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RECOMMENDATIONS OF THE NATIONAL COMMISSION ON RESTRUCTURING THE IRS TO EXPAND ELECTRONIC FILING OF TAX RETURNS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

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RECOMMENDATIONS OF THE NATIONAL COMMISSION ON RESTRUCTURING THE IRS TO EXPAND ELECTRONIC FILING OF TAX RETURNS

TUESDAY, SEPTEMBER 9, 1997

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to call, at 10 a.m. in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE CONTACT: (202) 225–7601
September 2, 1997
No. OV–7

Johnson Announces Hearing on the Recommendations of the National Commission on Restructuring the IRS to Expand Electronic Filing of Tax Returns

Congresswoman Nancy L. Johnson (R–CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold the second in a series of hearings to examine the June 25, 1997, report of the National Commission on Restructuring the Internal Revenue Service (IRS). The hearing, focusing on the Commission's recommendations to expand electronic filing of tax and information returns, will take place on Tuesday, September 9, 1997, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.

Oral testimony at this hearing will be from invited witnesses only. Witnesses will include officials from the U.S. Department of the Treasury and the IRS, representatives from practitioner organizations, and stakeholders who play important roles in tax and information return filing. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing.

BACKGROUND:

The IRS presently receives approximately 205 million tax returns each year. The largest workload associated with processing these returns involves the nearly 120 million individual tax returns that are received during the tax filing season from January 1 to April 15. The IRS uses 10 service centers in different regions of the country to process income tax returns. During processing, tax data from each return is manually entered into IRS computers by seasonal employees hired temporarily during the filing season.

During the 1997 tax filing season, the IRS received approximately 20 million individual tax returns electronically. Of the 100 million individual returns that were submitted in paper format, approximately 70 million exist in electronic format prior to submission to the IRS. Tax practitioners prepare approximately 60 million returns per year, almost all of which are prepared using tax preparation software. Another 10 million returns are self-prepared by taxpayers using tax preparation software on personal computers. The majority of these electronically prepared returns are printed out and sent to the IRS in paper format, after which they are reconverted to digital form through the manual data capture process.

This digital-to-paper-to-digital conversion creates inefficiencies that add to the cost of processing paper returns. For example, the error rate for the manual data entry process is approximately 20 percent, half of which is attributable to the IRS, and half to errors in taxpayer data. Because electronically filed returns are usually prepared using computer software programs with built in accuracy checks, undergo

pre-screening by the IRS, and experience no key punch errors, electronic returns have an error rate of less than one percent. In addition, the IRS paper returns processing function still uses outmoded equipment that experiences significant downtime and slower operator productivity. If the returns prepared in electronic format were transmitted directly to the IRS, these redundancies and inefficiencies could be avoided.

The Commission concluded that to develop a successful electronic filing program, the IRS must put into place a comprehensive plan to remove barriers, increase benefits, and broaden the appeal of electronic filing to all segments of the taxpayer and practitioner population. The Commission recommended that the IRS, Congress, and the Administration establish a goal that 80 percent of all tax returns should be filed electronically within 10 years, and that IRS's leadership should be held accountable for accomplishing that goal.

The Commission's recommendations are embodied in H.R. 2292, which was introduced on July 30th by Reps. Rob Portman (R–OH) and Ben Cardin (D–MD). The specific provisions in the bill relating to electronic filing include: (1) a mandate for the IRS, within 180 days, to implement a plan to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing over the next 10 years; (2) a mandate for the IRS, within 180 days, to develop procedures for the payment of incentives to qualified transmitters of electronic returns; (3) extension of the filing deadline to May 15th for taxpayers who file their returns electronically; and (4) amendments to the Internal Revenue Code to facilitate paperless electronic filing.

In announcing the hearing, Chairman Johnson stated: "A comprehensive strategy to encourage electronic filing of tax returns holds significant potential not only to make the IRS returns processing function more efficient, but also to greatly benefit taxpayers. Errors would be reduced, in turn, reducing the number of notices that are triggered by errors in the manual data entry process. In addition, taxpayers who file their returns electronically would receive confirmation from the IRS that their return was received."

FOCUS OF THE HEARING:

The Subcommittee will examine the Commission's recommendations for expanding electronic filing and is seeking comment on other actions which could be taken to help achieve the goal of receiving 80 percent of tax returns electronically within 10 years. It will also examine the plans that are currently being developed by the Treasury and IRS to expand electronic filing, including the draft Request for Proposals (RFP) on Electronic Tax Administration which will be issued by the IRS in mid-September. This RFP will solicit proposals from practitioner groups and other stakeholders regarding the establishment of strategic partnerships with the IRS to facilitate the expansion of electronic filing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) single-space legal-size copies of their statement, along with an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format only, with their name, address, and hearing date noted on a label, by the close of business, Tuesday, September 23, 1997, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not

in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on an IBM compatible 3.5-inch diskette in ASCII DOS Text or WordPerfect 5.1 format. Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman JOHNSON. Good morning. This is the second in a series of hearings to examine the recommendations of the National Commission on Restructuring the IRS. Our focus today will be on electronic filing of tax and information returns.

Each year during the tax filing season, the IRS faces a monumental task. Day after day, from February through mid-April, trucks pull into the 10 IRS Service Centers around the country, delivering 100 million or more individual paper returns. Thousands of temporary workers are hired to open stacks of envelopes, sort returns and checks, and assist in the process of manually entering the information from each return into IRS computers—a process which is both costly and prone to error.

Of the 100 million individual returns submitted on paper this year, 70 million existed in electronic form before they were printed out and mailed to the IRS. Tax practitioners prepare about 60 million returns per year, almost all of which are prepared on computers using tax preparation software. Another 10 million returns are self-prepared by taxpayers on their personal computers using tax preparation software.

Significant benefits would be derived both by taxpayers and the IRS if we could figure out an effective strategy for getting all the

returns that are prepared each year in an electronic form transmitted to the IRS in electronic form.

Most importantly, taxpayers would be protected from all the problems caused by the errors made as data is entered manually into IRS computers by temporary employees, because hundreds of thousands of computer notices are generated each year as a result of the 20-percent error rate in the manual data entry process. In addition, all taxpayers who file electronic returns would receive confirmations that their returns are received and accepted by the IRS. Clearly, electronic filing would save big money for the Federal Government and big problems for taxpayers. For the IRS the benefits are obvious—lower costs and fewer errors.

The Commission concluded that to develop a successful electronic filing program, the IRS must put into place a comprehensive plan to remove barriers, increase benefits, and broaden the appeal of electronic filing to all segments of the taxpayer and practitioner population. Among other things, the Commission recommended that the IRS, Congress, and the administration should establish a goal that 80 percent of all tax returns should be filed electronically within 10 years, and IRS' leadership should be accountable for accomplishing that goal.

We will hear from Assistant Treasury Secretary, Donald Lubick, and Acting IRS Commissioner, Michael Dolan, regarding the administration's plans for Electronic Tax Administration, and how those plans relate to the Commission's recommendations. We will also hear from tax practitioners and other stakeholders who play important roles in tax and information return filing. Hopefully, by the end of the hearing we will have a better idea of the steps that must be taken to expand the appeal of electronic filing.

I would now like to recognize my Ranking Member, Bill Coyne, for his opening statement.

Mr. COYNE. Thank you, Madam Chairman. We will have the opportunity on the Subcommittee on Oversight today to review various recommendations for improving and enhancing electronic filing of returns.

During the 1997 tax return filing season approximately 120 million individual tax returns were filed; 20 million of those were filed electronically and 100 million were filed on paper. Unfortunately, electronic filing has increased only gradually in recent years with the bulk of the increase coming from TeleFile and PC returns.

Much more can be done and now is the time to do it. Electronic tax return filing needs to be promoted by the IRS. The public needs to understand the advantages of filing error-free electronic returns directly with the IRS. Also, taxpayers need to be assured that electronic filing does not increase the likelihood of audit or other contact by the IRS.

The tax preparer community can also help in promoting and facilitating electronic filing. In fact, in many ways tax preparers have been the prime promoters of electronic filing. For example, many tax preparation firms and accountants have been providing electronic filing free of charge.

Importantly, the IRS' blueprint for modernization is in progress and on track. Next week as part of the blueprint implementation plan the IRS will issue a request for comments on electronic tax

administration to solicit from tax practitioners ideas and joint IRS/private sector strategies for expansion of electronic filing. We should hear about some of their ideas at today's hearing. I am pleased that there is strong bipartisan support for legislation to enhance electronic tax return filing. I look forward to our review of proposals to authorize the IRS to promote and advertise the benefits of electronic filing, and to allow the acceptance of taxpayer signatures and other tax documents in electronic form.

I commend the Subcommittee Chairman for holding today's hearing and look forward to working together with her and other Members of the Subcommittee on these issues in a bipartisan manner. Thank you.

Chairman JOHNSON. The Subcommittee will recess while we vote. We will try to keep it to 5 to 7 minutes. We will just go over and get right back and start with Mr. Dolan.

[Recess.]

Chairman JOHNSON. The hearing will reconvene. Other Members who have opening statements may submit them for the record.

[The opening statements follow:]

Statement of Hon. Rob Portman, a Representative in Congress from the State of Ohio; and Cochairman, National Commission on Restructuring the Internal Revenue Service

Greatly increased electronic filing is an important component of the overall effort to revamp the IRS and improve taxpayer service. Because it reduces costs and complications for each, it's a classic win-win situation for IRS and the taxpayer.

Currently, there is at least a 20 percent error rate on the approximately 120 million paper 1040 returns. Half of that error rate comes from the IRS—often when employees inadvertently misinput numbers. When forms are electronically filed with the IRS, there is less than a 1% error rate. By reducing unnecessary errors and notices, electronic filing can prevent downstream costs and headaches for taxpayers *and* the IRS.

Increased electronic filing will also save the IRS money—some experts (including witnesses before the Subcommittee today) believe it costs the IRS about $7 to process a paper return, and less than $1 to process an electronic return. It makes returns easier for the IRS to process, speeding refunds for taxpayers and allowing the IRS to spend less time and money shuffling paper.

The IRS Restructuring and Reform Act requires the IRS to develop and implement a strategic marketing plan to make paperless filing the preferred, most convenient and cost-efficient form of filing for 80 percent of taxpayers within the next ten years. Our legislation provides tangible incentives—not mandates—to make electronic filing so easy that taxpayers will not want to file paper forms. The new management structure created by this legislation will provide the accountability, continuity and expertise that are needed to ensure that this electronic filing plan is successfully implemented.

By reducing errors and speeding return processing, electronic filing has the potential to vastly improve customer service. In the long run, it has the potential to produce a smaller, more efficient and less intrusive IRS. It's an important step in substantially alleviating the frustrations so many taxpayers experience with the current system.

Statement of Hon. Jim Ramstad, a Representative in Congress from the State of Minnesota

Madame Chairman, thank you for holding this important hearing on the recommendations of the National Commission on Restructuring the IRS regarding electronic filing.

I also want to commend our colleagues Mr. Portman and Mr. Cardin for their efforts to translate the Commission's recommendations into legislative form by introducing H.R. 2292. This legislation has already stimulated a healthy debate about how we can improve efficiency and customer service at the IRS.

Clearly, more widespread use of electronic filing will increase efficiency, decrease human errors, and save somewhere between five and seven dollars per return. A completely paperless system would multiply efficiency, accuracy and cost savings.

Sometimes the greatest obstacle to progress is the fear of the unknown, so I hope we will be able to effectively educate taxpayers about how electronic filing will benefit them, as well as their government.

Again, Madame Chairman, thanks for your leadership in holding this hearing. I look forward to the continuing examination of IRS restructuring recommendations over the coming weeks.

Chairman JOHNSON. Mr. Lubick, Acting Assistant Secretary for Tax Policy, U.S. Department of Treasury.

Mr. LUBICK. Madam Chairman, I would like to ask that Mr. Dolan testify first. I think we have coordinated our testimony and——

Chairman JOHNSON. OK, thank you. I was just going in the order on my list.

Mr. Dolan.

STATEMENT OF HON. MICHAEL P. DOLAN, ACTING COMMISSIONER, INTERNAL REVENUE SERVICE; ACCOMPANIED BY TERRY LUTES, ACTING ASSISTANT COMMISSIONER, ELECTRONIC TAX ADMINISTRATION

Mr. DOLAN. Thank you, Madam Chairman. It is a pleasure to be back with the Subcommittee this morning, particularly on a topic like this. I have with me at the table, Terry Lutes, who is making his first appearance before the Subcommittee. Terry has been acting as our Assistant Commissioner at our newly created Electronic Tax Administration organization, so between the two of us we hope to be responsive to questions you might have later.

And with your permission, Madam Chairman, I ask that my longer statement be accepted in the record, and I will maybe just make a few remarks.

I mentioned that it is a pleasure to be here because I think this is one subject around which there is considerable alignment, both with respect to the Subcommittee's interest, the work of the Restructuring Commission, and many of the witnesses that follow us. I think there are perhaps some differences in pace and spectrum, but largely there is a tremendous conversion and set of interest in moving forward in the Electronic Tax Administration, specifically the electronic filing arena.

What I would like to do this morning is cover a couple of different areas. One is to, as sort of an extension of prior conversations we have had about this, give the Subcommittee a picture of how we are approaching the entire umbrella of Electronic Tax Administration; talk a little bit then about some of the products we already have online. Some of those products are products that we have engaged the Subcommittee on in the past, and gotten your suggestions to improve.

Third, I will talk a little bit about what we hope taxpayers will experience next filing season as an extension of the electronic program as we have in place; and then I will discuss what we really are quite excited about, which is a major new opportunity to expand the partnering and the whole Electronic Tax Administration.

Finally, I will also respond to your question, that we comment on some of the specific proposals made by the Restructuring Commission.

I do not think, based on both your statement, Madam Chairman, and Mr. Coyne's, that there is much disagreement that this is a business that government, and specifically the Internal Revenue Service, needs to be in. The Electronic Tax Administration process produces an outcome that is both faster and cheaper. That is measured both by the impacts on the customer, the taxpayer, as well as on the government at large.

Clearly, the quality of interaction, in addition to it being faster and cheaper, the quality is vastly enhanced based on the statistics that both of you cited in your opening statements; and based on what we also know to be the taxpayer's ultimate desire in this process—which is, get closure and know that there is closure. The quality of that interaction when done electronically is one that facilitates that much better than the historical paper processes.

And last, we are clearly in a world today where our customers do not differentiate their customer expectations when dealing with a government entity versus a financial services industry. So essentially what customers are superimposing on us, where we can like it or not, is an expectation that we offer a quality of interaction, a quality of products and services that are analogous to what they have experienced in dealing with their credit card companies, banks, insurance companies, financial institutions.

I think what we already have on the docket are some things that have begun to make the right advances in the right areas, and some of these I will not regale you with all the rats and the stats. I think, however, you are quite familiar that our electronic filing product is one, that again this last year made 19-percent improvement over the prior year in terms of the people that participated in it. Somewhere between 14 and 15 million people will have filed the conventional electronic file return this year; 366,000 of them though have done it using their individual PCs, which is an opening that we hope to continue to be able to exploit. In addition to the very fertile marketplace of those 70 percent that are today done on computers, and the high percent that are done by practitioners, we also want the window of an individual preparer of a tax return, based on a software package, to be able to come at us through the electronic filing process.

I think that the TeleFile product is one that has only been in the second year of operation. That is a product that clearly speaks to one specific segment, the 1040–EZ filer. That is a segment though that we found reacted quite nicely to the product, based on its ease. It is a product that I think some of you know. Almost 5 million people participated in TeleFile last year. Essentially an 8-minute telephone call allows people to totally satisfy their tax obligation. At the end of that transaction on a telephone it allows people to know, by virtue of a code that we give them, that their return has been accepted. They have the closure and the certitude that they have told us and that is so important to them.

I have a couple of attachments in my prepared testimony and a couple of charts over here on the side, which reflect the general progress in both the overall TeleFile and in the overall ELF and

TeleFile. I think those of you who served on this Subcommittee over a period of time, know that the dip in our progress is, in large part, a function of us collectively deciding that we had to respond to what were some pretty significant questions about some types of fraud to which the system was at risk a couple of years ago. And so, in large part, the dip you see in 1995 was a function of a series of changes we made to mitigate some of those risks. We are hopeful that the trend that is reflected in the two subsequent years is a trend that we cannot only sustain at the incremental level, but I think we share the interest of doing some geometric increases there wherever possible.

Electronic business returns are something that we came to after our initial foray and the individual return filing. To date, we have had some reasonably good experience with bringing the 941, the employer's quarterly tax return, into the electronic process. This year we have piloted, again taking the smallest businesses with the less complex kinds of transactions, in a 10-State area with putting a TeleFile product in front of them as well, and to date we have had 50,000 returns that have been filed using that TeleFile process, with the customer reaction being exactly the same as it was on the individual side. In excess of 99 percent of the people who have used that have said to us, "I want that product. I like that product. It is an improvement over the way I used to do business with you."

Based on the experience we have had in this pilot in the 10-State area we will actually operationalize it and go nationwide with it next year, again creating an opportunity for the smaller businesses to do those quarterly tax transactions on the telephone, rather than using the process of returns and coupons as in the past.

The fifth arena that is frequently not talked about in the same breath as electronic filing, but is equally crucial to us, is what we have been able to produce in our Web site. We call it our Digital Daily. It is indeed the process by which we created an electronic window or door, or access to the population at large. The last filing season 117 million people came through that digital door, often in search of a technical tax law answer. They would have otherwise wanted to call us, or walk into an office, or do something more arduous to find the answer.

Also notably, 6 million times during the filing season, that Digital Daily—our home page—was the source for a copy of a form or a copy of a publication. Somebody, presumably at their kitchen table on a Sunday or Monday, or the night before filing, could access the IRS Web site instead of having to traipse off to find that form or publication.

So we think that that represents the nugget of what will still be a considerable opportunity to leverage more fully in this Electronic Tax Administration business.

One facet that we experimented with last year, and we again expect to be able to expand on this experiment, is we began to take e-mail messages back from taxpayers. Last year in a relatively controlled environment, we invited people to ask their technical tax questions on e-mail. And of course, that again creates a flexibility as to when and where we respond to those. That takes some of the contention out of the business hours. Somebody might either be

trying to get to a walk-in counter, or get to our toll-free number. So again, the whole ability to leverage the advance of technology on the Web is one that we think is a considerable and important part of our future.

Something on which this Subcommittee had an awful lot of involvement with us, and on which many of you gave some counsel both to me directly, and us collectively, was the whole EFTPS process. There was, of course, a fair amount of legitimate skepticism. As that electronic tax payment system was first introduced there were many who were concerned about the extent to which both the users and the custodians of that process were ready at the time that it went in place. I am pleased to report though that I think the early experience from that is also a harbinger of some very good potential with respect to making payments electronically.

As you know, we worried about the extent to which people would—those in the mandated category—would indeed be enrolled on time, and 96 percent of the 1.1 million people who were "mandated," are indeed enrolled. In addition to the 96 percent that are enrolled there are some 500,000 people who are voluntarily in the process because of either the sense it makes to them, or some appeal to using the system that they have identified in the process.

We have at this point in the year accepted a half trillion dollars electronically through the combination of the new EFTPS and the phaseout of the old TaxLink process. That represents about 46 percent of all deposits that have been made this year. The error rate that is being run right now is one-quarter of 1 percent on those transactions. So I think there are an awful lot of people who were vigorous in their participation with us, interested in getting this off and getting it off right. We took an awful lot of input, not only from the Members of the Congress but from small business. There were many, many constituencies interested in this thing working right. And I think as an opening volley it looks like it does work right; it looks like it is an opportunity for us to leverage on, as I said, other electronic payment processes.

One last area is an area also that this Subcommittee has been quite interested in, and that is the whole business of how do we bring greater effectiveness to telephone access to the Internal Revenue Service. In the past the way we might have thought about that is, you need more bodies to answer more calls. While that is some part of the solution, the other thing that we have been experimenting with, and have what we think are some reasonably nice early results, is the ability to find the kinds of questions and those kinds of inquiries that the taxpayer can assist himself to a conclusion. They may not require personal interaction in an office or over the telephone. And we have put in place something that we call a Telephone Routing Interactive System, through which people can do such things as call the IRS and set up an installment agreement in response to a notice or a bill that they have gotten from us.

They can obtain, for example, most current payoff balance, if they are interested in sending us a check or sending us a payment that pays off their account. If they are interested in the status of their refund, either because they are just curious, or because there is some financial transaction that is pending receipt of that refund, they can also get that information.

If they desire to get a copy either of their tax return or a transcript of their account to be used in a transaction, such as a mortgage or student loan application, they can also get that under that interactive system. This is something that this year we took 2.9 million calls on, and it is not operational across the organization yet, but we look forward to being able to make it operational systemwide very soon. That is in addition to 48 million of what we would have called our more classic kinds of computer-assisted calls that come in through our TeleTax system today.

As much as we are proud of what has happened, it is building the pattern that reflects the kind of incremental, but strong growth, in these products. It is clear to us, and has been for some time, that what we really want to do is leverage this; not incrementally but exponentially if at all possible. And that is what inspired us a better part of a year ago to create what we have now created in our Electronic Tax Administration, the Assistant Commissionership. In so doing we thought we needed to create focus within the organization that really was responsible for leveraging the technology, but more importantly was to be the exclusive spot for which we could stimulate the partnering required to do this and do it right.

The key premise of how we proceed on a forward going basis I think mirrors the Restructuring Commission's recommendation; that is, it has to be done in partnership. There are huge enablers created by structuring the partnerships with the software preparers, with the practitioner community, with the various constituencies.

What we have done in order to create a structure for that though, is in addition to creating an organization, we have recently had the good fortune of selecting a leader for that organization. Some of you have met and worked with Bob Barr, formerly with Intuit. Bob happens to be here in the audience today and is trying to get himself relocated from San Diego. But we have in Bob somebody who brings considerable experience from both sides of the ledger, both experience in the business of electronic commerce and the creation of software, and working with the government. He also has the added benefit of having been a tax administrator for the State of South Carolina, and has been one of our earliest partners in making the electronic filing project a Federal and State product.

What we will do though as a way of building on this premise, the partnership, is this. Last week, on August 27, we put an announcement in the Commerce Business Daily that said we intended on September 15, as Mr. Coyne mentioned, to release a draft RFP. Some question why we issued the draft versus the permanent RFP. One of the things we have learned as we have looked at the modernization blueprint life, what we realize is when you put these things out in draft, you continue to dialog with industry in a very positive way.

So on September 15 we will put a draft RFP out to industry, which in large part is designed to take all comers. It is designed to say to the constituencies that we have been partnering with, and we know are acutely interested, as well as every other potential player out there, these are our goals. Our goals are to significantly expand the volumes of receipts through the Electronic Tax Admin-

istration process. And it says we want your ideas; your ideas of not only the technologies associated with Electronic Tax Administration, but the incentives, the quid pro quos, the impediments, the issues that that constituency thinks can be addressed and overcome for the ultimate benefit of the taxpayer/consumer's ease of filing with us electronically.

So we are putting a considerable stock in the ability of that request for proposal—at first the draft and then subsequently the formal RFP—is at least the most organized and structured way we have ever created to get what we know is a very rich burst of feedback from those industry groups. We are quite optimistic about the extent to which the kinds of responses that it evokes will deal with the hard chestnuts; will deal with the issues about signature alternatives and authentication strategies; will deal with the capacity to truly make these products paperless instead of today's half in/half out world; will deal with fraud detection and prevention, something in the past that we thought we perhaps had to own the total laboring. I think the industries have said to us in a lot of formal and informal ways, that they know they belong in that business with us, and we expect that the RFP will also produce new ideas about how to share the responsibility for mitigating risk of fraud.

Last, one of the areas that the industries have been quite vocal with us in the past, is how do we relate to them as a group of players. And one of the things we are asking in the RFP is for people to come back and talk about the ground rules that ought to apply to the regulation, small "r" perhaps, of the industries that will participate with us in electronic commerce. So I think collectively the potential that is resonant in the RFP to take us to the places that we all say we want to go in this whole electronic arena, is very considerable.

Now, in addition though to minding the results of the RFP, there is more. My testimony makes the point.

The RFP is not designed to be some theoretical exercise that says, tell us what we will do in the year 2000, and bump. What the RFP is designed to do is say, our objectives are to translate the industry's feedback into substantial return growths in 1999, namely tax year 1998 returns filed in 1999. So it is a very proximate set, very actionable set of recommendations that we want from industry; all the while also cognizant of the fact that the overall modernization blueprint and the capacity to leverage a link to that later on, will give us additional opportunities. But the invitation that we have extended to the industry today is not one to come back about theoretical things to do in the year 2000 plus, but something to do with tax year 1998 returns that were received in calendar year 1999.

Now, in advance of that, there are some things we can do in the current structure, and we will do them. I made mention of a couple of them. I will not spend a lot of time on them. I already mentioned that we are going to expand the 941 TeleFile in the business community. We are going to take on a couple of additional forms in the next year in the regular ELF product that practitioners have—one is, in order to be able to claim the adoption credit, and the other is to claim the motor fuel excise tax credit.

Beyond that we are looking very hard at the ability to expand the current universe of TeleFilers. Today it is limited to the EZ filer. We think we are going to be able to do some things for sure next year; that we will bring in additional EZ filers that this year might not have played, but beyond that we are looking at ways of expanding beyond the EZ market into the potential 1040–A market, as ways of bringing more taxpayers into using this easiest form of transaction with us.

We are looking at the entire range of forms and schedules that today are not included. Some of those are ones that I think Don Lubick will at least make a reference in his testimony that we may need congressional help to make changes and code provisions that today might require schedules or certifications, or things which are not readily adaptable to an electronic submission. There are a huge number of those; there are some of those that we will bring back no doubt to this Subcommittee, and ask for your help and sponsorship in implementing. But we are going to look at the whole universe of things that today cannot be included, and look very carefully for opportunities to even bring more in next year.

And last, with an eye toward 1999 and some of the other opportunities we are going to have with the RFP, we are working very closely with the FMS, the Financial Management Service, for ways of increasing the opportunity for people who today file balance-due returns. For the most part, the electronic filing product, whether it is the TeleFile or the regular ELF product is a product used by somebody who is a refund filer. In very large part, the attractiveness is the speed of the refund; the accuracy of the refund.

What we are very aggressively involved with right now, as I say with FMS and Treasury, are initiatives that will create payment options. We will, for example, do a takeoff of today's ACH debit capacity that exists in the EFTPS system; make that an easier process for an individual, and create opportunities and incentives for somebody who files a balance-due return to be equally interested in using electronic filing as a process, and perhaps have the benefit of sending us paper 1 day, and warehousing and triggering their ACH debit perhaps on another date.

The last arena that I know this Subcommittee has been very interested in, and one that is for us at the end of the day a substantial, if not a show stopper—certainly show and center—and that is the whole ability to get to an alternative signature. And we are very optimistic that by the time we confront the tax year 1998 filing season in 1999 we will have the alternatives for signatures and the ability to capture W–2 information electronically; and, have the ability to truly produce a paperless outcome. That, in large part is the feedback that we have gotten both from the practitioner community and individuals. If you call this an electronic process it must truly be an electronic process. You cannot have these trailing paper tentacles that we have today. And again, I say it looks to us very optimistic that we can achieve that.

One of the things that I think—Mr. Coyne and maybe Madam Chairman, you as well—said in your comments, and it is a place that we got some feedback from this Subcommittee when I appeared—I think when we talked about the filing season, and in

connection with EFTPS—you all said to us, you may know something about tax administration. You probably do not know as much as you should about marketing, and about advancing products. I know in the context of the Restructuring Commission's work, there was clearly a finding that, with respect to some of the products that were placed online we acted more like government bureaucrats than we did people trying to intelligently introduce a product to our customer base.

One of the things that we are quite excited about this coming filing season, is we have used our communications contractor to help us develop, not only some products, but some approaches to introducing these electronic products in a way more professional and more effective than we have in the past.

Just last week we brought in the practitioner groups and other constituencies, and exposed them to what our contractors had helped us put together. We received some pretty enthusiastic responses from them and some good suggestions as well. But I am hoping that with the upcoming filing season we will also be able to put a bump on these kinds of numbers by virtue of doing a better job of bringing the product to the customer on the basis that the customer wants to get it. We hope to explain its attributes in terms that are relevant to the customer, not in terms that are relevant to perhaps a government agency or a bureaucrat.

Let me spend just the last couple of minutes on specific reactions to some parts of the report from the National Commission of Restructuring. I think it is pretty self-evident that the general thrust of that report is one that not only we endorse, but we embrace enthusiastically with respect to the desire to increase this entire area.

There are three or four areas though that we at a minimum would want to be circumspect about. The first one is not really such an area. The first one recommends that there be such a thing called the Electronic Tax Administration Advisory Group. On the face of it that is a good idea because it stands for the proposition of having people in this together with you. The only thing that I would want this Subcommittee to appreciate is, we do not think that that statutory call is necessarily the only answer to those kinds of partnerships.

Clearly today, we have a very active set of relationships with what we think is the spectrum of groups. We also use the Commission's Advisory Group and a liaison group to do that. So the notion of making sure that we create a group that creates a value as opposed to being a group for group's sake, is probably where we would be somewhat careful in that provision.

The second one would be one in which there has been some fair amount of debate, both within the confines of restructuring and elsewhere about incentive payments. This is something that I think is a considerably dicier proposition than some have thought it to be. I think what we would hope to persuade the Subcommittee is that, this is a very valid area to explore. It is a very interesting area to explore, but it is one that probably is best explored in the context of the request for proposal that we have out there. So that people who respond to us, say to us, Yes, incentives are critical in this regard or not in some other regard. Because I think the thing that we would not want to do is intersperse incentives in a way

that artificially affects the way that these products are received or acted on by the marketplace.

The third area that is of some interest to us is the whole rearrangement or potential rearrangement of the filing dates. Again, it is clear from the work of the Restructuring Commission that the idea was to create incentives for people to file electronically. And while on the face of this proposal it has the potential of doing that, it also has the potential of creating a level of confusion or complexity that again we think ought to be evaluated very carefully. Because among the things that, sort of are constant in our current system is, most people relate to April 15 as a pivotal date. Sometimes they do not relate to it quite as pivotally as we would hope they would, but nonetheless, April 15 is a date in large part that is synonymous with meeting a tax obligation. And so to the extent that we were to significantly affect that dynamic, at a minimum our caution—my caution—would be that we do it very carefully and very intelligently, so as to not produce a series of unintended consequences.

I will wrap this up by saying that, clearly I have not attempted to say the last word on any of the restructuring proposals. I know Don will have additional comments in this area. I personally appreciate the kind of support that we have gotten, not only from you, Madam Chairman, but from the Subcommittee at large, in this area. It is an area where I have consistently felt more collegiality and support than I have any kind of contention or antagonism. We look forward to your continued support, and quite frankly, your ideas, and your urgings for us, because we think collectively this is probably one of the best metaphors the taxpayers will hold out to both you and us with respect to treating them as customers and meeting the needs they have. And so with that, I will be obviously available for your questions.

[The prepared statement and attachments follow:]

Statement of Hon. Michael P. Dolan, Acting Commissioner, Internal Revenue Service

Madame Chairman and Distinguished Members of the Subcommittee:

I appreciate the opportunity to appear before you today to discuss the Service's progress in and plans for Electronic Tax Administration as well as how those relate to recommendations made by the Commission on Restructuring the Internal Revenue Service. For some time, Electronic Tax Administration has been an issue of prime concern in our discussions with the IRS Management Board. With me today is Terry Lutes, Acting Assistant Commissioner, Electronic Tax Administration.

I. INTRODUCTION

While most of the previous dialogue, as well as the majority of the Commission's recommendations, has focused on our electronic filing program, I would like to talk about electronic filing in the larger context of what we are defining as Electronic Tax Administration. Electronic Tax Administration (ETA) is an umbrella term we are using to describe the two-way electronic information exchanges the IRS has with the taxpaying public, tax practitioners, employers, and other government organizations. Electronic transactions included in our vision for ETA include tax returns, information returns, payments, correspondence, and government exchange. Since the beginning of this year, we have taken some significant strides within the IRS to make this vision for ETA a reality.

