of new e-filers needed to sustain the same growth rate increases. Second, the filers most easily attracted to e-filing have now made the switch from paper filing – the more difficult target population remains to be converted.

Table B: Growth Trends in e-filing

Year	Total Returns	Online Returns	Practitioner Returns	TeleFile Returns	Total Electronic	% e-filed	Annual % Growth
2002	131.7 M	9.4 M	33.1 M	4.2 M	46.7 M	35.5%	16.4%
2001	131.0 M	6.8 M	28.9 M	4.4 M	40.1 M	30.6%	13.3%
2000	128.4 M	5.0 M	25.2 M	5.2 M	35.4 M	27.6%	20.8%
1999	126.0 M	2.4 M	21.2 M	5.7 M	29.3 M	23.3%	20.1%

Note: Totals and percentage may vary due to rounding

Section 2: Progress Report – Filing Season 2003 Results for Business e-Filing

Overall, business return e-filing levels are relatively low and e-filing is not yet available for many business return forms. However, the IRS business e-file initiatives that have been implemented generally have been well received, particularly where the e-file process added value and didn't increase administrative burden or cost. For example, the Form 1065 partnership return e-filing program is popular with many practitioners, growing from around 9,000 participants in 2001 to an estimated 51,000 in 2003.

While progress in business e-filing growth lags the progress being made with individual returns, the IRS is moving aggressively to make up ground, and has adopted a strategic approach to business e-filing and e-services that includes the development of modern new business return e-filing systems that should promote more rapid growth in the future. A plan is in place to roll out additional business e-filing products over the next few years through the Expanded Business Products Initiative.

Information Returns

Electronic filing of information returns - including Forms W-2, 1098, 1099, 5498 and W-2G - grew to 543 million returns in 2002 (418 million filed with the IRS and 125 million filed with the Social Security Administration) and is projected to grow to about 666 million returns by 2005. The Internal Revenue Code requires electronic or magnetic media filing when submitting 250 or more information returns. The Restructuring and Reform Act of 1998 extended the due date for Forms 1098, 1099, W-2, W-2G to March 31, if filing electronically.

Form 940 Employer's Annual Unemployment Return & Form 941 Quarterly Federal Employer's Tax Return

For calendar year 2002, 5.4 million Form 940s were filed – 86% on paper forms, 8% on magnetic media and 6% electronically. Of all Form 940 filings, 97% come from Small Business/Self Employed (SBSE) entities, slightly more than 1% from Large & Medium Size Businesses (LMSB) and about 2% from Tax Exempt and Government Entity (TEGE) filers.

Form 941 Quarterly Federal Employer's Tax Returns, reporting tax withholding and FICA tax information, are filed on a quarterly basis and can be filed on paper, on magnetic media, by Tele-File, online, or through e-file applications provided by software vendors. Of the 23.5 million returns filed in calendar year 2002, just fewer than 82% were on paper, about 4% were on magnetic media and nearly 15% were electronically filed (including Telefile and online filing). Of all Forms 941 filed, 93% came from SBSE filers, 6% from TEGE filers and just over 1% from LMSB filers. The IRS projects Form 941 e-filing will grow to about 25% by 2007.

Enhancements were made to the 940/941 e-filing platform in January 2003 to standardize on a data exchange protocol (XML) and to provide greater flexibility for electronic transmitters.

Form 1065 Partnership Returns

The 1065 e-filing program has turned out to be a very successful initiative, receiving positive reviews based on user surveys. There were 2.3 million 1065 returns filed in 2002, with most coming from SBSE taxpayers. The 1065 platform was the first true business e-file application to be developed; it includes 62 forms and schedules. For filing year 2002, 1% of partnership returns were e-filed, but these filings included over four million K1 attachments (approximately 17% of all K1's filed). The IRS projects that 13% of all 1065's will be e-filed by 2007.

Form 1120 Corporation Returns

Electronic filing is not yet available for corporation returns, but is schedule for implementation in January 2004. In tax year 2002, 2.36 million Forms 1120/1120S corporation income tax returns were filed. SBSE taxpayers filed 98% of these returns, with the remainder coming from large businesses. Paid preparers produced 89% of these returns. There were also more than 3 million Form 1120S Subchapter "S" corporation returns filed in 2002. Almost 100% of these returns came from small business taxpayers. Paid preparers produced 92% of these returns.

Electronic Payments

More than 94% of all federal employment deposits are paid electronically. In FY2002, the IRS received over 80 million EFTPS payments from 4.4 million enrollees, of which 3.8 million are volunteers. Electronic payments now total approximately $1.6 trillion per year, reaching a peak in 2002 of $55 billion dollars and 1.5 million transactions on a single day.

The IRS implemented the Electronic Federal Tax Payment (EFTPS) in 1996. EFTPS is a tremendous success overall. Among the many benefits of EFTPS, it provides an electronic payment research facility for taxpayers and their authorized representatives. The IRS added EFTPS Online in 2001, a new Internet-based program that has been very successful in moving a large percentage of tax deposits to direct electronic transfers and reaching $105 billion received to date over the Internet. Recently, the IRS has focused on making individual taxpayers aware that they can also use EFTPS to schedule planned payments up to one year in advance.

Additional enhancements to EFTPS are planned to increase utilization by both individual and business taxpayers by making it easier for first-time users to enroll and pay. Discussions are also underway regarding the use of EFTPS for state tax payments.

Section 3: Assessment and Recommendations – Individual Self-Preparers

An Electronic Tax Administration Vision for Individual Self-Preparers

While 100% e-filing among individual taxpayers may not be realistic, ETAAC's vision for serving individual taxpayers who prepare and file their own returns is to make it possible for everyone to file electronically if they so choose. "Making it possible" means:

- Ensure that free Internet access is available to those who chose to file online and can't afford it.

- Ensure TeleFile is meeting taxpayer expectations.

- Create as many incentives as possible for using e-File.

- Make individual taxpayers aware of the various e-File options and advantages.

- Instruct taxpayers on the use of those options.

