Electronic Tax Administration Advisory Committee

Annual Report to Congress

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ETAAC Annual Report to Congress 2004

Table of Contents

ETAAC ANNUAL REPORT TO CONGRESS – 2004

EXECUTIVE SUMMARY

The Electronic Tax Administration Advisory Committee (ETAAC) is charged to report annually to the Congress as outlined in the Internal Revenue Service (IRS) Restructuring and Reform Act of 1998 (RRA 98). ETAAC's analysis of the IRS e-file programs and recommendations for attaining the stated goal of RRA 98 follows.

ETAAC Vision:

The Internal Revenue Service must revise its business model. A paradigm shift is required for the entire organization. It must begin to think of itself as an electronic tax administration agency that is a communicator, transmitter, receiver, and repository of e-information rather than as a paper handler. It must make e-transmissions, e-payments and e-correspondence the method of preference internally as well as externally.

Progress of the IRS in meeting RRA 98 goals:

The IRS will not meet the goals of RRA 98; specifically the goal of 80 percent electronically filed returns by 2007, and did not achieve the intermediate goal of 100 percent of computer generated returns electronically filed by 2003. (Exhibit 1) More dramatic steps must be taken.

Status of the strategic plan to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing:

The draft ***IRS E-Strategy for Growth - Expanding e-Government for Taxpayers and Their Representatives*** fails to address many of the key ETAAC recommendations in these three areas. The strategic plan includes little discussion of incentives that could be used to encourage electronic filing. There is no marketing plan to reach balance due filers or to focus marketing on the demographic groups that show the most potential for dramatic increases in electronic filing (Exhibits 4-7).

Recommendations to Congress to Assist the IRS in Meeting RRA 98 Goals:

- Congress should authorize additional funding for the IRS, specifically earmarked for Modernized e-File (MeF).

- Congress should support mandated e-filing by paid preparers.

- Congress should allow elections to be considered timely if the pertinent return was initially submitted electronically and could be identified by IRS.

- Congress should, when enacting tax code changes, allow adequate time for systems design and implementation by the IRS and stakeholders.

- Congress should not support legislation to extend the Form 1040 return due date as an e-file incentive.

Recommendations to Internal Revenue Service:

- IRS should develop an exception processing routine for edit errors by the IRS to reduce practitioner and taxpayer frustration with return rejection.

- IRS should adjust the current e-file systems to require the same Form W2 and Form 1099R data as paper processing or seek alternative data input methods.

- IRS should enhance the current Form 8453 procedures to include forms and schedules that are not eligible for e-filing.

- IRS should open e-services to all tax practitioners that have the authority to obtain taxpayer information for their clients.

- IRS should be provided with the necessary dedicated resources to properly plan, design, code, and test every aspect of e-file programs.

- IRS should develop a marketing strategy that addresses taxpayer and tax practitioner perceptions of increased likelihood of audit as a result of e-filing.

- IRS should continue to oversee the Free File Alliance program.

- IRS should revisit the definition of reasonable cause for penalty abatement to address technological failures on a universal level.

ETAAC VISION STATEMENT: Electronic Transactions for Every Function

The IRS should reinvent their internal business model across all operating divisions to one that embraces standardized electronic interactions.

In order for the IRS to achieve the goals of RRA 98, the IRS must, as an enterprise, adopt the vision of electronic transactions for every function. Currently, electronic initiatives tend to be centralized in the Electronic Tax Administration (ETA) Group, without wide-spread acceptance or support from within each Business Operating Division (BOD).

ETA must, with the visible support of the Commissioner and other executives, develop a top-down driven strategy to make electronic administration the rule, rather than the exception to the rule, within the IRS. This will require a cultural shift within the agency regarding preconceived notions of how returns are processed, and how the IRS communicates internally, as well as with taxpayers, tax preparers, employers and other primary sources of tax information, such as state revenue agencies. Until the IRS as a whole adopts electronic transactions as the primary and preferred method of communication, the goals of RRA 98 will not be accomplished.

IRS should commit to revise internal procedures to support electronic methods of communication and data transfer as the first choice of interaction. IRS should consider this objective, holistically seeking ways to reduce the need for paper while remaining compliant with the tax laws and the needs of stakeholders.

An evolution of current systems is required in order to move to an electronic schema from paper, and IRS should cease attempting to overlay paper handling concepts onto electronic settings. The Service must be proactive in addressing filing issues and requirements regarding the types of data that must be retained for audits. This will have relevance to all taxpayers - individuals and businesses. In an electronic world, it is too difficult and expensive for taxpayers to retain everything. The Service must provide clear safe harbor guidelines on electronic record retention for taxpayers. These guidelines must be updated regularly due to technology changes.

SECTION ONE
Progress Toward Goals of RRA 98

The IRS will not meet the goal of RRA 98 of 80 percent electronically filed returns by 2007.

Background

RRA 98 specifies that the IRS should set goals to have at least 80 percent of all Federal tax and information returns filed electronically by 2007 and all returns that are prepared on a computer filed electronically by 2003. In order to properly assess the accomplishments of the IRS in this area, it is important to clarify two terms: "electronic" and "return".

For purposes of this report, the term electronic is perhaps a misnomer. More precisely, the ETAAC would interpret the goal of RRA 98 is to maximize paperless tax and information return filing so as to eliminate the data entry associated with paper. To this extent, any return that is filed in a format that does not require human data entry should be deemed to be electronic. This would include, for example, information returns and payroll returns that are filed via magnetic tape. While the transmission of these returns does not occur electronically in the strictest sense of the word, human data entry by IRS is not required and there is no paper involved in the processing of the returns.

Again, for purposes of this report, the word "return" is defined to include all documents required to be submitted to the IRS to establish filing compliance with individual income tax, corporation income tax, fiduciary income tax, partnership income tax, payroll tax, and information returns.

Analysis by Tax Type:

Return Category	Tax Forms Included in Return Category						
Individual Income	1040A	1040EZ	1040C	1040NR	1040PR	1040SS	
Corporation Income	1120	1120A	1120S				
Partnerships	1065	1065B					
Estate and Trusts	1041	1041S	706	706NA	706GS(D)	706GS(T)	
Gift	709						
Tax Exempt	990	990EZ	990-PF	990-T	990C	4720	5227
Employment	940	940EZ	940PR	941	941PR/SS/M	943	943PR
Excise	2290	720					
Information Returns	W2	1099					

	% of 2002 Returns	% E-Filed
Individual	75%	40%
Employment	17%	19%
Business	3%	n/a
Estates & Trusts	2%	36%
Other	2%	n/a
	100%	

As indicated in the above table, 75 percent of all tax returns filed are for individuals (the Form 1040 family of returns). This group, therefore, represents our biggest concern in the acceptance of electronic filing and achieving the goals set forth by RRA 98.