Like many large financial services organizations, the IRS is in the midst of fundamental change. Even though we continue to process information, increasingly that information comes to the IRS in electronic form instead of on paper. We, along with the Administration, believe that the continued growth of electronic transactions is of strategic importance to the future of the IRS. Our efforts to provide higher qual-

ity, faster, and more efficient services to the public depend in large part on the exchange of information and tax return data in electronic form. Our programs encompass more than just electronic filing of tax returns; they are a broader effort to provide a wide array of electronic service delivery options to the public. At the same time we expand options and access, we must assure that we maintain the privacy and security of taxpayers' sensitive financial information.

Today, I would like to speak to you briefly about some of the strategic challenges and opportunities confronting the IRS in its Electronic Tax Administration programs. I plan to do that by discussing our results for ETA programs from the past year, outlining our plans for the future, and responding directly to your questions concerning the Restructuring Commission's recommendations in the area of Electronic Tax Administration.

II. Recent Results

As the rest of the financial world has moved toward more electronic transactions, the Service has been doing likewise. IRS efforts to offer more service options to taxpayers and practitioners that do not rely on paper have helped increase the number of electronic transactions and decrease the volume of paper-based transactions. Results from this most recent filing season include the following:

- Our electronic filing (ELF) system allows individual taxpayers to file tax returns electronically through using an IRS-approved electronic return originator (ERO). More than 14 million taxpayers used this program in 1997, a 19% increase over 1996. Although most of these taxpayers relied on an ERO for the tax preparation, 366,000 of these returns were initiated by taxpayers using tax preparation software on personal computers. More than 4.3 million of these taxpayers who filed electronically also took advantage of the opportunity to simultaneously file their state tax return. Electronic filing provides significant benefits to the taxpayer and the IRS. The error rate for electronically filed returns this year was less than 1 percent. This means that taxpayers participating in electronic filing were much less likely to get a notice from the IRS as a result of mistakes typically associated with paper filing. The other advantage is that when the return is accepted electronically, the taxpayer received an acknowledgment that the return was filed and accepted.
- This year more than 4.7 million taxpayers eligible to file 1040EZ returns took advantage of the opportunity to file their returns using a simple telephone call to our TeleFile system. This was a 65% increase over 1996. Attachment 1 illustrates the significant growth of this program since its nationwide roll out in 1996. Surveys of users of TeleFile show that they are extremely satisfied; 99% like the system and would use it again. The error rate for TeleFile returns is also less than 1 percent and the system is one of the finalists for the 1997 "Innovations in American Government" award program sponsored by the Ford Foundation.
- Attachment 2 shows the growth pattern of ELF and TeleFile combined over the past five years. Except for the dip which occurred in the initial year of our Revenue Protection Strategy, our growth has been steady and one of every six individual tax returns was filed electronically in 1997.
- We are also aggressively pursuing getting more business returns electronically. In 1997, we are on track to receive electronically almost 500,000 Forms 941, Employer's Quarterly Federal Tax Return, in addition to the 1.6 million we will receive through our magnetic tape program. This spring we began a pilot program to allow the smallest businesses to file their Form 941s using TeleFile. The pilot has been extremely successful with more than 50,000 taxpayers using the system during the second quarter with an error rate of less than 1 percent and a 99% customer satisfaction rate. The IRS intends to roll out this system nationwide in the first quarter of 1998.
- Thus far this year, more than a half a trillion dollars have been deposited electronically using our Electronic Federal Tax Payment System (EFTPS) and the older Taxlink system rather than using paper coupons. This represents 46% of the total dollars collected. Of the taxpayers mandated to use EFTPS, 1.1 million, 96% of the total, have enrolled as shown in Attachment 3. More than 500,000 taxpayers not covered by the mandate have also already enrolled and this number is growing. The current error rate for these electronic transactions is .21%. Attachment 4 shows the growth in the percentage of tax dollars collected electronically.
- The Digital Daily, our award-winning home page on the World Wide Web experienced more than 117 million hits this past filing season which included the downloading of more than six million forms and publications. As you know, this service is available 24 hours a day and taxpayers can get access to needed information in the comfort of their home or business upon demand. Additionally, this past filing season we began testing the use of the Internet for E-mail customer service

inquiries and responses. The initial feedback on this service has been extremely positive and we will offer this service nationwide next year.

The IRS has also expanded the use of technology to increase telephone access to services for taxpayers.

• Thus far this fiscal year, we have had 2.9 million calls completed through our Telephone Routing Interactive System (TRIS) which provides for resolution of certain customer inquiries without human intervention. Currently taxpayers can use the system for services such as setting up an installment agreement or obtaining payoff information for a balance due account, determining the status of a refund and ordering an account transcript or copy of their return. Additionally, 48 million taxpayers accessed our older Teletax system this year and received information such as answers to a wide range of basic tax law questions and refund inquiries.

III. Plans for the Future

We are extremely encouraged by our success with electronic filing systems up to this point. But, to be frank, taxpayers' use of the ELF and Telefile systems has not grown as rapidly as we had hoped and the potential uses of technology have grown far beyond our original concepts. As a result, we are formulating a broader strategy for electronic service delivery that builds our services through partnership with private industry.

To provide a focus to our plans in this area, this past year the IRS established an Electronic Tax Administration (ETA) organization devoted solely to the operation and enhancement of ETA. As you know, we recently announced the selection of Bob Barr as the first permanent Assistant Commissioner to head this organization. Bob will join us in October from his position as a Vice President for Intuit Corporation, where he worked extensively on Federal and State electronic filing programs. Bob also has prior experience in tax administration as he previously served with the South Carolina State Tax Commission and on the IRS Commissioner's Advisory Group and the Information Returns Program Advisory Committee (IRPAC). We are excited about the impact Bob's extensive program knowledge, private and public sector experience, and business savvy will have on our ability to move the program forward.

This is consistent with our efforts to strike strategic partnerships with the private sector outlined in the Modernization Blueprint and the hiring of a prime integration contractor. The IRS is also seeking private, public, and not-for-profit sector assistance to increase electronic transaction volumes in the next several years. We believe that we can best address critical issues for ETA such as authentication, fraud detection and prevention, third-party ground rules governing participation in the electronic filing programs, and accepting all forms and schedules by using a structured process to seek and evaluate proposals from outside the IRS. To put these partnerships in place, the IRS placed a notice in the Commerce Business Daily dated August 27, 1997, announcing that the IRS will issue a draft Request for Proposals (RFP) on September 15, 1997. This RFP is being issued in draft form at this time so that external ETA partners can provide input into the final procurement, resulting in maximum responses to the RFP from outside the IRS. We are structuring this RFP in a manner that solicits easy to implement proposals which can impact the 1999 filing season. In addition, it will solicit long term partnerships which will help the IRS design systems and programs in a manner which will maximize taxpayer and return preparer use.

While we are excited about the possible results of the RFP, we are continuing to move ahead with efforts to enhance and expand our successful electronic programs where it clearly makes sense.

• We will expand our E-mail customer service capacity and additional services will be provided through TRIS. New TRIS services will include automated determination of the status of payments. If additional funding to combat EITC fraud is received as expected, TRIS will also provide for releases of refunds involving invalid social security numbers.

• We intend to roll out 941 Telefile nationwide in 1998 and are projecting that more than one million returns will be filed through the system in the first year.

• While significant portions of our programming resources have been committed to Century Date Change and implementation of tax law changes, we will be able to accept two additional forms, those involving adoption credits and motor fuel excise taxes, as attachments for ELF returns. Additionally, returns where either the taxpayer or a dependent has an Individual Taxpayer Identification Number (ITIN) or Adoption Taxpayer Identification Number (ATIN) will be accepted by ELF for the first time.

• We are in the process of initiating a complete analysis of all forms and schedules not currently accepted through the ELF system to identify all of the issues related to each to determine the steps we need to take in order to accept them without diminishing the accuracy rate for ELF returns or increasing refund fraud. We expect to use the results of this analysis, along with the proposals resulting from the RFP, to develop during fiscal year 1998 a comprehensive plan for accepting all forms and schedules.

• We are in the process of completing a thorough analysis of the extent to which we can broaden the range of 1040 returns accepted through TeleFile without diminishing taxpayer satisfaction due to the increased complexity of the telephone interaction. This effort will lead to expansion of the number of taxpayers eligible to file returns through TeleFile for the 1999 filing season.

• We are actively working with the Financial Management Service and the private sector to develop payment alternatives which would be cost effective for the government and give taxpayers a choice in how to make tax payments. By working closely with the Department and the Financial Management Service, we are developing plans which, beginning in 1999, will allow taxpayers filing balance due electronic returns to pay using an Automated Clearing House (ACH) debit payment as part of the electronic return. We will be looking at all ACH credit and debit options including home banking and telephone payment systems, as well as working with credit card companies under the legislation contained in the Taxpayer Relief Act of 1997 (P.L. 105–34) to determine the potential for payment of federal taxes by credit card.

• Most significantly, plans are now under development which we believe will lead us to an alternative electronic signature for ELF returns in 1999. This would eliminate the most frequent criticism of the program—that the system has not up to this point been paperless. Feedback from the practitioners' community has been that this alone will significantly increase the willingness of tax preparers to file returns electronically.

We have listened to feedback from external stakeholders and consultants that we need to do a better job of introducing taxpayers and tax practitioners to the benefits of electronic transactions. Thus, for the upcoming filing season and the longer term, the IRS is going to increase its efforts to inform and educate taxpayers and practitioners about the benefits of electronic filing. Despite the recent successes in increasing electronic filing volumes, we believe that taxpayers and tax practitioners have to better understand the benefits of filing electronically compared to filing on paper. To that end, we are working with an outside marketing firm to develop a strategy for increasing public awareness and use of electronic filing options for this upcoming filing season. Just last week, we provided a preview of this new electronic filing marketing strategy for tax year 1997 to practitioner and industry groups. Preliminary responses to our efforts to promote the benefits of electronic filing in concert with the practitioner community have been quite positive. While we are still finalizing this strategy, we are confident that it is going to be a substantive improvement to our past communications efforts. At the same time, we are conducting a comprehensive market research study to enable us to better understand taxpayer needs and concerns related to electronic tax administration. This will allow us to focus our long term marketing efforts as well as to assist us in modifying current electronic products and developing future ones that meet taxpayer needs.

IV. IRS Perspective on Commission Recommendations

As you can see, many of the steps we have underway are consistent with the recommendations contained in the Final Report of the National Commission on Restructuring the IRS.

Since the Commission made a significant number of recommendations relative to electronic tax administration, I am not going to try to address all of them individually in this testimony although we will be happy to address any questions you have. However, I do want to comment on several of them which I have not directly addressed in outlining our plans for the future. Additionally, I want to discuss legislative proposals relative to ETA that we have been assisting the Department in developing.

First, the Commission recommended that an Electronic Tax Administration Advisory Group, consisting of external stakeholders, be formed to advise the IRS on ETA programs and plans. We have no objection to this proposal and are developing plans that would enable us to establish such a group under the Federal Advisory Committee Act. However, I want to emphasize that the electronic filing program would not be where it is today if we did not have regular interaction with the stakeholders and give careful consideration to their concerns. There would be no ELF program

if it were not for the software companies, electronic return originators and transmitters. We have almost daily informal communications, our current Electronic Tax Administration executives have been regular participants in meetings of the various trade organizations and, where appropriate, we have convened forums of industry representatives to address common issues. Additionally, the Commissioner's Advisory Group and the Commissioner's Liaison Group have frequently provided advice on ETA matters. In establishing a separate advisory group for ETA, we want to make certain that it is value added, not merely a duplication of existing external stakeholder groups.

Second, much discussion has occurred relative to the Commission proposal for payment of incentives to third parties for electronic returns. We believe that this is an option well worth considering and our RFP will provide a mechanism for evaluating such proposals. We are, however, opposed to such payments being legislatively required. We need to determine the level of savings for electronically received returns compared to paper. We need to let the market determine (though the RFP) what level and kind of reimbursement third party service providers require, and then determine whether using savings from increased volumes of electronic filing to reimburse third parties is in the best interest of the government. We believe that the RFP process is the best tool for answering these questions and the market research will help us better understand the potential for payments to increase the volume of electronic returns. One additional point that must be made is that any requirement to make payments out of the IRS budget for those 19 million returns currently received through ELF or TeleFile would essentially cause us to make a commensurate decrease in effort in customer service or compliance programs. Our RFP process is being designed to ensure that we only pay for the additional volume of returns received.

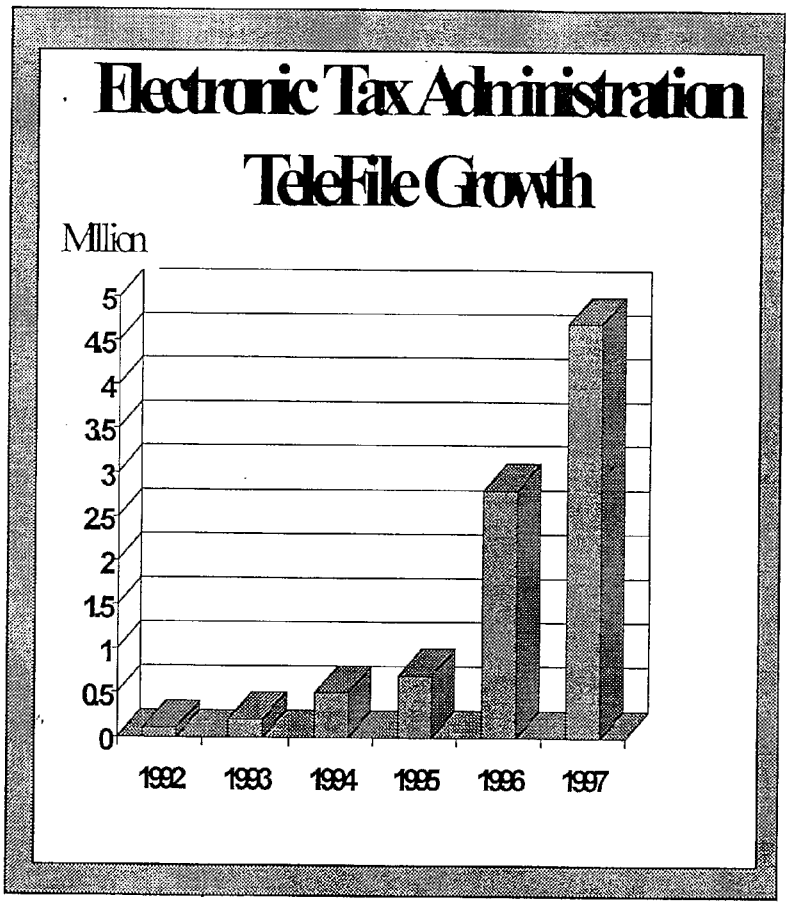
Next I would like to point out that we have a number of concerns about the proposed realignment of due dates for electronic returns. While this proposal might result in some increase in the use of electronic filing, it would also add new complexity in one area of taxation where there is no confusion—the fact that tax returns are due on April 15. It would also add complexity to the administration of the tax law which always comes with a cost. Finally, I would like to reinforce the Department's assessment that the cost of delayed receipt of payments on balance due returns would be significant.

VI. Conclusion

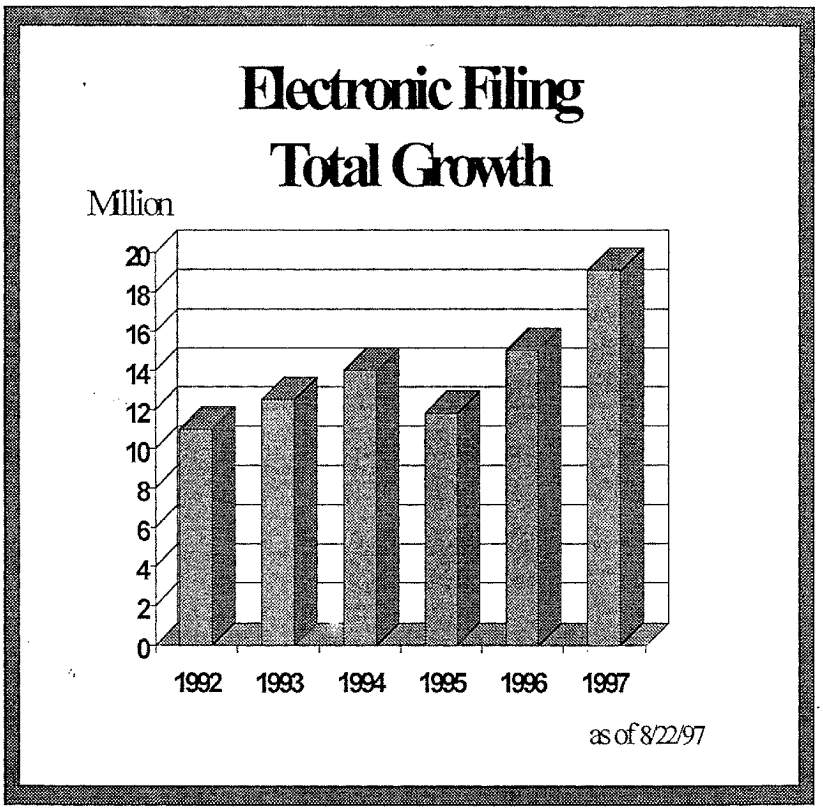
I have not attempted to specifically address every recommendation the Restructuring Commission presented on ETA. However, I believe that the progress we have made in increasing the volume of electronic transactions as well as the range of electronic services available for taxpayers, along with the enhancements we have under development, show that we are in agreement with the general direction of, and the emphasis placed on electronic services by the Commission even if we disagree with some of the specific proposals. The continued growth of electronic transactions is of strategic importance to the future of the IRS. It is our intent to work with the Congress and the other interested groups to assure that we provide taxpayers with electronic tax administration options that are secure, easy to use, and that provide for levels of accuracy that minimize the need for taxpayer interaction with the IRS to resolve problems.

Madame Chairman, I want to thank you and the Subcommittee for your continued support and for the insight that led you to emphasize the important of electronic tax administration by making this your initial hearing regarding the Final Report of the Commission. I will be happy to answer any questions you may have.

Attachment I



Attachment II



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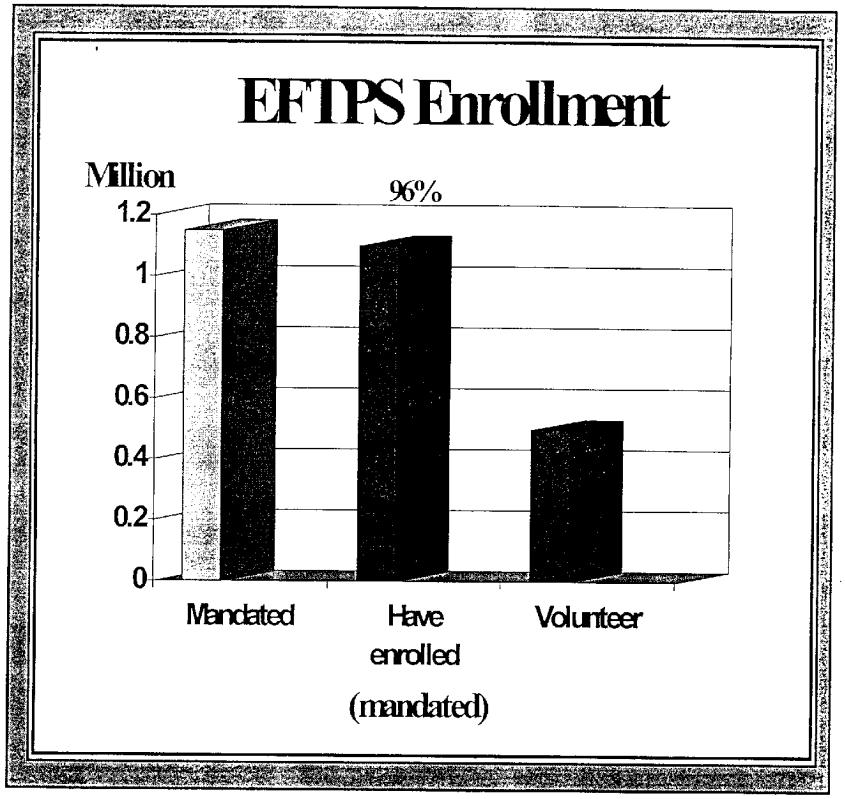
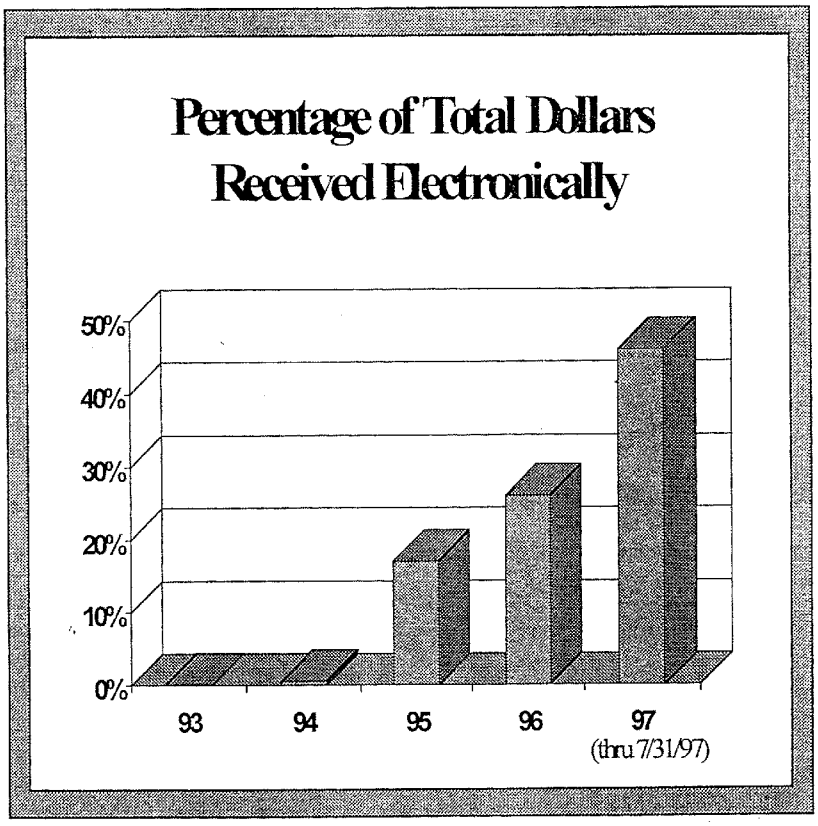


Attachment IV



Chairman JOHNSON. Thank you, Mr. Dolan. In your testimony and toward the end of your opening remarks, you do begin to address the Commission proposals. First of all, let me say it is extremely helpful to have you go through and share with us the efforts that the Department is making and the new initiatives, and where you are with electronic filing; that is very useful, and it is gratifying to know that the majority of the mandated filers have now registered, and we will watch that process with you with great interest.

I am pleased that we did relieve the penalties, because there are problems yet to be ironed out, as people actually start paying through this system, and recognizing that it is not just withholding taxes, but it is all taxes. So, we will be interested in working with you or following with you the progress of that program. And I appreciate the overview that you have given us very much.

In addressing the Commission's recommendations, you discuss the Advisory Group proposal, and the use that you have made of advisory groups and of regular interaction with stakeholders.

Is then the bottom line that you oppose establishing in law an advisory group?

Mr. DOLAN. No, I think it was more, Madam Chairman, a request that, any legislative attempt to codify a partnership be one that is cognizant of both the processes that are currently in place, and does not establish a group for the sake of a group; one that creates the dynamic that we will have it be. I think I personally take the position that it is probably not necessary. To the extent that somebody codifies it in law, my petition would be that it would be done with an eye toward being more effective and not be a constant formality.

Chairman JOHNSON. In other words, with recognition of what has worked for you and your experience in this area.

On the second recommendation that you discussed—excuse me, I misunderstood your comments, Mr. Lubick.

I know my staff had discussed with you the order in which people were going to testify, so we have the order down there, but when your comments were made I thought you meant that Mr. Dolan was going to present everybody's proposals, and then that all of you were going to take part in the questioning.

Mr. LUBICK. I will not trespass on your time very much.

Chairman JOHNSON. Now, you would like to comment, and would Mr. Lutes like to comment as well?

Mr. LUBICK. I wonder if I might just take a couple of minutes——

Chairman JOHNSON. You certainly may.

Mr. LUBICK [continuing]. And we can answer questions jointly.

STATEMENT OF LAWRENCE H. SUMMERS, DEPUTY SECRETARY, AS PRESENTED BY HON. DONALD C. LUBICK, ACTING ASSISTANT SECRETARY, TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. LUBICK. As you know I am the pinch-hitter today for Deputy Secretary Summers, who is chairing an international conference out of the country, and he has prepared a written statement, which I ask be included in the record. And I will just spend a couple of minutes dealing primarily with the legislative aspects that have been raised.

[The prepared statement of Secretary Summers follows:]

Statement of Hon. Lawrence H. Summers, Deputy Secretary, U.S. Department of the Treasury

I am pleased to be able to submit testimony today on the subject of electronic tax administration (ETA). I understand that Deputy Commissioner, and currently Acting Commissioner, of the Internal Revenue Service, Michael Dolan, and Acting Assistant Secretary for Tax Policy, Donald C. Lubick, will be appearing before you to testify in more detail on current efforts underway at the IRS in this area.

I would like to focus my comments on three areas. First, I would like to describe our overall strategy for increasing the level of electronic filing and reporting. Second, I will discuss legislation introduced yesterday by Congressman Coyne to give us the tools we need to further improve our system of electronic tax administration. Finally, I will comment briefly on other legislation that has been proposed.

I. Our Strategy for Electronic Tax Administration

Since Secretary Rubin and I announced a sharp turn in our approach to modernization of the IRS, we have dramatically strengthened leadership and increased oversight of the IRS. Our goal has been to promote continuity, accountability and increased access to outside public and private sector expertise.

As you know, we have identified a new Commissioner for the IRS with a background in information technology. We have in place a new Chief Information Officer, Art Gross, who has assembled a new team to modernize the information architecture of the Service. Next month, a new Assistant Commissioner for Electronic Tax Administration will assume his duties. All in all, we have put new leadership in place with knowledge about information technology.

At the same time, we have significantly expanded our partnership with industry. We are in the process of identifying a new prime contractor for information technology. Next week, we will release a draft Request for Proposals (RFP) for comment from a variety of electronic tax administration partners. After making necessary changes, we expect to issue the RFP in final format by the end of the year. Our new IRS Management Board, the successor to the Modernization Management Board (MMB), as well as the new Advisory Board, which the President has created by Executive Order, will bring outside expertise to the administration of our system of taxation.

While we are committed to deep and significant structural reform, we are not waiting for these deeper changes to take place to improve the level and quality of electronic tax administration.

Madame Chairman, we believe—in common with many members of this body—that electronic transactions are an indispensable part of building the IRS of the future. Electronic tax administration may offer many advantages to taxpayers and the government compared with traditional paper processing. It can reduce costs and errors. It speeds up the process of tax administration. It expedites refunds. For most Americans who have access to computers, it will be generally more efficient and economical than paper-based methods.

Over the last two years, we have begun a process to markedly improve the quality and level of electronic service for taxpayers. We have seen increases in the use of existing electronic products and we are taking steps that will expand and enhance those products while at the same planning for new products and services. Let me go through a number of specific examples.

II. 1998—Investing in Successful Programs

The IRS currently has two major programs that permit electronic filing. Of the more than 118 million individual tax returns filed this year, 14.4 million were filed through the Electronic Filing (ELF) program, including 366,000 in which taxpayers used a personal computer and tax preparation software to file from home through a transmitter. An additional 4.7 million filers, eligible to file a 1040 EZ return, participated in the TeleFile program using a touch tone phone. Both of these programs have been expanding at a steady pace. In 1997, 19% more taxpayers filed using the ELF program than in 1996, while use of TeleFile was up 65%. TeleFile is a finalist for the 1997 "Innovating in American Government" award program sponsored by the Ford Foundation.

In 1998, we are committed to investing in and expanding these successful programs.

TeleFile

At present, for fraud control and technical reasons, taxpayers who have moved in the last year are unable to file using the TeleFile program. Therefore, for 1998 we have developed a methodology which will allow us to update our TeleFile address directory, making approximately six million more taxpayers eligible to use the system.

Second, based upon a pilot currently underway, we expect that next year 25% of the businesses required to file quarterly Form 941 returns will be able to use the TeleFile system to file those returns with a 10 minute phone call. This group will represent smaller businesses, a significant step in our efforts to minimize burden for those taxpayers.

Electronic Filing (ELF)

This year almost 50% of individual taxpayers used a paid preparer to complete their returns. Almost all returns prepared by these paid preparers are completed using computer programs. This makes nearly 60 million taxpayers potentially eligible for the ELF program on this basis alone. Approximately eight million taxpayers

prepared their returns on their home computers, many with software that could have been used to transmit the return to the IRS electronically. However, most of these returns are still filed on paper. A primary focus over the next several years will be to get those returns already being prepared on a computer program sent to the Service electronically.

Next year we hope to launch a large educational campaign to inform more practitioners and taxpayers about the benefits of this program and have already awarded a contract for design and development of this campaign.

We are also continuing with steps to assure that the ELF system ultimately will be open to all forms and schedules. Several new forms are being added for 1998 and the system will also be ready to accept Adoption Taxpayer Identification Numbers (ATINs) and Individual Taxpayer Identification Numbers (ITINS).

III. 1999—Paperless Filing

These are important steps. But looking forward to 1999, we have additional improvements in mind. First, we have asked the Service to undertake all possible efforts to accept an alternative signature for the ELF system for the 1999 filing season. The need to send the IRS a paper signature document is the most frequently criticized element of the ELF program. However, the signature is a legal requirement for a tax return. The Department believes that in the electronic age, what we need is not a traditional paper signature per se, but rather a system for authenticating that the return filed is that of the taxpayer identified on the return. The Service, in common with many other government agencies, has been using some signature alternatives for a number of years and is testing others. We believe it time to apply the available technology to the ELF program.

In addition, in 1999 we hope to make it possible for those taxpayers filing balance due returns to be able to authorize an electronic payment as part of their electronic return. This will eliminate the need for paper payments and will represent a big step forward in our quest to offer taxpayers a suite of electronic options for making tax payments. I should add at this point that the IRS is beginning an effort to implement the legislation provided in the Taxpayer Relief Act of 1997 to accept credit card and debit card payments.

IV. 2000 and Beyond—Adding Value Through New Services

In the year 2000 and beyond, we will continue to enhance the ELF and TeleFile programs and aggressively market their advantages for taxpayers. But we also plan to add additional value to our electronic services by incorporating features such as an electronic Power of Attorney and, when we are comfortable that such a system can adequately protect taxpayer privacy, even on-line account access. I must note, however, that we will not develop concrete plans for these additional services until we see the results of the ETA Request for Proposals (RFP). This process will both help us determine what additional services taxpayers and other stakeholders value most and help the IRS focus its resources on those investments that will receive widespread acceptance.

V. Our Legislation

We can and will accomplish most of our goals under current law. But to accelerate progress in electronic filing, greater flexibility is needed. Yesterday, Representative Coyne introduced legislation, supported by the Administration, entitled the Internal Revenue Service Improvement Act of 1997, to further improve our system of tax collection. In coming weeks and months, I expect this proposed legislation to be widely discussed. I would like to focus my comments today on one section of the bill, section 201, entitled Promotion of Electronic Tax Administration.

Madame Chairman, the IRS has a demonstrated need to inform the public about its programs and activities such as electronic filing. Yet every year, the Treasury Department appropriations specifically bar the use of appropriated funds for promoting departmental programs. This has forced the Service to rely primarily on free public service advertising to promote the advantages of electronic services. We believe, and have been advised by stakeholders and consultants, that we need to reach a broader audience if we are to see dramatic growth in taxpayer use of electronic filing. Proposed subsection 6011(g) would explicitly authorize the Secretary to use appropriated funds to promote and encourage the use of electronic filing methods.

The legislation would also authorize the use of appropriated funds to provide financial incentives for electronic filing. Our RFP will open the door for such proposals and we would like clear legislative authority to use a portion of the savings

gained through electronically filed returns to make incentive payments, provided the proposals are in the best interest of the government.

Currently the tax code requires that certain statements and supporting documents, which are difficult to accept electronically, be filed as part of the return. The legislation would permit the Secretary to prescribe alternative ways of receiving information necessary to ensure that the return is accurately filed.