A second part of our vision for individual filing is to better understand the impact of a "return-free" option. Since the IRS receives information returns covering most of the data required on simple individual returns, a return-free option could make some sense for taxpayers with straight-forward tax obligations. While a return-free system may present both operational and compliance challenges, ETAAC recommends that the IRS assess the potential benefits relative to these risks.

Online Filing and the Free File Alliance (FFA)

The percentage growth in online filing (nearly 27%) continues to lead the way for all e-file programs. While online filing is falling short of the projected 46% increase for filing season 2003, ETAAC believes those projections were overly optimistic. As online filing matures, a decline in the rate of growth can be expected.

While the overall growth of online filing was less than expected, the launch early in 2003 of Free File Services by the Free File Alliance (FFA) of private sector software companies gave a boost to online filing. More than 2.7 million returns (over 23%) of 11.8 million total online returns were filed using Free File programs provided at no charge by the 17 companies participating in the Alliance. This is a significant level of market penetration, given that the FFA agreement with the IRS was not finalized until late fall of 2002.

ETAAC commends the IRS and the FFA for launching such a successful program in a short amount of time. The Free File initiative will be an important factor in the future growth of online filing. With the 2003 filing season now substantially complete, a review of the first year is important.

Recommendation: The IRS and the Free File Alliance should take the following steps to improve the program:

- Seek feedback from FFA product customers and incorporate comments and recommendations into future offerings.

- Devise a plan to market the Free File option to targeted taxpayers, primarily the economically disadvantaged.

- Build on the success of the first year and meet with FFA members to resolve any issues of concern.

Reducing e-File Barriers

Significant future growth in online filing is dependent on access to Internet-connected computers. Free File, for example, is aimed at those who do not e-file due to cost considerations. In spite of the options available, however, many taxpayers in this category don't have access to a computer and the Internet, or sufficient computer literacy, to be able to prepare and e-file their returns.

In addition, while electronic filing results in faster refunds relative to paper filing during the April processing peak, for those who file refund returns early, paper return refunds are paid about as quickly as electronic return refunds, so there's little incentive for early filers to e-file.

Recommendation: The IRS should activate a partnering program with schools, libraries, community facilities, tax practitioners, software providers and other interested parties to provide free Internet access and assistance in teaching the fundamentals of online filing.

In conjunction with efforts to improve computer and Internet access, the IRS should increase the attractiveness of e-filing for early filers by adopting a consistent refund processing payment schedule for paper and e-filed returns throughout the processing year. That would mean consistently paying electronic refunds in approximately 10 days and consistently paying paper refunds in approximately 40 days (the IRS has a statutory 45 day interest-free window to process refunds), thereby enhancing the advantage of e-filing over paper filing.

Self-Prepared - Simple Paper Returns

There are currently 17 million paper returns from the "self prepared - simple" taxpayer group. Self prepared - simple returns are those from taxpayers (not a paid preparer) using form 1040EZ, 1040A, or 1040 with no schedules. This group is ripe for conversion to e-filing, but needs a little help from the IRS to make it happen.

Recommendations:

- In addition to the surveys recommended above, a limited pilot program designed to tutor a small group of paper filers in e-filing should be conducted and evaluated.

- For low income, disabled and/or elderly taxpayers, the Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs support the proposition that these taxpayers should not have to pay to file a tax return. These programs provide assistance to more than 3 million taxpayers, nearly 50% of which are using e-File. Access to computers and the Internet is a constraint at many VITA and TCE locations, particularly smaller sites. The IRS should work with emerging local volunteer organizations that may be willing to provide technical support at these locations. The IRS should also explore the use of secure wireless Internet access.

- The IRS should strengthen the VITA and TCE programs with updated computer hardware and telephone/Internet access and should increase the number of locations.

TeleFile

During the past five years, TeleFile usage for individual return filings has decreased 33% to just 4 million returns in 2003. The IRS has talked about eliminating this e-File program option, because the cost of processing TeleFile returns is growing as volume decreases. The IRS estimates TeleFile must grow to 9 million returns to be cost competitive. IRS research estimates the following for the total cost for submission processing and information technology operations for processing submitted returns, including labor, IT operations, and channel costs such as the 800 number telecommunication costs.

- TeleFile return $ 4.48
- 1040EZ paper return $ 4.25
- e-file $ 3.35

IRS research also indicates modal migration out of TeleFile is to a paper return more often than not. Depending on the length of time they have been telefiling, over 50% of all taxpayers who leave TeleFile revert to paper filing.

In the past, telefilers who changed address subsequent to receiving their TeleFile package have been ineligible to TeleFile. This has contributed to the historical decline in usage. The IRS has taken two actions to address this issue. First, the vendor that prints and mails the TeleFile packages uses the National Change of Address File service provided by the US Postal Service to update addresses just prior to mailing. Second, beginning with tax year 2002, taxpayers who move after receiving their TeleFile package are eligible to use the TeleFile system if they have their refund directly deposited in their savings or checking account.

Recommendations:

- Conduct a survey to determine why telefilers tend to revert to paper filing.

- Aggressively promote Free File to current TeleFile users. Select a subset of TeleFile users to evaluate the effectiveness of the campaign.

- If TeleFile continues to decline, develop an exit strategy for transitioning the TeleFile population to acceptable e-file alternatives.

Attitudinal Research

The IRS has access to voluminous statistical data, much of which is useful in making good decisions about services and targeting taxpayers with those services. However, there is insufficient data available to understand attitudes among taxpayers who chose not to use e-file options. As noted in the 2002 Report to Congress, IRS research reveals 10 reasons taxpayers give for not e-filing, but no one reason was given by more than 19% of the people surveyed. Lack of understanding of benefits, privacy concerns and fear of change seem to be the general themes expressed by taxpayers in the study. These reasons are not sufficiently detailed to help in marketing e-file services.