There is little, if any progress toward electronic filing of employment tax returns. The majority of the Form 94X returns is filed by individual employers. There are no incentives yet devised to address this market, and there is no cost free option to use when filing except 941Telefile if eligible.

The availability of e-file for corporate returns commenced with the 2004 filing season. Comments on this tax type will be addressed when more data becomes available.

Estate, trusts and other tax returns represent less than five percent of all returns. The 2004 ETAAC Report will not address the specifics of these return families. The majority of these returns are filed by paid preparers and it is presumed that e-file acceptance for these tax returns (when available) will ultimately be dependent upon the then present use of e-file by the paid preparer community for the individual and corporate business. The acceptance of e-file for estates and trusts that occurred with minimal IRS marketing effort evidences the validity of this position. (See Exhibit 3).

SECTION TWO
Status of the Internal Revenue Service Plan

The current (*Draft IRS E-Strategy for Growth - Expanding e-Government for Taxpayers and Their Representatives)* fails to address many of the key ETAAC recommendations to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing.

The original articulation of the IRS ETA Strategic Plan was issued in December 2000 (see *A Strategy for Growth*, Publication Number 3187). This has since been revisited by the IRS in order to pull the various aspects of e-filing under the influence of each business operating division (BOD) into one overall document. Rather than being top-down strategic documents, both are accumulations of goals and projects that are more tactical than strategic in nature. The current draft, (i.e. *Draft IRS E-Strategy for Growth - Expanding e-Government for Taxpayers and Their Representatives*) provides a review of BOD products and services that, while certainly beneficial to the overall electronic administration of taxes, are not specifically focused on achieving the goals of RRA 98.

The most recent plan does provide valuable data regarding electronic filing of tax and information returns. Statistics for prior year electronic filing as well as projections for future years are represented. However, even these projections show the IRS falling well short of the goal to achieve the 80 percent target. Total electronic individual returns are projected to reach only 65.1 percent by 2010. Business tax returns are projected to be well below the 80 percent target.

The draft plan identifies specific barriers to electronic filing and plans for the IRS to reduce or eliminate these barriers. The IRS is moving forward to implement some of these projects. However, incentives in certain areas are not specifically identified and in other areas may be inadequate to further promote electronic filing. The ETAAC believes that incentive-based tactics to move practitioners and individuals to e-filing are losing effectiveness.

SECTION THREE
ETAAC Recommendations to Congress

Congress should move to authorize additional funding for the IRS specifically earmarked for Modernized e-File.

Background: The IRS has made significant progress in modernizing certain of its systems to enable electronic filing of information returns and electronic transfers of funds. However, major initiatives such as Modernized e-File (MeF) are substantially under funded in order to be implemented in a timely manner. Historically, the IRS has not had adequate resources in order to provide internal staff with updated hardware and software. This has led to challenges with the timely testing of programs and systems for release.

While we believe that MeF will help practitioners file returns that had previously been ineligible for e-filing, we realize that this alone may not be enough of an incentive. Practitioners, transmitters, and the IRS will need to make substantial investment in hardware and data communications systems due to the larger file size and conversion from proprietary formats to the XML schemas employed by MeF.

At this time both the IRS and external stakeholders must use and support three processing systems, -- the legacy e-file systems, MeF XML, and paper. Requiring multiple systems for handling tax returns is more costly to practitioners and is perceived as a significant barrier to the adoption of e-filing. A single approach that will accept all forms and schedules (as is anticipated with MeF) will eliminate this barrier and should also increase the effectiveness of available IRS staff.

MeF will move us closer to what might be labeled “transparent” electronic tax administration and will reduce the cost of operating and maintaining three “primary” filing systems. The timely implementation of MeF would allow the IRS to redeploy resources towards more value-added efforts such as compliance programs and increase the level of customer service.

> **Recommendation 3.1**: Congress should authorize additional funding for the IRS, specifically earmarked for e-services, technology (E-modernization, XML Platform), and related operational expenses, including necessary hardware and software to accommodate changes. A budget should be approved that is large enough to collapse the timeline for Form 1040 XML implementation into no more than three years. This would eliminate the single largest barrier to accomplishment of the RRA 98 goals.
>
> The number of returns using the Telefile system for submitting Form 1040 has decreased every year since 1999. Telefile is the most expensive mode of processing returns, (on a cost per return basis). (See Exhibits 7 and 8) We believe this service should be eliminated immediately and the funds redirected to help pay for MeF.

Congress Should Support Mandated e-filing by Paid Preparers

__Background__: The current IRS strategic plan includes limited or veiled initiatives aimed at meeting the goal of RRA 98 that 80 percent of all returns be e-filed by 2007. While many within the IRS express agreement in spirit with the 80 percent goal, there appears to be a reticence to establish a singled-minded approach to meeting the RRA 98 goal as well as a general lack of a consolidated effort to that end.

Most, if not all of the increase in electronically filed returns for Tax Year 2003 is in direct correlation to those states that enacted state mandated requirements for e-filing (CA, WI, MN, MI, and OK). In other words, Federal e-file growth may now be entirely dependent on what states may be doing rather than because of incentives offered by the IRS.

> **Recommendation 3.2:** We believe that the IRS has the best chance of coming close to the RRA 98 80 percent goal if there is a mandate requiring that paid preparers (or paid practitioners) e-file returns. A mandate will likely encourage development of consistencies in the processing of tax returns, which will in turn lead to increased efficiency and, eventually, cost savings.

A review of successes and lessons learned with respect to recent state-level e-filing mandates will provide valuable insights for the IRS to help make any federal e-filing mandate a success.

See Exhibit A for specific implementation recommendations.

Congressional Action Needed to Remedy Electronic Filing Barriers

__Background__: For Tax Year 2003 there was a significant increase in e-filed returns from the paid preparer segment. To date it appears that this was largely attributable to volume increases from those states that enacted mandatory state electronic filing. There still remains strong resistance to adopt e-filing from some tax professionals, particularly among those whose practices involve very complex returns. Frequently, returns falling into this category cannot be completed until close to the filing due date and many include elections.