The legislation would also explicitly establish that the Secretary has the authority to establish signature requirements for electronic returns and other forms. It would also clearly establish the legal standing of documents authenticated by means other than the traditional paper signature. This step is necessary if we are to truly move the maximum number of transactions to electronic media while maintaining our ability to address civil and criminal fraud.

Finally, the legislation would also enable the Secretary to explicitly establish that the acknowledgment of return acceptance, which is provided by both the ELF and TeleFile systems, constitutes prima facie evidence of filing. This will establish a clear legal basis for what we believe to be one of the major advantages of electronic filing for the taxpayer: proof that the return was, in fact, received and accepted on a timely basis by the IRS.

We believe these provisions will give the IRS the statutory authority it needs to dramatically increase electronic filing.

VI. Other Legislative Alternatives

We believe the approach to electronic tax administration taken by our bill, combined with the RFP and our proposed management structure, is the best one to prepare the IRS for the twenty-first century. However, we realize that the Subcommittee is also considering the legislation introduced by Congressman Portman, based on the report of the National Commission on Restructuring the IRS.

We share the overall goals of that legislation and the objective of increasing electronic filing. A comparison of our legislation with Senator Kerrey's and Congressman Portman's bill will also demonstrate that we agree on many, but not all, of the particulars. I believe that there are some key principles that should be followed in negotiating this legislation.

First, we must not force people to file electronically. Secretary Rubin and I believe the marketplace will work better than arbitrary targets or the equivalent of mandates. While computer access is steadily climbing, it is important to recognize that more than half of Americans do not have computer access. Any requirement that taxpayers file electronically would force those without a computer to use tax preparers or a public computer, for example, in a library. This would unfairly disadvantage a large segment of our population. We must recognize that paper returns will remain important, and we must continue to support paper submissions for the foreseeable future. It would be wrong for example to require that some specified percentage of forms be filed electronically by a certain date.

Second, we need to be realistic about adding major new burdens to the IRS. We should avoid adding major new elements of complexity to tax administration.

Finally, as we all know, the electronic environment and the marketplace are evolving rapidly. What works today may not work tomorrow. For this reason, it is vital that we retain flexibility. The Congress and the Administration should agree on objectives and overall direction; however, like the private sector, we as a government should not impose rigid targets or lock ourselves into solutions that will soon be outdated.

These principles should guide us in looking at the specific proposals included in the Restructuring Commission report and the legislation offered by Senator Kerrey and Congressman Portman. As I have previously testified, there is much we agree with in this report. And we share many of the same goals. We do, however, differ in some specific requirements regarding electronic filing. Let me briefly discuss some of these differences.

Portions of the proposed legislation would make major changes in the overall filing program. In my view, these could be disruptive and are unnecessary. Instead, we need to rely on the judgment and abilities of taxpayers, government employees and the continued strong oversight by Congress and Treasury, working in partnership with the IRS, to keep us on track.

First, the bill mandates the implementation of specific programs that have not been tested or evaluated, may expose the system to fraud and may entail major new costs. Madame Chairman, I do not believe that this is the best way to implement public policies. The mandates in the bill do not meet the criteria I described above, which I am sure we jointly share.

Second, H.R. 2292 would extend the filing dates for electronically filed individual, corporate and information returns. This provision would significantly increase the complexity of the system, making it harder for taxpayers to understand and harder for the IRS to administer. Indeed, Madame Chairman, it would devalue what may be one of the IRS's greatest intangible assets, the public's knowledge that returns are due April 15. The proposal also favors sophisticated, balance-due taxpayers over middle and lower income filers who are owed refunds. Changing the filing date would cost the Federal government several hundred million dollars each year in additional interest. We do not believe this is a wise use of Federal resources for the purpose of encouraging electronic filing.

The bill would also mandate a program to pay fees to transmitters (not preparers) of electronic returns. In the absence of clear evidence that these provisions are worth what they would cost, we believe they are ill-advised and premature. While government may be able to structure incentives to encourage electronic filing, these incentives should be carefully developed. Our RFP will clearly be open to such proposals, and we will pursue them if they prove to be the best, most cost-effective method of increasing electronic filing.

Finally, the Kerrey-Portman legislation provides for new regulation of return preparers—although we note that it does not provide any funding and actually prohibits the IRS from administering examinations in order to qualify as a return preparer. While there are some clear advantages to the proposed regulations, the administrative cost of effective regulation, and enforcement of those regulations, covering everyone who prepares tax returns for a fee would be significant. We do not believe this would represent the best use of the IRS's limited resources.

VII. CONCLUSION

In conclusion, we are making progress on increasing electronic filing. But going forward, additional legislative authority is required. I have outlined our approach as well as the principles that I believe will best guide legislative action in this area. As we go forth, we look forward to working closely with members of this Subcommittee and others on our shared goal of increasing the level of electronic filing.

Mr. LUBICK. Commissioner Dolan has explained in detail the current efforts underway at the IRS, and the advances that he has described reflect, I believe, the first fruits of the Treasury Department's increased concern for the revitalization for our system of tax administration and our oversight role in that.

We have new leadership in place at the IRS with an increased level of knowledge of information technology. Mr. Dolan has described the increased reliance on outside expertise. The management board on which I sit has been made permanent by executive order. And in all of this, nowhere has more attention been paid than in this area of Electronic Tax Administration, and I think it is very encouraging to see the progress that Commissioner Dolan has described.

There are a few matters involving legislation, and I think that, although the improvements that have been made are significant, I believe we share the opinion of many of the Members of this Subcommittee, that to take electronic filing to the potential that it deserves, legislation is appropriate.

There are apparently two bills on the table. Yesterday Congressmen Rangel, Coyne, Hoyer, Waxman, and Matsui introduced legislation entitled the IRS Improvement Act of 1997, and of course Congressman Portman has introduced a bill, which is the outcome of—and Mr. Cardin, which is the outcome of the Restructuring Commission.

The Code currently requires that certain supporting documents be provided on paper, and the IRS Improvement Act would give the

Secretary the explicit authority to prescribe alternative methods of verification for electronic returns, and would allow electronic receipts to serve as prima facie evidence of filing. We believe the tools in that act, in common with the legislation proposed by Congressmen Cardin and Portman, would give the IRS much needed flexibility to adapt to the new information technologies.

We do have some differences and some concerns about aspects of the legislation introduced by Congressmen Portman and Cardin, and I think I can summarize them very quickly.

In particular we are concerned about mandates or their functional equivalents through specified targets, and we are afraid that this will introduce a rigidity in an area where flexibility is really the order of the day. We have seen such rapid developments in technology that what appears to be truly useful today can indeed be a burden in a relatively short time.

It is true that more Americans are gaining access to a computer daily, but it is unlikely that in the foreseeable future all Americans will have that access. We think there ought not to be any requirement that everyone file electronically; that would be unfair to those without computers who choose not to pay for professional assistance. And we think that a specified target perhaps would lock us in to areas where more flexibility would be necessary.

Another provision that is inconsistent in our view with sound tax policy is, which the Commissioner has referred to, the extension of the filing dates for those who file electronically. Alternative deadlines we think may well impair tax compliance and will certainly cost revenue in favor of sophisticated taxpayers who have balances due. Moreover, since sophisticated balance-due taxpayers might be more likely to file electronically if the deadline were extended, postponing that deadline for electronic filers would be unfair compared to middle- and low-income working families who are frequently in a refund position.

And again, we probably think it is unwise to mandate incentives for transmitters of electronic returns. We agree, however, that we do not want to dismiss the notion of incentives, and therefore we think it is much sounder to go the route of giving authority to develop incentives.

So in sum, while we, I think, share qualitatively most of the provisions of the bills in common, we think in a few areas that there should be no mandates, rather authorization, more flexibility, no dual filing dates, and no specific percentages. This is not to say that we do not think that the work of this Subcommittee in monitoring the progress of the IRS in achieving these objectives is not necessary; indeed we welcome it and we would like to work closely with you, and report to you, so that you can constantly see what progress is being made. And we think that we can work as partners more effectively on that basis.

We thank you for your interest in this, and I will attempt to join Commissioner Dolan in answering any questions which you have.

Chairman JOHNSON. Mr. Lutes, do you have a statement also?

Mr. LUTES. No.

Chairman JOHNSON. Thank you. In your testimony you mentioned that you need to determine the level of savings for electronically received returns compared to the cost of paper returns.

Does the IRS have an estimate of the average cost of processing a paper tax return, and do you accept the $7 as the average cost of processing a paper return? And if not, how far are you from knowing these facts?

Mr. DOLAN. I like the last question better than I do the first two, because it is one I can answer easier.

Chairman JOHNSON. Actually, it is sort of interesting that the IRS does not want to deal with numbers.

Mr. DOLAN. It is really more a question of having too many numbers. And part of what has been at work here—and frankly I am embarrassed that we did not have a way to differentiate these numbers better, even for the Restructuring Commission.

We can tell you what the front-end processing, what the difference is between keystroking something, and what the difference is between getting a data stream. A part that has never been done very effectively is that is clearly not the only benefit of getting an electronic stream because there are many, many things that happen in perfecting that return, and subsequently providing taxpayer customer service. And so our deficiency has been in really giving a number that is anything more than this sort of simplistic up front number.

We are in the process—have been for some time, stimulated in large part by the interaction we have with the Restructuring Commission, of doing a cost assessment, which I believe in late September, is supposed to serve up for us at least a far better ability to compare than we have today.

Most of the folks who look at it, strictly with respect to the comparisons we made on the front end, think that the 6 to 1 or $6, $7 savings, is a far exaggerated rate of savings. But I do not want to sit here before you today and try to tell you it should be something else to 1 until I get the benefit of this work in September.

Chairman JOHNSON. Thank you. We certainly do need to refine those numbers; that is terribly important——

Mr. DOLAN. Absolutely.

Chairman JOHNSON [continuing]. And the contrast between manually entering and transmitting is just so stark that the dollar difference has got to be very significant just on the front end. And if 70 million of the 120 million individual filings exist on electronic record, at some point in the process we ought to be able to take advantage of that, and when we do, it ought to have a very significant cost component.

So, it is imperative that we move forward because that is money we can use on technology and so on. This is an issue that bears a lot of analysis, scrutiny, and it is just something that we must know.

I am going to yield to my Ranking Member to question. I am very interested in the issue of signatures, but I think that that will come up amongst the other Members. And so that everyone gets a chance, I am going to yield. I am going to tell Members that we will not break for this vote. If you will go serially so that some toward the end can go now and come back, then we can go through the question period and keep our bearing on our time schedule.

So thank you, Mr. Dolan and Mr. Lubick, and Mr. Lutes.

Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairman, and thank you, Mr. Dolan and Mr. Lubick, for your testimony.

You indicated that you are going to encourage people to file electronically, and you pointed out that one method might be the personal computer. I wonder if you could outline for us what would be available to the taxpayer—how they would file their return if they did not have a personal computer but wanted to file electronically.

Mr. DOLAN. Today the principle alternative is obviously the use of a practitioner, but there are a series of other alternatives, which are, for example, are VITA sites——

Mr. COYNE. What sites?

Mr. DOLAN. I am sorry, voluntary assistance sites. Frequently they also make available an electronic filing capacity. But that is sort of a hit and miss proposition today. So short of somebody having and utilizing their own computer access or utilizing the services of a prepared tax preparer, there are not many systematic alternatives for somebody to go and use either somebody else's computer or some other electronic form of access to the system today.

Mr. COYNE. You mentioned people who use the electronic system to file. You are still having to ask for paperwork from them, and you want to totally eliminate that.

I wonder if you could outline for us what are the more prevalent requests for paper that you make of electronic filers? In other words, what are the necessary paper files?

Mr. DOLAN. The principle information items that we today receive in paper are a signature and wage information. And I think it is pretty clear to us that we can resolve the question of whether you need to supply W–2 information by paper, and I think we can solve that problem on our own.

The one that has been a little dicier and the one that the Chairman alluded to, is the extent to which we can provide an alternative to the signature, and that comes packaged a couple of different ways.

One, we want to be very clear that we have a process to authenticate the return. We do not want people violating the returns on your behalf or my behalf, and us not being able to authenticate who the actual initiator of the return is. We also have, in a more narrow sense, sort of an open playingfield here with respect to our ability in subsequent kind of enforcement actions to satisfy the judicial standards, that yes indeed, this is a return that was filed by the person who we assert filed it.

As Mr. Lubick indicated, the administration would like to see us pin down with certitude that there are some of these alternatives to the written paper signature that will have the same legal force and effect that today's written signature does. Today, the Secretary and the Commissioner have some discretions about authorizing alternatives, but I think what any bill passed could do is make that unequivocal; there are alternatives that are legally defensible and sustainable.

Mr. COYNE. On the telephone filing system, how many taxpayers did the IRS contact to authorize them to do it that way this year?

Mr. DOLAN. Twenty-six million then, Mr. Coyne.

Mr. COYNE. And how many took advantage of it?

Mr. DOLAN. 4.7 million.

Mr. COYNE. How many?

Mr. DOLAN. 4.7 million.

Mr. COYNE. And what are your plans for the new tax year coming up?

Mr. DOLAN. As I mentioned before, by every matrix we have looked at, it is one of our best received products with a 99-percent satisfaction rate.

Two things are going to be crucial for us. One, when a person gets an invitation or a package from us to do TeleFile, it is unique. It does not look like the other tax packages. It has a set of unique characteristics. So one of the things that our communications contractor has told us is, that we really ought to leverage even better our equivalent of a direct mail ability to sort out that 26—and we think it is probably going to be more than 26 million. So we are going to try to increase the effectiveness of the product that is first received to alert people that they have something that is different. And we have a couple of different schemes that we are in the final stages of testing that may help people anticipate this package, and may remind them that they have gotten the package, and we hope then would get a bigger response rate.

Second, there were a number of people last year that because they moved between the point of their last return and their next return, were made ineligible by the criteria that we were using to select and invite people. We think we have some ways this year to not lose that part of the universe, but indeed to invite many of them into the process of using the TeleFile product as well.

So those would be the two things: First, the increased effectiveness on the message or the marketing; and, second, the expansion of this part of the universe, that those who moved would have been eligible last year, and hopefully would have participated by at least the same rate that the 25 million did.

Mr. COYNE. Thank you.

Mr. PORTMAN. Thank you, Mr. Coyne, and thank you, Mr. Dolan, for your work with the Commission with Mr. Coyne and myself, and a year's worth of work on this topic, electronic filing, and for coming here today—Mr. Lubick, thank you also for being here.

What I thought I would do is, rather than talk more generally about some of the issues you have discussed, many of which we agree on, is get into some of the specifics of the legislation. The charge today really is that this Subcommittee is to put together a report on the legislation, H.R. 2292, and you have addressed some of the issues.

I wanted to clarify the record, if I could, to start with what is one of the issues apparently where there may be some disagreement. Incidentally, I find myself alone again with Treasury and the IRS. This will be, I am sure, a much more amiable discussion than the last time I found myself here. I am outnumbered today among other things.

Mr. Lubick, you said you do not like H.R. 2292 because you should not mandate that everyone file electronically. That is the quote I wrote down here. Of course H.R. 2292 does not mandate that, and I think the record needs to be clarified. This is something we talked about for a year; Mike Dolan knows this. We went back and forth on various iterations with the IRS, with Treasury. We

made a very deliberate decision not to mandate electronic filing. So, if it is going to be mischaracterized, I think we are going to have a hard time getting to points of agreement, even on these few issues where we tend to disagree.

You say also in your testimony—at least your oral testimony—that you are happy to have us monitor your progress, but we should not set any guidelines. And you also say that there should not be mandates to transmitters. There are no mandates to transmitters in this legislation. So let us just make that clear. What we do provide is some incentives to transmitters that you apparently disagree with, and that is fine, we can talk about that. But at least we need to clarify what the legislation does.

Just briefly on the reason we came up with this—and then I want to get some feedback, if I could, from the IRS and Treasury—is an 80-percent goal by 10 years. Now, despite efforts over the years to get the IRS to come up with a plan to more aggressively pursue electronic filing, we do not have such a plan from the IRS still. And the Commission set about its task seriously, and put together a plan with the IRS' help that we think is a very practical plan that makes it quite easy to get 80 percent within 10 years. My personal view is it will happen long before 10 years. We have seen the changes in technology already in the last year since we have been working on this, and we will see more changes, I am convinced. But the notion is to set a goal, because if you do not set a goal you are less likely to get there. And certainly the experience of the last decade would lead us down that track, but there is no mandate on individual taxpayers; no mandate on transmitters. There is a goal set out very firmly to the IRS to meet that 80-percent deadline, 80 percent of individual taxpayers filing electronically.

I guess what I would ask, Mr. Dolan, is if you would give us your response to that from the IRS point of view, number one, whether you think that is an obtainable goal; and number two, if you would give us some alternatives to that. In your RFP you say you are going to ask that significant expansion of electronic filing be sort of the underlying goal. Well, that is fine. What is significant expansion?

In your strategic plan of January of this year in 1997 we did not get a goal on electronic filing. Again, August 15, this year, your strategic plan for the IRS is very vague about electronic filing; the strategic plan encourages electronic filing, and I think we agree on that, but how do you feel about the goal and what are your alternatives to it if you do not think it is appropriate.

Mr. DOLAN. Thanks for the question. I happen, as you know, to have the benefit of attending I think what was the last session of the Restructuring Commission, where the group was wrestling with how to state this, and I know there is dialog that I missed about that. But the tension that I saw that day is the right tension. Eighty percent, as it expresses what you and I might believe is sort of the intuitive right place to be. The fact that it was set against 2007, I believe, on the surface you would look at that and say, I mean what is not to believe about the reasonableness of that.

Now, to the extent that people are satisfied with that level of analysis, then 80 percent may work. I think the part that I would

urge, Congressman, is that one of our problems in the past in thinking about this in some other areas was to kind of set an aspirational goal. Now to some extent that works, if the aspirational goal is the kind of thing that keeps you vigorous about trying new things. But what I guess I hoped would happen was that the RFP process would give us an opportunity to maybe place, through what we heard in the RFP, maybe place the building blocks where you and I could sit across the table and say, Hey, this is not about aspiration; this is not about hope for good work and luck. This is a series of building blocks that the industry has said 80 percent is too modest or 2007 is too far off.

Mr. PORTMAN. Mr. Dolan, I am going to have to run over and vote. I am going to actually pass along to my colleagues. But it sounds like you and I largely agree, and the question is whether the legislation should establish that goal. I think we have already heard from the industry, and we have already heard from you, we have already heard from Treasury. We know where we are. We have reams of testimony; we are going to hear more today.

I personally believe that it is not only attainable in 10 years, but probably in 5 years, but I think certainly 10 years is a reasonable goal.

With that I would like to move to Ms. Dunn, and then I will be back after voting.

Ms. DUNN. Thank you very much, Mr. Portman. And welcome, gentlemen. It has been very interesting, this whole process. And Mr. Dolan, we have appreciated your involvement in it.

Mr. Lubick, I have a concern about your comments. I agree with what Mr. Portman said. I do not see the goals and objectives that are measurable, that we have set through this proposal of 80 percent by the year 2007 as a mandate on the taxpayer. I see it as a mandate on the agency, and the agency apparently, according to Mr. Dolan, is happy to accept this objective. And I do not think you do not get work done unless you do have a guideline that tells you what needed to be done and what time.

But I really hope from Treasury that we are going to see some coordination with what we are all trying to do to make the IRS more efficient, and more effective and more helpful to the taxpayer. I know that you lose power for Treasury because of the Control Board and other areas, but I would like to think that you are going to look at this objectively, and what can we do better for the taxpayer. I certainly give the administration credit for doing that many areas, and I hope we can count on that hereto.

I have a couple of questions. I would like, Mr. Dolan, have you analyzed how many jobs, how many dollars can be—jobs done away with dollars saved, paperwork done away with, through this particular objective?

Mr. DOLAN. Ms. Dunn, the analysis that I talked about—and I am not sure whether you were in the room when the Chairman asked me about this—is it 6 to 1, is it 7 to 1.

I think the analysis that we will produce as a result of this product that we should have at the end of September will put us in a better place today than what we have had in the past. Historically what we have had, and what has actually been harvested from our budget, as electronic receipts have gone up, we have had the com-

mensurate withdrawal from our budget of the dollars and staff years that would have been associated with key entry. But beyond that, I think if you put yourself in a world that Congressman Portman projected of 80 million filers by a date certain, and payments made electronically, we do not have a satisfactory picture of what the staffing and production impact would be. It would obviously be considerable. And then the discussion we want to have is the one the Chairman talked about, which is, so what are the choices around those? Are they choices about just recouping the dollars totally, or are they choices about placing them in some other aspect of customer service or compliance?

Ms. DUNN. Thank you, Mr. Dolan. I see as a primary goal of what we are trying to do here in making the IRS more effective, of downsizing the IRS. Are you still at 102,000 employees at the IRS?

Mr. DOLAN. Yes, we are, Ma'am.

Ms. DUNN. And certainly making it more of an effective partner to the taxpayer.

Let me ask you a question about the incentives to the preparers of tax returns. I would like to know, if you are thinking about paying H&R Block and other preparers, $3 per tax return for filing electronically. It seems to me it is a huge benefit to the taxpayer, and that these folks, these preparers, are already out there charging taxpayers $20, $30, $40, $50, sometimes more dollars, to prepare an electronic return.

What is the thinking? I mean why would you not take this $3 per return, for example, and use it for educating the public to get to our goal of 80 percent more quickly than we projected?

Mr. DOLAN. I think Mr. Lubick may have an answer. Let me just say, you and I would probably get to the same page in the hymnal pretty quickly. I do think it is something we have to look at very carefully, as to whether we would use $3 in the way that some have urged. And particularly I would be concerned, if I were to go back now and pay $3 for the $20 million that I received last year. That would be $60 million out of my budget that would have to come at the direct expense of doing work in customer service, or doing other activities that those $60 million would have bought. So I do think that either that dollar amount or any other dollar amount being applied as an incentive, is something that has to be looked at very carefully. And Mr. Lubick, I think, may want to comment as well.

Mr. LUBICK. Incidentally, Congresswoman Dunn, I did not mean to imply that the legislation did mandate that taxpayers file electronically. I was simply stating that if we mandate, as you said, the agency, that it has to reach 80 percent. It seems to me that is unwise to put in legislation. I think it is perfectly satisfactory to say, and announce, and have this Subcommittee monitor an aspirational goal of achieving 80 percent, but circumstances change, and I think you ought to retain the flexibility to adapt your position to the circumstances. You may want to change that goal to more or less.

And the same applies to the question of incentives. I think we would favor the authorization of a program of incentives if it can be demonstrated that it would be cost beneficial; not only taking

into account the cost to the Internal Revenue Service, but the cost to taxpayers and the cost to preparers. There are costs of complying with the tax system that go beyond tax administration. They fall on private citizens, and those have to be taken into account.

So, if we mandate the furnishing of incentives to transmitters, I am not sure that that is the right expenditure, for reasons that have been discussed by Mr. Dolan and suggested by you. It may be that you would want to give incentives to the taxpayers themselves. It may be that the preparers should be given incentives. I think we have to keep open in this, and we have to work together as this proceeds, to be flexible and to go in the most efficient way to accomplish our mutual and exactly congruent objectives. So I think it is flexibility that we are urging here, and the avoidance of rigidity. I did not mean to suggest that the legislation intended ever—and I do not think it could—to require every taxpayer to file electronically.

Ms. DUNN. Good, and I appreciate your comments, Mr. Lubick. I certainly think, if anything, that Congress has proved itself very resilient in changing goals and objectives. I do not worry that we will find ourselves locked into something, and I would hope, as Mr. Portman suggested, that we might reach these goals much, much more quickly. I would certainly hope so; 10 years is a lot.

Madam Chairman, may I just have one more brief question?

Chairman JOHNSON. OK.

Ms. DUNN. I am very interested in the signature portion of the program, and I understand California has a program where they have tested, or are in the process of testing filings that do not include the signatures, which are going to be such an expensive part of our program if we are not able to eliminate the personal signature.

Do we know how the California program is doing? Is there fraud involved or is it at a point where we can evaluate it?

Mr. DOLAN. I think the short answer is we do not know much, Ms. Dunn. I would be happy to try to find some of that. And Terry may want to spend a minute on the relative comparisons between the States and our experience, but the direct answer is that we do not have much information on California's experience at this point.

Ms. DUNN. Well, it would be a great interest to me, and I am sure the Subcommittee. Thank you, Madam Chairman.

Chairman JOHNSON. Thank you. Mr. Cardin.

Mr. CARDIN. Thank you, Madam Chairman, and let me thank you for your testimony. It is clear that we all share the same objective to increase the amount of electronic filing, and the legislation that we have introduced moves us rapidly to achieve that objective.

It is interesting. Whenever you have change, people will look back later and say, why did we ever do it the other way. And I understand that we need to educate the taxpayer, and we need to deal with the obstacles that are currently involved to make it available for us to do more electronic filing.

The Commission's recommendation offers a major incentive for taxpayers to use electronic filing, by giving them an additional 30 days to file their tax returns. I understand the administration's bill allows the IRS to come up with financial incentives for electronic filing. So, in one instance we are trying to be specific to offer an

incentive for taxpayers to take advantage of electronic filing. The administration desires to use incentives, but wants to study and come back, and give us some recommendations or implement some changes.

I would hope that you could be more specific as to what type of financial incentives you believe should be considered in order to encourage more electronic filing. Because once we get our numbers up we will never go back, and people will start to understand the advantages, and the financial advantages to a taxpayer filing electronically.

What type of incentives would you consider?

Mr. DOLAN. I think, Mr. Cardin, we will know a lot more about this within a couple of months when we have the responses to the RFPs, because we will have input from a number of people in the private sector who will presumably educate us considerably on that. We will have a better handle on what are the costs involved, and what are the benefits and how we might target incentives.

I think some sort of a payment would be something that we would consider, but to whom it would be paid—whether it would be the transmitter or the preparer, or the taxpayer—I do not know. I think at this stage my feeling would be that the fairest of all might be an incentive that went to taxpayers.

Mr. CARDIN. Might you also consider a different filing deadline as an incentive?

Mr. DOLAN. Consider——

Mr. CARDIN. A different deadline for filing. Is that not one that is on your list?

Mr. DOLAN. I would be dubious about that right now. I think it would be somewhat disruptive of the tax administration not to have a uniform filing date.

Mr. CARDIN. If I could just interrupt on that, because that seems to me a little bit unusual to say, because we seem to be spreading different deadlines in governmental agencies in order to manage the workload more effectively. And different deadlines, it seems to me, could give you some advantages in addition to more electronic filing.

Mr. DOLAN. I would fear that different deadlines might, rather than spread the work, might make the work of the IRS more difficult. For example, if many returns are filed a month later, that is going to cause further delays in processing and audit.

Mr. CARDIN. Of course you have an automatic delay now that you could get in filing your returns if you paid your taxes. You already have that built into the system. I am not sure I quite understand the concerns with a 30-day delay, when you can get a longer delay in filing tax returns under current rules.

Let me just caution you. It would be shortsighted to fail to quickly move to accept electronic filing because of the transition cost. Ultimately, I think we all understand electronic filing is going to be less costly, not more costly; that ultimately when the system is more efficient it is going to be easier for the taxpayer, for the tax preparer, and for the government. And I would hope that as we develop financial incentives for electronic filing that we do not build into the system additional costs that are going to be difficult to back out of.

As we try to spread the workload or look at other issues, I think you raise good points. Having a different date is something that needs to be considered in addition to just the impact it will have on electronic filing, and I agree with your concerns there. But to just dismiss it because it sets up a different date I think is also wrong.

What we try to do in the bill that we filed is be specific on a financial incentive, to encourage more electronic filing. And I would hope that you would be a little bit bolder, and come forward with recommendations that will make it easier for the taxpayer to take advantage of electronic filing. I have not heard enough ideas yet, and I would hope that you would be forthcoming with additional suggestions. Thank you, Madam Chairman.

Chairman JOHNSON. Mr. Ramstad.

Mr. RAMSTAD. Madam Chairman. As you know, Mr. Dolan, a few months ago this Subcommittee examined the Electronic Federal Tax Payment System, and particularly the disastrous communication effort by the IRS that I dare say really frightened many in the small business community, and I appreciate your testimony about the lessons learned by the IRS from the EFTPS debacle.

In looking at that experience, which many reported to me as being heavy handed, I would ask you if there is a specific marketing plan that is more taxpayer friendly; if you have specific steps in mind in marketing electronic filing to taxpayers.

Mr. DOLAN. Congressman, we do, and what I would maybe ask for is the opportunity, a couple weeks hence, to brief the Subcommittee. As I mentioned in the earlier part of one of my questions, we exposed just last week the work that our communications contractor had done with us, to some of the outside groups that will partner with us in this marketing approach. We are in the process of taking some of their feedback and finalizing our plans, but we have some very specific ideas—with respect to the way media would be used, and the way we would use, as I mentioned in the TeleFile. TeleFile is sort of a direct mail opportunity for us of a unique sort, and there are some changes that we are going to make in that arena as well. And so, within a couple of weeks I would be happy to make available to you or the Subcommittee, more broadly what those marketing approaches will look like in the next year.

[The following was subsequently received:]

1998 Filing Season Campaign

BACKGROUND

In developing our national promotion strategy for the 1998 filing season, the Internal Revenue Service (IRS) and Treasury consulted with Emmerling-Post, our advertising agency. We reviewed the results of our TeleFile promotion in 1997 and looked at the areas for greatest potential to help the Service meet its overall electronic filing goals.

This year's filing season campaign will promote the use of electronic filing options, with primary emphasis on practitioner electronic filing. We hope to build on last year's successes. During the past filing season, there was an increase in the number of returns filed using electronic filing options. Not only did the number of TeleFile returns increase, returns filed through third party providers also increased. This growth provides a good platform for our 1998 electronic filing program.

OVERALL APPROACH

This year's campaign will introduce a new name and logo for electronic filing options. In their presentation to the Service, Emmerling-Post recommended use of the term IRS e-file to refer to our electronic filing options. E-file is a commonly used phrase on the Internet and is also used by Revenue Canada to describe their electronic filing program.

KEY MESSAGES

• IRS e-file is the quickest way to get refunds. You receive refunds in half the time over paper returns—even faster with Direct Deposit.
• IRS e-file returns are more accurate and reduce the chance of getting an error letter from the IRS.
• IRS e-file options provide acknowledgment your return has been accepted.
• IRS e-file is a proven commodity. Over 19 million people like you chose an IRS e-file option last year.

NATIONAL IRS E-FILE CAMPAIGN STRATEGY

• Develop a unified public service campaign and supporting materials with the IRS e-file logo to increase public awareness of IRS e-file options.
• Use tax practitioners and practitioner groups as IRS e-file champions.
• Provide a promotional kit to IRS e-file third party providers. The kit will provide third parties with materials they can use to promote their IRS e-file service to their clients and customers.
• Reinforce messages from the public service campaign in the 1040 packages.

TELEFILE STRATEGY

• Use the TeleFile booklet as a direct mail marketing tool to emphasize the benefits of filing by phone.
• Redesign the TeleFile booklet covers and logo to be more effective.
• Test the impact of supplemental post card mailings to some TeleFile booklet recipients.

IRS e-file via a Personal Computer Strategy

• Make taxpayers aware, through the tax package, magazine ads and articles and in the software packages, that the benefits of IRS e-file are available to individuals who prepare their tax return using a personal computer, tax preparation software and a modem.
• Partner with software providers to promote IRS e-file options.

EXTERNAL STAKEHOLDERS

A major feature of the promotion effort is building partnerships with third party providers and associations to enlist their active participation and promotion of IRS e-file with their customers and members. On September 4, IRS executives met with members of national tax practitioner organizations and industry representatives from the Council for Economic Revenue Communication Advancement (CERCA). At that meeting Emmerling-Post presented an overview of the practitioner IRS e-file campaign and the kit for third party providers. The kit includes an IRS e-file logo and stickers, a letter to clients, posters, and a decal to read "Authorized IRS e-file provider." The kit will also include copies of the public service campaign. Electronic versions of the kit will be available to IRS field offices and practitioner associations in October. Hard copies will be sent to Electronic Return Originators (ERO) in December.