Recommendation: Before developing a targeted marketing program for converting paper filers, the IRS should work more closely with taxpayers (focus groups or one-on-one interviews) to identify the problems and associated solutions to address the reasons for non-participation. For example, if a taxpayer does not know where and how to get online to access Free File, the interviewer should determine whether the individual has ever been online or has ever used a computer. If a taxpayer is worried about the privacy of tax information, the interviewer should probe and understand exactly why there is such a worry.

e-File Marketing Strategies

The IRS has made good progress in making individual taxpayers aware of e-file opportunities:

- Options described in forms mailed to taxpayers
- Media release on Free File
- Links from IRS.GOV to Free File and other e-file options
- TeleFile kits
- Mailing of self-select PIN instructions
- Mailing of EFTPS options

Reaching the 36 million self-prepared paper filers is clearly not a single-strategy proposition. A segmentation of the market is required first before developing a comprehensive marketing program. That segmentation should be in as much detail as possible, including but not limited to the following:

- Age
- Income
- Return complexity
- Historical behavior, e.g. first-time filer, previous telefiler, previous e-Filer, etc.
- Degree of computer literacy
- Access to Internet
- Privacy concerns
- Need for paper files
- Sensitivity to cost

Recommendation: Once the segments are well defined, the challenge becomes one of targeting and reaching the individual segments with the information and motivation to move the taxpayer to e-File. If a particular group (low income or elderly, for example) has difficulty gaining access to the Internet, addresses and telephone numbers of those who can give them access (VITA, TCE, libraries, schools, etc.) will be most useful.

The IRS has made a good start in the past several years publicizing and promoting its preferred products. We encourage continuation and strengthening of that effort.

Cooperation with States

From the taxpayer perspective, the ability to prepare and electronically file both federal and state tax returns in a coordinated fashion is a key element to making e-file a more attractive alternative than paper filing. The IRS and the states need to work cooperatively to address e-filing barriers that result from inconsistent policies and procedural requirements and to market the advantages of e-filing.

Recommendation: Electronic filing at the state level increased 20% through May 15, 2003 and online state filing went from 850,000 to 1.1 million. ETAAC encourages cooperation between the IRS and state governments to decrease barriers to the use of federal/state e-filing. Recognizing the importance of federal/state cooperation, the IRS and the Federation of Tax Administrators (FTA) recently formed a federal/state Tactical Advisory Group (FTA TAG) to explore a range of federal/state filing issues.

ETAAC acknowledges the validity of concerns from the member Free File Alliance (FFA) companies with the competitive aspect of state online filing products but encourages FFA members to meet with state representatives on an individual basis to explore non-competitive ways to meet state online filing needs more effectively. As examples of how this cooperation can be achieved, New York, Massachusetts and Georgia are linking to private sector products, rather than offering their own online options.

Section 4: Assessment and Recommendations – Business Self-Preparers

An Electronic Tax Administration Vision for Business Taxpayers

Our self-assessment tax system relies primarily on voluntary compliance by taxpayers. Successful electronic tax administration must take into account the needs of the IRS to increase its operating efficiencies and effectiveness, and encourage and facilitate compliant tax filings and use of electronic methods and systems by taxpayers. Successful electronic tax administration requires a partnership with taxpayers and must consider the business taxpayers' needs, not only with respect to filing returns electronically, but also with respect to the data that is retained to support those tax filings. Business taxpayers need clear guidance on what electronic records should be retained, for how long, and in what format. In addition, the IRS must adapt its requirements to the realities of the current business environment, including current business record keeping systems and methods. The IRS must also recognize that the record keeping burdens currently placed on business taxpayers are excessive, and it must provide direction that will satisfy both the government's and the business taxpayers' needs.

Business taxpayers want to limit the ongoing uncertainty that exists after they file their tax returns. These uncertainties include not only how items were treated on the return, but also whether the records that are being retained are adequate to meet IRS requirements.

Compliance with the tax law requires the following: a business taxpayer must file a properly completed tax return and must retain enough information that, in the event of an audit, the taxpayer could show the IRS how the amounts on the tax return were derived. Effective electronic tax administration starts with electronic compliance. Such compliance comprises both electronic filing and electronic record retention.

In an ideal world, the business taxpayer would be able to file the business tax return electronically and know, with relative certainty, what data must be saved in the event of a future audit. The business taxpayer would also know the required format in which the data was to be saved, and this required format would be easily integrated with the modern commercial software that the taxpayer uses in its normal course of business. The IRS' interests would thus be served - the business taxpayer's return would be electronically filed and the records retained in a way that enables the IRS to conduct an audit at a later time. Paper records would not be retained. The business taxpayer would only need to retain essential data, limited to that required to show how the amounts reported on the return were derived. Volumes of records of minute details would not be required and the IRS would rely on audited financial statements and management information reports and summaries that support the tax return as filed. This would provide for effective electronic tax administration and efficient business practices.

As the IRS expands electronic filing offerings, it's important to understand that successful electronic tax administration encompasses not only electronic deposits and return processing, but also the broader areas of communication with taxpayers and retention and retrieval of records. The IRS must develop and communicate updated records storage and retention standards which rely on the electronic systems used by business taxpayers today.

Business Electronic Return Filing

Electronic filing should not be more costly to the business taxpayer than paper filing. There are currently few incentives for business taxpayers to file electronically. For example, the business taxpayer incurs additional expense to file employment tax returns (e.g., Form 941, Form 940) electronically. These returns are relatively simple and over 80% do not require a payment. To file these returns electronically, the taxpayer must change its return preparation process and perform additional steps to enter the data into the tax filing software. The taxpayer also incurs a filing charge from the software vendor (typically about $2 per return). Although the fee is small, businesses are not inclined to go to extra effort and pay $2 when it can file paper for the cost of a 37-cent stamp.

Recommendation: The IRS needs to provide incentives and advantages to business taxpayers that file electronically.

Business Electronic Record Retention

A major concern for the business taxpayer is what records must be retained in the event of a future audit, in what format, and for how long. In the past, the IRS would enter into record retention agreements with business taxpayers, but no longer does so. Electronic data should be viewed as having equal status with paper data, and record retention agreements as well as record retention guidance should be critical parts of IRS electronic tax administration. The IRS should not require retention of paper documents where information is available electronically to show how the data on a tax filing were derived, and taxpayers should not be required to retain excessive electronic data. For example, a multi-billion dollar company should not be required to retain invoices supporting $500 payments when its audited financial statements and business records kept in the normal course of its business should suffice.