If a return is not timely filed, the election is not considered valid. Paid preparers continue to express concern regarding the ramifications of missed elections. When filing the taxpayer's return electronically, rather than having the taxpayer submit his/her return on paper, the preparer shoulders an additional liability that many are not ready to accept.

> **Recommendation 3.3**: There should be legislative relief that allows elections to be considered timely if the pertinent return was initially submitted electronically and could be identified by IRS. If a return is then rejected, IRS should allow for a paper resubmission process and consider the election timely made within a reasonable time frame.

Congress should, when enacting tax code changes, allow adequate time for systems design and implementation by the IRS and stakeholders.

Background: Congress can play a significant role in improving the operational effectiveness of the Internal Revenue Service**.** Late law changes cause considerably more problems with e-file than with paper. Paper returns can be received and warehoused until necessary procedural changes can be implemented to process them. E-file returns must have the software and processing routines available at the start of tax season. Software vendors, reporting agents, large employers, and tax practitioners require adequate ramp up time to plan, program, test, and distribute modifications to existing requirements.

> **Recommendation 3.4**: Congress should consider the lead time necessary to allow the IRS and industry to successfully implement changes when enacting tax legislation. We recommend that input from stakeholders on the relative ease of implementation of new code provisions be sought whenever practical. Congress should recognize that changes that are minor in terms of revenue impact might be very cumbersome operationally.

Congress should not support legislation to extend the Form 1040 return due date as an e-file incentive.

Background: There has been serious consideration given by both the Administration and Congress to extending the filing and payment due date to April 30 for those taxpayers who e-file and, if applicable, electronically pay their balance due.

While the ETAAC has supported the concept of extended due dates for e-filed returns in previous reports, further review and analysis led the ETAAC to conclude that this is a recommendation whose implementation costs (e.g., taxpayer re-education, conflicts with state and locality filing dates, added burden for practitioners, confusion when dealing with inconsistent due dates for extension and estimated tax payments) would tend to work against any initial taxpayer receptivity to an extended filing date. In addition, even in the absence of such an incentive this year, e-filing of balance due returns increased in 2004 by over 24 percent.

> **Recommendation 3.5**: Congress should not pursue any legislation to extend the Form 1040 return due date as an incentive for e-file.

SECTION FOUR
Recommendations to Internal Revenue Service

IRS should develop a system to address the current lack of exception processing.

Background: The IRS has begun development of a modernized technical infrastructure to support a robust electronic tax administration program that addresses the needs for return filing. The MeF system will enhance the current filing process and make it less complex for the IRS to process certain electronic returns – that is, electronic returns that while technically capable of being processed by the IRS, contain errors that require correction.

The existing IRS submission processing system provides for error correction of both paper and e-filed returns. For paper returns, some errors may be resolved within the IRS service center, avoiding a processing delay and the expense of sending the return back to the taxpayer. However, in some instances the same errors in e-filed returns result in rejection of the return. It is then sent back to the electronic return originator (ERO) for correction and subsequent re-submission. The IRS maintains that the legacy system would need to be significantly altered to allow for the IRS to internally handle error correction of electronically filed returns.

Rather than investing in an alteration of the current system, the IRS strategy is to eventually migrate all programs to MeF, an XML platform with increased flexibilities. The first programs to be moved to MeF are the Form 1120 and Form 1120S for corporation returns and certain returns for exempt organization. The Form 1040 family and other business returns are not scheduled to move to MeF until 2010 or beyond.

> **Recommendation 4.1:** The ETAAC fully supports the development of MeF to enhance the IRS' ability to provide error correction in the same manner for all returns, regardless of the media through which it is filed. However, both practitioners and taxpayers continue to express frustration with the high rate of rejection of electronically filed returns that are technically capable of being processed but which do not fit the current IRS configuration for error correction. Accordingly, the ETAAC recommends development of an exception processing routine for edit errors by the IRS.

IRS should adjust the current e-file systems to require the same Form W2 and Form 1099R data as paper processing or seek alternative data input methods.

Background: 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 all taxpayers. In addition, there are significant incentives to paper filing over e-filing. These incentives apply to self-prepared returns as well as professionally prepared returns.

> **Recommendation 4.2**: The IRS should find ways to decrease data requirements and/or find technological solutions to data capture that will reduce burden. There should not be a more stringent requirement for e-filed returns than is currently required in the paper environment unless absolutely necessary. If more information is deemed necessary, the IRS should promote solutions to automated data importation for Form 1040 purposes such as 2D bar coding technology on Forms W2 and K-1.

IRS should enhance the current Form 8453 procedures to include forms and schedules that are not eligible for e-filing to be submitted.

Background: The fact that all returns and attachments cannot be filed electronically is a significant barrier to the adoption of e-filing by the practitioner community. Practitioners would be more inclined to adopt e-filing as a business model if all returns could be filed using the same process.

Not all forms and schedules can be e-filed. In addition, the number of occurrences of some items (e.g., Forms 1099-R, Forms W-2G, and Schedule E) is limited, precluding some returns from being e-filed. In addition, some returns even when e-filed, require the paper submission of certain forms (primarily signature documents) that cannot be filed electronically. Furthermore, the frequently changing requirements regarding taxpayer forms do not allow the IRS sufficient lead time to react to ensure that the forms covered by IRS' e-file arsenal can accommodate new requirements.

IRS indicates that changes to the current legacy systems to enable all forms and schedules (as well as ad hoc attachments) to be e-filed will likely result in high development costs rendering this possible solution prohibitive from a cost/benefit perspective.

While the ETAAC recognizes that these issues will be alleviated with the advent of the MeF XML e-file platform, this remains a distant solution as budgetary barriers will likely delay the deployment of the modernized Form 1040 platform to tax year 2010 or beyond.

The IRS currently has a process whereby taxpayers can submit a paper document which relates to an electronically filed return. There are currently five forms that require the signature of third parties and which require that the taxpayer use Form 8453 (*U.S. Individual Income Tax Declaration for an IRS e-file Return*) as the signature document for the taxpayer's return (e.g., Form 8332, *Release of Claim to Exemption for Child of Divorced or Separated Parents*, a common attachment). Form 8453 is mailed to the IRS and is matched with the electronic portion of the return.