THE PUBLIC SERVICE CAMPAIGN

A second aspect of Emmerling-Post's recommendations is a public service campaign in radio, television and print focusing primarily on third party IRS e-file. The messages in the materials stress fast refunds through electronic filing. These materials will be distributed to print, radio and television outlets in December to begin appearing the last week of December.

In January, a video news release will be distributed to support the IRS e-file messages. Interviews in the media will keep the message prominent throughout the filing season.

FOLLOW-UP

This year's campaign includes an evaluation component. In May, we plan to survey third party preparers, conduct an attitude and awareness survey among taxpayers and do an analysis of paid media tests. The IRS will also be conducting a survey of taxpayers to provide the quantitative market research data for use in developing enhancements to our ETA products. The results of each of these evaluations will be used to enhance the campaign for the 1999 filing season.

Mr. RAMSTAD. I think a collaborative effort would be helpful. You refer to the communications contractor. I trust it is a different communications contractor. You fired the first one.

Mr. DOLAN. Well, actually, the first one was kind of an in-house job, Congressman, so we did not have a contractor to fire. That is really the dialog that we had with this group before. We were trying to be marketeers.

Although, I might not use quite the language you did in terms of debacles and other things; part of what we learned from that lesson was, we also had a number of cooks in that broth. We had agents of the government; we had various components of the private sector. I think what we are trying to do differently on electronic filing is get everybody's vote so that we understand our respective roles, and understand the convergence of our objectives.

Mr. RAMSTAD. Well, I appreciate that approach and that recognition of the problem. The term debacle is not mine. It came from my constituents, members of my Small Business Advisory Committee and others, and that is one of the most polite reactions that I heard. So I think it is important—and I think you have recognized that this was not a successful effort, to put it lightly, and by hiring a communications contractor, and by doing it a different way, and by offering to be forthcoming with the Subcommittee, and working in a collaborative way on the approach the second time around in marketing electronic filing, that is very, very encouraging to this Member, and I am sure to my colleagues here, and most importantly to our bosses, the American taxpayers.

Thank you, Madam Chairman.

Chairman JOHNSON. Thank you, Mr. Ramstad.

Mr. Kleczka.

Mr. KLECZKA. Thank you, Madam Chair. I think I will pass at this time.

Chairman JOHNSON. Ms. Thurman.

Ms. THURMAN. Thank you, Madam Chairman. In the information you gave us—we break it down in some ways, but I am interested—who is filing electronically? Are these people that are nonitemizers, itemizers, young, old? Can you tell me who this group is out there that is actually doing this.

Mr. LUTES. Yes. Let me try to answer that. We are currently undertaking effort to give us more robust information. We are going through our master file and trying to do a complete profiling of the people who actually do file electronically versus those who do not, which will give us better information. But generally—and I think the external stakeholders will reinforce this—the biggest population that we have tracked is the refund audience who is looking for the fast refund. That has been the major appeal the program

has had. In fact our marketing strategy is going to try to emphasize that point. I do not have the percentage with me, we can get you that, but the vast majority of the electronic returns are refund filers.

[The following was subsequently received:]

Percent of Balance Due Returns Filed Electronically

Total 1997 ELF (Practitioner/On-Line) Returns	14,450,000
Balance Due Returns	345,000
% Balance Due Returns	2%
Total 1997 TeleFile Returns	4,694,000
Balance Due Returns	310,000
% Balance Due Returns	7%
Total 1997 Electronic Returns	19,144,000
Balance Due Returns	655,000
% Balance Due Returns	3%

Mr. DOLAN. Which would mean also that they are largely the taxpayer who has all or the majority of their wages in some kind of withholding environment. That is typically the fact pattern that produces the highest likelihood of having a refund, which in turn is the appeal of the quicker electronic product.

Now the TeleFile product is a little different, because the TeleFile product is one that we are clearly aiming at entrance to the work force, because of its nature.

It is a 1040–EZ, which means that by definition your financial life is pretty uncomplicated, your sources of income. And so what we are trying to do there is target what we would understand would be the profile of a lot of entrants, which would be people who are recently out of school; people who are genuinely entering the labor force for the first time. We are attempting, both in our marketing and in the customization of that product, the accountance that that is the profile that will likely be the eligible population for the TeleFile product. And as Terry said, what we would like to be able to do is to better differentiate the demography, so that we know that this feature of ELF is more appealing to this particular set of demographics than some other.

Ms. THURMAN. The other question that I am kind of curious about—and I know it was part of the recommendations, and it seems to be in some of the testimony that we are going to hear later on, is on the signature issue.

What safeguards does the taxpayer have, if there is this nonsignature, if it is being done electronically? Particularly—not that I would think that anybody would do that meaningfully or whatever, but just this idea that you send something. Is there some kind of protection for them if they were sent up and they did not have the signature or did not know what had been sent to IRS? I would think there would be a concern.

Mr. DOLAN. Clearly there is, and I am going to ask Terry to supplement my answer, but as I mentioned earlier, authentication is really our crucial interest here, both for the sake of the taxpayer and for the system. And that is not just so we can recognize the signature, it is because of the very point you make. We want to be certain that when this transmission comes to us labeled as a filing,

or a payment, or a request, from a specific taxpayer, that it indeed is what it purports to be.

Now there are a variety of combinations today of technology that are being used. Some are being used in less volatile and confidential arenas than ours, and others being used on the other end of the spectrum, where it is highly confidential. And I think what we expect to be able to produce is some combination of things like personal identification numbers, and combinations of data that might possibly relate to a prior return, or might possibly relate to some component that would be known to only the individual. So you combine those things in a way that you have a reasonably high level of certitude; that this really is an authentic verification. And as I say, we do not have the answer today but we are virtually certain that the work that is out there, both done by others and the work done by us, will put us in that position with respect to the tax returns that we file, tax year 1998 returns.

Mr. LUTES. One thing I would add is, is that we probably will not have one solution, one replacement for the paper signature, because the level of risk depends upon the type transaction. The level of risk in a 1040 refund return is very different than the risk in submitting information returns, which is simply providing information to us. So what our process is—and we are working with other government agencies who are also tackling the same problem—is to associate the level of authentication with the level of risk, associated with the particular submission to the service. And what the administration's bill has asked for is maximum flexibility for the service and the Department. As technology changes, as we move down this road, to be able to implement those technologies that authenticate at the appropriate level of risk, while at the same time obviously enabling us to make certain that the information on the return is correct.

Chairman JOHNSON. Thank you, Ms. Thurman. Mr. English.

Mr. ENGLISH. Thank you, Madam Chair. I have a couple of questions, but having listened to the testimony from this panel, I would like to make a comment that I hope you will take back to the Treasury.

In the IRS strategic plan through fiscal year 2002, which came out in the middle of last month, little was said about electronic filing and no quantitative goals have been set. I realize in the past the IRS has set quantitative goals, like in 1993, and has not been able to achieve them. But what troubles me is the idea of establishing a goal of 80-percent electronic filing in 10 years. This is something that from the perspective of people out in the real world, like in my district, is a glacial pace.

Now they have had to respond to a scale of change that is much quicker, and I think, given the dollars involved, and that we can save literally hundreds of million dollars every year if people move into electronic filing, then it seems somehow fundamental that we should find a way of getting done and do it very promptly. Lay some specifics out, and debate them if you want. Consider incentives, consider sanctions if necessary, but we need to move people into electronic filing at a time when we are moving toward a balanced budget, and hundreds of millions of dollars could be much better used, than by pursuing the paper trail in the IRS.

Let me move to my specific questions. Has the IRS Chief Counsel expressed an opinion on whether the IRS has an authority to go paperless? That is, accept returns without a signature document as has been discussed in the Commission recommendation. And would you need additional statutory authority to waive the signature requirement, Mr. Dolan?

Mr. DOLAN. Thank you for the question. I made a brief reference to this earlier. I do believe that the Chief Counsel's opinion is, that there is today discretion—and I believe it is both in the hands of the Commissioner and the Secretary. The Secretary is delegated, so the Commissioner has the ability to accept alternative forms.

The question that is more equivocal is whether or not it would not be more helpful to have a explicit provision that would make certain that when such a reality found its way into the courts or found its way into challenges that herefore have not been made——

Mr. ENGLISH. But has he issued an opinion indicating that a statutory change is not necessary?

Mr. DOLAN. No, I think the opinion that we have—and I would like to get back to you make sure that I tell you this correctly. I think the opinion that we have is one that suggests that the Commissioner currently has the authority to authorize various forms of a signature alternative. And what I think the legislation would seek, or what we might have a mutual interest in, is——

Mr. ENGLISH. Would you be able to provide the Subcommittee with that opinion?

Mr. DOLAN. I certainly will.

Mr. ENGLISH. Thank you.

[The following was subsequently received:]

Electronic Signatures

This responds to your request for our views on whether current law permits the Service to accept electronic signatures. This memorandum also addresses certain additional issues that will be present if the Service accepts electronic signatures. The Service wants to use electronic signatures, instead of traditional pen-to-paper signatures, to authenticate and verify electronically filed returns and supporting documents. The Commissioner is considering the need for legislation.[1]

ISSUES

1. Does the Commissioner have authority to accept electronic signatures to authenticate and verify returns and supporting documents under sections 6061, 6062, 6063, 6064, and 6065 of the Internal Revenue Code of 1986?

2. Will the electronic signature technologies satisfy the "subscription" and "written declaration" requirements of section 7206(1) or the "written" or "writing" requirements of section 6103?

3. Will courts accept electronic signatures as evidence to identify, authenticate, and verify returns and supporting documents?

CONCLUSIONS

1. The Commissioner has authority to accept electronic signatures on electronically filed tax returns and supporting documents. The Commissioner may promulgate regulations that authorize electronic signatures sufficient to authenticate and verify electronically filed returns and supporting documents. The Commissioner should accept only signatures that reliably authenticate and verify a return as that of the filer and do not place an unreasonable burden on taxpayers.

2. Existing signature technologies likely satisfy the "subscription" and "written declaration" requirements of section 7206(1), although new technologies that use

[1] *See* proposal two in the Commissioner's January 10, 1995, legislative package, "IRS Legislative Initiatives for Administration's Budget."

oral statements may not satisfy the written declaration requirement. However, even if the written declaration requirement is not met, persons who willfully file incorrect returns could be prosecuted under other statutes that do not require written declarations. The Commissioner has authority to prescribe regulations that provide for alternatives to the traditional pen-to-paper writing media subject to one caveat—an oral statement cannot be used to satisfy the writing requirement.

3. Courts will accept technologically reliable electronic signatures as evidence to identify, authenticate, and verify returns and supporting documents.

DISCUSSION

I. Electronic Signatures

A. *Authentication and Verification*

Section 6001 requires that taxpayers adequately document tax liability. The Service prescribes returns and supporting documents to verify tax claims. Reflecting the state of "writing" through most of the twentieth century, returns and supporting documents were paper. Taxpayers used traditional pen-to-paper signatures to authenticate and verify these documents.

A goal of the Tax Systems Modernization (TSM) initiative is to convert paper filings to more efficient, electronic filings.[2] To date, the Service has required separate paper signatures and declarations to authenticate and verify returns and supporting documents filed under the electronic filing (ELF) programs. The Service retained the traditional pen-to-paper signature and declaration, in part, because of uncertainty about whether existing statutes permit "alternative" electronic signatures and declarations. As discussed below, we conclude that under existing statutory authority, the Commissioner may prescribe regulations under which electronic signatures can be used to authenticate and verify electronically filed returns and supporting documents.

B. *Statutes*

Section 6061 states that, except as otherwise provided by sections 6062 and 6063, relating to corporation and partnership returns respectively, any return, statement or other document required under the internal revenue laws or regulations shall be signed in accordance with forms or regulations prescribed by the Secretary.

Section 6062 provides that the return of a corporation with respect to income shall be signed by the president, vice president, etc., or other officer duly authorized so to act. Additionally, section 6062 provides that the fact that an individual's name is signed on the return shall be *prima facie* evidence that such individual is authorized to sign the return on behalf of the corporation.

Section 6063 provides that the return of a partnership shall be signed by any one of the partners. Additionally, section 6063 provides that the fact that an individual's name is signed on the return shall be *prima facie* evidence that such individual is authorized to sign the return on behalf of the partnership.

Section 6064 provides that the fact that an individual's name is signed to a return, statement, or other document shall be *prima facie* evidence for all purposes that the return, statement, or other document was actually signed by such individual.

Section 6065 provides that, except as otherwise provided by the Secretary, any return, declaration, statement, or other document required to be made by the Code or regulations shall contain or be verified by a written declaration that it is made under penalties of perjury.

C. *Legislative History*

The current authentication and verification requirements in the Code originated in the first modern tax statutes. The Revenue Act of 1909 imposed an income tax on corporations, joint stock companies or associations organized for profit. Section 38 of the Revenue Act of 1909, ch. 6, 36 Stat. 112, 114 (1909), required that "a true and accurate return under oath or affirmation ... shall be made" by the taxpayer. The subsequent Revenue Acts imposed a similar oath or affirmation requirement for attestation on other filers.

The Internal Revenue Code of 1939, ch. 2, 53 Stat. 1 (1939), continued to impose the oath or affirmation requirement for all filers. Section 51(a) of the 1939 Code required individuals to "make under oath a return"; section 52(a) required that "the [corporation's] return shall be sworn to" by two of the corporation's officers; section 187 stated that "the [partnership's] return shall be sworn to by any one of the part-

[2] Current Section 6011(e)(1) prohibits the Service from requiring any income tax return of an individual, estate, or trust to be other than on a paper form furnished by the Service. Despite the Service's broad authority to prescribe the verification or define what constitutes a signature, legislation would be required to *mandate* electronic filing for individuals, estates or trusts.

ners"; section 821(a) stated that executors of domestic estates "shall make a return under oath"; section 864(a) stated that executors of foreign estates "shall make a return under oath"; and section 1006(a) required that gift donors "make a return under oath."

Section 136(a) of the Revenue Act of 1942, ch. 619, 56 Stat. 798, 836 (1942), amended section 51 of the 1939 Code by deleting the requirement that returns of individuals be made under oath and substituting the requirement that individuals attest by written declaration that the return is made under the penalties of perjury. The Senate Committee Report indicates that the change was made because the oath requirement "causes considerable annoyance and inconvenience to taxpayers in that their returns must be sworn to before a notary public or other similar officer." *See* S. Rep. No. 1631, 77th Cong., 2d Sess. 5 (1942), 1942–2 C.B. 507. The 1939 Code retained the requirement that a return be made under oath by corporations, partnerships, fiduciaries, executors of estates, and donors of gifts. By 1954, Congress had largely replaced verification by oath with verification by signed declaration.

The 1954 Code made a number of changes. Section 6062 changed the corporate filing requirements (a) to allow one of the described corporate officers to sign a corporate tax return (instead of requiring two officers to sign), (b) to allow the corporation to designate an officer not specified by statute to sign a tax return, and (c) to provide that a person's signed name is *prima facie* evidence that the person is authorized to sign. Section 6063 changed the partnership filing requirements to provide that a partner's signature on a return is *prima facie* evidence that the partner is authorized to sign for the partnership. Section 6064 contained no material change from preceding law. The predecessor of section 6065 required all returns (except those made by individuals) to be made under oath but permitted the Secretary to allow by regulation a return to be made by a declaration under penalty of perjury instead of by oath. Section 6065 reversed the regulatory presumption to favor declarations over oaths. Current section 6065 requires all returns to be made under penalties of perjury, except the Secretary may by regulation permit a return to be made without such declaration or the Secretary may exercise his or her authority to require verification by oath.

Section 6065 gives the Secretary very broad interpretative authority to prescribe the form of verification. The legislative history indicates that Congress intended to allow the Secretary to accept less than a written perjury declaration as a form of verification. "Under section 6065, all returns, etc., are to be made under penalties of perjury, except that the Secretary may permit them to be made without such declaration ..." H.R. Rep. No. 1337, 83rd Cong., 2d Sess., A400 (1954); S. Rep. No. 1622, 83rd Cong., 2d Sess., 567 (1954).

Administratively, the Service has required a signature to authenticate a return since the first revenue acts. The original verification, by oath or swearing, included a signature. The signature requirement is now codified in section 6061.[3]

Neither the Code nor the legislative history defines signature. 1 U.S.C. section 1 provides that "in determining the meaning of any Act of Congress, unless the context indicates otherwise, signature includes a mark when the person making the same intended it as such." Further, the generally accepted legal definition of signature is very broad: "[t]he act of putting one's name at the end of an instrument to attest its validity; the name thus written. A signature may be written by hand, printed, stamped, typewritten, engraved, photographed, or cut from one instrument and attached to another, and a signature lithographed on an instrument by a party is sufficient for the purpose of signing it; *it being immaterial with what kind of instrument a signature is made*." (Emphasis added.) *See Black's Law Dictionary*, 1381–82 (6th ed. 1990). Nothing in the Code or regulations suggests a narrower definition. The common law definition is broad enough to encompass electronic signatures.

D. *Regulatory Authority*

In determining the Commissioner's authority to accept electronic signatures to authenticate and verify returns and supporting documents, it is necessary to review

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[3] The Code and Treasury regulations require that a tax return be signed for two purposes. The purpose in section 6061 and section 1.6061–1 of the Treasury regulations is the authentication of the return as that made by the signer. *See Receipt of Tax Data in Machine Useable Form*, GCM 33879 (Supp.), I–3149 (Aug. 8, 1968) at 2, stating that the objective in requiring signatures on returns is to identify a return as the return of the taxpayer. Under section 1.6065–1 of the Treasury regulations, the purpose of the signature is to verify the truth, correctness, and completeness of the return.

There is a sufficient body of case law with respect to section 6061 holding that a tax return must be signed to be a valid tax return and thus an unsigned tax return is not a "return" for purposes of the Code. *See Dixon v. Commissioner*, 28 T.C. 338 (1957); *Reaves v. Commissioner*, 295 F.2d 336 (5th Cir. 1961); and *Vaira v. Commissioner*, 444 F.2d 770 (3d Cir. 1971).

the standards for review of such authority. Treasury regulations issued pursuant to the Secretary's general authority to prescribe "all needful rules and regulations for the enforcement" of the internal revenue laws are considered interpretive regulations. Section 7805(a). The Supreme Court has established the standard of review for interpretive regulations. The basic rule is that if the intent of Congress is clear, the agency must give effect to the unambiguously expressed intent of Congress. Where Congress has *implicitly* left a statutory gap (to be filled with an interpretive regulation), the standard of review is whether the regulation is a "reasonable interpretation" of the statute. *See Chevron U.S.A., Inc. v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

In describing the standard to be used in reviewing an Executive department's construction of a statutory scheme, the Court in *Chevron* stated:

If this choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress could have sanctioned.

Chevron, 467 U.S. at 844, citing *United States v. Shimer*, 367 U.S. 374, 382–383 (1961). While *Chevron* undoubtedly stands for the principle that deference is to be paid to an administrative agency's construction of a statute that it is authorized to administer, the opinion stands equally for the proposition that such deference is not unlimited. First, there must be statutory silence or ambiguity on the point in question to trigger such deference. Second, a court will defer to only statutory interpretations that are reasonable in light of Congressional intent.

When sections 6061 through 6065 were enacted, there existed no technology for signing a return other than a person manually signing his or her name or placing an authorized mark on a paper. The Service has required pen-to-paper signatures with attestations since 1909. The statutory provisions have remained substantially unchanged since 1954, but Congress has not explicitly defined what constitutes a signature for these purposes.

Sections 6061, 6062, 6063, 6064, and 6065 do not prohibit the Commissioner from defining what constitutes an acceptable signature. In light of the statutory framework and legislative history, a regulation may prescribe the form of signature for electronically filed returns.[4]

If the validity of regulations authorizing electronic signatures were challenged, a court would closely scrutinize the circumstances surrounding the adoption of the regulations. The fact that the regulations were promulgated long after enactment of the controlling statutes would heighten the degree of scrutiny. In light of the legislative history, a court might find that an alternative form of signature is unreasonable or arbitrary if the technology is not reliable or if the regulation imposes an unreasonable burden on taxpayers due to increased cost or difficulty of use. For example, a court would be more likely to invalidate a regulation mandating a particular form of signature, as opposed to providing an optional form of signature, because a mandated form imposes a definite burden. However, provided that the Commissioner promulgates regulations prescribing only signatures that reliably authenticate and verify the return as that of the filer and do not place an unreasonable burden on taxpayers, we believe that regulations that authorize electronic signatures for authentication and verification purposes would be upheld as a valid exercise of the Commissioner's authority to prescribe regulations.

II. Definition of "written" under sections 7206(1) and 6103

A. *Section 7206(1)*

Most of the criminal tax provisions in the Code (except section 7206(1)) do not focus specifically on the requirement of a signature or a written declaration. However, it is often necessary in criminal tax cases to "tie" a tax return to the taxpayer under investigation. In situations where an electronic tax return would consist of an electronic transmission and a signature, "tying" the computer-based transmission to a taxpayer may require additional evidence not necessary with paper returns.

Section 7206 of the Code makes it a felony for any person to "willfully make and *subscribe* any return, statement, or other document, which contains or is verified by a *written* declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter." (Emphasis added.)

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[4] In fact, the Service currently accepts alternative (facsimile) signatures where specific authenticating safeguards are present. *See, e.g.*, Rev. Rul. 68–500, 1968–2 C.B. 575; Rev. Rul. 82–29, 1982–1 C.B. 200; section 1.6695–1(b)(4)(iii) of the Income Tax Regulations. Additionally, Temporary Regulation section 1.6061–2T authorized signing of returns by voice signatures for certain taxpayers filing 1992 and 1993 calendar year returns.

In our view, the "subscribe" requirement can be satisfied by the traditional signature made by ink on paper, or by any of the new signature alternative technologies.

With regard to the section 7206 "written declaration" requirement, an issue exists as to whether the numerous new technologies will meet the "written declaration" requirement. The term "written" has acquired a broader definition than traditional pen and ink. *See* 1 U.S.C. section 1, Fed R. Evid. 1001. In our view, existing electronic signature technologies should be sufficient to satisfy the written declaration requirement. However, as other technologies are developed and implemented—such as technologies that use oral declarations that are transcribed to writing—there is a point at which the written declaration requirement no longer will be satisfied. Nevertheless, even if such technologies are insufficient to satisfy the written declaration requirement, other criminal statutes that address false statements or false claims—and which do not require a written declarations—could be used to prosecute taxpayers who willfully file incorrect returns. *See, e.g.,* 18 U.S.C. section 287, 1001.

B. *Section 6103*

The terms "written," "written request," and "writing" are used numerous times throughout section 6103.[5] There is no definition of writing in section 6103. Similarly, there is no legislative history to the 1976 Tax Reform Act, which substantially revised section 6103, explaining the meaning of the terms "written" or "writing."

The legislative history to the 1976 Tax Reform Act indicates that, to the extent practical, all disclosures of tax information are to be made in documentary form in order to protect the privacy of the taxpayer and to protect IRS personnel making the disclosure from subsequent charges that information was improperly disclosed. S. Rep. No. 938, 94th Cong. 2d Sess. 343 (1976), 1976–3 C.B. (Vol. 3) 381. The purpose of the written request requirement appears to be the same. The initial written request helps maintain accountability in the IRS and agencies that are the recipients of tax information.

The only court to address the "writing" issue in the section 6103 context held that an oral consent was clearly not a "written request for or consent to ... disclosure" as that term is used in section 6103(c). *Huckaby v. Internal Revenue Service,* 794 F.2d 1041 (5th Cir. 1986). The Fifth Circuit noted that the purpose of the written form was to assure the taxpayer's clear assent before return information is disclosed. The court also noted that oral requests like the one at issue in that case were subject to misinterpretation.

The Service has not, for disclosure purposes, interpreted the requirement for a written consent to limit written requests to traditional writing media, *i.e.,* pen-to-paper. For example, the Service currently accepts photocopies and facsimile copies of section 6103(c) disclosure consents.

Under section 6103(q), there is authority to prescribe regulations as are necessary to carry out the provisions of section 6103. Section 6103(p)(1) provides that requests for the inspection or disclosure of tax information shall be made in such manner and at such time and place as shall be prescribed by the Service. Section 6103(c) also provides for implementing regulations to prescribe requirements and conditions to the disclosure of tax information pursuant to a written consent.

We believe that the crux of section 6103's writing requirement is to ensure that disclosures are fully documented, as opposed to purely oral. As such, given the regulatory authority under section 6103 and the purposes which the writing requirements in the statute appear to serve, there is authority to administratively develop alternatives to the traditional pen-to-paper writing media subject to one caveat—an oral statement cannot be used to satisfy the writing requirement.

Having said that broad authority exists to administratively define writing in section 6103, it is equally clear that, in evaluating alternative forms of writing, the Service should carefully consider the ultimate issues of identification, reliability, and retrievability (for evidentiary purposes) of electronically transmitted requests or consents. For example, technologies that utilize transcription may blur the oral/written distinction. Also, coding and identification number technology raise potential custody and security issues. Counsel will address such issues as the Service makes business decisions on specific technologies.

III. Evidentiary Use of Electronic Signatures

Electronic signatures are subject to the same evidentiary standards that generally govern computer generated, stored, and retrieved data. The Service has an established history with its computer system. Courts have consistently taken testimony about the information that the system contains (or does not contain) in evaluating the weight of computer evidence.

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[5] The Regulations have required that certain applications for the inspection of tax information be made in writing since 1914.

A. *Admissibility*

Alternative signatures will be created, transmitted, and stored electronically. For litigation purposes, the evidence will typically be a printout of the electronically stored signature. The admissibility into evidence of alternative signature printouts will be determined by the same evidentiary standards that generally govern the admissibility of computer printouts. Computer-generated evidence has been accepted by the courts for many years. *Transport Indemnity Co. v. Seib*, 178 Neb. 253, 132 N.W. 253 (1965). In general, under Fed. R. Evid. 901(a), "authentication or identification as a precedent to admissibility is satisfied by evidence sufficient to support a finding that the matter in question is what its proponent claims." This can be satisfied by a variety of means. Authentication of alternative signatures is likely to involve Fed. R. Evid. 901(b)(9) evidence regarding the "process or system used to produce a result and showing that the process or system produces an accurate result." Courts customarily take testimony as to the information that the IRS computer system contains (or does not contain) as proof of filing or nonfiling. *United States v. Faris*, 517 F.2d 226 (7th Cir. 1975); Fed. R. Evid. 901(a)(7). Most common objections could be easily overcome in today's jurisprudence.

Section 6064 provides that an individual's name signed to a document is *prima facie* evidence that the document was signed by that person, but additional evidence is necessary to establish the validity of the signature. In the final analysis, the conclusion of validity will turn upon the weight of all the evidence.

Additional supporting evidence may come from a variety of sources. Occasionally, the taxpayer will admit the validity of the signature if called to testify under oath. More often, the taxpayer will admit the validity of the signature at the time the examination was initiated ("Is this your return and signature?"). The admission of a party opponent would be admissible and persuasive. Fed. R. Evid. 801(d)(2).

Circumstantial evidence from the Service's records may also be very persuasive. Fed. R. Evid. 401, 406. Evidence of other signatures of the taxpayer may be admitted and utilized. Fed. R. Evid. 901(b)(2). In some cases, it may be necessary to secure the testimony of an expert witness to assist the trier of fact in reaching a conclusion.

B. *"Best Evidence" Rule and Other Objections*

Challenges under Fed. R. Evid. 1002, the "best evidence rule," are typically satisfied by reference to Fed. R. Evid. 1001(3), which defines computer printouts as originals, and to section 6103(p)(2) of the Code, which specifically allows the Service to use reproductions of returns. Hearsay objections may be raised to the extent the underlying computer data was input, analyzed, or rearranged by Service personnel. Most such objections are overcome, under Fed. R. Evid. 803(6), by the hearsay exception for business records. The party opposing the introduction of public records has the burden of establishing that the records are not reliable. *Ellis v. International Playtex, Inc.*, 745 F.2d 292, 302 (4th Cir. 1984). Generally, resort to the hearsay exception will not be necessary since the typical evidentiary use of a tax return is a nonhearsay use, i.e., the return constitutes a statement of the opponent and is admitted not for the truth of matters asserted therein.

C. *Probative Value—Scientific Evidence*

Even though it is nearly certain that the printout of an alternative signature will be admissible under the Federal Rules of Evidence, the key issue is whether the court will accept that printout as *the* signature of a *particular* taxpayer. That is, can the Service establish a link between the admitted data and the person to prove that the particular person prepared and filed the particular document? To some extent, this question is part of the preliminary inquiry of admissibility. Fed. R. Evid. 901. However, since authentication is a preliminary question with a low threshold (*see* Fed. R. Evid. 104), a court might admit the signature but reserve the ultimate issue of whether that signature is the signature of the particular person. This latter question is one of identification.

Section 6064 provides that an individual's name signed to a document is *prima facie* evidence that the document was signed by that person. *See also* Fed. R. Evid. 902(10) concerning self-authentication. Regulations under section 6064 could apply the same presumption to alternative signatures. Even so, expert testimony may be necessary to establish an alternative signature as that of a particular person. The Federal Rules of Evidence do not provide for lay testimony about these alternative methods. Scientific or technological evidence about signature evidence would be governed by Fed. R. Evid. 702. Fed. R. Evid. 702 allows for expert testimony, including opinions on the ultimate fact question when that evidence would be helpful to the fact-finder. The test for acceptance of this testimony is established by the recent case of *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 509 U.S.——, 125 L. Ed. 2d 469 (1993), where the Court set forth a rather low threshold for acceptance of scientific expert testimony. The Court held that scientific evidence need not have "gen-

eral acceptability" in the scientific community to be presented to a jury. The Court held that the trial judge must preliminarily assess the threshold question of admissibility of the evidence. However, the Court held that the federal rules were intended to be applied liberally in order to encourage further development of scientific evidence.

In setting forth the inquiries that the judge should consider in allowing evidence, the *Daubert* Court cited four factors for determining the ultimate acceptability of the evidence: (1) whether the scientific technique can be (and has been) tested, (2) whether the theory has been subjected to peer review and publication, (3) the known or potential rate of error in the technique, and (4) general acceptance in the scientific community. Expert testimony and opinion should certainly satisfy the *Daubert* standard.

The Service should consider the *Daubert* factors in evaluating potential forms of alternative signatures. In sum, technologically reliable signature alternatives could be used in court to identify the person who signed the document.

JUDITH C. DUNN
ELIOT D. FIELDING

Mr. DOLAN. If you do not mind, Mr. English, can I double back on your principle point?

Mr. ENGLISH. I would prefer to go on because I have limited time.

Mr. DOLAN. Very good.

Mr. ENGLISH. It is my understanding that about 30 percent of all return filers have a balance due. How do you intend to attract balance-due filers to file electronically, given that under the current filing system—I am not sure what the motivation for a taxpayer with a balance-due return would be to file electronically.

Mr. DOLAN. Well, I think the motivations overlap to a considerable extent. Obviously, a quick refund is not one of the motivations, but the same sense of closure, clarity, accuracy of the transaction may be. The same benefit of a minuscule error rate or a balance due, for a refund filer is there. And secondarily, as we mentioned earlier, and I believe Mr. Lutes elaborated on, when we create this ACH debit capacity for somebody, he or she does not have to worry about writing us a check that catches up with the electronic return. When you have the ability to both send the return electronically and initiate a payment, potentially a payment suspended for a later date, if he or she decides to file before April 15, the additional motivation may be there. There will be the incentives of an accurate return, a high quality transaction, and knowing that there is closure will help motivate.

Mr. ENGLISH. Thank you, Mr. Dolan. Mr. Lubick, it is always a pleasure to see you here, and we appreciate your testimony.

Again, I want to reemphasize, I think it is very difficult for us to go back to the real world, to the districts we represent, and tell them that it is very difficult somehow for the Treasury and the IRS over 10 years to move to a system which saves hundreds of million dollars a year that could be better allocated to other things or could simply shrink the deficit, and I thank you.

Chairman JOHNSON. Thank you, Mr. English.

Mr. Kleczka.

Mr. KLECZKA. Thank you, Madam Chairman.