The IRS' position is that the business taxpayers must retain all records that could be needed in the event of an audit. This sounds reasonable on the surface, but the reality is that business taxpayers cannot retain every conceivable piece of data created in the event of audit since that would be very expensive and unmanageable. The old record retention agreements enabled the tax manager at a company to have something written that could be used to communicate the need and commitments of the company to retain data. The company's technicians understood the record retention requirements and kept the appropriate data. Without any written guidance by IRS, the tax manager cannot articulate with sufficient specificity the IRS' requirements for data retention throughout the company. This becomes even more complex for global companies.

It is not unusual for taxpayers to have data in multiple systems in multiple locations. To save everything that may possibly be relevant for an audit is confusing and prohibitively expensive. The reality is that data and records are being deleted everyday. Many times data and records are deleted accidentally or because the people may not be aware that data must be retained. In the normal course of business, data and records are routinely purged.

Recommendations: To correct these problems and to move to improved compliance, we recommend that the IRS consider the following issues that focus on the needs of business taxpayers, especially those who prepare returns in-house:

- The IRS should define and publish clear guidance on record retention (both paper and electronic) so that business taxpayers know what to retain and for how long. The IRS should specify what electronic data must be retained. While there could be limited circumstances without specific guidance, as a general matter business taxpayers could take comfort that if the identified data were retained then they would be in substantial compliance with record keeping requirements. This would eliminate much uncertainty and help build a stronger partnership between the IRS and the business taxpayer. This change can only encourage improved tax compliance. We acknowledge that the IRS has issued some guidance on the topics and a basic procedure allowing taxpayers to keep books and records required by section 6001 electronically. The IRS also permits return preparers to maintain copies required under section 6107 electronically. However, this guidance does not sufficiently respond to the needs of business taxpayers and address the concerns outlined in this Report. Success of electronic tax administration requires that the IRS set realistic electronic storage guidelines for business to follow and that these guidelines be continually monitored to stay current with technological developments and changes in business electronic storage practices.

- The IRS should actively participate in world-wide organizations that are looking at setting international standards for electronic data storage. The IRS should publish guidance on specific information required to support the return data for business taxpayers' overseas operations. The aim of this effort would be to reduce the cost of compliance and improve the competitive position of both small and large companies doing business internationally.

- For audit examination purposes, the IRS should rely on management information reports and audited financial statements used to prepare the return.

- The IRS should work with business taxpayers and commit to record retention agreements that recognize the realities of how data is stored in modern systems and which allow reliance on electronic data and summarized financial data. This would greatly reduce taxpayer burden and enable more streamlined audits, thus providing a more efficient process for both taxpayers and the IRS.

- The IRS should consider publishing materiality standards with respect to record retention requirements and examination issues. Especially with companies whose financial statements and underlying data is already audited by a third party, it is not efficient for either the IRS or the business taxpayer to waste time and effort hunting down the hard-copy back-up for very minor details. Perhaps a sliding scale could be established that would provide an appropriate level of comfort based on the taxpayer's relative size. The IRS may deem it essential for the taxpayer to retain proof of certain items in hard copy or original format (e.g., specific documents to support a specific tax return item). The IRS is employing Limited Issue Focused Exam methods with many business taxpayers to enable more efficient and effective audits. Accordingly, IRS should not require business taxpayers to maintain and retain low levels of detailed records for audit.

- The IRS should allow business taxpayers to discard records within a reasonable period after the tax return is filed. An incentive to file business tax returns electronically could be tied to this (e.g., business taxpayers who file electronically would be allowed to discard records six years after the return is filed or upon the close of the audit, whichever comes first). This could provide relief to small businesses and incentives for e-filing of all business tax returns.

- IRS personnel assigned to business taxpayer audits should be afforded additional training to enhance the knowledge, familiarity, and skills that IRS auditors have with respect to software and electronic record-keeping systems used by businesses, especially large businesses.

- As an incentive for business e-filing, the IRS should emphasize and fast-track its transcript modernization efforts so that business taxpayers who self-prepare have electronic read-only access to its data on deposits, returns, and other related transactions contained on the IRS' taxpayer master-file database. A modernized taxpayer return database should display taxpayer records in a user-friendly format (i.e., showing full descriptions of transactions in English rather that use of cryptic codes that are difficult for both the taxpayer and IRS personnel to decipher). Currently, the IRS transcripts are very difficult to obtain, understand and use. Budgetary constraints have resulted in business taxpayers having less access to knowledgeable IRS personnel who can assist the taxpayer in researching and understanding tax matters.

Section 5: Assessment and Recommendations – Third-Party Tax Professionals

Tax practitioners file nearly 60% of all individual tax returns and more than 85% of all business tax returns, using specialized tax software produced by private sector tax software developers. When filing electronically, they often use the services of third-party electronic transmitters. Third-party tax professionals hold the primary key to increased e-filing and electronic tax administration.

Some segments of the professional tax preparation community have adopted e-filing as their principle way of doing business. For example, the four largest national tax preparation firms file an average of more than 80% of their returns electronically each year. However, there were more than 30 million returns computer-prepared by practitioners but submitted on paper rather than e-filed. Most of those 30 million paper returns were filed by non-mass market practitioners who prepare returns using software, but often submit them on paper.

As a group, tax practitioners produce approximately 72% of all computer-prepared individual tax returns, but only 46% of them are e-filed. To increase their participation in e-filing, it is critical to understand what would attract more of them to the program.

An Electronic Tax Administration Vision for Third-Party Tax Professionals

A vision for future e-filing would include central repositories for all data filed electronically. This would be accessible to taxpayers and their authorized representatives.

The taxpayer would always maintain the ultimate control of the information. Such a central repository could be made available through private industry offerings with multiple partnerships or available in a controlled manner through a government site. As with any such offering, legal ramifications, privacy concerns, as well as security, will be major areas to address.