> **Recommendation 4.3**: The IRS should modify the current procedure for Form 8453 so as to allow the taxpayer to attach all forms and schedules that are not eligible to be e-filed or that make paper filing easier (e.g. subsidiary schedules of stock sales). This would permit electronic filing of all returns that are currently ineligible due to unsupported schedules and forms.

By adopting this recommendation, the IRS could use an existing procedure (well accepted by practitioners) but expand its use to enable practitioners and taxpayers to file all returns electronically. This would remove a major barrier to adoption of e-filing. Providing this flexibility would also be a key ingredient to receiving support to any requirement that practitioners e-file and assist in making operationally practical any future mandates for electronic filing.

IRS should open e-Services to all tax practitioners that have the authority to obtain taxpayer information for their clients.

Background: This committee in past years has recommended that e-Services be held out as an incentive for tax practitioners that e-file more than 100 returns. It is unclear that this has resulted in substantial practitioner adoption of e-file. This restriction serves to keep smaller practitioners from e-services and penalizes tax practitioners, (most notably tax attorneys) who do not e-file as a part of their tax practices. Allowing all practitioners to use e-services will demonstrate the benefits of operating in a digital world and in turn assist in the adoption of e-file.

Recommendation 4.4: Open e-services to all tax practitioners that have the authority to obtain taxpayer information for their clients.

Operational excellence needed in product roll-outs and enhancements.

Background: e-filing is unique among the Internal Revenue Service programs in that a conscious effort was made and continues to be made to raise the expectation level of the participants. The IRS and the tax industry have expended a great deal of resources assuring tax preparers that e-filing will provide efficiencies to their businesses, and assuring taxpayers that they will have a good experience should they choose to e-file.

Meeting those heightened expectations is essential if there is to be continued growth in e-filed returns. The industry segments that have already endorsed e-filing as their business model may tolerate sporadic or known problems, but the balance of potential participants may not be so willing and are likely to continue to have a business model based on paper filing. A tax preparer making the move from paper to e-file will quickly switch back to paper if significant problems occur, especially those that cost them additional time and resources at a point in their business cycle when they can ill afford it. Similarly, taxpayers who have e-filed previously might be amenable to accepting an occasional bad experience, but the late adopters may not participate a second time if their first experience is unsatisfactory.

We fully support the Services efforts to add return types to the e-file program, and to add new features and benefits to existing programs. Continued enhancements of services and features are important to enticing the remaining preparers and taxpayers to become e-file participants, but only to the extent they are delivered on time and in working order.

> **Recommendation 4.5:** The ETAAC believes there are insufficient resources to deliver all the facets of e-file that are being planned and developed. We strongly recommend that the Service be provided with the necessary dedicated resources to properly plan, design, code, and test every aspect of these programs. We suggest that the limited resources could be best used when developing or enhancing programs and services by better utilization of the usability testing lab at the Ogden Service Center.
>
> The ETAAC also encourages the IRS to delay implementation of any new initiative that has not been found to be operationally sound through exhaustive user testing. Unlike many other software applications, users of e-file get one chance a year to participate. That precludes the practice of releasing programs with known "bugs" to be corrected in a later release – a process often followed in other industries.

IRS should develop a marketing strategy that addresses taxpayer and tax practitioner perceptions of increased likelihood of audit as a result of e-filing.

Background: The IRS is working to overcome the public's perception that there is a greater chance that they will be contacted or audited by the IRS if they file electronically. Despite the fact that such suspicions are generally unfounded, the IRS must recognize that "perception is reality" and should take proactive steps to dispel this myth.

Currently, e-filed returns are subject to a higher threshold for initial acceptance into the batch processing system, which is largely a paper-based processing protocol. This can only lend credence to the taxpayer perception that e-filed returns are subject to a higher degree of post-filing scrutiny than paper returns.

> **Recommendation 4.6:** The ETAAC fully supports current IRS efforts to eliminate such taxpayer concerns. In future years, IRS must make a compelling case for electronic filing for reasons other than a quick refund, (e.g., fewer errors, acknowledgment that the return has been received, paperless signature options, etc.) while clearly addressing the taxpayer perception of a higher level of review for electronically filed returns.

IRS should continue to oversee the Free File Alliance program.

Background: The IRS has identified cost and complexity as major barriers to converting all functions to an electronic environment. To reduce these barriers, the IRS entered into a partnership agreement with the Free File Alliance, a private-sector consortium of tax preparation and e-filing companies to provide convenient, simple and free tax preparation and e-filing to taxpayers.

> **Recommendation 4.7**: The ETAAC applauds the IRS, practitioners and software vendors for development of the Free File Alliance. We support the continued use of this program, subject to continued oversight by IRS, and encourage eligible taxpayers to consider using Free File Alliance services when appropriate.

IRS should revisit the definition of reasonable cause for penalty abatement to address technological failures on a universal level.

Background: The definition of reasonable cause for penalty abatement should be revisited to address technological failures on a universal level.

In an electronic process there are many single points of failure during the hand-off of information. It will be difficult, if not impossible, for the small business owner, tax practitioner, or individual taxpayer to have total control over all situations that might create a transmission failure. In the absence of a safety net, this will continue to cause a reluctance to move to electronic filing.

> **Recommendation 4.8:** We recommend that this concern be seriously studied and appropriate procedural changes be implemented. This is with the intention of creating parity with the current paper world. A taxpayer is released of responsibility when turning their tax return over to the Post Office or other designated courier service in the paper world, but is not "cleared" in the electronic process until the IRS has received the information, and the return has passed the more extensive e-file edits.

Exhibit A
Paid Preparer Mandate Implementation Recommendations

While the IRS should focus any paid practitioner e-filing mandate on Form 1040, other forms typically filed by paid preparers should also be considered for a mandate (e.g., Forms 94X, Form 1120, and Form 990). Some Form 1065s are already mandated.