Commissioner Dolan, a couple of quick questions. One of the problems that we have to find a resolution for is the electronic sig-

nature question. However, I note that the TeleFilers have grown to about 5 million per year, and I assume that the bulk of the people who use that method are in a refund situation. Now, there is no signature accompanying the TeleFile filing. Why has that not been a problem up to now, and why do we foresee such a grave problem in the regular electronic filing with no signature?

Mr. DOLAN. It goes back a little bit to the answer that Terry gave a moment ago. There is an authentication process used in TeleFile.

Mr. KLECZKA. The number that is given to the tax filer.

Mr. DOLAN. First of all, you start with a very defined parameter. Unlike the ELF world in general, we initially invite a group of people into the TeleFile relationship with us based on the attributes of their financial life. And so there are some parameters that clearly on the front end defines that population in a way that mitigates risk on the front end. Secondarily, we use a process of authentication; while it is not the written signature, that additionally takes that risk and mitigates it further.

Mr. KLECZKA. I missed the last point.

Mr. DOLAN. By virtue of using the PIN interaction with other data, we take the risk that has already been limited by having a define and confine universe, and limit it still further, which is a slightly different technique than you would have if you said, any member of the 120 million filers can choose to file electronically. In those cases there will be different standards for wanting to be certain that we can authenticate that this person is the person they purport to be.

Mr. KLECZKA. Well, that is something we are going to have to discuss further. But I think the system can be expanded. It just makes no sense to electronically file and follow up with a piece of paper.

Mr. DOLAN. It clearly can be expanded, and we want to do that.

Mr. KLECZKA. The other question is, how many filers use the form 1040–PC? Is that a growing area that is getting a lot of interest?

Mr. LUTES. A little over 8 million taxpayers this past year filed paper returns using the 1040–PC, so that is growing also as a method of filing one's tax returns.

Mr. KLECZKA. Yes, it is growing somewhat. Has any thought been given by the service to provide an option to filers to submit a floppy disk to the service. That would be an area where you could probably utilize, for example, with an amount-due check attached.

Has there been any thought to giving filers the option of providing a floppy?

Mr. LUTES. We have not done a detailed analysis on that.

Mr. KLECZKA. How about in your thought?

Mr. DOLAN. There clearly has been thought and there has actually been a couple of experiments done in our Philadelphia Service Center. One of the difficulties is, if you can jump that step—if you can avoid the need to manage the receipt of disks and inventories——

Mr. KLECZKA. Another thing to handle, so electronic would still be the preferred option.

Mr. DOLAN. Yes, absolutely. It is absolutely a step to be jumped if you can do it.

Mr. LUTES. At one point you emphasized the 1040 PC filers—that use software. They do have the ability to use that same software to transmit this return electronically.

Mr. KLECZKA. OK, thank you.

Chairman JOHNSON. Thank you very much.

Mr. Watkins.

Mr. WATKINS. Mr. Dolan and Mr. Lutes, and Mr. Lubick, I am glad to see you back. And I reflect. I just returned from traveling 21 counties in my district for townhall meetings, and a lot of people came up to me and said, You know, we sure would not have your job. And I reflect a little bit about your job, and I sure would not want your job, because even biblically it talks about tax collectors, and I do not know if you are in a win situation out there.

But there is a great alarm out there with a lot of people. I know Mr. English talks about electronic filing and some of the technology moving in that direction. There are a lot of mom and pop businesses which are concerned about being forced into electronic filing, because they are not equipped with high technology. And they are concerned about how they are going to handle it, and many of them are probably doing their own taxes, or trying to do their own taxes, without having CPAs. Some of them would be using public accountants or CPAs.

So I think one of the big things in my area is trying to provide some kind of information out there so they feel like they are not forced into something.

Do you have anything planned, such as an educational program, to inform some of these people?

Mr. DOLAN. Mr. Watkins, I think the point you make kind of dovetails to an earlier part of the conversation.

Mr. WATKINS. And I apologize, I am redundant.

Mr. DOLAN. Oh, that is fine. Congressman Portman said, and said accurately, there is no such thing on the table right now as a mandate. But one of the things I think you heard maybe from Mr. Lubick and I both is that, I think we all expect that the optimism expressed here, and the comment made by Mr. English about letting us get on with this. That is where the world is going. I think most of us in this room can sit here and intellectually accept that is where this thing is headed. At the end of the day I think the test for us and for us cumulatively is, can we put this product in front of the taxpayer, the customer, in a way that they say, hey, this works for me. This is a logical way to do my business with the government, versus saying, the government tells you, you have to do this.

We had a little discussion about EFTPS before and lessons learned. One of the things that we collectively take away from that is that the people do not like it much when somebody says, you do it this different way. And so one of my hopes would be—I mean people today, we would say are maybe not technologically adept. I think the world is going to move them more and more, whether it is through their television sets, or interaction with their banks. And there will be a point in which some will still say, I do not want to play that world, and for those people we ought to still have it as easy a process as possible.

Mr. WATKINS. I hope you recognize there are some in the economically depressed areas which are not worried about participating in the technology world. I stop at the businesses and have a cup of coffee with them; some are the greatest people in the world.

In addition, I know the Association of Enrolled Agents had some testimony earlier, and they proposed a new incentive to encourage the individual taxpayers to file electronically, modifying the statutory period for examination of an individual income tax from 36 months to 24 months if the return is filed electronically, by the due date. There is no mismatch with the other information return programs, data that has been received by the IRS.

Do you have any immediate reaction to that suggestion?

Mr. DOLAN. First of all, I just read it shortly before the hearing, and my reaction is, it is an interesting proposal. It is of exactly the stripe that we would expect we would hear more of when we put this RFP out. And it also makes the point, I think, that maybe Mr. Lubick was making earlier. I suspect at the end of the day there are going to be lots of incentives that people tell us exist that are not necessarily paying somebody $3 or paying somebody $4. Part of what we deal with, and it may be exactly the concern you raised earlier, that is, a lot of people today say, one of my reasons that I do not want to file electronically is that I fear that my susceptibility to audit is greater. And so maybe there is some connection between agreeing that somebody who files electronically will have his business or her business finished with us, by an earlier date certain. And that might actually be a more appealing way to think about it than the discussion we were having earlier about moving filing dates around. Maybe there is a promise of earlier certainty if you come to us electronically. But those are exactly the kinds of proposals we hope to see in the RFP.

Mr. LUBICK. I would worry about that change. I think this reflects my conversation earlier with Mr. Cardin. I think the rules of the game ought to be the same for all taxpayers, what their obligations are, when they have to satisfy them, what the period is for reviewing it. I think electronic filing should prevail based on market-based incentives; it is a better way to do it; it is more efficient; it is easier; it is going to be error reduced greatly. And so I would be very reluctant to change the statutory rules that favor one taxpayer over another. I would be reluctant to see a shortening of the statute of limitations, which is basically what that proposal is.

Mr. WATKINS. Thank you, Madam Chair. I do have another one, but maybe I better ask it privately after awhile.

Chairman JOHNSON. Thank you, Mr. Watkins. I would like to follow Mr. Watkins' question with another issue that will be raised in follow-on testimony.

The National Association of Accountants indicates that the electronic filing compliance visitation is a significant deterrent to the electronic filing program.

Could you explain to us how this compliance visitation works? How the IRS handles compliance visitations for big electronic preparer filing corporations, like H&R Block? How does the IRS handle visitations for a small accounting business that files its clients' returns electronically through a third-party transmitter? And do

you believe that the number of visitation checks will increase as the growth in the number of practitioners filing electronic returns increases? I think this is a very important issue.

Mr. LUTES. Let me address that if I could, Madam Chairman. We initiated these visitations back a couple years ago when we were dealing with the refund fraud issue that we worked with the Congress on, and I think those steps were necessary and I think they made a point at that time. Since that initial year 1995 filing season we have been gradually decreasing the number of those visits. I do not have the 1995 number, but the number of visits between 1996 and 1997 dropped by about 40 percent, and the majority of the visits that were made this year were for cause. We received complaints from taxpayers. We saw patterns in the filings from particular offices. However, we do still conduct random educational assistance visits to attempt to spot patterns in the industry during those visits. But again, the majority of visits that we are doing now are for cause. And when we do the monitoring visits, we make them more educational assistance visits; looking for questions we can answer, trying to make them supportive of the ERO and practitioner community.

Chairman JOHNSON. Well, thank you. I also wanted to get your reaction to the National Association of Enrolled Agents testimony in regard to their recommendation; their belief that there are four incentives that could ensure greater electronic filing participation by enrolled agents.

First, permit electronic communications between the IRS offices and practitioners on client account issues; permit alternative forms of tax payments; permit the online submission of installment agreement requests and collection information statements; and permit the electronic submission of powers of attorney and transcript requests.

Mr. DOLAN. Madam Chairman, those are all good ideas. The only question is, in what sequence is that a part of what total set of initiatives. There is not a one of those that is a bad idea. They are ones that we have had dialog with the enrolled agents. I know they have been frustrated that we have not been able to prioritize some of those quicker than we have. The ideas are all sound ones, and I think we will ultimately want to look at them, as those and other ideas come back in response to the RFP. There will have to be some prioritization of both investment and use of our intellectual capital to get them done, but not a one of those is a bad idea.

Chairman JOHNSON. Mr. Dolan, in terms of timeframes, I think your RFP, being flexible, was a very good idea. On the other hand, clearly none of the ideas you are going to get back are ideas that we are hearing today or ideas that you have already heard.

Do you have any idea how long it will take you to evaluate those things, and particularly in the light of Mr. Lubick's comments, whether or not you are really going to be able to move ahead with flexibility as I think some of us conceive it?

Mr. DOLAN. Well, I tried—perhaps not effectively—earlier to make that the point that the target that will be in the RFP is, tell us what you can do, and what you think we need to do, to have a substantial impact on the returns that are filed in 1999. So it means, not the most immediate next filing season, but for the filing

season thereafter. So the trust we hope of both the ideas we get and the nature of our responses will be targeted for——

Chairman JOHNSON. What is the response deadline?

Mr. LUTES. Well, the initial RFP that will be issued next week is a draft. This was at the request of the industry. They wanted the opportunity to help us craft the final product.

Chairman JOHNSON. I appreciate that.

Mr. LUTES. We anticipate, based upon all the procurement processes, it would be some time in the spring, probably late spring.

Chairman JOHNSON. So you expect it will take you 6 months.

Mr. LUTES. Yes.

Chairman JOHNSON. You will wait 6 months for the responses to the September 15 proposal. You will allow 6 months for responses?

Mr. LUTES. No, the draft will be out there for 30 days. The industry will provide us with feedback. We will take that feedback, and build it into a final request for proposals, that will then go out on the street for input in the form of final proposals, which we will then have a regular structured process to evaluate, and make the determination to——

Chairman JOHNSON. And your spring estimate gives you about 7 months to evaluate ideas that are coming back.

Mr. LUTES. Yes. Let me expand on something Mr. Dolan said a moment ago. We are looking for impact on the 1999 filing season. Obviously for the 1999 filing season at that point in time I think your concern is, we are not going to be able to build any major new systems over that 7-month period. So what we are looking for is ideas, and again some of the incentives that are mentioned are things that could clearly be done; if we were to pay an incentive for returns, that clearly could be done in that short of time.

But at the same time we are open and asking folks for longer term proposals that, as Mike mentioned earlier, would enable us to maybe even modify the modernization blueprint to build systems that would involve for example some of the ideas that the NAEA has raised around powers of attorney and so forth. But with the limited funds we have, we have to choose which ones of those systems to spend those funds on.

Chairman JOHNSON. By what date would you have to make a decision for something to affect the 1998 filing?

Mr. LUTES. The 1998 filing season? In terms of any changes to our systems we are well past that point. That software is in final testing now. The software companies remember, need our final products so they can develop their products also. So 1998 is essentially in the bag at this point.

Chairman JOHNSON. And 1999?

Mr. LUTES. For 1999, we would be looking at spring, early summer, so that we can then make the programming changes to our existing systems to effect them for 1998.

Chairman JOHNSON. Well, I certainly would want to work with you for you to report to us on changes that are going to be made for the 1999 filing season early enough so that we can have input and understand what your plans are. And I think that might help focus your process in a timeframe that we get some real good work done for the 1999 season.

Mr. DOLAN. Madam Chairman, the other points you highlight here, is that this is not for us—this is not like going and buying a piece of furniture or a piece of gear. This is for us a unique RFP arrangement. Because we are basically using the sort of classic commercial products, it is necessary to go to people and say, not only give us your ideas, but give us some financially binding commitments. We structured this relationship with you, and a lot has been said about how many of these returns are prepared in software, and how many are prepared by practitioners.

What we expect to see back are some fairly imaginative proposals that say, OK, I have the capability of giving you a stream of these kinds of returns. And in return these are the kinds of interactions I would want to have, or these are kinds of cross-commitments I would like. So it is an adaptation of something that is used typically more at the commodity level, and so it is going to be a very interesting and exciting process I think to see what people tell us in the context of that kind of request.

Chairman JOHNSON. I think it is interesting, and I think it is an exciting process. I do not want it to bog down so that it is the year 2000 or 2001, before we get any benefit from it.

Mr. DOLAN. Agreed.

Chairman JOHNSON. It clearly is going to have enormous economic costs and implications, as well as benefit implications for taxpayers. I think it is really beholden upon us to move rapidly enough, so the decisions are made in a timeframe that the changes can be marketed well, and we get real advances by the 1999 filing season.

Now, since I did raise a couple of additional questions myself, if there are other questions from Members of the Subcommittee before we let our experts go, I would be happy to recognize you.

Mr. Cardin.

Mr. CARDIN. If I could just quickly—I notice that in the bill that the administration filed that you seek explicit authority to use appropriated funds to promote and encourage the use of electronic filing. And the explanation, as I understand it, is that there annually are prohibitions in the appropriation process to promote programs explicitly approved by Congress.

Could you just for the record tell us how important that authority is to be granted, or whether you have sufficient authority now to promote electronic filing.

Mr. LUBICK. Well, as I understand it we have been promoting electronic authority through donations of time, and not using appropriated funds, relying upon public interest. As I understand it, we now feel we can undertake legally a promotional effort, using funds out of our appropriation, and therefore if we are to do that type of marketing that is indicated that will be very appropriate to the success of the transition, we need this authority.

Mr. CARDIN. Well, I would like to work with you with some language, because I think obviously we do not want to restrict our ability to carry out policy for more electronic filings.

One other quick point. The legislation that was filed on behalf of the Commission's recommendation, spells out a goal, as you pointed out, of 80-percent filings by the next 10 years; and it spells it as a goal. It seems to me that it is appropriate for Congress to

spell out what it hopes will be achieved. And I am just curious as to whether you think that is a reasonable expectation—that in 10 years that we should be able to achieve 80 percent filing electronically; or whether you have a different percentage that you would think should be expected if the rest of the authority is given to you, including changing some of the obstacles that are in current law.

Mr. LUBICK. Well, our record on achieving goals is such that I am very wary of stating what I think the appropriate one should be. Maybe Mike would like to do that. And I do not have any objection to there being a goal and to having——

Mr. CARDIN. I want to stop you. I think the record of this administration on trying to change the IRS has been good. So I would not downplay your success.

Mr. LUBICK. I would be glad to be recognized for having outdistanced our targets, but from time to time we have been chastised for the opposite result, and maybe we are just being gun shy.

Mr. DOLAN. If I could rise to the bait a little bit here, Mr. Cardin, I think particularly in the light of Mr. English's comment, the last thing I want to do is to leave this table, conveying an impression that we are trying to play safe here. I mean I personally think that trying to move this reality to the 80-percent world makes a heck of a lot of sense, and over a 10-year period, all that we know around us, seems like that is not an extraordinary or a reckless kind of goal. And certainly for the Congress to say to the IRS, that is our vision, that is what we would like you guys to add, and we like your commitment to get there—all those seem like the right sorts of conversations to have.

Now typically though, most of us when we go back and set a goal, we expect, we are going to deploy this goal. I am going to take this percent of the goal, and this year certain, and I want to see how this maps out. I just do not want to light candles and say prayers; I want to have some idea of, *a* followed by *b*, followed by *c*. And what you are hearing from me is more the reservation about thinking that when we get back some of what we are going to get from the RFP, and we get a little better understanding of some of the research that is being done now, I think I will be able to map to that goal with a lot more precision than I can today. But I do not shrink from—as I call it—the aspirational or the notional objective that that is the right place to be in that 10th year or the 9th year.

Mr. CARDIN. I appreciate that. I think that is a good point. And remember, this is just one part of the restructuring act, and it depends upon the entire program, I think, being implemented, and the support that you need in order to carry out these goals, and that obviously is hard to predict for the next 10 years. But I am glad to see that we all can agree that 80-percent filing in 10 years is a reasonable goal for us to set as a Nation. I think that is what it is about. It is not just what you can accomplish; it is what we can accomplish together. If you do not have the cooperation of Congress you are not going to be able to achieve this, and I cannot tell you what this Congress is going to do, let alone the next Congress. So hopefully we can set a mutual goal of at least 80-percent filing in 10 years, and then we can make sure that we do everything we can to see that that goal is carried out. Thank you.

Chairman JOHNSON. I would like to say that I think the point that Mr. Cardin raises is a very, very important one, and one we will discuss with you thoroughly. I am very pleased at the aggressive efforts you are making. I think the work that is going on is truly commendable, but it is also true that in 1993, 4 years ago, the IRS established an electronic filing goal of 80 million returns by 2001, and that program never got clearly implemented, no clear strategy, and no clear achievements.

And in your plan released August 15, 1997, you certainly do talk about electronic filing, but it is a matter of encouraging it through product development and market improvements. There are not quantitative goals or strategic plans laid out. There are going to be successive people out there implementing this plan, like there will be successive Congresses in backing it up. And I think you really ought to think about it being in your interest as well as ours, to be a little bit more specific than simply encouraging something we know is important to do, and is a good thing, both for the government and the taxpayers.

I think we do have a challenge before us in this regard, and being somewhat more specific, because it has in the past focused at least the Congress' attention, and I think it tends to focus the executive branch's attention as well. So we will look forward to discussing those matters with you.

Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair. I just have a few followups and maybe some clarifications. Again, we have talked about the 80-percent goal. I think that is not only doable, but probably can be done sooner given your new expertise with Mr. Barr. And I want to commend you for bringing in someone of his experience and knowledge. I think that will be a tremendous benefit to the service.

With regard to the transmitting fee, we have gone over that quite a bit. I think Mr. Lubick preferred that incentives for electronic filing should be market based, and we should not have additional monetary incentives. Let us just keep in mind what we are talking about here. We have a much more expensive system now, which is paper returns. Others have talked about it, and we have talked about it, perhaps ad nauseam, over the last year. We want to provide these incentives because it is good for the IRS and good for the taxpayer.

If the paper return now costs $7, and the electronic return costs $1, it is worth it, Mr. Lubick to have the government engage in providing incentives. Let us say it is $2.68—what you think it is—it is still worth it. So if we are going to talk about markets, I think we need to talk about the taxpayer and the cost to you and to the service.

I will also say, just to clarify what is in the legislation, we do not say it should be $1, $2 or $3; we say fair market cost to the transmitters. I would love not to get into it now, because we have a lot of things I would like to get into, but I would like to comment on Mr. Lubick's suggestion that the incentive be paid to individuals. I think that would be a big mistake. And if the IRS could get back to us very soon on that, as in the next week, that would be great. In H.R. 2292 the incentive is paid to transmitters, which I think

is where we all come out, and not to 120 million individual taxpayers.

Let's just quickly discuss signature requirements. We all know there is Form 8453 that must be signed and submitted. It does not make any sense. Those of us who visited service centers have seen it. Most of the cost of electronic filing is associated with this signature requirement.

Mr. Lutes has said there is no one way to deal with it. Well, H.R. 2292 has one very specific way to deal with it. And I still have not heard the Treasury Department's opinion as to that, nor the IRS opinion. What we say is very simple. H.R. 2292 only requires that the taxpayer retain the signature on file. And I think it makes a lot of sense. Seventeen States do. We talked about California earlier, and the IRS did not have any thoughts as to what the California experience is, good or bad. We have 17 States that do it. Now Australia does it, Canada does it. The SEC does it. If the SEC can do it maybe the IRS can consider it.

I just think it makes so much sense for you all, when you go to those service centers and you see the hassle that the current signature requires, to have it at least on an interim basis, so you can perfect some kind of electronic signature. It seems to make a lot of sense. That is the specific proposal before us today. You need to tell us specifically how you feel about that.

Finally, with regard to the extension of the filing deadline, Mr. Lubick said it would be unfair to middle- and low-income working families and taxpayers. I hope Treasury is not trying to inject class warfare into electronic filing; God forbid, we have had enough of that in the last couple of months.

Because you raised it, let us get into the fairness issue a little bit. Is it fair if you are a refund taxpayer—which I guess is what you are referring to when you say low- and middle-income working families. If you are a refund taxpayer, you are able to file electronically and get your refund therefore in 2 weeks, rather than 6 weeks, but there is no comparable shift for balance-due taxpayers. If you are going to talk about fairness, this is certainly a fairness issue that would mitigate toward extending the filing deadline for balance-due taxpayers, so that they could have some of that same benefit. I mean, if we are going to talk about fairness, I think your argument is exactly contrary to where we ought to move.

I would just say one more thing about the extension. Mr. Lutes, in his response earlier to the questions regarding why people file electronically, said it is because they get a refund sooner. What are you going to do for 30 percent of the taxpayers who are balance-due filers? How are we going to meet our 80-percent goal, Mr. Dolan, if we do not do something for the 30 percent of taxpayers who are balance-due taxpayers. We have to do something for them. I have heard no good ideas today except extending that deadline for 30 days. And I understand that April 15 is sacrosanct, and it is an important date and so on. It will remain an important date for all but those who are willing to file electronically.

If you look at the data it shows quite clearly that this is going to have an impact—and probably the only thing we can do, in terms incentive for the balance-due—If we do not get to the balance-due folks, we would not have solved the problem here, because

there will still be those 30 percent taxpayers outstanding. They do tend to be the most complex returns. Therefore, guess what? They are the highest cost to the IRS. Is that correct, Mr. Dolan?

Mr. DOLAN. Sure it is, but at this point you said that you heard no good ideas.

Mr. PORTMAN. For the balance-due taxpayer.

Mr. DOLAN. Yes, we talked about the balance-due taxpayers, and perhaps it was when you were out. I think, creating the ACH debit capacity will help motivate them. One of the other feedbacks for us is, Why should I send you electronic—since I have to send you this paper check.

Mr. PORTMAN. You have an indication that that will move a lot of balance-due taxpayers into electronic filing?

Mr. DOLAN. I do not have a way of comparing that to the sliding filing dates. But all I would want to stipulate is, that I agree with you. Not only for the goal, but for good tax administration, we have to find ways to bring that balance-due taxpayer in. I think some combination of the ACH debit, and continuing to perfect the things we know are good about this system. It is still a cleaner, less error-prone, more certainty-packed transaction to do that, whether you are balance due or refund, electronically.

Mr. PORTMAN. Is it less than one-quarter of 1 percent error rate that you are experiencing in the EFTPS for electronic filing?

Mr. DOLAN. I would like to point out that the refund taxpayer is getting back money which the IRS has been holding all year; that was really his. And the balance-due taxpayer—we are after all theoretically on a pay-as-you-go system—has been holding money from the IRS.

Mr. PORTMAN. This is a longer discussion, but what is the unfairness of allowing anyone who wants to, to have this extension if they file electronically? Again, the benefits of electronic filing, Mr. Lutes has said very clearly, goes to those who are refund taxpayers. It is true. If you talk to people and if you look at surveys that is the answer. So, if we all have the same goal we need to address the balance-due taxpayer.

Mr. DOLAN. Well, I want to address the balance-due taxpayer. I share your goal on that; we should do it. But nevertheless if there is an accounting date when we settle accounts between taxpayers and IRS, it seems to me that that fairness dictates that that be uniform, whether you are refund or balance due.

Mr. PORTMAN. If you file electronically, it is for either type.

Mr. DOLAN. But it seems to me, why do you want to give a slow-pay person an incentive to be slower pay?

Mr. PORTMAN. Well, if you are talking about the revenue impact to the government we can get into that discussion.

Mr. DOLAN. That is a different question.

Mr. PORTMAN. I think strongly that the revenue impact will be positive in the end because of the cost savings the IRS will have because of electronic filing. So if that is your argument, not the fairness argument, we can get into that.

Mr. DOLAN. Well, I was not getting to that, but I am not sure that is true. I think we will have to see. But it seems to me that the same rules of when you have to pay and what time you have

to be audited—all of those questions that have been raised ought to be uniform for all taxpayers.

Mr. PORTMAN. They will be uniform. The differentiation will be electronic versus nonelectronic, which is in the interest of the Federal Government, but certainly of Treasury and the IRS.

Mr. DOLAN. That is turning on something different from whether you are a taxpayer or not. It turns on how you file your return. I just do not see that as a criterion for differentiating between your obligations.

Mr. PORTMAN. I thank the witnesses. I look forward to ongoing dialog and for responses to some of those specific questions, because we do have a requirement at the Subcommittee to provide this report to the Full Committee on the legislation.

Chairman JOHNSON. Thank you, Mr. Portman, and I urge you in the strongest terms possible that you do provide specific responses to the specific recommendations. I thought frankly that you would do that today. You chose to give a background, an update, and responses to a couple of the major ones, but it is very important that we get your written response to the individual recommendations of the Commission in a timely fashion. We would appreciate that.

I want to announce that we are going to combine the last two panels, so that Members returning from this vote will have the opportunity to hear the testimony of everyone. And then if they cannot all stay for questioning, that is unfortunate, but I am anxious that they at least get a chance to hear the testimony of the seven remaining invited guests. And so we will combine the last two panels and resume in about 10 minutes. Thank you.

[Recess.]

Chairman JOHNSON. If the two concluding panels will both join us at the table, Mr. Zimmerman, Mr. Wolfe, Mr. Langer, Mr. Carver, Mr. Harris, Mr. Lane, and Ms. Kelley.

We will start with Mr. Zimmerman, president of H&R Block Tax Services. Welcome, and thank you for being with us.

STATEMENT OF THOMAS L. ZIMMERMAN, PRESIDENT, H&R BLOCK TAX SERVICES, INC., KANSAS CITY, MISSOURI

Mr. ZIMMERMAN. Chairman Johnson, Ranking Member Coyne, and Members of the Subcommittee.

Thank you for inviting us to testify. With your permission I would like to submit my statement for the record and summarize it briefly.

Chairman JOHNSON. All of the testimony——

Mr. ZIMMERMAN. What is that?

Chairman JOHNSON. All of the testimony will be included in the record, and you each will have the opportunity to make the points that you think most important to us. Thank you.

Mr. ZIMMERMAN. Thank you.

I am Tom Zimmerman, president of H&R Block Tax Services Inc., the tax services subsidiary of H&R Block. Among our other subsidiaries is Block Financial, which distributes Kiplinger Tax Cut, tax preparation software.

To highlight our views, I would like to make four points.

First, we strongly support electronic filing. We provide the majority of the 15 million electronic returns the IRS now receives, and are working to expand that number.

Second, the government and the private sector must work together to clear away obstacles to electronic filing that include cumbersome IRS procedures and public resistance based on inadequate information, fears, and, in some cases, cost.

Third, the key to increasing electronic filing is massive IRS marketing, promotion and public education, which has been missing. Taxpayers, not tax preparers, must be convinced of the advantages.

And fourth, while we support most of the Commissioner's recommendations for electronic filing, we strongly believe that Federal subsidies for electronic return transmitters and extending the tax filing deadlines for electronically filed returns are unneeded and unwise.

First, H&R Block's role. H&R Block handles more than 18 million returns in the United States, Canada, and Australia. All of our returns are filed electronically in Australia and over 65 percent in Canada. In the United States, where we process returns for 1 out of every 7 individual taxpayers, we provide 7.3 million, or about half, of the electronic returns the IRS receives from commercial practitioners.

To promote electronic filing, we spend $2.4 million on television ads, have window banners in our 8,500 U.S. offices, distribute more than 5 million brochures in English and Spanish, target direct mail to 11.5 million prior clients, and highlight the benefits on our Web site, on a CompuServe forum, and in our "Ask Henry" syndicated newspaper column.

Electronic filing is provided free as part of the enhanced services we offer at our 600 H&R Block Premium Offices and by some of our franchisees. On March 1 we generally lower our electronic filing fee from $25 to $15 at our other offices.

We plan to reduce fees in steps over several years as volume increases. We will be reducing electronic filing fees by one-third for returns we prepare in the coming tax season.

In addition, we recently concluded a 3-year agreement with CompuServe to upgrade their system to provide capacity to transmit up to 40 million electronic returns, an investment we believe shows our strong commitment to increased future electronic filing.

Second, government and the private sector must work together to communicate the advantages of electronic filing and to clear away IRS obstacles and public misunderstanding. There are a number of advantages to filing electronically and a number of reasons taxpayers do not do so. For most of our clients, the compelling advantage and only driving force for electronic filing is a quick refund. Because of the desire for a quick refund, over 70% of our customers file early. Despite the advantages, most taxpayers who receive refunds still do not file electronically.

In H&R Block's case, all of our returns are prepared on computer but only half are filed electronically. Nationally, half of all individual tax returns are prepared on computer, but only 13 percent are filed electronically.

Reasons for the fall off vary.

Many clients do not have enough information or have misinformation. Some fear an increased possibility of audit, worry about invasion of privacy, distrust computers, or are more comfortable with the familiar ritual of a trip to the post office.

For some taxpayers cost may be a factor, although we believe this is less than might be expected. A recent USA Today/Gallup Poll from April 2, 1997, finds only 24 percent of paper filers cite fees as a reason for not filing electronically. The vast majority give other reasons.

We tested free filing over several years in about one-third of our offices and found 60 percent of our clients preferred paper filing. So cultural factors, misinformation, or a lack of perceived value may be more significant barriers than cost.

IRS procedures also add difficulty to electronic filing. Cumbersome paperwork, signature requirements for electronic returns, paperwork gluts over applications, revisions to participate in the electronic filing program, and delayed confirmation of electronic filer identification numbers could all be eliminated or streamlined.

The application to become an electronic filer, for example, cannot be filed electronically.

To clear these obstacles, government and industry must work together.

My third point is that, short of mandating electronic filing, the key to increasing electronic filing is massive IRS marketing, promotion and public education, which has been missing. The emphasis must be on persuading taxpayers and just not tax preparers.

The 1040 booklet most taxpayers receive covers many issues, but it has never emphasized the benefits of electronic filing. We recommend that page 1 of each 1040 booklet have a large, highlighted area asking taxpayers directly to, Please return electronically for faster refunds, fewer errors and followup letters, no greater audit risk, proof of filing, and lower IRS data entry costs which saves tax dollars.

We are encouraged by plans being developed to launch an IRS public service television campaign next year with tie-in printed materials. Congress can help by relaxing appropriations restrictions on the use of IRS funds for paid advertising.

Which brings me to my last point. We support most of the Commission's recommendations for electronic filing, but we strongly believe that Federal subsidies to electronic return transmitters and extending tax filing deadlines are unneeded, unwise, and divert resources from where our focus should be.

We support the Commission's recommendations for realistic goals, clear strategy, private sector advice, and lower barriers to paperless filing and payment.

But we do not believe a subsidy to electronic return transmitters of up to $3 per return for taxpayers not charged a fee is needed or appropriate, especially given pressures on the IRS budget.

First, market forces are already moving to lower filing fees. In some cases electronic filing fees is already offered free, meaning subsidies would be a windfall for some firms. And electronic filing is up 19 percent this year without subsidy.

Second, a subsidy of up to $3 per electronically filed return may cost the IRS money since the average data entry costs for paper return are less according to the IRS.

Third, electronic return transmitters are ill equipped to verify whether their customers, mostly commercial electronic return originators, are actually providing free filing, and the program would be difficult to police.

We believe subsidies are a bad idea, but if any are provided, they should go to taxpayers as a tax credit or to the 70,000 plus electronic return originators who have the ability to enlist their customers, not to transmitters, most of whom have no direct contact with taxpayers.

We also do not believe it is cost effective to extend the tax filing deadline to May 15 for electronic returns.

If the primary target is the balance-due filer, who files late in the season and might see some advantage in slower payment, delaying that revenue by 1 month could cost the Treasury as much as $100 million, adding to the deficit.