From this repository, the taxpayer or authorized representative would have the ability to download and populate some or all of their tax returns in an automated fashion. This might be limited to bringing in the prior year's return data, and progress into loading current year information. Naturally the timing of such information's availability would be another area to be addressed.

This system would potentially serve as an archive for the current paper environment, and represent to the individual another way to safeguard information, much like an electronic safe deposit box. For this to work seamlessly, it would have to achieve the goal of being completely paperless, address security, privacy, and data protection concerns and allow for complete data portability among the various potential repositories. It would also have to be both business-friendly and attractive to the individual to be practical and economical.

The following scenario depicts what a tax practitioners' business might look like in a future where tax preparation, planning and administration is totally electronic. Naturally, this assumes a level of technical proficiency, technology and the desire for electronic interaction on the part of the practitioner and the taxpayer.

The practitioner's system would automatically schedule an electronic appointment for interviewing a taxpayer client online. An automatic email would be sent to the practitioner's client to remind her of the appointment. At the prescribed time, both the practitioner and client would meet in an electronic conference room to collaborate on the preparation of the tax return. Both the practitioner and client would have access to the client's electronic tax administration account and the practitioner would download the estimated tax payments made electronically by the client during the year into the tax preparation software.

The client would connect to various financial institutions and employers to automatically request an electronic transfer of 1099 and W2 information into the practitioner's tax software. After all of the data had been imported, the practitioner and taxpayer would review the completed tax return online. Once the taxpayer agrees with the preparation of the return, it would be electronically filed with the IRS and state and local revenue departments. If the returns had a balance due, those payments would be automatically transmitted to the various agencies. Confirmations that the returns had been filed and payments had been received would be electronically posted to the taxpayer's accounts with an email sent to the practitioner.

Finally, the practitioner would present the taxpayer with an electronic bill for services and the taxpayer would electronically transfer payment for the bill from her bank account into the practitioner's account, potentially without the practitioner and taxpayer ever having met face-to-face.

2-D Bar coding and OCR

High volume processors of paper documents have for years searched for an answer to converting a paper medium into electronic systems. Many of these systems have evolved around various types of optical character recognition (OCR) meant to take a printed document into an electronic data processing environment in a manner that does not require transcription from the printed document. OCR systems have limitations and, while generally less expensive and more efficient than key entry systems for capture of machine printed data, they can be relatively costly to operate and maintain.

2-D barcodes have been developed and used by several states in reducing the handling requirements of paper returns. These systems have required special programming that imprints the 2-D barcode on the standard paper document that can be read and translated into an electronic format. The approximately 40 million 1040 family returns that are prepared by computer (V-code returns) and then mailed to the IRS are potential targets for 2-D barcode technology. However, adoption of 2-D bar coding requires a significant investment by the IRS and the third party software developers and could undermine efforts to promote e-filing.

Recommendation: ETAAC sees any use of an OCR system, including 2-D barcode, as a fallback strategy to deal with residual paper that won't or can't be converted to electronic filing. Information Reporting Program Advisory Committee (IRPAC) is currently studying the effectiveness of a 2-D barcode strategy on numerous information reporting documents including W-2s, 1099s, and K-1s. We support IRPAC's efforts in that arena and see that as a good solution as most of these documents are prepared on computer and this would allow an electronic front end to the tax return preparation process which we believe would enhance the e-filing experience. However, ETAAC cautions the IRS that any development of an OCR strategy can ultimately undermine the future of e-filing and the efficiencies inherent in electronic submission processing and electronic tax administration.

Many software partners have joined the IRS in pushing forward the e-file vision set by Congress and premature development of alternative strategies that are not core to the e-file target will divert resources - internal and external - available for this effort. We strongly recommend that the IRS maintain a clear focus of attention and resources on the development and enhancement of the Modernized e-File platform and related e-services as strong incentives to promote participation in electronic tax administration.

Lack of Parity between Paper and e-Filing of 1040s

The lack of parity between paper filing and electronic filing of 1040 returns continues to be a significant barrier to the adoption of e-filing as the preferred method of filing for tax practitioners. In the current environment, there are inherent structural incentives for paper filing over e-filing. These incentives apply to self-prepared returns as well as professionally-prepared returns.

For simple returns (1040EZ, 1040A and some 1040s), some preparers find paper easier to use than having to use software that allows them to e-file. Those that attempt to e-file often find that electronic connections are not reliable and the required information for electronically filed returns is more stringent than paper. Couple this with rejection of certain information that fails the screening at the service center and you have many preparers abandoning e-filing and returning to paper. For balance due returns, there is little perceived advantage to e-file or e-pay.

While electronic filing results in faster refunds relative to paper filing during the April processing peak, for those who file refund returns early, paper return refunds are paid about as quickly as electronic return refunds, so there's little incentive for early filers to e-file.

Many paid preparers are reluctant to incur additional cost to e-file due to the difficulty of charging their clients and collecting a fee to electronically file the return. They do not see the benefit of e-filing, especially for balance due returns. Electronic filing also introduces different processes to be accommodated in their offices. Finally, many preparers are demand-driven and wait for their clients to request a different method of filing.

Recommendation: The IRS should continue to explore positive ways to bring parity between paper filing and e-filing, provide incentives for e-filing returns and accommodate conditional acceptance if e-filed returns fail some screening criteria. The IRS should increase the attractiveness of e-filing for early filers by adopting a consistent refund processing payment schedule for paper and e-filed returns throughout the processing year. That would mean consistently paying electronic refunds in approximately 10 days and consistently paying paper refunds in approximately 40 days (the IRS has a statutory 45 day interest-free window to process refunds), thereby enhancing the advantage of e-filing over paper filing.

E-Services

The IRS plans to offer a suite of e-services to tax practitioners as an incentive for them to promote and use e-filing for their clients. This is presented to the tax community as a win-win situation, where the IRS gains e-filing efficiencies and is relieved of costs while the practitioner gains a cost-effective, valuable ability to more quickly resolve and track client returns and accounts, thereby providing higher levels of customer service while increasing e-filing.