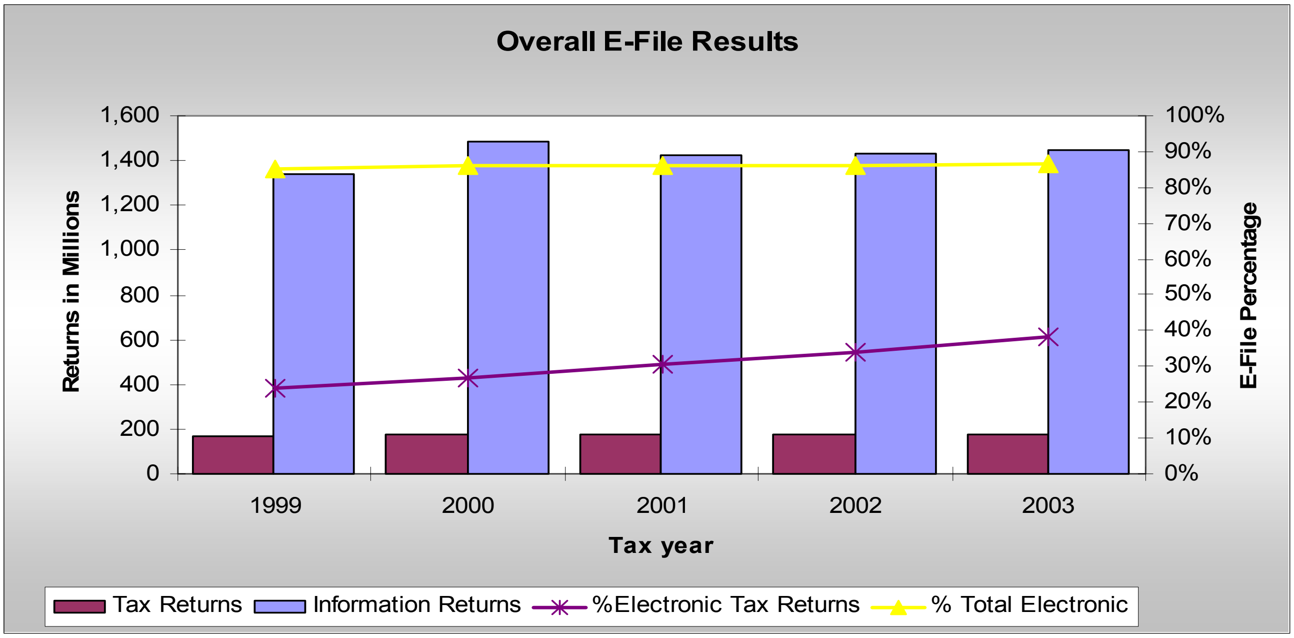
To ensure successful implementation of a mandate, the IRS should allow for a "safe harbor" provision to ensure that practitioners are not forced to e-file low volume forms, or to incur substantial burden to file electronically. The IRS should also provide a mechanism whereby a tax practitioner could opt out of e-filing for certain taxpayer situations. The goal is to increase e-filing and to increase adoption without creating issues and barriers throughout the tax practitioner community. The IRS should work with tax practitioner and stakeholder groups (e.g., software developers, state tax administrators, industry groups) in order to understand how to best craft an appropriate safe harbor and to ensure that the mandate issued is practical for the tax preparer community and that the transition is "user-friendly."

A mandate must incorporate an implementation timeframe that is workable for tax practitioners – providing sufficient lead time and a phase-in that allows practitioners to adjust systems, methods, and business processes to an e-file environment. For example, an appropriate phase in could be to mandate business returns in Year 1; Forms 1040 if over 200 returns are filed in Year 2; add all returns in Year 3. A phased-in approach to eventual full implementation of a single e-filing mandate for paid preparers should be pursued. The design stage of implementing mandates should not lead to "more studies" but to timely and workable solutions.

The IRS should work cooperatively during development with software providers and other stakeholders as they are key to making mandates work at both federal and state levels. Bringing software developers on board will help ensure development of standards and consistency with states, and will help encourage filing. The IRS should also assume greater leadership with states who are also moving towards greater e-filing.

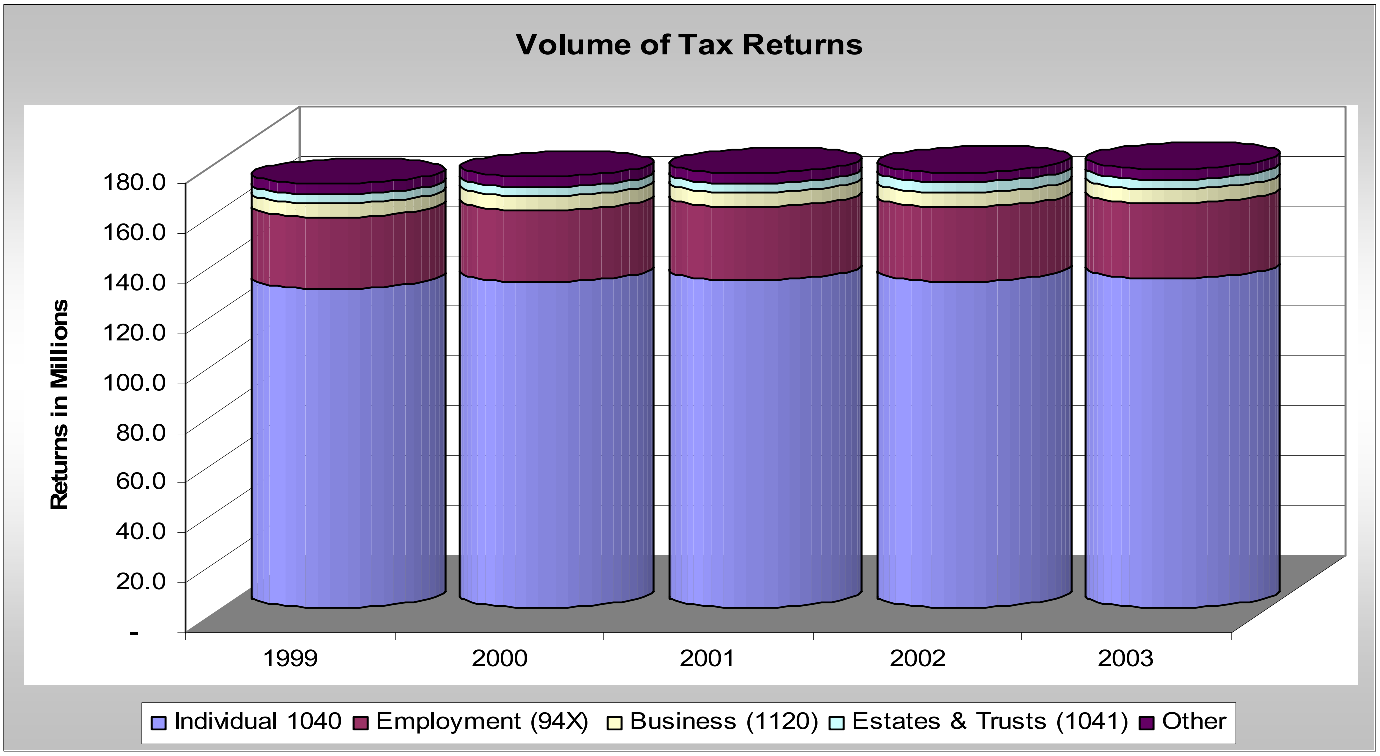
The IRS' Tactical Advisory Group (TAG) should consider taking a greater role in this area. Since states are beginning to mandate e-filing, the IRS should anticipate more states following suit in order to realize the cost savings benefits and efficiencies of electronic return submissions. The IRS needs to get in step with the states and provide leadership in this area to reduce the emergence of divergent approaches, which will result in a deleterious effect on the success of federal return e-filing efforts.