The taxpayer is already able to file for an automatic extension if he needs more time, so the only incentive is the benefit of slower payment, which increases Treasury borrowing costs. The benefit would be greatest for large balance-due filers.

We believe the IRS should focus more productively on the 71 percent of taxpayers that get a refund and have a stronger incentive to file electronically because they may want it quickly.

Electronic filing is growing, even without an extended season or subsidies. We believe the key to further increases is not to lose focus on the need for a massive IRS marketing campaign that parallels private sector advances.

We look forward to working with the Subcommittee on these issues. We are proud of the contribution we now make, and hope to build on it in the future. I am happy to respond to your questions.

[The prepared statement follows:]

Statement of Thomas L. Zimmerman, President, H&R Block Tax Services, Inc., Kansas City, Missouri

Thank you for inviting us to testify on the recommendations of the IRS Restructuring Commission to increase the number of electronically filed (ELF) tax returns.

I'm Tom Zimmerman, president of H&R Block Tax Services, Inc., the tax services subsidiary of H&R Block. Among our other subsidiaries is Block Financial, which distributes Kiplinger TaxCut® tax preparation software. I have worked in the tax preparation industry for 24 years, starting as a tax preparer and rising to district manager, regional director, divisional director, and executive vice president before assuming my present position.

We strongly support electronic filing. We have worked closely over the past decade with the IRS and more recently with the Commission to accomplish that goal. We agree with many of the Commission's electronic filing recommendations, but believe that two of their recommendations—delaying tax filing deadlines and subsidizing private-sector tax return transmitters—would misplace priorities and resources. We do not agree that they are cost-effective ways to increase electronic filing.

H&R BLOCK'S ROLE

H&R Block handles more than 18 million returns in the United States, Canada and Australia. All of our returns are filed electronically in Australia and over 65% in Canada. In the U.S., where we process returns for one out of every seven individual taxpayers, we provide 7.3 million, or about half, of the electronic returns the

IRS receives from commercial practitioners. This year, the number of electronic returns we filed increased by 15.7%.

To promote electronic filing, we spend $2.4 million on television ads, have window banners in our 8,500 U.S. offices, distribute more than 5 million brochures in English and Spanish, target direct mail to 11.5 million prior clients, and highlight the benefits on our web site, on a CompuServe forum, and in our "Ask Henry" syndicated newspaper column.

Electronic filing is provided free as part of the enhanced service we offer at our 600 H&R Block Premium Offices and by some of our franchisees, and on March 1 we generally lower our electronic filing fee from $25 to $15 at our other offices. We plan to reduce fees in steps over several years as volume increases.

We will be reducing electronic filing fees by a third for returns we prepare in the coming tax season. In addition, we recently concluded a three year agreement with CompuServe to upgrade their system to provide capacity to transmit up to 40 million electronic returns, an investment we believe shows our strong commitment to increased future electronic filing.

Five Electronic Filing Advantages

Five advantages of electronic filing are clear: (1) refunds in less than half the time of paper returns; (2) reduced follow-up IRS correspondence as social security number, math and IRS transcription errors are caught or eliminated [20%+ error rates for paper returns vs. less than 1% for electronic returns]; (3) no greater risk of audit; (4) proof the return has been filed; and (5) savings for the IRS with reduced data-entry costs.

For most of our clients, however, the compelling advantage and only driving force for electronic filing is a quick refund. Because of the desire for a quick refund, over 70% of our customers file early.

Obstacles to Electronic Filing

Despite the advantages, most taxpayers who receive refunds still don't file electronically. In H&R Block's case, all of our returns are prepared on computer but only half are filed electronically. Nationally, half of all individual tax returns are prepared on computer, but only 13% are filed electronically. Reasons vary. Many clients don't have enough information or have misinformation. Some fear an increased possibility of audit, worry about invasion of privacy, distrust computers, or are more comfortable with the familiar ritual of a trip to the post office.

For some taxpayers, cost may be a factor-although we believe this is less than might be expected. A recent USA Today/Gallup poll (4/2/97) finds only 24% of paper filers cite fees as a reason for not filing electronically while the vast majority give other reasons. We tested free filing over several years in about a third of our offices and found 60% of our clients still preferred paper filing. So cultural factors, misinformation, or a lack of perceived value may be more significant barriers than cost. We continue to search for the right mix of incentives and information to enable growing numbers of taxpayers to benefit from electronic filing.

IRS procedures also add difficulty to electronic filing. Cumbersome signature requirements (Form 8453), paperwork gluts over applications and revisions to participate in the electronic filing program (Form 8633), and delayed confirmation of electronic filer identification numbers could all be eliminated or streamlined. The application to become an electronic filer, for example, can't be filed electronically. To clear these obstacles, government and industry must work together.

Where Focus Should Be

Short of mandating electronic filing, we believe what is most needed is a massive IRS campaign, reinforced by the private sector, promoting and marketing electronic filing and educating taxpayers to the advantages.

The 1040 booklet most taxpayers receive covers many issues, but it has never emphasized the benefits of electronic filing. We recommend that page one of each 1040 booklet have a large, highlighted area asking taxpayers directly to—

Please file your return electronically for—
- Faster refunds
- Fewer errors and follow-up letters
- No greater audit risk
- Proof of filing
- Lower IRS data-entry costs which saves tax dollars

See pages _____ for more information.

On subsequent pages, there would be a strong sales pitch.

We are encouraged by plans being developed to launch an IRS public service TV campaign next year with tie-in printed materials and more information in the 1040 booklets. Past promotion of TeleFile has successfully boosted use by those who file simple returns. The emphasis must be on persuading taxpayers, not just tax preparers.

Congress can help by relaxing appropriations restrictions on the use of IRS funds for paid advertising.

We are also encouraged by renewed efforts at IRS. A history of inflated estimates, attempts at strategic plans, and delays in acting on repeated recommendations all suggest that IRS needed a spur to action. A new combination of IRS personnel changes, Treasury oversight, Congressional criticism, and Commission efforts may finally yield results. The problem with electronic filing has been less one of uncertain strategy than lack of resources and execution.

We support the Commission's recommendations for realistic goals, clear strategy, private-sector advice, and lower barriers to paperless filing and payment. We strongly believe, however, that federal subsidies to electronic return transmitters and extending tax filing deadlines are unneeded, unwise, and divert resources from where our focus should be to increase electronic filing.

SUBSIDIZING ELECTRONIC RETURN TRANSMITTERS UNNEEDED

We don't believe a subsidy to electronic return transmitters of up to $3 per return for taxpayers not charged a fee is needed or appropriate, especially given pressures on the IRS budget. First, market forces are already moving to lower filing fees-in some cases electronic filing is already offered free, meaning subsidies would be a windfall for some firms. Electronic filing is up 19% this year without subsidy. Second, subsidies may undermine the incentives some preparers now have to invest fees in electronic filing start-up costs including advertising and promotion, which could be counterproductive. Third, a subsidy of up to $3 per electronically filed return may cost the IRS money since average data entry costs for a paper return are less ($2.65 vs. $4.15), according to the IRS. And, fourth, electronic return transmitters are ill equipped to verify whether their customers-mostly commercial electronic return originators-are actually providing "free" filing, and the program would be difficult to police.

We believe subsidies are a bad idea, but if any are provided, they should go to taxpayers as a credit or to the 70,000+ electronic return originators who have the ability to enlist their customers, not to transmitters most of whom have no direct contact with taxpayers. Any subsidies should also be targeted as an incentive to new filers, not used to reward existing electronic filers.

EXTENDING TAX FILING DEADLINES UNWISE

We also don't believe it is cost-effective to extend the tax filing deadline to May 15 for electronic returns. If the primary target is the balance-due filer of a complex return who files late in the season and might see some advantage in slower payment, delaying that revenue by a month could cost the Treasury as much as $100 million, adding to the deficit. The taxpayer is already able to file for an automatic extension if he needs more time (although payment in full should be made by April 15), so the only incentive is the benefit of slower payment-which increases Treasury borrowing costs. The benefit would be greatest for large balance-due filers.

New dates and a longer filing season would also add complexity, create taxpayer confusion, and, by diminishing the single focus on April 15 as the national deadline, contribute to weakened compliance.

We believe the IRS should focus more productively on the 71% of taxpayers that get a refund and have a considerably stronger incentive to file because they may want it quickly. They have a built-in incentive to file electronically—if we can educate them and promote the service.

Electronic filing is growing now even without an extended season or subsidies. We believe the key to further increases is not to lose focus on the need for a massive IRS marketing campaign that parallels private-sector advances.

We look forward to working with the Subcommittee on these issues. We're proud of the contribution we now make and hope to build on it in the future.

Chairman JOHNSON. Thank you.

Mr. Wolfe.

STATEMENT OF LARRY WOLFE, SENIOR VICE PRESIDENT, TAX PRODUCTS DIVISION, INTUIT, INC., SAN DIEGO, CALIFORNIA

Mr. WOLFE. Madam Chairman, Ranking Member Coyne, Representative Portman, other distinguished Members, it is an honor to make my first appearance before this Subcommittee, and, in fact, before any Committee of Congress.

My name is Larry Wolfe. I am a CPA and vice president of the tax products division of Intuit, a U.S.-based software company, which produces a variety of tax and personal finance products, including TurboTax and MacIntax, the Nation's leading and best selling tax preparation software.

More than 14 million tax returns were prepared using Intuit software last year. We followed closely and with great enthusiasm, the work done by the National Commission of the Restructuring of the IRS, led by Congressman Portman and Senator Kerrey. The Commission got it right.

The Commission's report on electronic filing, taken as a whole, is an excellent and balanced set of recommendations, and it deserves Congress' support. There is uniform agreement that electronic filing of tax returns is desired. Paper returns are expensive to process, and while hard costs have proven difficult to determine, the best estimates of processing costs are about $7 per return, while truly paperless returns on the other hand cost only pennies.

So what is keeping this from happening and what can Congress do to help achieve these goals? We believe two things need to be done. First, we need to eliminate everything that makes electronic filing less attractive than the current method of sending it in with simply a postage stamp. However, this is not enough. To simply get to the point where taxpayers see both methods as equal will not drive substantial increases in electronic filing. We must make electronic filing the preferred method of filing tax returns.

H.R. 2292 directs the Secretary of Treasury to implement a plan to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing. Intuit supports this directive and encourages Congress to ensure that every barrier is removed, and that taxpayers are incentivised to file electronically.

Specifically here are the barriers that we would like to see removed. First, eliminate the 8453 form; second, eliminate the requirement to file paper copies of W–2 forms; third, ensure that the IRS can accept all tax returns electronically; fourth, eliminate the need to send in a check with a balance-due return; fifth, work to eliminate public skepticism of electronic filing. Taxpayers are uncertain about electronic filing, and need to be assured through IRS promotional campaigns that electronic filing does not increase the risk of audit, and is a safe efficient way to file the returns. We are delighted that the IRS is already working on this, and we believe that they will see benefits from that.

Finally, most taxpayers pay between $10 and $25 to electronically file their returns. This amount must be reduced to zero in order to compete with the 32 cent stamp. The bill includes a provision that requires the Secretary to implement procedures to provide for the payments of incentives to transmitters if they make electronic filing free for their customers.

Collectively, these provisions are dramatic, and Intuit fully supports all of them. They, however, will only make taxpayers ambivalent about whether to file on paper or electronically. In our opinion the IRS will not see the huge increases in electronic filing that they are looking for simply as a result of leveling the playingfield.

The second step must be to make electronic filing the preferred method. We believe the following items are necessary to create a real movement to electronic filing:

The first already exists. Only electronically filed returns get an acknowledgment of receipt from the IRS. Second, allow taxpayers who file electronically to view in a secure way certain information about their accounts with the IRS. Third, and most important, is to extend the filing deadline for electronic returns. This will be the catalyst that causes taxpayers to push the file electronically button, rather than the print button on their keyboards. We support this filing extension because we believe it is the most significant incentive for people who have balances due.

We commend the Commission's work, and H.R. 2292 that resulted from it. We encourage Congress to support the provisions as a total package. As I conclude, I would be remiss if I did not mention how impressed we are with the markedly increased level of dialog, openness, and outreach by the senior Treasury and IRS officials. We have enjoyed those communications, and we believe that they will bear much fruit in the future. Thank you very much.

[The prepared statement follows:]

Statement of Larry Wolfe, Senior Vice President, Tax Products Division, Intuit, Inc., San Diego, California

Madame Chairman, Ranking Member Coyne, Representative Portman and other distinguished Members of the Committee: My name is Larry Wolfe. I am Senior Vice-President, Tax Products Division of Intuit, Inc., a U.S. based software company which produces a variety of tax and personal finance products including TurboTax and MacInTax, a personal and professional tax product that is the best selling tax preparation software in the United States. Fourteen million tax returns are prepared using our software. More generally, Intuit's mission is to improve the way individuals and small businesses manage their financial affairs. To that end, Intuit develops, markets and supports personal finance, small business accounting, tax preparation and other consumer software products. We provide related supplies and electronic financial services that enable individuals, professionals and small businesses to automate commonly performed financial tasks and better organize, understand, manage and plan their financial lives. It is an honor to appear before the Subcommittee.

We followed closely, and with enthusiasm, the electronic filing review and recommendations made by the National Commission on Restructuring the IRS ("the Commission") led by Senator Kerrey and Congressman Portman. The Commission got it right. The Commission's report on electronic filing, taken as a whole, is an excellent and balanced set of recommendations. It deserves Congress' support and we hope you will see that the IRS, who are making strides of their own in the same direction, is asked to implement it.

BENEFITS OF ELECTRONIC FILING

Chairman Johnson's statement announcing this hearing squarely addressed why incentives are needed. For Tax Year 1996, approximately 120 million individual tax returns were filed. More than half, and probably as many as 60 million returns, were prepared by paid tax preparers using a variety of tax preparation software. In addition, at least 10 million tax returns were completed by individual self preparers who use consumer-oriented tax preparation software products such as Intuit's. Only a small percentage of these electronically prepared tax returns, less than 20 million, were submitted to the government in an electronic format, and, we have been told the majority of electronically submitted tax returns are RAL's—refund anticipation loan recipients. Collectively, most current electronic filers were receiving

refunds. For these reasons, the number of electronically submitted returns, while increasing, is generally static when compared with the total number of returns that could be returned in electronic format.

The Commission, the IRS and this Subcommittee have recognized that there is an enormous financial and service benefit to the government in electronically receiving the returns currently prepared in electronic format, a number which is growing each year. Although approximately 70 million returns (out of the 120 million returns received by IRS) currently are prepared electronically, approximately 60 million taxpayers using PC's, or preparers, *print* out their tax return on paper and mail it in. The IRS is then required to pay approximately 8,000 full time and, more importantly, 21,000 seasonally hired workers to manually enter *only* 40% of the information contained in these paper returns on IRS computers. This manual handling of paper returns delays processing and introduces new errors to the process.

The IRS figures reported regarding labor costs vary widely. Assuming all returns take roughly equivalent time, the total process of labor and service center cost to IRS is $7 per *paper* return. During the press conference releasing the Commission's report, Co-Chair of the Commission, Congressman Portman, emphasized that the Commission found the $7 figure to be the best available estimate.

In addition, the Commissions Report found that the error rate for manually prepared paper returns is approximately 20%. Addressing a return with errors requires multiple handling in data processing, and consequently the cost of each wrong return is far more than the estimated $7 average. Because electronically filed returns usually are prepared by computer programs with built in software checks, undergo pre-screening by the IRS, and experience no key punch errors, the Commission estimated the error rate for electronically filed returns to be less than one percent. This low error volume will translate into a huge cost savings if electronic returns grow.

Moreover, the actual cost of inputting such returns requires aggregating labor, facility costs and computing. For example, for every 15 million additional returns obtained electronically, IRS could eliminate the cost of building and maintaining one major service center.

As Chairman Johnson's announcement statement accurately described and the Commission reported, returns prepared and received electronically actually have a significantly lower cost to process and have a higher accuracy rate than those returns that are prepared manually. The Commissions Report estimated that the cost of processing electronic returns was at $1.15 per return, including the processing of additional documents to authenticate the return, which costs H.R. 2292 will hopefully reduce.

INTUIT SUPPORTS COMMISSION RECOMMENDATIONS IN THE PROPOSED LEGISLATION

Specifically, we believe the following six recommendations, made by the Commission and already included in Title II of H.R. 2292, are critical and necessary:

First, the requirement to file the 8453 signature document is being dropped. A signature alternative will be identified and enabled. This will eliminate a significant barrier to electronic filing that remains both for returns professionally prepared and those self prepared. Under the Telefile program, IRS already has evolved a way to provide personal PIN numbers to taxpayers. Some method must be utilized to authenticate each return and remove the current need to require signature forms, or mailing a paper return for matching with an electronic record. This will remove a *barrier* in the current system.

Second, the bill permits a limited power of attorney permitting the taxpayer to authorize the IRS to speak to their professional tax preparer with respect to an electronically filed individual return. This will provide an *incentive* for preparers to encourage electronic returns.

Third, moving towards secure account inquiry by individual taxpayers is appropriately recognized, as is the need to protect private information. This will provide an *incentive* for taxpayers and encourage filing of electronic returns.

Fourth, an extension of 30 days for electronically filed returns is being offered, and paperless payment options are being enabled. This is a major *incentive* to taxpayers to electronically file. In concert, the balance due filer, who today has no incentive to file electronically, will find it easier and more attractive to file electronically.

Fifth, the bill requires IRS to incorporate market incentives for electronic filing to bring the cost of electronic filing into equality with a $.32 stamp. I will return to this issue for some additional comments, but cost to taxpayers is a key *barrier* to electronic filing.

Finally, a strategic pe industries increased confidence that the IRS understands the challenge, the benefits and the opportunities to make electronic filing and payment the preferred and most convenient means of filing.

COMMISSION RECOMMENDATIONS THAT INTUIT BELIEVES SHOULD BE INCLUDED IN THE SUBCOMMITTEE'S LEGISLATION

There are four recommendations identified in the report of the National Commission on Restructuring the IRS: *A Vision for a New IRS*, that H.R. 2292 has not, as yet, embraced. We would recommend that four additional issues be included prior to passage of the bill. These include:

The first, and most critical, is the need to eliminate the requirement to file a W2 for electronically filed returns. Paper W2s are currently attached to the paper 8453 signature document when the electronic filing method is used. Eliminating the requirement to file a paper 8453 document without also eliminating the requirement to file paper W2s will not truly provide a paperless filing. This *barrier* to electronic filing must be removed.

Second, the Commission recommended expanding the range of 1040 returns that can be filed electronically. Today, there are limitations in the electronic filing program (for example, the number of stock transactions which can be reported on an electronically filed return) which exclude a number of 1040s from the electronic filing process. The returns excluded are typically the more complex, and therefore, more costly to keypunch. The IRS should be required, over a reasonable period of time, to find ways for all returns to be permitted to be electronically filed. This will remove an unnecessary *barrier* to electronic filing.

Third, the extension incentive for balance due filers should be accelerated. This is a huge *incentive* to a group that will not otherwise file electronically, and the Committee should clarify the effective date of this provision.

Finally, the Commission recommended permitting the IRS to promote electronic filing. Today, the only promotional avenue the IRS has for electronic filing is public service announcements. These rarely run during prime time. To aggressively advance and promote electronic filing, the IRS should be authorized and funded to promote this program in magazines, newsparrier to IRS effectiveness should be removed.

INCENTIVES: A CRITICAL COMPONENT

H.R. 2292, Section 201(c) embraces a version of the Commission's recommendation on *incentives*, an issue that the Commission found is of paramount importance in increasing the number of electronically filed returns.

From an individual taxpayers perspective, there is little or no economic incentive to file electronically. Taxpayers are generally charged service fees ranging from $10 to $25 for electronic filing. Occasional temporary promotions of electronic filing at lower or no cost are just that—promotions that are not likely to be continued. Therefore, a rational taxpayer will continue to choose a $.32 stamp to mail a printed return. A series of customer surveys conducted by independent third parties have stated that cost is the single greatest impediment to electronic filing. (A copy of one such polling study, and another reported in *USA Today* are attached). We have heard other companies say that cost of electronic filing is not the main issue for their customers. We strongly disagree, and would suggest that the Committee seek hard data if cost is not perceived to be the most important issue. We do agree cost is *not* the *only* issue.

In fact, in the polling data, 53% of these people surveyed said economic incentives should be used to drive up electronic filing, 40% said they didn't have an opinion, and only 7% opposed use of economic incentives.

An economic incentive approach is appropriate for the following reasons:

First, a proposed incentive system reduces governmental and taxpayer risk to a minimum. IRS should only be asked to pay for tax returns it actually received in the desired format. IRS currently acknowledges receipt for filings it receives from third parties. Electronic filing actually results in greater certainty for taxpayers because they will have a record of actual receipt of their return by IRS. (Paper returns do not result in such receipts.) Currently, service providers and the IRS are already doing this exact function for millions of returns—the Commission proposed shifting a very high cost from the individual taxpayer to a much smaller cost borne by all taxpayers, in order to reduce total expenditures on IRS operations. The IRS has stated that it has the ability to accept as many as 100 million electronically filed returns annually without requiring any new systems development effort. Current IRS standards appropriately require suitability checks of the transmitter—such as

the technical background of the concern, credit worthiness, and necessary background checks on employees.

Second, this incentive does *not* require the IRS to enable Internet access. Instead, transmitters would send their batched returns on the public telephone network through a dedicated connection to the IRS—as they currently do for the returns IRS already obtains electronically. As Internet security and encryption concerns are satisfied, the service providers can utilize the Internet.

Finally, it makes economic sense once all costs of manually processing paper returns are accumulated, that the IRS will still net as much as $4 per return electronically filed, *even if it pays a $3 incentive fee per return, for every return, every single year*. The savings obviously would multiply if 10 million, 20 million, or more additional returns, already in electronic format, were obtained in this manner.

It is the transmitters who have the costs, for example, of telephone lines, servers, and staff at call centers to make electronic filing work. Intuit would be pleased with the incentive being paid wherever it will be effective, but it is not clear how payments or credits to taxpayers will solve the cost problem of transmitters.

The Commission's recommended incentive proposal would permit a variety of vendors to provide electronic filing free to the taxpayers. The resulting surge in ELF should save the government substantial sums, year after year.

DRAFTING COMMENTS

We note that Section 201(c)(2)(c) appears to distinguish between preparer returns and self-prepared returns. We see no policy reason to make such a distinction.

As a matter of drafting the numerous effective dates in the bill, we were uncertain whether Section 202 contained an effective date for corporate and individual returns.

NO COMPETITION WITH PRIVATE SECTOR

There is one other area where the Subcommittee could clarify existing law and practice. Intuit and other software companies, and I believe the preparer community, have no objection to IRS aggressively making their forms available on line. We and others spend tens of millions of dollars integrating a software package that we warrant and that responds to our customer needs. This bill should include simple language indicating it is congressional policy to rely upon value added private concerns to continue to service this private market without government competition. We believe such a firm policy guide would be useful, and consistent with OMB policy circulars.

DIALOGUE WITH TREASURY AND IRS

The level of dialogue, openness and outreach by senior Treasury and IRS officials has markedly increased in the past year. We believe Congress should be made aware of this valuable open channel between the stakeholders in the system.

CONCLUSION

While the IRS has stated they have sufficient legal authority to implement this proposal, H.R. 2292 will provide the necessary final push. Intuit believes the House Ways and Means Committee's efforts are critical in assisting the IRS.

http://www.usatoday.com

USA TODAY

Money

WEDNESDAY, APRIL 2, 1997

Taxpayers still cool to electronic filing

By Anne Willette
USA TODAY

Taxpayers are rushing to computers to do their federal income tax returns, but sticking with low-tech delivery — the mail — to get them to the IRS.

Since 1990, the percentage of taxpayers using tax-preparation software has rocketed to 36% from 9%, according to a USA TODAY/CNN/Gallup poll. The programs are most popular among higher-income taxpayers, many of whom have complicated returns.

But only 15% of taxpayers say they are filing electronically this year, vs. 10% last year. And the taxpayers most likely to use tax programs are least likely to file electronically, even though their preparation software will do it for them.

Biggest barrier: cost. Almost 25% of taxpayers who mail their returns say they don't want to pay a company $10 to $20 to send them to the IRS. Taxpayers also cited privacy worries and the inconvenience, and said they see no benefit.

The poll points out hurdles the Internal Revenue Service must clear to achieve its goal of a virtually paperless tax system. The IRS plans to address those issues in a May report.

The IRS likes electronically filed returns because they are cheaper to process. They also are more accurate. Only 0.5% have errors vs. 20% of paper returns. Many of those errors are caused by IRS data entry.

Greater accuracy means the IRS has to do fewer investigations, saving taxpayers headaches and the agency money. "If you want to stay away from problems with the IRS, file electronically," says Jeff Trinca, chief of staff of the National Commission on Restructuring the IRS. The commission's report, expected in June, will recommend ways to encourage electronic filing, including making it free.

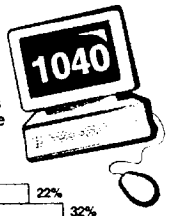
The main reason taxpayers file electronically is to get refunds faster, in 21 days rather than 40 for paper returns. Electronic filing is up 18% this year partly because loans based on expected refunds are easier to get.

That helps explain why electronic filing is most popular among taxpayers who earn less than $50,000 a year. Higher-income taxpayers are less likely to need the money right away. Yet, the IRS would benefit most if those taxpayers, whose returns tend to be more involved, filed electronically.

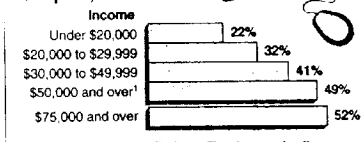
"We need an incentive for the balance-due filer," says Mike Mango, president of the Council for Electronic Revenue Communication and Advancement, an industry group. Such as: $15 tax credit or giving them until May to pay their taxes.

Fear of (electronic) filing

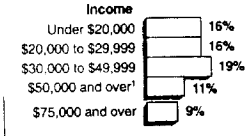
Almost 40% of taxpayers use a computer program to prepare their returns. Yet only 15% say they will file — or have filed — electronically this year.



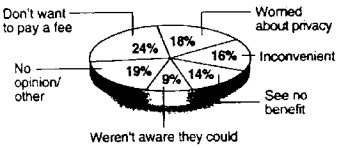
Upper-income taxpayers are most likely to prepare their tax returns on a computer, ...



... but they're least likely to file electronically.



Why taxpayers don't file electronically[2]



1 – includes those earning $75,000 and over
2 – based on 781 adults filing by mail; margin of error: ±4 percentage points

Source: USA TODAY/CNN/Gallup poll of 1,009 adults March 24-26; margin of error: ±3 percentage points

THE MELLMAN GROUP

RESEARCH-BASED STRATEGY

TO: CLS

FROM: The Mellman Group

RE: Electronic Tax Filing

DATE: May 28, 1997

This analysis reports the findings from a national survey of 1,035 adults who were interviewed by telephone May 1-4, 1997. The study is based on a random-digit dialing (RDD) probability sample of all telephone households in the continental United States which ensures that every telephone household had an equal chance of participating in the survey. The margin of error for the sample as a whole is +/- 3.1 percentage points at the 95% confidence level. The margin of error for subgroups varies and may be larger.

There is a significant margin of support for electronic filing of tax returns but changes in the current system will be required in order to tap into this market. Almost a quarter of people say they would be almost certain to file electronically if it was free. That number balloons to 33% among those under 35 years of age. Cost and technological comfort appear to be among the most significant barriers. While many Americans are undecided as to whether private companies should receive incentives to provide free electronic filing, there is almost no opposition, and those groups most likely to use the service strongly support incentives.

The Return Is In The Mail

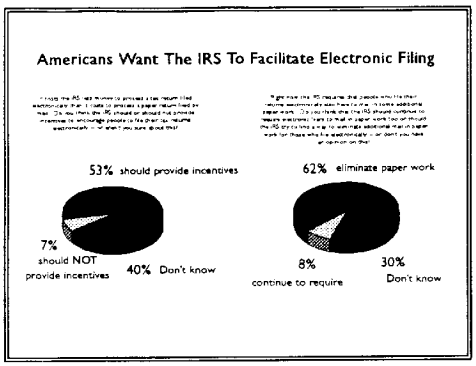
Electronic filing is more likely to be found among younger taxpayers than older taxpayers. Of those who used a professional tax preparation service and were therefore most likely to be offered an electronic filing option, only the youngest taxpayers were just as likely to file electronically as mail their returns. The older the taxpayer, the less likely they were to take advantage of electronic filing. For example, of the 41% of 25 to 34 year-olds who used a professional tax preparer, 22% mailed their forms and 19% filed electronically. In contrast, of the 24% of seniors who used such a service, 20% mailed their returns and only 4% filed electronically.

It remains that the majority of Americans (77%) who filed a tax return this year did so through the mail, despite the fact that nearly half of these filers (47%) report that they prepared their return electronically, either through a professional tax preparation service (40%) or themselves on a personal computer (7%). A majority (51%) of filers still do their taxes the old-fashioned way by filling out a paper return and sending it through the mail to the IRS.

THE MELLMAN GROUP, INC. 1000 THOMAS JEFFERSON STREET NW, SUITE 520 WASHINGTON, DC 20007 (202) 625-0370 FAX (202) 625-0371
2743 NE 20TH AVENUE PORTLAND, OR 97212 (503) 284-9007 FAX (503) 284-3380

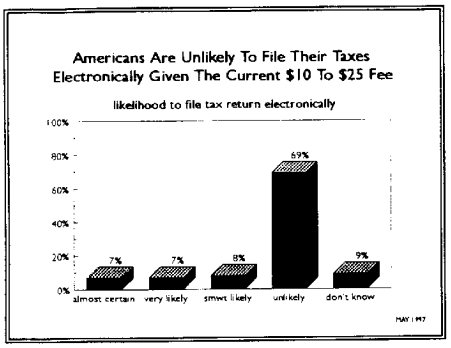
Americans Want The IRS To Facilitate Electronic Filing

After being told that it costs the IRS less money to process a tax return filed electronically than it costs to process a paper return filed by mail, a majority of Americans (53%) support having the IRS provide incentives to encourage people to file their tax returns electronically. Only 7% oppose the IRS providing such incentives, while 40% are undecided. The strongest support for IRS incentives comes from the college educated (67%), people aged 25 to 49 (65%), those with incomes of $40,000 and higher (62%), and those who prepared their returns electronically, but filed through the mail (63%). Older Americans, aged 50 to 64 (45% support) and 65 and older (34% support) are least likely to want IRS incentives for electronic filing. However even among this older group, few oppose incentives. Indeed, this whole set of issues seems simply less relevant to this age group.

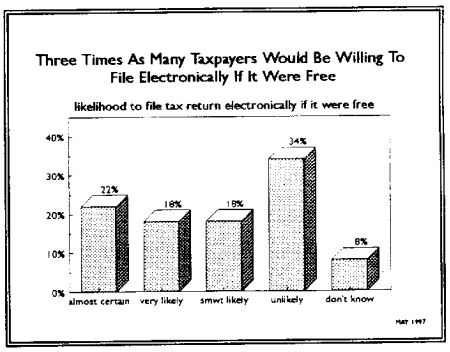


In addition to incentives to encourage taxpayers to file electronic returns, Americans also support the elimination of paperwork for electronic filers. When told that the IRS currently requires people who file electronic returns to mail in additional paperwork, 62% say the IRS should find a way to eliminate such paperwork. A mere 8% think the IRS should continue to require mailed-in paperwork. The strongest supporters of eliminating paperwork are people aged 25 to 34 (74%), those living in the west (68%) and the college-educated (72%). In addition, nearly three-quarters (73%) of those who consider themselves almost certain or likely to file electronically would like the IRS to eliminate additional paperwork.

Free Electronic Filing Has Appeal



The majority (69%) of Americans report that they are "unlikely" to file their tax returns electronically under the current system which costs between $10 and $25 in fees to companies authorized to file returns for taxpayers. In contrast, only 7% say that they are "almost certain" to file electronically under the current system, with another 7% saying they are "very likely" to do so. The youngest (18 to 24) and the oldest (65+) taxpayers are the least apt to pay the $10 to $25 cost of filing electronically (4% almost certain) while those aged 25 to 50 (10%) are the most likely to see themselves paying to modem in their returns.