Currently, the Service plans to limit e-services to those practices that e-file 100 or more Individual Income Tax Returns. We endorse a position that gives access to only those preparers who have made a concerted effort to join the e-file ranks. The intention is to continue to roll-out e-services to practitioners over the next few years.

The IRS plans to implement the following e-services in the near future:

1. The ability to submit a disclosure authorization online.
2. Electronic Account Resolution
    a. enter into installment agreements,
    b. trace payments
    c. address complex refund issues
    d. check estimated tax payments.
3. Obtain account transcripts.

The 80% goal will not be met unless the IRS can capture the remaining paid preparers. These include the certified public accounting community, enrolled agents and other practitioners that do not generally complete the taxpayers' return while the taxpayer waits.

The reason this market has been so hard to capture is that these practitioners continue to believe e-filing places additional burden and responsibility on them as well as taking them longer to prepare, due in part to the higher level of edits associated with e-filed returns. If the IRS intends to transfer the perfection (editing of error conditions) of tax returns from service centers to the third parties, it should recognize and reward such a transfer of responsibilities by continuing to offer inducements for participation.

Recommendation: It is important for the IRS to follow through on all previously published timelines for e-services to maintain momentum and gain credibility. Delays will take a serious toll, not just with those practitioners who will revert back to paper filing, but with those who are watching and as yet uncommitted to e-filing. It will be much harder to recapture the market if delivery dates for services are not met.

Change in Due Date

The Administration has proposed, and the House of Representatives has now passed, a change in the due date for e-filed 1040 returns to April 30th. The IRS estimates this proposal will increase e-filing by approximately 4.5 million returns in the first year of implementation and approximately 8 million by the fifth year. Since e-filed balance-due returns would have to include an electronic payment to qualify for the later due date, e-payments would be expected to increase by approximately 3 million in year one and 6.5 million in year five as a result of this change.

The practitioner community has raised concerns over the proposed due date change for e-filed returns. Their concerns include the added burden on practitioners, the confusion associated with non-conforming state and local departments of revenue, the added complexities of dealing with inconsistent due dates for extension payments and estimated tax payments, as well as the fact that April 15 is considered our "national tax day."

Representatives of that community have proposed extension of the payment date as a preferable alternative, if the return is filed and the payment is made electronically. Practitioners are important partners in promoting e-filing; their support and cooperation is critical to success.

Recommendation: ETAAC welcomes any initiative to encourage e-filing, and will be looking to the IRS to bring forward a well-conceived implementation of the change of due date for e-filed returns, if enacted, that addresses to the extent possible the concerns of the practitioner community. The implementation should:

- Minimize confusion through the development of clear regulations and marketing messages;
- Address conformity issues and harmonize payment due dates; and
- Provide relief from possible penalties where taxpayers or their preparers make a good faith effort to comply with electronic filing and payment requirements, but are impeded by taxpayer misunderstandings or circumstances beyond their control.

Speakers Bureau

IRS-ETA Tax Year (TY) 2001 data provides evidence of notable slow growth in paid preparer-simple returns electronic filing. Learning what impedes paid preparers from e-filing is a critical component in elimination of resistance to e-filing.

A basic theme has continued to be seen in research on practitioner resistance to e-filing, which is that tax practitioners need to be convinced that e-filing is a good business decision and can be integrated into their workplace business processes. Much of the IRS marketing and outreach efforts have concentrated on increasing the market penetration of paid preparers. However, moving to electronic filing from in-place paper methods takes time and effort, and causes disruption.

Recommendation: As a step in reversing this slow growth trend, ETAAC suggests that the IRS develop and maintain a "Speakers Bureau." The Bureau, which would result from a partnership between the ETA and Electronic Return Originators (EROs), would capitalize on the experience of ERO of the Year nominees – recognized by the IRS as examples of outstanding e-filing entities – to promote and encourage non e-filing entities to accept e-filing as a pathway to improving their businesses.

We believe that a peer to peer message delivered by those who have successfully adopted e-filing to their business models would be very effective in increasing e-filing by practitioners. Under this program, an appropriate ERO of the Year nominee would be made available to speak with and answer questions of interested non-e-filing entities. A standard presentation would be professionally produced and would include supporting data from both the ERO and ETA perspectives. The presentation should be scalable and concise with the recurring theme of "why e-filing is good for my business."

Just as there are various subgroups of potential e-filers, there should be more than one type of ERO of the Year represented by the Speakers Bureau. CPAs, circular 230 and non-circular 230 entities, V-coders and intermittent filers should all be targeted through ETA marketing efforts.

The IRS could utilize IRS.GOV with links to Speakers Bureau sites, which would highlight the availability of the speakers.

Third Party Employment Tax Returns

Some enhancements were recently made to the e-filing platform for the 94X family of returns (940, 941, 943, and 945). However, for the vast majority of filers, paper remains the preferred filing method. For tax year 2002, 81% of all 941 Forms (Employer's Quarterly Federal Tax Return) were filed on paper, 11% were e-filed, 4% via Telefile & 4 % on magnetic media. This is a total of 19% of 2002 returns filed in some automated fashion other than paper, which represents a minimal increase over 2001, (4.4%) when 15.6% of the returns were filed via magnetic media, Telefile or e-filing.

There are very few incentives to offer a business taxpayer to alter their habits and file the employment returns electronically, as 75% of 941 Forms are zero balance returns (no balance due or overpayment), and 10% of 941 Forms report zero wages, taxes, and deposits. Therefore we believe that the first approach to take is to partner with those third parties who file these returns on behalf of the taxpayers in bulk.

Recommendation: In order to obtain participation of third-party preparers, the IRS should take steps to offer comparable e-services to those organizations filing employment tax returns, (such as Reporting Agents and other payroll practitioners), as are currently being offered or in development for personal tax practitioners in the 1040 arena.

These e-services include:

- Online account resolution
    - review of client activity, modules, transcripts
    - submission of correspondence and adjustments
- Entity verification (confirmation of name, Taxpayer EIN, Assigned deposit schedule)
- Online Transcript Delivery
- Disclosure Authorization
- Reporting Agent Registration

We believe that providing e-services to reporting agents would result in significant administrative savings for the IRS by relieving the burden of manually handling simple employer requests. E-services could lower government operating costs by allowing authorized self-service, which should increase the adoption rate of e-filing overall for employment tax returns.