Exhibit 1



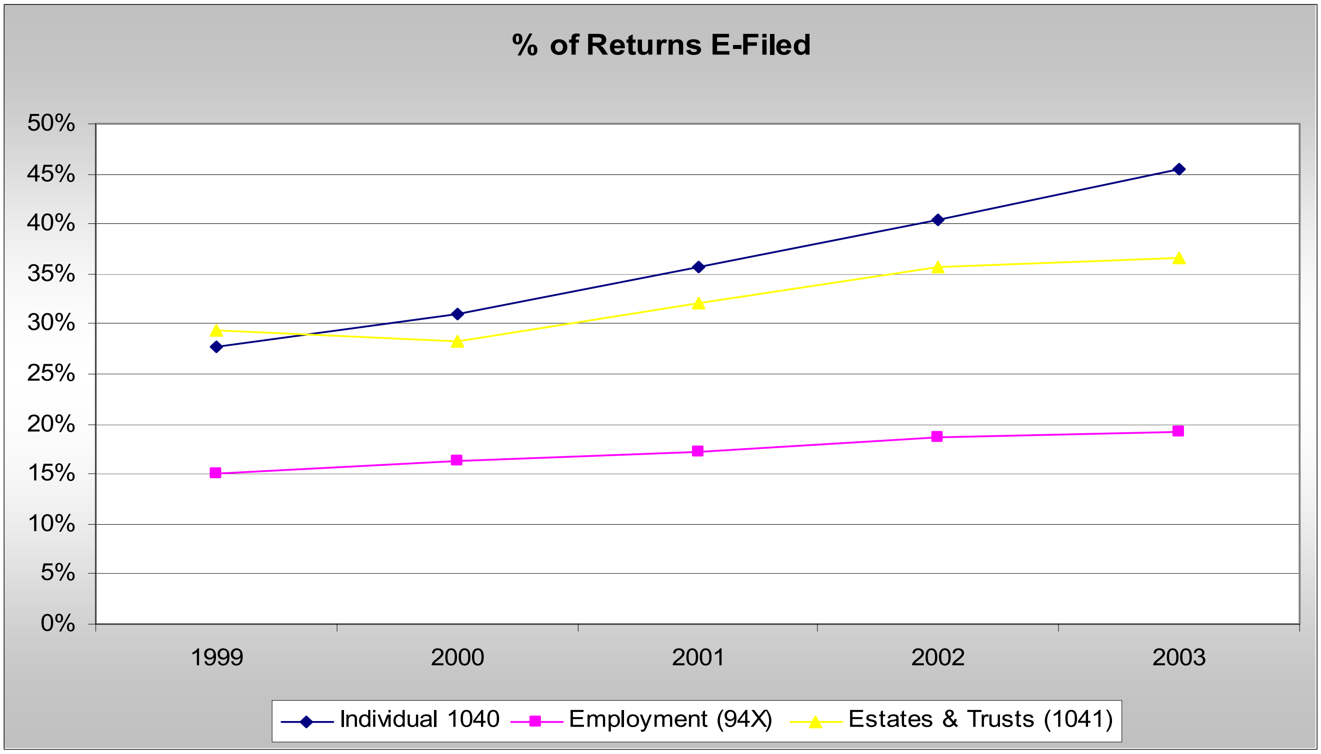
The percentage of tax returns filed electronically is significantly below the 80 percent target and will not reach that goal by 2007. Only information returns (Forms W-2 and Forms 1099) have met the 80 percent target.

Exhibit 2



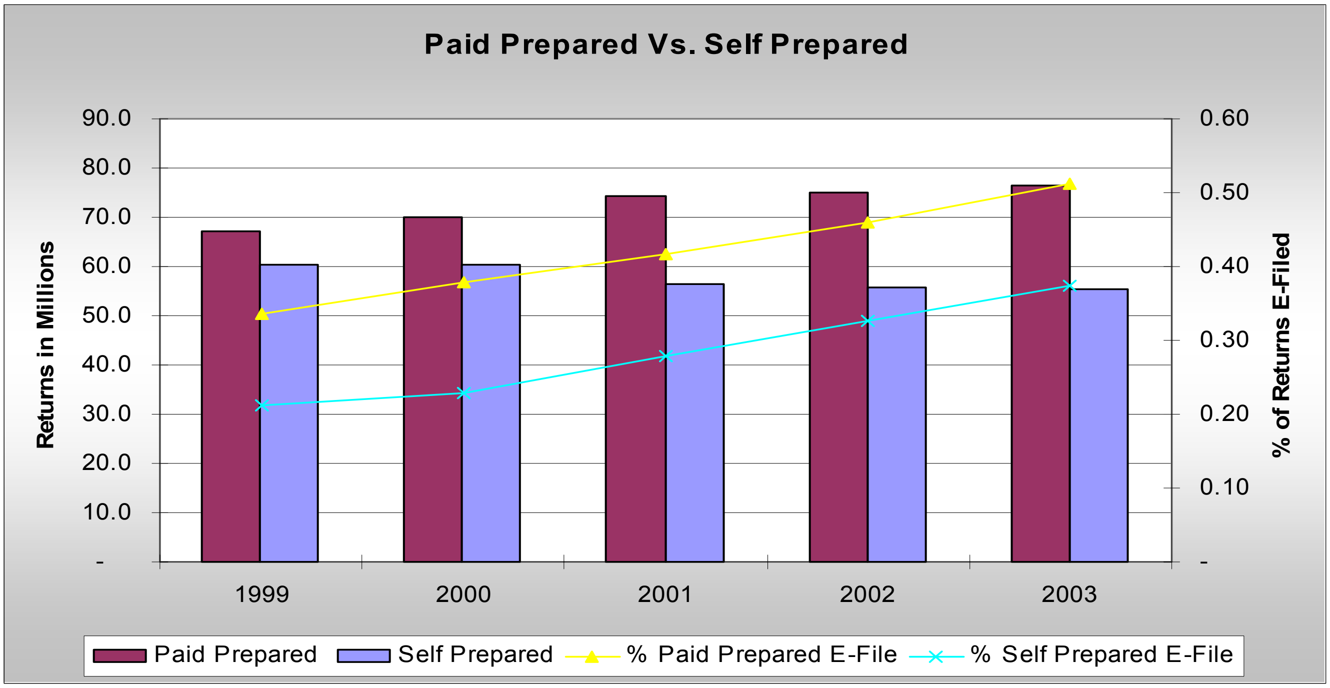
The above chart confirms that the majority of emphasis on e-file of tax returns belongs with individual returns and employment returns.