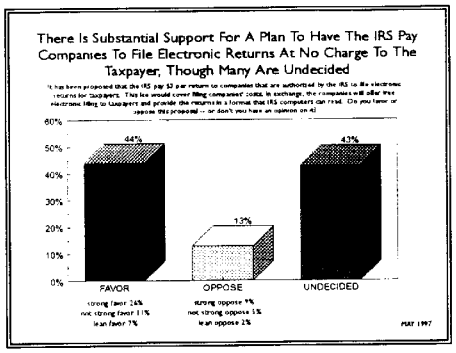
Interest in electronic filing increases dramatically when it is positioned as a no cost option to the taxpayer. Nearly a quarter (22%) report they would be "almost certain" to file electronically if it were free. This represents a three-fold increase from the number who report being almost certain to file electronically under the present system. Another 18% say they are "very likely" to do so. The number who say they would be "unlikely" to file electronically if it were free is 34%, or just less than half of those who say the same under the current fee structure. The younger the taxpayer, the greater their interest in electronic filing, with a third of those under 35 (33%) saying they would be "almost certain" to file electronically if it were free. Only 14% of 50 to 64 year-olds report such certainty and a mere 8% of seniors.

The current cost of electronic filing appears to play a more significant role among younger

taxpayers than older taxpayers. While only 4% of 18 to 24 year-olds say they are certain to file electronically given costs of $10 to $25, 30% say they are certain to do so if it is free, a 26 point increase. Similarly, while 11% of people aged 25 to 34 are certain to file electronically under the current system, that number increases 23 points to 34% if electronic filing is free. In contrast, only 14% of those aged 50 to 64 and only 8% of seniors would be certain to file electronically if it were free, an increase of only 10 points and 4 points respectively. For older Americans, the technology itself may be a greater barrier than cost.

There Is Both Support For And Uncertainty About The IRS Paying For Electronic Filing

Americans are generally supportive of a proposal that would have the IRS pay $3 per return to companies that are authorized to file electronic returns for taxpayers in exchange for such companies making electronic filing free to the public. Nearly half (44%) say they favor such a proposal, with about a quarter (26%) supporting this plan strongly. Yet, while there is little opposition to this plan -- only 13% oppose such a proposal to facilitate electronic filing -- fully 43% are undecided. Seniors (63%) and those with annual incomes less than $20,000 (52%) are the most undecided about this proposal.



Arguments for and against the plan do little to change public support. Respondents were read two arguments; one in favor of the proposal saying that paying filing companies $3 per return to file electronically on behalf of taxpayers will save the government up to $400 million per year, and one argument against the proposal saying it is wrong for the federal government to pay fees to private companies to file tax returns for taxpayers. With this information in mind, 42% support the $3 incentive proposal and 18% oppose the plan. Fully 40% remain undecided. This represents a 2 point decrease in support and a 5 point increase in opposition.

Removing obstacles to electronic filing such as mailing in signature forms and checks, do less to increase interest than simply making the service free. Approximately the same number say they would be almost certain to file electronically assuming it were free and the IRS instituted a taxpayer PIN number system to eliminate the need for a signature form (19% "almost certain") as say so assuming it were free and the IRS allowed taxpayers to pay the taxes they owe electronically using credit cards and debit transfers, rather than having to mail a check (18%).

There Is Some Interest In PC Filing

Given the choice between the IRS paying $3 per return to companies that are authorized by the IRS to file returns using existing technology and the IRS developing a new computer system that could allow people who do their taxes on personal computers to file their returns via modem, there is a slight preference for PC filing. Just over a third (35%) of Americans prefer the IRS to facilitate PC filing, while just under a third (29%) prefer giving incentives to private companies so all taxpayers can take advantage of electronic filing. As with other approaches to electronic filing, much of the public is undecided on this question (36%). Though we did not ask this question, it seems likely that most Americans have little idea of the problems the IRS has encountered with its computer system.

Younger Taxpayers Are Most Receptive To Electronic Filing

Taxpayers aged 25 to 34 are the most receptive to electronic filing. They are the most likely to have prepared their 1996 returns electronically (41%) and say they are most likely to file electronically with the current fee structure (11%) or if it were free (34%). This age group is also among the strongest supporters of IRS incentives for electronic filing (70%) broadly and is the most supportive of the $3 per return proposal (57%) specifically. However, this age group is also among the most likely to have a PC (40%) and a modem (31%), and has a slight preference for the IRS developing a new computer system to accept modemed returns over paying $3 incentives to private filing companies (34%).

Chairman JOHNSON. Thank you very much.
Mr. Langer.

STATEMENT OF JOSEPH W. LANGER, PRESIDENT, NATIONAL ASSOCIATION OF COMPUTERIZED TAX PROCESSORS, GREEN BAY, WISCONSIN

Mr. LANGER. Madam Chairman, Members of the Oversight Subcommittee, I appreciate the opportunity to testify on the issue of

electronic tax filing. The work done by the National Commission on Restructuring the Internal Revenue Service, as well as the changes recommended in H.R. 2292, are sweeping and appropriate, and they address the issues facing electronic filing today.

My name is Joe Langer. I am the president of the National Association of Computerized Tax Processors, and for the last 8 years, I have been the chair of the electronic filing committee of this association. And my profession, I am president of Nelco, Inc., an electronic filing service provider and tax form provider from Green Bay, Wisconsin. Our products are used by over 100 companies throughout the country; different tax preparation software companies.

Through my term as electronic filing chair, we have worked with the IRS and State agencies to promote standards and make recommendations to simplify and enhance electronic filing. This past year alone we submitted a paper making 22 recommendations to the Internal Revenue Service. The NACTP as an organization continues to promote professional standards for software development, and to promote a consistent method of automated tax filing.

Over the life of the Federal electronic filing system, the IRS has considered various types of signature alternatives. While this consideration continues, States are enabling paperless electronic filing systems, which either require no signature document for filing, or require the return—to retain a copy of the electronic return.

Today the State of Montana requires no signature document at all, and 17 States require the signature document to be prepared, but not submitted. It is time the IRS accepts one of these alternatives.

Digital signatures using public and private keys are not fully perfected to be implemented on a nationwide basis. Personal identification numbers are not yet developed for tax filing, and some have recommended a separate PIN for each type of filing. Until these systems are updated, or a new system can be made available to all taxpayers, another alternative, such as those being implemented at the State level must be deployed.

True paperless filing will be a great benefit to electronic filing, and promote its use over paper filing. Eliminating paper will reduce the cost to both individual and tax preparers. However, to be truly paperless the IRS must eliminate the need for filing Form 8453. The electronic filing system must accept all forms, all schedules. In addition, all forms, including the W–2 worksheets or explanation, which are attached to an electronic return must be submitted electronically, not on paper. For the true paperless system, electronic filing will grow substantially. The only way to accomplish this goal is to invest in the technology for the electronic filing system.

The proposed legislation in the Commission's report called for an incentive to electronic filing transmitter. Our membership believes to quickly change filing behavior and achieve the highest long-term results, the taxpayer should receive the incentive to file electronically. However, because of the administrative ability of such an effort and the perceived inequity with paper filers, and incentive-targeted electronic filing infrastructures, those offering the service

will accomplish growth in electronic filing, and reduce the burden on the professional tax preparer.

There are currently over 60,000 registered professional electronic filers today. Only 2,500 transmit direct to the IRS. The remaining 75,000 plus use a value-added network, such as a third-party transmitter. Third-party transmitters charge tax practitioners, from nothing for free electronic line to $10 a return. Some include their electronic filing costs for software development, product support and electronic transmission; in a lump sum, the software. Most like to charge a separate fee for the returns transmitted.

An incentive proposed of $1 to $2 will not cover these costs. Third-party transmitters will pass these incentives on to the tax practitioner clients, and continue to compete on a basis of the products and services that they offer. Practitioners costs include these electronic filing costs, as well as the additional processing costs for an electronically filed return.

Because not every return can be filed electronically, and an electronic return is not paperless, the practitioner must sort returns into paper, and electronic, and fill out forms for every electronic returns. Practitioners will welcome these incentives. However, without changes to the electronic filing system to accept all forms, and to become entirely paperless, the tax practitioners will not fully embrace electronic filing.

Consumers can purchase the software to prepare the return, and file electronically. Companies today charge between $10 and $15 to file electronically. With an incentive, the companies offering electronic—to consumers can reduce their cost for development, support and transmission. However, because there is a separate fee charged for electronic filing, the remaining costs will be added to the cost of the package, resulting in higher software costs.

Legislation proposes extensions for electronic file returns. NACTP has actively recommended creating nonfinancial incentives to promote electronic filing. Because there is no IRS data required for an electronic filed return, we support extensions to file electronically filed returns.

In addition, allowing electronic return originators to communicate electronically, file returns will also benefit for the electronic filer. NACTP has recommended the electronic communication of notices, delays in processing, and requests for additional information to be sent electronically to the electronic filer. By doing this the tax professional can quickly satisfy the request from the IRS, and eliminate additional burden on taxpayers.

Balance-due filers have not yet been attracted to the electronic filing system. The ability to accept credit cards, debit cards, as well as electronic funds transfer should encourage balance-due filers. However, the major impetus behind balance-due filing will occur when practitioners include electronic filing as their standard method of filing all returns.

Access to a taxpayer's account through a secure and private method will add to the attractiveness of electronic filing. Taxpayers can obtain answers to their questions regarding their return and refund status, rather than calling the IRS.

During 1995 and 1996 I served on the IRS Commissioner's Advisory Group while participating on the Commissioner's Advisory

Group and many subcommittees on such broad topics as taxpayer privacy, taxpayer service, and electronic filing.

For electronic filing the occasional topic and meeting did not serve to address the serious issues facing this system. We vigorously endorse the recommendation to establish a separate Electronic Commerce Advisory Group. This group must be comprised by the IRS, a tax practitioner and computerized processor group. It is a blend of these inputs which will result in active and growing electronic filing. The issues must be definable and discussed openly. The IRS just accepts these recommendations and acts on them with the full support of the service. Electronic filing only works with a strong relationship with external stakeholders.

Today there exist an inequity between professional paper return filers and electronic return filers. Electronic return filers must go through an application process, including fingerprinting and background checks, credit checks, and IRS suitability. Paper return filers have no such requirement.

During my tenure on the Commissioner's Advisory Group we recommended, along with the help of the director of practice, a system of registering all tax preparers. In fact, Joe Lane has the recommendation at the back of his testimony.

Our intention was to require registration of all paper and electronic filers to create one process for all tax——

Chairman JOHNSON. Mr. Langer, I have to ask you to kind of wrap up, so that we can get to more people before we have to go vote.

Mr. LANGER. In summary, the National Association of Computerized Tax Processors actively endorses division for the new IRS, published by the National Commission on Restructuring the IRS. The pending legislation capitalizes these recommendations, and seeks for a way to promote electronic filing. Through electronic filing service to the taxpayer can be greatly enhanced and the cost of the service reduced. Thank you.

[The prepared statement follows:]

Statement of Joseph W. Langer, President, National Association of Computerized Tax Processors, Green Bay, Wisconsin

INTRODUCTION

Madame Chairman and members of the Oversight Subcommittee, I appreciate the opportunity to testify before this committee on the issue of Electronic Tax Filing. The work done by the National Commission on Restructuring the Internal Revenue Service, as well as the changes recommended in Bill H.R. 2292, are very sweeping, and appropriately address the issues facing electronic filing today.

My name is Joseph W. Langer, and I am president of the National Association of Computerized Tax Processors (NACTP) and for the last 8 years I have been Chairman of the NACTP's Committee on Electronic Tax Filing. In my profession, I am President of Nelco, Inc., an electronic filing service provider and tax form provider based out of Green Bay, Wisconsin. Our products are used in over 100 tax software companies throughout the country. Over my term as Electronic Filing chair, we have worked with IRS and state agencies to promote standards and make recommendations to simplify and enhance the electronic filing system. This past year alone, we submitted a paper outlining 22 recommendations to the IRS.

The National Association of Computerized Tax Processors (NACTP) was founded in 1969 as a cooperative effort of competing tax service bureaus to create standards in tax processing and establish formal links with federal and state agencies. Over the past 28 years, the NACTP has grown to an organization of 50 companies offering tax preparation software, electronic filing services, and tax form services. Our organization continues to promote professional standards for software development

and consistent methods of tax filing. We look for ways to encourage and simplify automated filing.

DIGITAL SIGNATURES/PAPERLESS FILING

Over the life of Federal electronic filing, the IRS has considered various types of signature alternatives. While this consideration continues, states are enabling paperless electronic filing systems which either require no signature document for filing or require the return originator to retain a signed copy of an electronic return. Today, one state (the state of Montana) requires no signature document and 17 states require the signature document to be prepared but not submitted. It is time the IRS accepts one of these alternatives.

Digital signatures, using public and private keys, are not fully perfected to be implemented on a nationwide basis. Personal identification numbers (PIN numbers) are not yet developed for tax filing and may require a separate PIN for each type of filing. Until these systems are updated, or a new system can be made available to all taxpayers, another alternative, such as those being implemented at the state level, must be deployed.

True paperless filing will be a great benefit to electronic filing and promote its use over paper filing. Eliminating paper will reduce costs for both individuals and tax preparers. However, to be truly paperless, the IRS must eliminate the requirement for filing Form 8453. The electronic filing system must accept all forms and schedules. In addition, other forms, worksheets, or explanations attached to an electronic return must be able to be submitted electronically, not on paper. With a true paperless system, electronic filing will grow substantially. The only way to accomplish these goals is to invest in technology for the electronic filing system.

FINANCIAL INCENTIVES

The proposed legislation and the Commission's report called for an incentive to the electronic filing transmitter. Our membership believes to quickly change filing behavior and achieve the highest long-term results, the taxpayer should receive the incentive to file electronically. However, because of the administrability of this type of effort and the perceived inequity with paper filers, an incentive targeted at the electronic filing infrastructure will accomplish a growth in electronic submissions by reducing the burden on the professional tax practitioner.

Practitioner ELF

There are currently over 60,000 registered professional electronic filers. Only about 2,500 transmit directly to the IRS. The remaining 57,000 plus use a value added network call a "third-party transmitter." Third-party transmitters charge tax practitioners from $0 (that is, free electronic filing) to $10 per return. Some bury their electronic filing costs for software development, product support, and electronic transmissions in a lump sum software cost. Most elect to charge a separate fee for each return transmitted to cover these costs.

The incentive proposed of $1–$2 will not cover these costs. Because of this, third-party transmitters will pass on these incentives to their tax practitioner clients and continue to compete based on the products and services they offer. Practitioner's costs include the electronic filing fees and the additional processing costs required for an electronically filed return. Because not every return can be filed electronically and an electronic return is not paperless, the practitioners sort returns into paper and electronic and fill out paper forms for each electronic return.

Practitioners will welcome these incentives. However, without changes to the electronic filing system to accept all returns and to become entirely paperless, tax practitioners will not fully embrace electronic filing.

Online Filing (Non-Practitioner ELF)

Consumers can purchase software to prepare their tax return and file their return electronically. Companies charge $9.95 to $14.95 to file electronically. With an incentive, companies offering electronic filing to consumers can reduce their costs for development, support and transmission. Because a separate fee cannot be charged for electronic filing, the remaining costs will be added to the cost of the package resulting in higher software costs.

NON-FINANCIAL INCENTIVES

The legislation proposes extensions for electronically filed returns. The NACTP has actively recommended creating non-financial incentives to promote electronic fil-

ing. Because there is no IRS data entry required for an electronically filed return, we support extensions to file for electronically filed returns.

In addition, allowing the electronic return originator to communicate on electronically filed returns will also be a benefit for the electronic filer. The NACTP has recommended the electronic communication of notices, delays in processing, and requests for additional information be sent electronically to the electronic filer. By doing this, the tax professional can quickly satisfy the request from the IRS as well as eliminating additional burden on the taxpayer.

Balance due filers have not yet been attracted to the electronic filing system. The ability to accept credit or debit cards, as well as electronic funds transfer, should encourage balance due filers. The major impetus behind balance due filing will occur when a practitioner includes electronic filing as their standard offer.

Access to a taxpayer's account through a secure and private method will add to the attractiveness of electronic filing. Taxpayers can obtain answers to their questions regarding return and refund status rather than calling the IRS. This would be another benefit for electronic filing.

ELECTRONIC COMMERCE ADVISORY GROUP

During 1995 and 1996, I served on the IRS Commissioner's Advisory Group (CAG). While on the CAG, I participated in many subgroups on such topics as taxpayer privacy, taxpayer service, and electronic filing. With the broad approach to this group, no single topic received a strong focus. For electronic filing, the occasional topic and meeting did not serve to address the serious issues facing the system.

We vigorously endorse the recommendation to establish a separate Electronic Commerce Advisory Group (ECAG). This group must be comprised of the IRS, tax practitioner, and computerized tax processor groups. It is a blend of these inputs, which result in an active and growing electronic filing partnership.

The issues must be definable and discussed openly. The members of the group must be selected to contribute to the process and search for real solutions to the electronic filing challenges. The IRS must accept these recommendations and act on them with the full support of the Service. Electronic filing only works with a strong relationship with external stakeholders.

REGULATING TAX PREPARERS

Today, there exists an inequity between paper return filers and electronic return filers. Electronic return filers must go through an application process that includes fingerprinting with background checks, credit checks, and IRS suitability processing. Paper return filers have no such requirements. During my tenure on the Commissioner's Advisory Group, we recommended, along with the help of the Director of Practice, a system of registering all tax preparers. Our intention was to require registration of all paper and electronic filers to create one process that all tax preparers could use. We would require a minimum of continuing education for all tax preparers.

The legislation envisions regulating all tax preparers under Circular 230. While this can be the ultimate goal, many tax practitioners who are not affiliated with a national professional organization are not looking to represent their clients before the Internal Revenue Service. Therefore, we believe some type of registration for all preparers is appropriate. Regulation through Circular 230 can be an ultimate goal, but steps can be taken prior to imposing Circular 230 on all tax preparers. When this happens, the current electronic filing application process should be eliminated.

CONCLUSION

The National Association of Computerized Tax Processors actively endorses The Vision For A New IRS, published by the National Commission on Restructuring the Internal Revenue Service. The pending legislation capsulizes these recommendations and seeks ways to promote electronic filing. Through electronic filing, service to the taxpayer can be greatly enhanced and cost for the Internal Revenue Service can be reduced. This results in a system of mutual benefit for the taxpayer, the IRS, and the American public.

Thank you for this opportunity today.

Chairman JOHNSON. Your testimony, Mr. Harris' testimony. So if you will; try to notice when the light turns red and wrap it up. You have about 6 minutes, then we can go over and vote, about 7 minutes, and hear the last two.

STATEMENT OF ROBERT J. CARVER, CONSULTANT, KACHINA GROUP, ANNAPOLIS, MARYLAND

Mr. CARVER. I would be happy to do that. Madam Chair, I am happy to be here today to talk a little bit about why electronic filing is important to the IRS.

My name is Robert Carver, and for 30 years I was in the service center operations of the IRS. My last job was managing the 10 computer centers in the service centers.

The effectiveness of IRS is directly related to the quality of the information they can get their hands on. While we are all talking about exploding information age and all the rest of it, the IRS must keep up with that explosion and make some sense out of it. the way I like to describe this, is in the fifties the popular press said that most couples had 2.5 children, and in the nineties we found ourselves, most children have 2.5 parents, and those parents have 2.5 employers, and keep their money and so forth in 2 or 3 banks. And the world is certainly getting more complicated.

Businesses now have independent contractors, part-time helpers, consultants. They are multinational, they are interstate, and in the past they were a lot easier to keep track of for the IRS.

Now the IRS expects each of these taxpayers and businesses to send a report in once a year so that the correct amount of tax can be determined and paid. The IRS then must validate information on those tax returns between and among them; between the businesses, the banks, the pension funds, and the individuals filing their return.

We expect this annual validation to be done every year, and we expect it to be done without bothering the taxpayers, who have sent this information in. IRS would love that same ability, but they need information to do that. Lacking that information, they must bother each of us to ask for more information during the processes they go through to validate.

To get back to my enthusiasm for electronic filing however, I would like to describe a little bit about how IRS gets the information they use. Presently the IRS only uses about 40 percent of the data that the Internal Revenue Code desires, and we as taxpayers pay our time and money to send into them. And this sad fact is a result of two things that are well known.

The first is the state of the IRS computers that were designed in the sixties; and the second is the high cost of transcribing paper tax returns to get the information into electronic format. And I have to add, I only see more complex information being regarded by the IRS in the future, so this will only get worse.

When it is all said and done, there are only three ways the IRS can get the information it needs to do its job. The first is to hire more and more transcribers, and at the present time to change that 40-percent figure they would need at least two to three times the

number they presently have in today's environment. These transcribers require typing skills, a skill that is not taught by our schools anymore, and not utilized in the business environment, so the pool of trained transcribers is diminishing rapidly.

The second way to get this information to the IRS is to optically scan or image the paper tax returns. My experience with this particular technology is, that on a handwritten document the best anybody can do is about 50-percent recognition. If you want the rest of the data you have to send it over to somebody to again, transcribe the additional amount in. The rate's a little better on computer-generated information, but it is still nowhere near 100 percent.

The only feasible way for IRS to receive, validate, and manipulate all this data is through electronic filing. The data exists in electronic formats in businesses, and in taxpayers' computers, and in other government agencies' computers. To continue to convert these electronic files to printed paper, send it to the IRS, who must then transcribe or otherwise scan it back into an electronic format is at best, time consuming and very costly.

In addition, since there will never be enough funding to hire all the transcribers necessary, the IRS will not be able to do the job we expect it to do. The IRS needs vast amounts of information to do its job. We should all encourage using the most cost-effective and data-rich system available. In my opinion, electronic filing is the only system that satisfies that need. Thank you.

[The prepared statement follows:]

Statement of Robert J. Carver, Consultant, Kachina Group, Annapolis, Maryland; and former Executive Officer, Service Center Operations, Internal Revenue Service

INTRODUCTION

I am pleased to address the Subcommittee today on the subject of the importance of electronic filing to the Internal Revenue Service. My 30-year career with IRS has been involved with the returns processing operation. I also held a position as a Revenue Officer, but the majority of my time has been spent in the ten Returns Processing Service Centers. My last position before retiring in October 1995 was that of Executive Officer for Service Center operations. That assignment involved managing the ten processing centers with an annual operating budget of $1.3 billion. I was responsible for the performance of approximately 60,000 employees. In addition, I served on the President's Welfare Reform Commission in 1995 as the IRS representative.

At present, I am working with the Council for Electronic Revenue Communication Advancement (CERCA), which is an organization of companies to further electronic transmission and processing of tax information. This organization is not limited to dealing with the IRS but involves other Federal taxing and State agencies. CERCA is a two-year old association representing a broad cross-section of private companies and Government agencies leading in the movement toward electronic financial services. In addition, I am presently consulting with a leading software company, a financial institution, and a major accounting firm; but, my comments today are mine and are based on my 30 years experience with IRS and, specifically, with the experience I have had with managing the returns processing operation.

IRS MISSION AND NEEDS

IRS' Mission is compliance; they must:

Ensure that all taxpayers file tax returns and reports, report all income, expenses, deductions, and information correctly, pay the correct amount of taxes, penalties, and interest for domestic and international taxpayers.

Administer social programs; i.e., earned income tax credit.

Gather and validate data for statistics of income (SOI).

Interact with others; i.e., third parties (banks, employers, other financial institutions), 50 states, other government agencies, and other countries' government agencies.

Provide service to taxpayers using telephones, computers, and written correspondence.

To accomplish this mission, the IRS must gather and manipulate vast amounts of information, and the future only holds promise of ever more data. This data manipulation naturally falls into two phases of data processing.

- The first is accumulation and validation.
- The second is manipulation/comparison.

I will concentrate on the first phase for my testimony today but, before I do, I would like to briefly outline the several discrete information realities facing the IRS.

Taxpayer Service

Responsibilities: Receive and process 200+ million tax returns and 3+ billion information documents (for tax and statistics of income), provide customer service for tax law questions and account questions.

Taxpayer Service Needs: The ability to research return information, third party information, and modify (adjust) that data.

Collection

Responsibilities: Payment of all types of taxes (income, excise, pension, estate, etc.); oversight of trust funds (FICA, SSA, etc.); validation of accounting methods used by businesses (employee-employer relationships); enforcement of payments due (seizures, sale, garnishment of wages and financial accounts). Collection Needs: Access to business, financial, and state data, and local property and licensing information. Access to federal, state, and local legal services, sheriffs, and other process servers.

Examination (Audit)

Responsibilities: Ensure taxpayers use valid accounting practices for income and tax liability determinations; identify and correct underreporting of income, bartering transactions, and other schemes to avoid payment of taxes; evaluate foreign and domestic tax treaties to ensure compliance with U.S. laws; monitor, evaluate and correct tax treatments of businesses involved in tax exempt and pension organizations. Examination Needs: Access to all relevant tax and financial information on taxpayers; such as, individual and business financial data bases in banks, other financial institutions, state and local tax data, international tax information held by foreign governments. Ability to coordinate enforcement actions with tax partners, foreign and domestic. Ability to apply computerized evaluation programs (artificial intelligence) to data bases, both within and outside the IRS.

Criminal Investigation

Responsibilities: Discovery and correction of fraud, willful omissions, money laundering, income from drug, gang, and other illegal operations. Criminal Investigation Needs: Access to legal and illegal data bases. Ability to apply computerized detection programs; such as, pattern recognition, anomaly detection, and other artificial intelligence routines to those data bases. Ability to coordinate investigation activities with federal, state, local and foreign enforcement organizations. Ability to share information with U.S. attorneys and other judicial organizations. Ability to protect information if all parties are not legally authorized to receive such information.

Chief Counsel

Responsibilities: As the legal arm of the IRS, rules on laws and regulations, acts as legal counsel to executives of IRS in performance of their duties. Chief Counsel Needs: Access to legal opinions, rulings, and judgments for tax matters. Research capabilities in data bases in federal, state, and local tax jurisdictions.

IMPORTANCE OF ELECTRONIC FILING

The reason I described the information needs of the major IRS functions was to show how information on tax returns and other documents (that often seems more than necessary to satisfy a taxpayer's tax responsibility) is needed to carry out the other responsibilities in the IRS mission.

At the present time, only about 40% of the data IRS requires and taxpayers spend time and money providing is posted to the main IRS files. This sad fact is due to the state of sophistication of the IRS computer system (designed in the late 1960's) and the costs of paying people to transcribe the data from paper returns and docu-

ments to usable electronic formats. The result of this shortfall in data requested versus data ultimately used is that IRS Auditors, Agents, and Officers, in the performance of their duties, often must ask taxpayers for copies of returns and documents (copies with all the data intact).

We have watched, over the past years, as IRS tried unsuccessfully to modernize its computer systems. It is my opinion that one of the main reasons for these stumbles is the reliance on the need to have paper tax returns and documents converted to electronic formats. It seems that a paper return with its signature is a concept the IRS has been unable to give up. This is changing, but at a snails pace.

At this point in time, two things are true. The availability of trained transcribers (typists) is nearly zero; schools do not teach typing and businesses don't hire typists. The state of the art of electronic scanning equipment to read, interpret, and record data from computer generated, and especially hand written, documents is less than acceptable for the job IRS has before it.

This leaves only Electronic Filing of tax information the "Best in Class" option for IRS to accomplish its mission. The state of the art of computer technology is ready, most taxpayers are ready (more than 50% of individual tax returns are prepared by third parties using computers and most businesses use computers), and the computer industry is ready.

TRANSITIONING FROM A PAPER-BASED DATA CAPTURE SYSTEM TO AN ELECTRONIC-RICH SYSTEM

As IRS, or any large organization, makes this transition, careful oversight will be needed to ensure complete success, a success that is both effective and efficient. For electronic filing to be cost effective for taxpayers, we must ensure the current high costs of the manual transcription system are truly eliminated as electronic filing increases. As the need for skilled typists decreases, the costs are transferred to the public, either by the individual entering data on a home personal computer, or by the tax practitioner or business employee entering data on a computer. In addition, the costs of accumulating electronic tax returns by electronic transmitters also increase. This eventuality will require some compensation or other incentive to be effective.

As the volume of electronic returns increase, the physical plant (space, machines, etc.) the IRS needs will decrease. Oversight will be required to ensure that remaining workload doesn't expand into the vacuum, thereby eliminating the savings.

Before I retired from the IRS, I was responsible for the operation of the 10 service centers. Among other things, the service centers receive, perfect, and process all the tax returns and documents received by IRS. My budget was about 26% of the total IRS operating budget. Of that, over half was spent transcribing (converting paper information to electronic) tax information. In today's world, that expense can be eliminated. If the IRS were to receive the bulk of tax information electronically, it could use its budget for ensuring compliance with tax laws and providing service to taxpayers.

SUMMARY

The major functions of the IRS need information on all taxpayers, third party businesses, international, federal, state, and local taxing authorities. This information changes every year and, in some instances, almost daily. This massive undertaking is what the modernization effort should be about.

The only feasible way to enable IRS to receive, validate and manipulate this data is through electronic filing. The data exists in electronic format in taxpayers, businesses, and governmental files. To continue to convert these electronic files to printed paper format, send to IRS, and have IRS scan, transcribe or otherwise convert it back to electronic format is, at best, time wasting and very costly. In addition, since there will never be enough funding to convert all the paper, the IRS will not be able to accomplish its mission.

The IRS needs access to vast amounts of data, and we all should encourage using the most cost effective and data rich system available. It is my opinion that the use of electronic filing is the only way to meet that goal.

Thank you.

Chairman JOHNSON. Thank you very much, Mr. Carver.

Mr. Harris.

STATEMENT OF ROGER HARRIS, VICE CHAIRMAN, FEDERAL TAXATION COMMITTEE, NATIONAL SOCIETY OF ACCOUNTANTS

Mr. HARRIS. Good afternoon, Madam Chairman. Thanks for the opportunity to be back here today, speaking on electronic filing. My name is Roger Harris, and I am vice chairman of the Federal Tax Committee of the National Society of Accountants. NSA represents over 16,000 independent accountants, who provide accounting, business planning and tax preparation services, to an estimated 4 million individuals with small businesses.

According to a recent survey of our membership, nearly 90 percent of our members have and use computers for accounting and tax preparation services. However, only 22 percent of the returns that are eligible to be filed electronically by our members are actually filed electronically.

I also am president of Pagent Business Services. We have been providing accounting services to small business for over 30 years. Our 400 franchises prepare hundreds of thousands of tax returns, and yet only 5 percent of our franchises currently file returns electronically.

I think these numbers indicate that we are the group of people who need to be motivated if the 80-percent goal of electronic filed tax returns is to be reached. Most of the returns that we prepare are prepared by computer, but they are printed out on paper, mailed in, and then ultimately put back into a computer by IRS personnel. Clearly in the interest of saving both time and money the IRS would rather see these returns transmitted electronically. However, many practitioners currently refuse, for many reasons, to embrace the electronic filing program. To make this program successful, the IRS needs to enlist the support of the practitioner community by addressing all the reasons that they are currently staying away from electronic filing.

The National Society of Accountants and Pagent Business Services both support the underlying goals of the electronic filing provision of H.R. 2292. We applaud the approach taken in the legislation of letting the marketplace become the engine for the future growth.

I think we all learned from the EFTPS Program, that even a good program does not work well and is not well accepted when it is mandated. We support the measures that you have initiated, such as the elimination of the 8453, the current signature form, until a truly digital system can be developed. Perhaps a checkoff box on electronic returns, enabling taxpayers to authorize the preparation of electronically filed returns to communicate with the IRS.

The regulation of all preparers of paper, electronic and information returns; and the creation of a procedure, allowing for practitioners to transmit statements and schedules to make the filing of more difficult returns possible. These measures do in fact address some of the concerns practitioners have.

Other measures, such as extending the deadline to May 15, will also cause some practitioners and some taxpayers to embrace electronic filing. But it will not, in and of itself, move us near the 80-percent goal.

It also creates a potential problem that we are not clear the legislation addresses, such as, on April 15 our taxpayers are faced with the decision to file electronically by May 15 and therefore give up their opportunity to file an extension. If this is the choice then many of them will opt for the extension and will choose not to file electronically, because they only have 30 days to make that decision.