Harmonization of Authorization and Authentication Methodologies

Authorizations and the required accompanying authentication continue to be a major topic in the third-party arena. Third-party reporters such as enrolled agents, CPAs, reporting agents, public accountants, and payroll services, often are confused by the varying requirements and levels of authorization granted by the different documents.

There are several forms that taxpayers can currently select to grant authority to a third party to perform various functions on their behalf. These functions can include preparation of a tax return, payment of taxes, and filing of the tax return(s). Certain authorizations grant the ability to the third party to correspond on behalf of the taxpayer, and to resolve discrepancies within the granted account(s) area.

At present the IRS intends to roll out a web-based practitioner disclosure authorization e-service, which we believe is a step in the right direction. However, we also believe that now is the time to harmonize all authorizations. Furthermore, authentication and authorization processing is primarily paper-based, which we believe could be improved through automation.

Recommendation: ETAAC recommends that the IRS convene focus groups with stakeholders for the purpose of an across-the-board review of the various authorizations that are currently required, and the authentication(s) necessary to complete them. This analysis should include taxpayer input as to their understanding of such authorizations, and the nature of the authority that is intended to be granted.

We believe that now is the time to perform this to properly encompass the electronic, paperless interactions necessary in today's automated environment. We believe that such a systematic analysis at a high level will pave the way for more electronic transactions as well as contribute to overall efficiencies within the IRS, through the elimination of unnecessary paper handling.

Third Party e-File Assistance

When a third party decides to begin filing electronically, they usually have a series of questions. These range from how to set up procedures to what forms and returns can be e-filed. Continuity is important in the process of starting to e-file, so that follow-up questions can be addressed by someone who is knowledgeable of the situation. Even experienced EROs are faced with situations where they need expert assistance, and have a need to be updated on the latest enhancements to the existing e-file program.

When the IRS started the e-file program, they allocated a specialist (Electronic Filing Coordinator) in every area. These individuals knew the "ins and outs" of the electronic filing world. They not only spoke to the public about the benefits of e-filing, but they were also there to answer all types of practitioner questions. When the Service reorganized, it did not choose to continue this position.

While the Service, with the help of ETAAC members, has set up a question and answer site for new EROs on their website, this does not make up for the void left by the loss of the ELF Coordinator. "Question and answer" type assistance and help desks do not address the more complicated and unique situations that third parties are likely to encounter when either initiating or enhancing their own e-file practices. These typically call for ongoing technical support by a specific individual or team.

Recommendation: ETAAC recognizes that the ELF Coordinator position as previously designed may not fit in the new IRS organization structure. However, we recommend that every office with Stakeholder Partnerships Education and Communication (SPEC) and Taxpayer Education and Communication (TEC) staff designate an e-file specialist(s). This person should not only learn as much as possible about the e-file process, but should also be a liaison between the third-party community and the Service, and assist with public relation marketing opportunities related to e-filing. These staff should be able to either answer the preparers' questions or find a person within the Service who can. In addition, they could also provide feedback to the Service regarding third-party issues.

We also recommend that an e-mail system similar to Quick Alerts be initiated specifically for EROs. These quick sentence or two e-mails should notify EROs of changes, new procedures or areas for improvement that the Service has identified. This will assist EROs with learning about enhancements to e-file processes, and alert them to areas for improvements. In addition, the IRS should consider and test the use of other electronic communication facilities, such as facilitated chat rooms and online bulletin boards, where IRS staff and ERO peers could help with individual ERO questions and problems as they arise.

Regulation of Federal Tax Preparers

There have been concerns expressed related to the quality of tax preparation services provided by third-party tax preparers. Although some of the more than 71 million individual taxpayers who use a paid preparer receive poor service, the GAO indicated on April 1, 2003, in testimony to the Senate Finance Committee, that this was a small percentage of the total returns prepared. The National Taxpayer Advocate has recommended a legislative resolution that involves federal regulation, ongoing oversight, and annual examinations of any paid preparer who prepares more than five federal tax returns in a calendar year. This proposal excludes those already regulated (attorneys, CPAs, and enrolled agents).

It is very important for all taxpayers to have accurate return preparation from paid preparers. However, the percentage of problem returns appears to be small, based on GAO findings. It is important to analyze the impact of such a wide-ranging program. One issue that has been raised is that of public perception of an IRS "stamp of approval" that might also mislead taxpayers to the point of believing that once a preparer is certified by the IRS, the taxpayer would then have recourse to IRS should errors be made.

Another major concern is that of limited, competing resources. The scope of this proposal is very wide-reaching. The National Taxpayer Advocate estimates that there are up to 600,000 paid preparers who might be covered by this new program. Administration of the startup and subsequent ongoing management of this program would require significant IRS resources not currently allocated. Furthermore, the legislative proposal as written does not specify the target segment for regulation as only including individual return preparers. Therefore, the legislation could conceivably be interpreted to include preparers of corporate or payroll federal tax returns.

Historically, states have regulated professionals. The federal government has limited itself to regulation of those authorized to practice before the IRS. Two states (Oregon and California) have attempted regulation of paid preparers, but as yet are unable to discuss the effectiveness of such programs. Individuals that believe that they have received poor quality tax preparation service from paid preparers can seek redress through a variety of remedies available currently through the court system and other groups (e.g., better business bureau). Federal regulation of paid tax preparers would be duplicative of these solutions.

Recommendation: ETAAC recommends that the IRS Office of Professional Responsibility, in consultation with ETA, the Taxpayer Advocate Office, and the affected tax professional community, determine the best solution(s) to the issues raised concerning poor quality of tax preparation by some paid preparers. We believe a legislative cure is premature and inappropriate, and the situation would be better served by ongoing study of the two states that have attempted such regulation, continued taxpayer education, and the enhanced IRS programs of taxpayer outreach on how to choose a paid preparer. These education and outreach efforts should also attempt to clarify the significance of the IRS' current designation of "authorized e-file provider." Taxpayers need to understand that such a designation only means that a provider has been approved to submit electronic returns, without respect to the quality of the tax preparation service provided.