Exhibit 3



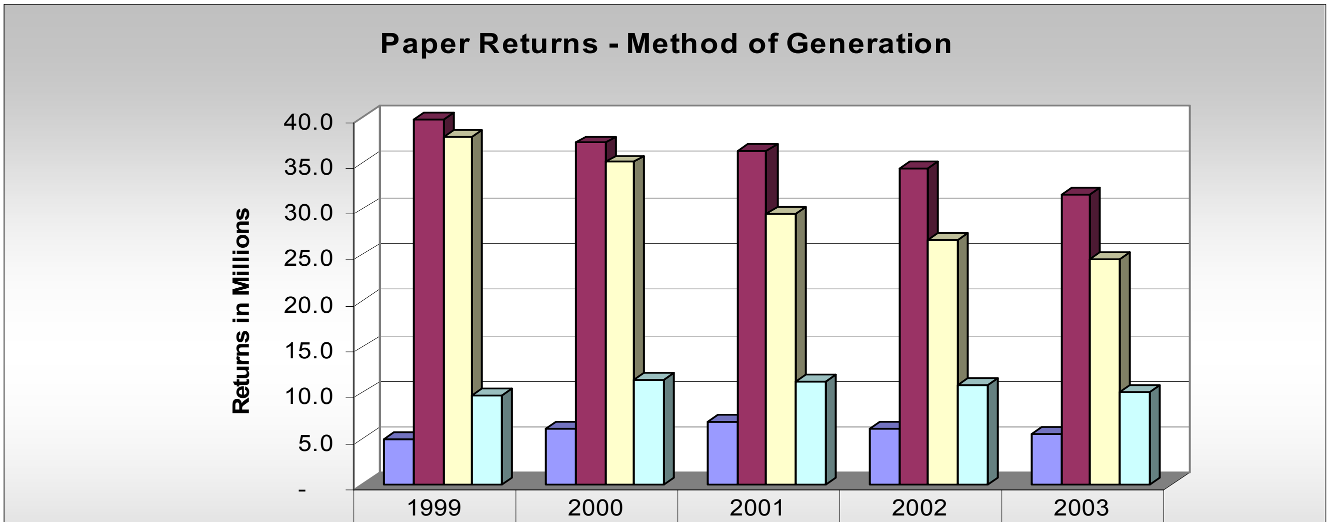
Of the three return types for which e-file was historically available, the adoption trend for e-file, while rising, is insufficient to meet the goals of RRA 98.

Exhibit 4



The paid preparers e-file at a significantly higher rate than self preparers. However, to achieve the stated goals of RRA 98 even beyond 2007 the paid preparer adoption of e-file will have to be closer to 100 percent.

Exhibit 5

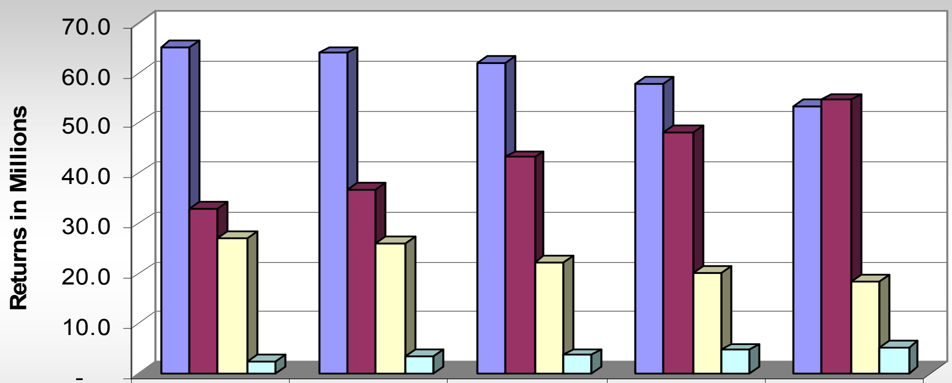


	1999	2000	2001	2002	2003
Paid Pencil	5.0	6.2	6.9	6.1	5.6
Paid Computer	39.7	37.2	36.4	34.4	31.6
Self Pencil	37.9	35.1	29.5	26.6	24.5
Self Computer	9.8	11.4	11.3	10.9	10.1

The vast majority of paid preparers filing paper returns are already on computerized systems. This should make the conversion to e-file more straightforward and the adoption to e-file more obtainable. The conversion of self prepared is more problematic as the majority of those preparers do not use computer software for return preparation.