Section 6: A Strategic Vision for Electronic Tax Administration

Many of the essential elements for creating an innovative future direction for tax administration are falling into place. The IRS is modernizing its core tax administration systems to make them more capable, flexible and responsive. New electronic service delivery channels are being implemented, including secure web "portals" for access to internal information resources, services and taxpayer account information by IRS employees and trusted external customers, including taxpayers' authorized representatives.

The IRS is beginning to offer electronic services, like the ability to register as a trusted external customer and for a new business to obtain an Employer Identification Number (EIN) online. These e-services are highly anticipated and will be much appreciated by the professional tax community. The IRS is also implementing the first of a series of modernized e-filing platforms, beginning with 1120 e-filing in January 2004. These modern new e-filing platforms will be based on industry-accepted standards for data sharing and communication, making them attractive to software developers and tax practitioners.

However, as important as it is to assess IRS progress and provide guidance on near term initiatives, ETAAC members believe that it's equally important to articulate and focus on a broad strategic vision of electronic tax administration that's informed by external stakeholders. This closing section of the Report is intended to help create that vision.

"End-to-End" Electronic Tax Administration

Not long ago, tax administration seemed to be perceived as the exclusive domain of government tax agencies. Relationships with external parties were generally at an "arm's length." Tax agencies defined the format, content and mechanisms for providing required information, and providing information back to external parties was generally a lower priority than getting it from them.

As has happened in the private sector, the growth of the Internet and the development of new "networked" business models have prompted a change in the way we think about those relationships in tax administration. The new view acknowledges that third parties in the tax business are also the IRS' partners in serving a common customer – the taxpayer.

In the private sector, new ways of doing business – driven by innovative thinking and enabled by new technologies – are emerging in industries with characteristics similar to the tax administration environment. Those characteristics include a diverse customer base, complex and highly-specialized functions, seasonal peaks and valleys and a high level of dependency on value-adding intermediaries.

Highly-competitive businesses have responded to new market challenges and opportunities by shifting their view from streamlining internal processes and systems to integrating internal and external service providers in a seamless, end-to-end service delivery network. That view takes into account business partner capabilities and needs, creating a flexible, dynamic environment that allows each partner to perfect its own specialized processes, reduce costs, enhance value and respond quickly to customer needs.

For the IRS, the corollary to this end-to-end electronic business vision could look like this:

Taxpayers would have multiple choices in terms of how they interact with the IRS (e.g., directly or through an authorized representative; electronically or by mail) and what value-added services they choose to use (e.g., online preparation and filing services from a variety of competing vendors). In this vision, taxpayers would not only be e-filers, but e-customers. They could decide among a variety of options how they would like to view their own IRS account information, perhaps choosing traditional paper correspondence, maybe through a secure session at irs.gov, or potentially as part of an electronic financial portfolio offered securely by a private sector financial institution.

Tax Software Developers would continue to be active participants with the IRS in defining new services that would be beneficial to mutual customers. The IRS would define changes requiring software investments in ways that minimize costs and maximize value for the tax software companies. The IRS would also provide electronic services and secure account access in ways that would integrate securely with private sector software. For example, the tax software used by a practitioner would automatically validate taxpayer identification information in near real time and securely pre-populate account information, such as Estimated Tax payments, reducing costs for the practitioner and increasing accuracy for the taxpayer and the IRS. Tax software companies, in turn, would be prompted by competitive market pressures to enhance other features of their software, such as providing direct links into IRS tax research knowledge bases.

Online Filing Providers similarly would have access to electronic services that they could incorporate into their tax preparation and e-filing offerings. Their services would be easily accessed and understood by taxpayers. The new Free File Alliance – a virtual marketplace for online filing – is an excellent example of how this type of business model could benefit the IRS, its partners and its customers.

Tax Practitioners, in the end-to-end vision of tax administration, would choose from a variety of third party software products offering highly interactive e-services, made possible through online communication with the IRS' systems. A full range of e-services would be available, allowing practitioners to make a clean break from their paper processes. Those services would include the ability to e-file all form types, research taxpayer account information online or through a direct software interface, correspond electronically with the IRS, easily obtain electronic taxpayer signatures and maintain all records electronically. Information returns would be filed electronically by employers and financial institutions (2D bar coding of information returns would be a helpful interim enhancement), and made available timely to taxpayers, practitioners and tax agencies.

Other Government Agencies, such as SSA, FMS and state tax agencies, would exchange information electronically with the IRS to improve compliance, taxpayer service and processing accuracy.

Employers and Financial Institutions would file withholding and information returns electronically, providing electronic copies to taxpayers and their designated representatives. Financial institutions may integrate tax account information with other customer financial information into an electronic financial portfolio, allowing online account inquiry, customized financial advice, tax filing and payment reminders and electronic tax payments. As an incentive to customers, financial institutions and other third parties may offer free online tax preparation and filing, provided by a specialized online filing provider.

The IRS would act as an integrator of this network of tax administration service providers. Its own electronic tax administration processes and systems would be designed to facilitate the smooth interaction of its internal functions with the specialized functions of its third party partners and taxpayers. The focus of its electronic tax administration initiatives would be to increase value and reduce costs for all the participants in the tax administration service network, while protecting the security and confidentiality of taxpayer information.

Those initiatives would enhance timely processing of returns and refunds and speedy resolution of issues, standardize interface and data transfer protocols, provide simple and comprehensive views of taxpayer account information and facilitate the ability of third parties to dynamically tailor services to the needs of individual customers. Key enablers of this future vision, led by the IRS, would be the creation of "natural integration points," such as an electronic means for designating, tracking, updating and authenticating authorized representatives, definition of open standards such as XML for data exchange and development of simple but effective data encryption and electronic signature mechanisms.

In this environment, existing tax administration service providers would likely innovate with new and creative electronic service offerings and new providers would undoubtedly enter the market with fresh ideas and new business models. Taxpayers would be the ultimate beneficiaries.

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