Exhibit 6

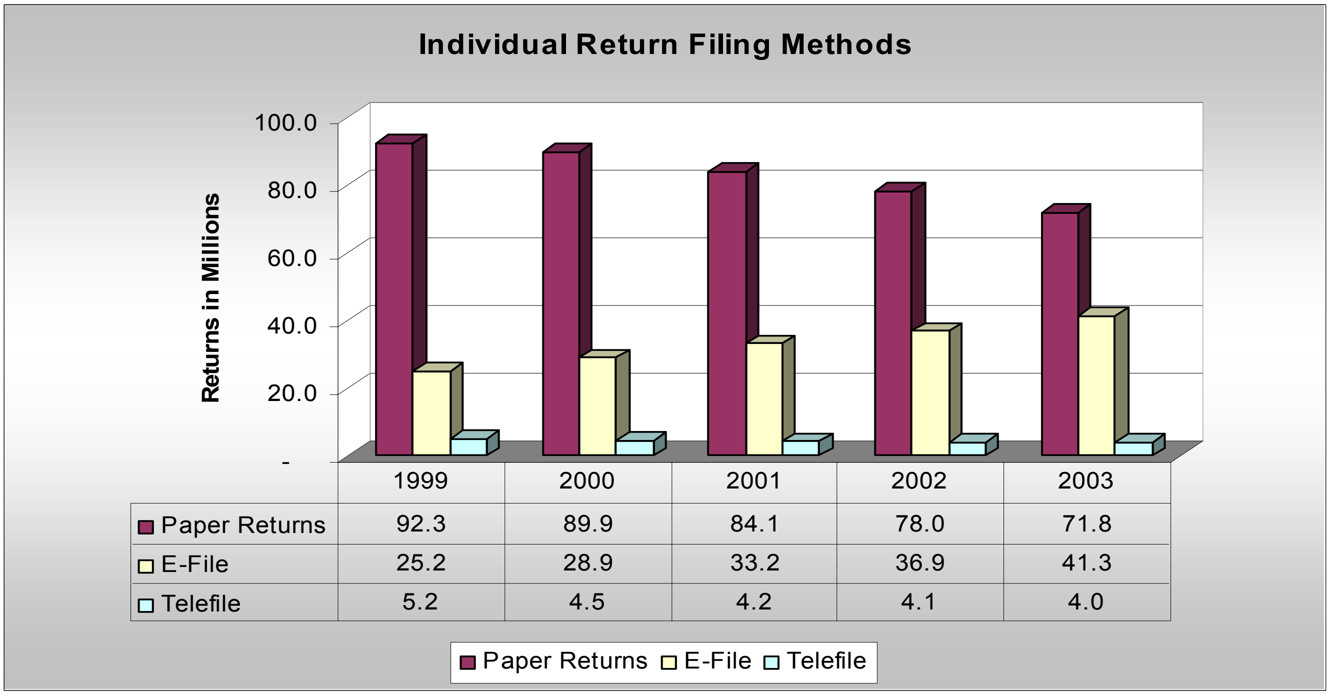
Refund Vs. Balance Due



	1999	2000	2001	2002	2003
Refund Paper	65.3	64.0	62.0	58.0	53.4
Refund E-File	32.9	36.8	43.2	48.1	54.6
Even or Bal Due Paper	26.9	25.9	22.1	20.0	18.4
Even or Bal Due E-File	2.5	3.4	3.6	4.6	5.2

While the message has been successful in getting refund returns e-filed, it has been less successful in getting the ‘even or balance due’ returns to be e-filed.

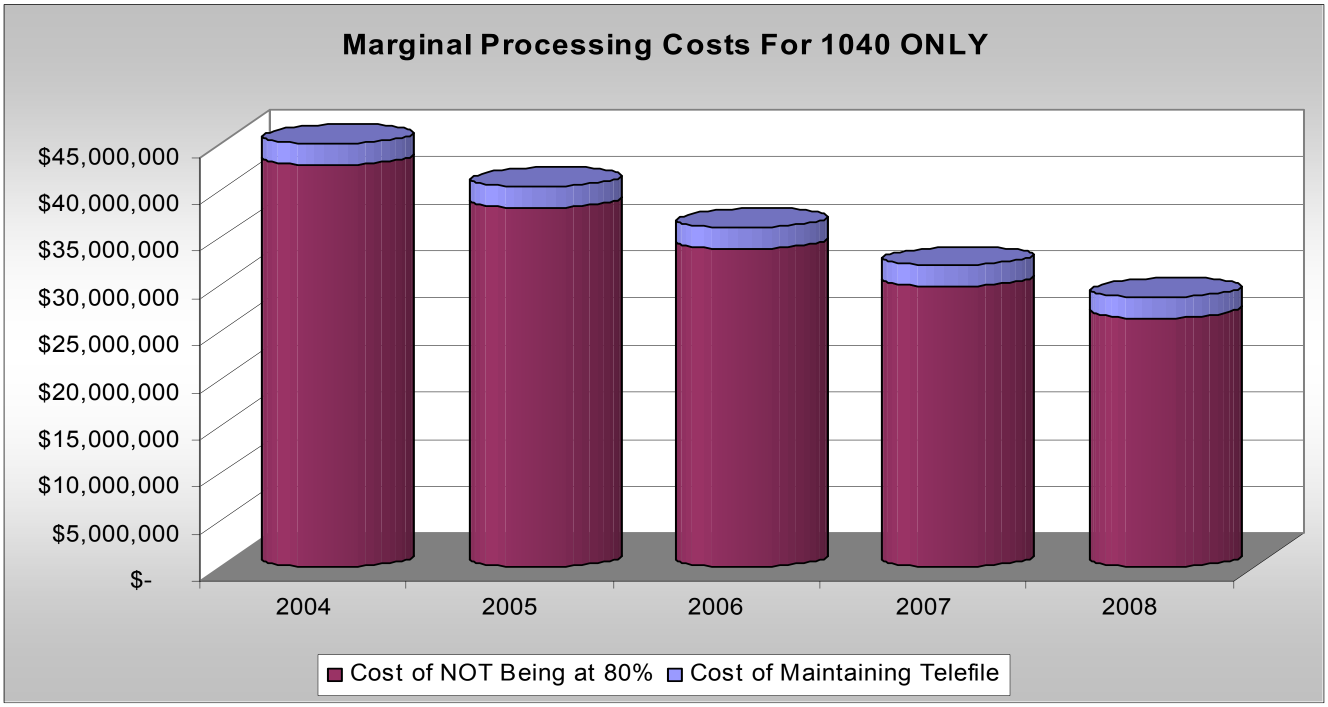
Exhibit 7



	1999	2000	2001	2002	2003
Paper Returns	92.3	89.9	84.1	78.0	71.8
E-File	25.2	28.9	33.2	36.9	41.3
Telefile	5.2	4.5	4.2	4.1	4.0

The trend for filing methods of individual returns shows a continued decline in the use of Telefile making this method of filing increasingly costly.

Exhibit 8



There is a continued cost to the taxpayer of not achieving the goals of RRA 98, and a significant cost in the maintenance of the Telefile program. These costs only consider Form 1040 returns and do not value the system-wide savings arguable for complete adoption of e-file.

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