We also strongly support the implementation of the Electronic Commerce Advisory Group, consisting of representatives from the tax practitioner, preparer, and computerized tax processor communities. We view this group as an essential component of any strategy designed to foster growth in the use of electronically filed returns. We do, however, recommend two additional ways to strengthen the effectiveness of this group.

The first recommendation is for small business representation on this group. The current legislation provides for the panel to receive input solely from tax practitioners and elements of the electronic filing industry, and none from the average small business owner. Because our membership and our clients are both small business, we would emphasize that small business input, in the early stages, of any new electronic filing program would be valuable. And such input would allow the IRS to gain insight, and perhaps avoid some of the problems that we saw with EFTPS.

A second recommendation is that the IRS should be encouraged to get out of the box thinking in this group. Look for ways to solve these problems. For it to be widely accepted electronic filing must benefit practitioners, taxpayers, and small business as well as the IRS. Creating this type of environment requires that the ECAG be empowered to think creatively and outside the current paradigms.

While our members recognize that electronic transmission of return will be savings to the IRS——

Chairman JOHNSON. I am sorry to interrupt you, Mr. Harris. We only have 3 minutes left on this vote. I thought we had a little more time left. It would be better if you wrapped up when you came back. Save your conclusion. We will be back in about 6 or 7 minutes.

[Recess.]

Mr. HARRIS. NFA's members recognize that the electronic transmission of returns will bring savings to the IRS, but they are also asking what advantage would they gain by becoming electronic transmitters. Practitioners have the ability to move large numbers of tax return filers into the electronic world. We talk to our clients throughout the year and have an ongoing relationship with them. I believe a practitioner has greater influence over the client and recommending electronic filing as the preferred method than any marketing campaign, regardless of its focus. But practitioners are first and foremost business men and women. Any change in their operating procedure must have a valid business reason. If the IRS can develop a plan for electronic filing that saves practitioners either time, money or both, practitioners can then deliver to the Internal Revenue Service millions of electronically filed returns.

The IRS should give serious consideration to adopting a multilevel marketing campaign, focusing on incentives for practitioners

as well as individuals. In this way the goal of 80 percent I believe can easily be reached in 10 years.

While H.R. 2292 moves in a significant direction toward an improved electronic environment, more needs to be done to address the many reasons practitioners are reluctant to file electronically, such as registration procedures for return originators and electronic filing compliance visitation. These problems that impede practitioners' use of electronic methods must be worked out in a way that is mutually satisfactory to both the IRS and the practitioner community.

In conclusion, I would like to emphasize NSA support for the proposed improvements in the electronic filing program. Over the next 10 years we will encounter opportunities that we cannot even envision today. By thinking creatively and working in partnership with the IRS, we hope to contribute to the development of an electronic filing program that is mutually beneficial to all parties involved.

We thank you for the opportunity to be here today, and look forward to answering any questions that you may have.

[The prepared statement follows:]

Statement of Roger Harris, Vice Chairman, Federal Taxation Committee, National Society of Accountants

The National Society of Accountants (NSA) is pleased to testify on H.R. 2292, The Internal Revenue Service Restructuring and Reform Act of 1997. NSA commends Representative Rob Portman and Benjamin Cardin for introducing H.R. 2292. The legislation, modeled on the recommendations found in the report of the National Commission on Restructuring the IRS, greatly elevates the prospects for modernization, improvement in agency efficiency, and enhancement of taxpayer services.

The National Society of Accountants is an individual membership organization representing approximately 16,000 practicing accountants located throughout the United States. NSA members are for the most part either sole practitioners or partners in moderately-sized public accounting firms who provide accounting, tax return preparation, representation before the Internal Revenue Service, tax planning, financial planning and managerial advisory services to an estimated four million individual and small business clients. The members of NSA are pledged to a strict code of professional ethics and rules of professional conduct. As our members serve a sizable small business constituency, NSA is in a unique position to address the impact of electronic filing both upon tax practitioners as well as individual taxpayers.

ELECTRONIC FILING

Overview of Electronic Filing

The National Society supports the underlying goals of the electronic filing provisions of H.R. 2292. Most practitioners use a computer to prepare tax returns; however, instead of electronically transmitting the information directly to the IRS, many of those practitioners print out paper returns which are mailed to IRS where it is re-keyed into another computer. One of the keys to the success of the electronic filing program is to entice the practitioner community to embrace electronic tax information transmission.

The bill, while not mandating electronic filing, sets a goal that 80 percent of all returns filed by the year 2007 be filed electronically. Of significant note, the bill sponsors rejected a proposal requiring preparers by the year 2004 to file returns only electronically. By rejecting the urge to mandate the electronic filing of tax returns, Congress and the IRS are likely to avoid many of the perception problems which have impeded implementation of the Electronic Federal Tax Deposit System (EFTPS) over the last two years.

The EFTPS system is an excellent program and NSA supports its full implementation. Nevertheless, the fact that EFTPS is largely a mandatory system has resulted in resistance and perhaps hostility toward the program by some small business persons and practitioners. The drafters of H.R. 2292 have chosen the wiser course of letting the market place become the engine for the future growth in the overall electronic filing program rather than by mandating it.

Under the legislation, the IRS is required to develop within 180 days of enactment a plan "to eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing gradually over the next 10 years..." To facilitate development and implementation of the plan, the bill requires the IRS to establish an Electronic Commerce Advisory Group to receive input from the private sector. The IRS also is required to implement procedures for providing incentive payments to transmitters of electronically filed returns, incentives which would be based on the fair market value of costs associated with electronically transmitted returns.

The National Society views the overall thrust of the requirement—that the IRS develop a plan to spur growth in the use of electronic filing—as being very positive. We hope that this plan will be responsive to many of the concerns practitioners have had with utilization of electronic filing in the past. According to previous surveys of our membership only about 35 percent of NSA members transmit electronic returns on behalf of their clients. In this connection, tax practitioners who prepare complex returns are the least apt to use electronic filing. The IRS' electronic filing program to date has focused principally on the filing of simple returns by taxpayers expecting a refund. H.R. 2292 clearly attempts to rectify these problems by making significant attempts to reach out to the practitioner community. We support this and look forward to being of assistance to the government in making the system work as it should.

Checkoff Box and Regulation of Preparers

The National Society also is in complete support of the conceptual provisions of H.R. 2292 relative to a checkoff box on electronic returns and the initiative to regulate all preparers of paper, electronic tax, and information returns. Under the legislation's checkoff provision, the IRS is required to establish procedures enabling taxpayers to authorize the preparer of electronically filed returns to communicate with the IRS on matters concerning such returns.

According to the National Commission report, uniform requirements of these kinds "will increase professionalism, encourage continuing education, improve ethics, and better enable the IRS to prevent unscrupulous tax preparers from operating." We consider the goals meritorious and concur in them. However, in the case of the checkoff box provision, we strongly recommend that the provision be extended to cover all types of returns, whether filed by paper or electronically. The same principles and goals underlying the checkoff for paperless returns also apply to paper returns.

Electronic Commerce Advisory Committee

As stated above, the legislation requires the IRS to convene an Electronic Commerce Advisory Group (ECAG). It further requires that the panel include representatives from the "tax practitioner, preparer, and computerized tax processor communities and other representatives from the electronic filing industry." We strongly support implementation of this electronic advisory group. NSA views the group as an essential component of any strategy designed to foster growth in the use of electronically filed tax returns.

The National Society recommends one additional way to strengthen the effectiveness of the Electronic Commerce Advisory Committee. The current legislation provides for the panel to receive input solely from tax professionals and elements of the electronic filing industry, and none from the average taxpayer or business establishment. We suggest that the panel also include small business representation. By including small business input at the early stages of development of any "new" electronic filing program, the IRS will gain additional insight and might avoid some of the public relations mistakes the agency has made with respect to its electronic return programs, such as the implementation of EFTPS.

NSA views the ECAG as a vehicle where practitioners can work with the IRS in developing an electronic system they can enthusiastically adopt, allowing IRS to reach its goal of 80% electronic returns by the year 2007. While NSA's members recognize that electronic transmission of returns will bring savings to IRS, they also ask what advantage they would gain by becoming electronic transmitters. Practitioners have the ability to move large numbers of complex return filers into an electronic environment. A practitioner has greater influence over his client in recommending electronic filing as "the preferred method" of filing than any marketing campaign regardless of its focus. But practitioners are first and foremost businessmen and women. Any change in their operating procedures must have a valid business reason. We hope the ECAG will serve as a means to develop incentives to encourage practitioners to switch to electronic means, as well as a platform for discussion and solution of remaining problem areas that inhibit practitioner participation in electronic programs.

Extension of the Due Date for Electronically Filed Tax Returns

For the purpose of "encouraging" more persons to file returns electronically, H.R. 2292 provides taxpayers with an additional month to file income tax returns if such returns are filed electronically. This change in the due date involves electronically filed tax returns for individuals, corporations, partnerships, and other information returns. Payers would still be required by the legislation to provide information returns to payees by January 31.

The National Society recognizes the Restructuring Commission made the recommendation to realign the due dates in order to simplify return processing and to foster paperless filing. NSA has not had a chance to poll our membership regarding their position on the extension of due dates for electronically filed returns. Nevertheless, should this provision become law, NSA urges caution against granting taxpayers only a one month extension for choosing an electronic filing method at the expense of the current automatic four-month extension available to all filers.

Procedures for Facilitating Truly Paperless Electronic Filing

For purposes of facilitating truly paperless electronic filing, H.R. 2292 requires the IRS to develop procedures for the acceptance of digital signatures. Until the IRS develops a method for acceptance of digital signatures, the bill mandates that the IRS accept electronic filed returns without signatures as long as the taxpayer retains a signed copy of the original until the expiration of the applicable statute of limitations.

The National Society supports the elimination of Form 8453, the current signature form for electronic returns. We believe this not only will help expedite the filing process for practitioners, but will eliminate a step in such process that practitioners have found daunting. Consequently, this would be a positive step in enhancing electronic filing.

NSA urges the IRS to closely consult with tax practitioners before implementing any procedures under electronic filing requiring the taxpayer to retain copies of signed returns. We are concerned that to the extent this requirement is not implemented properly and carefully, it may increase the professional liability exposure of return preparers, thereby negating any real prospects for spurring the use of electronic filing overall.

Under the legislation, the IRS also is required to establish procedures to receive explanatory statements or schedules in electronic form for the purpose of eliminating the need for paper statements or schedules. We believe this is a positive provision, one which is designed to facilitate the filing of complex tax returns electronically.

Availability of Credit Cards For Payment of Taxes

H.R. 2292 authorizes the IRS to accept payment of taxes by commercially acceptable means, including credit cards. While the National Society is supportive of this provision, we do raise two issues relative to a taxpayer using a credit card to pay taxes. This first issue concerns bankruptcy. Currently, credit card debt is treated as an unsecured debt dischargeable in bankruptcy proceedings, while income tax liability attributable to a tax return due within three years prior to the bankruptcy filing may not be discharged. It is conceivable that unpaid taxes charged on a credit card would be treated differently from taxes that were simply not paid. The second issue concerns the cost of processing the credit card payments, usually borne by the merchant offering a credit card payment option. Although the bill prohibits passing those costs on to taxpayers, the question remains as to who will bear the processing costs for credit card payments of income taxes. It is NSA's recommendation that the protective language of the bill be very clear so that ultimately the costs not be passed back to the taxpayer using the credit card payment option.

IRS Electronic Filer Visitations

While not contained in H.R. 2292, NSA is concerned about a practice used by the IRS in recent years as a means to address potential fraud problems in the electronic filing program. We realize that the Service must take steps to limit abuse of the system. Our members have expressed concern that draconian efforts to stop fraudulent practitioners may hamper the ability of honest practitioners to conduct their practices during busy season. This is at variance with the enhancement of the electronic program.

An example of this problem is a procedure known as an "electronic filing compliance visitation." During a compliance visitation, Service personnel come into the practitioner's office—often unannounced—to review the signature documents and W–2 forms the practitioner is required to keep on file and review security measures

regarding the use of the electronic filing identification number (EFIN). After initially performing all visits unannounced, the Service improved the visitations by scheduling appointments with practitioners where no suspicion of criminal activity exists. The past filing season was relatively uneventful in this respect; however, practitioners remain concerned about the electronic filing compliance checks that have caused problems in past years.

NSA understands the reasons for conducting these checks and acknowledges the need to perform them unannounced in certain circumstances. What we must emphasize is that practitioners are already "swamped" at the time of year the visitations have taken place. Consequently, the intrusion must be kept to a minimum. It often creates an unfavorable impression with tax clients who are waiting to have their tax interview. Further, the interviews must be delayed by the practitioner who is constrained to take time out to meet with Internal Revenue employees from Collection, Examination, and/or the Criminal Investigation Divisions. The Service achieves the goal of completing a compliance check at the expense of another valued goal, i.e. promoting goodwill and open communication between the Service and electronic filers. If the House Ways and Means Committee is interested in investigating additional impediments to the growth and expansion of the electronic filing program, the National Society recommends that the Committee review the IRS' use of electronic filer visitation checks. We believe that the visitation program is a significant deterrent to the electronic filing program.

THE IRS MANAGEMENT STRUCTURE

Internal Revenue Service Oversight Board

NSA knows that the House Ways and Means Committee is well aware of the national press surrounding the provision found in H.R. 2292 regarding an independent Internal Revenue Service Oversight Board. We believe an independent Oversight Board is one of the legislation's most important contributions to the issue of making the IRS a more customer service oriented agency. An independent Oversight Board has the potential of affording the IRS the opportunity to take an objective look at the agency's procedures and programs—as well as creating a real opportunity for overcoming problems concerning them.

The legislation calls for the establishment of a 9 member Oversight Board, two of whom are to be the Secretary of the Treasury (or the Deputy Secretary) and a representative of the IRS employees union. Under the bill, the other 7 Board members will be appointed on the basis of their professional experience and expertise in the areas of management of large service organizations, customer service, compliance, information technology, organization development, and the needs and concerns of taxpayers. H.R. 2292 provides that all members of the Board may be removed at the will of the President of the United States.

The National Society believes the independent Oversight Board will contribute to the agency's ability to achieve a higher level of customer service. An emphasis on customer service as part of IRS' mission statement is what NSA believes is needed to significantly improve the federal tax administration process. NSA's 16,000 members and 4 million individual and small business clients salute the emphasis of H.R. 2292 on improved customer service. In connection with the Oversight Board, we have a recommendation we believe is important.

Small Business Representation on the IRS Oversight Board

NSA believes that the frustrations of small taxpayers and small business persons played a critical role in the reasons for formation of the IRS Restructuring Commission. All of us have heard the stories of small business people working 60 to 80 hours a week in their business. Small business persons are notorious for wearing many hats in the firm. They are the firm's salespeople, marketing agents, bill collectors, and service providers. At the same time, they must comply with complicated federal tax laws and regulations. Because a small business owner is often a jack-of-all-trades yet master of none, he will simply pay an assessed tax penalty rather than take time away from the business to fight it. In many cases, a small business person who lacks resources available to larger corporations often pays—proportionately—a greater level of tax penalties than large businesses. Large business establishments are better able to afford and contest a tax matter as opposed to the average small business person.

NSA's membership consists of small business owners who provide accounting services for a small business clientele. Our experience in this respect leads us to strongly recommend that final legislation include small business representation on the IRS Oversight Board. H.R. 2292 already mandates that large businesses be represented on the Oversight Board as reflected by a requirement that Board members

have professional experience and expertise in the area (among others) of "management of large service organizations." Small business must be provided with direct representation on the Board as well. Small business has been described as the engine that drives our economy. Without representation on the Oversight Board by small business, there might not be input from a key and critical constituent group. We believe small business representation on the Oversight Board is the best way to ensure that the needs and concerns of all taxpayers are heard.

Office of IRS Commissioner

NSA supports the establishment of a five-year appointment for the Commissioner of Internal Revenue position. We also support the provisions of the legislation giving the Commissioner greater flexibility in the hiring, firing, and salary decisions involved with IRS' senior management.

H.R. 2292 states that the appointment of the Commissioner "shall be made on the basis of demonstrated ability in management and without regard to political affiliation or activity." The National Society supports and appreciates the legislative intent underlying this particular sentence of the legislation. The legislation strives to ensure that any new Commissioner has the capacity and expertise to manage a large establishment or entity—in a similar fashion to a chief executive officer (CEO) managing and running a Fortune 500 company. Nevertheless, we believe that safeguards be built into the legislation in order for any new Commissioner to recognize the unique needs of small taxpayers and small businesses. Thus, NSA recommends that the final legislation (or report language) stress the need for the Commissioner to focus on the needs of small business and meet on a regular basis with representatives of the small business community and those who serve it.

CUSTOMER SERVICE

Overview of Customer Service

One of the major objectives of the National Commission's report and of the legislation is to enhance the level of customer service provided by the IRS. The tax practitioner community is an important stakeholder relative to customer service. A great number of taxpayers deal with the IRS through their representatives. Consequently, they experience IRS customer services at all levels, from telephone contacts through examinations, collections, and appeals. Based on their repeated and varied contacts with the IRS, practitioners have a unique perspective on customer service.

The legislation emphasizes the concept of customer service over compliance. This is unlike the traditional public view that the IRS' main mission is tax compliance, i.e. audits and collections. While the importance of compliance obviously is clear, NSA agrees that the service component should be the primary engine which drives the agency's mission. We believe that a customer service oriented mission will bring out the best in all who deal with the tax system. This is what the public wants, and it is what we believe IRS employees want as well.

There should be improvement in all aspects of IRS' customer service. For example, from the public's perspective, the front lines in IRS customer service is their principal experience when dealing with an IRS representative on the telephone. The quality of the IRS' telephone systems, as well as the way in which the IRS employees answer the telephone, has shown substantial improvement in recent years. Nevertheless, the IRS telephone system and customer relations process continue to cry out for further and dramatic improvement.

The proper training of IRS employees and providing them with technology are important keys to quality customer service. The Commission's report strives to portray IRS employees as competent, hard-working employees who want nothing more than to deliver the highest quality in service to the public. In order to turn around the supertanker we call the IRS, there needs to be a change in the Service's management structure along the principles described above. This includes better training of IRS employees. They also need to be provided with more of the basic technology tools of the 1990s, tools which NSA's members often take for granted. This includes providing employees with more fax machines, copiers, and computers. Such tools should be at a level to take them into the next millennium.

Office of Taxpayer Advocate

The National Society commends the sponsors of H.R. 2292 for providing for certain meaningful improvements in the office of Taxpayer Advocate. We view this provision as being critical in improving IRS customer service. It must be stated at the outset that the Service's problem resolution program is viewed by NSA membership as viable and deserving of high marks. Nothing should be done to diminish its availability.

The legislation builds on the beneficial customer service provisions found in the Taxpayer Bill of Rights II (P.L. 104–168). The Taxpayer Bill of Rights II (TBORII) established the office of Taxpayer Advocate within the Internal Revenue Service. It empowered the Advocate to resolve individual taxpayer problems, to analyze problems of the tax system, to propose legislative and administrative solutions to those problems, and to report to Congress on the operations of the Advocate's office. Moreover, TBORII gave the Advocate broad authority to take any action as permitted by law with respect to taxpayers who would otherwise suffer a significant hardship as the result of IRS action.

In testimony earlier this year, NSA stated that in order for the Taxpayer Advocate to be successful, he or she must possess an intimate knowledge of the functioning of the IRS. This knowledge is best gained from years of experience within the Service. At the same time, we also stated that in order to truly be the taxpayer's advocate, this individual must be willing to question, publicly as well as internally, the functioning of the very agency to which his or her career has been devoted.

NSA believes H.R. 2292 strikes the right balance in ensuring that the Taxpayer Advocate is successful in his job within the IRS. The legislation provides that the Taxpayer Advocate will be appointed by and report directly to the Commissioner of Internal Revenue, with the approval of the Internal Revenue Service Oversight Board. H.R. 2292 also provides that the Advocate must have substantial experience representing taxpayers before the Internal Revenue Service or with taxpayer rights issues. For a person who becomes the Advocate, but one who has worked for a significant period of time for the IRS previously, the legislation requires that the Advocate agree not to accept any employment with the IRS for at least 5 years after ceasing to be the Taxpayer Advocate.

From a positive perspective, we believe H.R. 2292 is carefully crafted in that taxpayers are not foreclosed from benefitting from the appointment of a Taxpayer Advocate who may happen to have the experience and insight of an IRS veteran. Ironically, the IRS veteran may in fact be the person best situated to "fill the shoes" of the Taxpayer Advocate. By requiring that any IRS veteran interested in the Taxpayer Advocate take an oath that he or she will not work for the IRS for at least 5 years after leaving the Advocate post, the legislation has taken critical steps to ensure that the Advocate is willing and able to report openly about potentially sensitive issues within the IRS.

H.R. 2292 broadens the scope of the Taxpayer Advocate's annual report to identify areas of the tax law that impose significant compliance burdens on taxpayers or the IRS. In addition, the scope of the report must identify—in conjunction with the National Director of Appeals—the 10 most litigated issues for each category of taxpayers with recommendations for mitigating such disputes. The legislation also makes certain improvements in the selection process, geographic allocation, and career opportunities of problem resolution officers. NSA strongly supports these improvements. We particularly support the requirement that the Advocate take steps to ensure that local telephone numbers for the problem resolution officers be published and made available to taxpayers.

Performance Awards

H.R. 2292 requires the IRS to establish a performance management system that covers all IRS employees, with the exception of members of the IRS Governance Board, the Commissioner, and the Chief Counsel. As part of this performance management system, the bill generally gives the IRS flexibility in granting awards to employees. More specifically, the legislation provides that "A cash award...may not be based solely on tax enforcement results." While this particular sentence appears to be well intentioned, the National Society believes that the sentence could be misconstrued to authorize IRS officials to make cash awards to employees principally on tax enforcement results.

NSA believes that the legislation's criteria for cash awards should be redrafted to highlight the point that customer service should be considered an important determinative factor with respect to any determination to make a cash award to an IRS employee. Tax enforcement should be considered as only one factor in a determination of making a cash award to such employee. We believe this change in the bill's language is consistent with the spirit of the IRS Restructuring Commission report encouraging the IRS to place greater reliance on customer service and less on enforcement. We believe this kind of change in the bill's language is good for tax compliance and for taxpayers as well.

TAXPAYER PROTECTION RIGHTS

The National Society is very supportive of the provisions contained in Title III of H.R. 2292 which are designed to expand and protect taxpayer rights. The following taxpayer rights measures are considered some of the more significant provisions from the perspective of NSA's membership.

Expansion of the Authority to Issue Taxpayer Assistance Orders

In order for a problem resolution officer (PRO) to issue a Taxpayer Assistance Order under current law, the PRO must determine whether the taxpayer is suffering or is about to suffer a significant hardship. If a significant hardship is deemed to exist, then the PRO makes a determination as to whether the IRS action warrants being changed. The tax regulations define a significant hardship as meaning a serious deprivation caused or about to be caused to the taxpayer as a result of IRS administration of the tax law.

H.R. 2292 modifies the current definition of significant hardship by requiring the Taxpayer Advocate to consider whether IRS employees followed applicable administrative guidance (including the Internal Revenue Manual); whether there is an immediate threat of adverse action; whether there has been a delay of more than 30 days in resolving taxpayer account problems; and whether the taxpayer will have to pay significant professional fees for representation. NSA considers these to be positive modifications which should help resolve a taxpayer's problems in a reasonable and constructive fashion.

Offers in Compromise

The legislation provides for the IRS to develop and publish schedules of national and local allowances to ensure that taxpayers entering into a compromise can provide for basic living expenses. While we feel this provision attempts to address a real problem underlying the IRS collection process, we are concerned that the provision (as currently drafted) does not provide any practical relief to taxpayers.

NSA members believe that the current allowable expense standards for Offers in Compromise and Installment Agreements are inconsistent with the real cost of living for families. Practitioners have informed NSA about their concerns that the expense standards do not adequately compensate for such factors as family size, housing and utility allowances, and the cost of car ownership. With respect to the Offer in Compromise process, these practitioners also are concerned that IRS Revenue Officers are principally using the expense standards as strict rules as opposed to general guidance.

The National Society believes guidance should be given to IRS collection personnel that they are authorized to make exceptions with respect to a taxpayer's expenses under an Offer in Compromise, particularly when a reasonable basis exists relative to the taxpayer's state of health or his or her ability to generate income. Further, IRS Revenue Officers should be given the authority to weigh available options for achieving the most desirable result. Often taxpayers who cannot negotiate an Offer in Compromise simply file bankruptcy, causing the IRS to recover even less than if the taxpayer's offer had been accepted.

We also feel that there must be consistency throughout the nation for the program. The internal cultural change concerning Offers in Compromise has made this difficult to achieve. More training and oversight are positive ways to accomplish this. We encourage these steps.

Problems with Interest and Penalties

The bill makes a number of positive changes in the law with respect to interest and penalties. First, the bill eliminates the differential in the interest rates for overpayments and underpayments "in a revenue neutral manner." Second, the bill tolls the application of the failure to pay penalty while a taxpayer is making payments under an IRS installment agreement. Third, the legislation establishes procedures for a safe harbor for taxpayers to qualify for an installment agreement should the outstanding tax liability be under $10,000. While NSA understands that the installment agreement provision is drafted as a safe harbor, we recommend that the legislative report language be drafted to declare that the provision does not in any way restrict other available settlement options with the IRS collection division, including other available options to obtain an installment agreement. NSA commends the bill sponsors for including these pro-taxpayer measures as part of the legislation.

Other Pro-Taxpayer Initiatives

H.R. 2292 includes a number of positive provisions to enable taxpayers to recover certain costs and fees when they prevail and the position of the IRS was not sub-

stantially justified. Other positive, pro-taxpayer provisions in the legislation include grants for the development, expansion, or continuation of qualified low income taxpayer clinics, certain modifications with respect to the U.S. Tax Court's jurisdiction, and procedures for cataloguing and reviewing taxpayer complaints regarding the misconduct of IRS employees.

Tax Penalty Reform

NSA is very supportive of the provision mandating a study by the Taxpayer Advocate on tax penalties by July 30, 1998. The legislation calls for the Advocate to review the administration and implementation of penalty reform recommendations made by Congress in 1989, including legislative and administrative recommendations to simplify penalty administration and reduce taxpayer burden.

NSA believes that tax penalty reform should become the next serious phase of IRS restructuring. Moreover, we strongly recommend the bill be clarified so that the Advocate is required to review the extent to which the federal government relies on tax penalties for revenue raising purposes.

Removal of Preparer's Social Security Number from Tax Returns

The practitioner community is becoming increasingly concerned about the requirement that a paid preparer's Social Security number must appear on returns. Currently, practitioners are required to include their Social Security number on every return they prepare for a fee. Revenue Ruling 79–243 states that under Section 6109(a)(4) of the Internal Revenue Code, "any return or claim for refund prepared by an income tax return preparer must bear the identifying number of the preparer, the preparer's employer, or both ...(and) that the identifying number of an individual shall be the individual's Social Security number." Revenue Ruling 78–317 gives some relief by stating that "an income tax return preparer is not required to sign and affix an identification number to the taxpayers copy of a federal income tax return," being required only to affix his Social Security number to the copy of the tax return that is filed with the Internal Revenue Service.

In today's world of instant access to volumes of sensitive information about an individual, including even credit reports accessible over the Internet, practitioners understandably are very concerned that their Social Security number could be the key to unauthorized release of their own sensitive financial information. NSA's members feel that the requirement they include their Social Security number on returns violates their privacy, as it could provide a possibly unscrupulous taxpayer with the opportunity to access certain records that otherwise would not be available. Once the taxpayer leaves the practitioner's office, there is no guarantee that he will immediately file the original copy of the tax return with the IRS, without first making additional copies. There is always the possibility those copies could end up in an undesirable location. As part of the House Ways and Means Committee's deliberations on H.R. 2292, NSA suggests that the Committee review this requirement with the Internal Revenue Service and recommend development of a separate system for identifying tax practitioners.

In conclusion, the National Society of Accountants supports the legislation restructuring the Internal Revenue Service and applauds the Subcommittee for addressing the important issue of electronic filing of tax returns. Thank you for the opportunity to contribute to this effort.

Chairman JOHNSON. Thank you, Mr. Harris.

Mr. Lane.

STATEMENT OF JOSEPH F. LANE, ENROLLED AGENT, NATIONAL ASSOCIATION OF ENROLLED AGENTS

Mr. LANE. Thank you, Madam Chairman. The NAEA testified five times before the National Commission on Restructuring, and provided testimony written for the record for a sixth hearing. We support entirely the report of the Commission. We believe that some of the most far-reaching and innovative suggestions are included in its electronic filing package. We are here today to testify on the specifics. I think the Commission has had a dramatic impact on forcing the Service to try to confront some of the issues and

problems that have been raised to them by practitioner groups and taxpayer groups, and the data processing industry over the last several years. I have to say, we have been critical of the Service in the past for not providing the kind of management we would like to see in the Electronic Tax Administration arena. I think as a direct result of the Commission, we now see things like the appointment of Bob Barr, who will be the next Assistant Commissioner for the Electronic Tax Administration, and that is a very, very significant deviation from what their practice has been in the past, and we applaud that. I think the Service is starting to learn its lesson, and starting to focus on the need to broaden the amount of input they are getting, and to be more inclusive in their decisionmaking process. We urge them to continue that effort.

We also believe their blueprint for implementing the modernization of the data systems will take into account the views of the people represented at this table, and the other people in the practitioner community, to a far greater degree than they would have had the Commission not been present.

Some of the discussion that happened this morning about whether or not it should be the year 1999 or 2000 before some of these considerations get online is of concern to us as well. One of the concerns that we have about this request for proposals going out, is the time delay it builds in just because of the process that has been involved.

We are not talking rocket science here. There are a lot of suggestions that everybody already knows as a result of a year's worth of Commission testimony, that the IRS could implement tomorrow to increase significantly the number of electronically filed returns in the 1998 filing season. I think we ought to take a look at what is submitted in the proposal process, and maybe the Subcommittee could urge them to go out front a little more on some suggestions; liberalize some of the provisions that we are talking about here today, and have it affect next tax season.

We outline in our written statement some specific programs which we proposed to IRS 1½ years ago, which had they followed would have resulted in about 1,800 additional practitioners from our organization filing electronically this past filing season. I think the Service needs to pay attention to that.

We support, without reservation, the establishment of an electronic commerce advisory group. We think that E–CAG will be the focal point for IRS and industry communication, and help the guidance and direction of the Service in its efforts to establish a paperless filing system.

We also think that the Commission recommendations are a continuously woven cloth. We have had some criticism today, and some attention paid to the different pieces of whether or not balance-due taxpayers will be attracted by it, an extension of the filing date, and whether or not we should offer incentives. I think each one of these things has brought out a certain percentage. In order to get to the 80 percent, we need to attract a certain percent of taxpayers who are motivated by different realities. And I think the Commission's recommendations, when they are considered as a whole, accomplish that. It is important not to try to pick and choose which one of these provisions you want to throw out or keep

in. I think as an experiment it makes sense to just bring the whole package forward, because it is, as we see it, a continuously woven cloth.

Particularly important, I think, is an indication of some of the testimony we had today from Treasury. It reminds me of a story when I worked here in the IRS National Office in 1972. I had a meeting scheduled with someone at Treasury, and I spoke to him the day before and confirmed the meeting for 2 the next afternoon. I had to call the following morning to talk about something, and his secretary said to me, "Oh, he is in Red China." This was about 1 month before Kissinger and everybody else had gone to China, so it was all on the news here, and everybody was saying, "Wow, China."

And I said, "Well, I guess then we will postpone the meeting until he gets back." And she said, "No, he will be back at 2 for your meeting." I said, "Wait 1 minute, he was in the office yesterday when I spoke to him, and he is in Red China this morning, and he will be back this afternoon?" And she laughed and said, "You do not realize; I forget you do not work here. That is what we call the IRS."

And I said, "Why do you call IRS Red China?" And they said, "Because it is big; it is huge; it is full of people, and nobody knows what goes on over there."

I think it was pretty obvious this morning. Maybe we should have a reorganization of the Treasury Department next after we finish this reorganization of the IRS, because they are not bringing the innovative ideas to the table that we are talking about. When they start to say that we cannot consider incentives, and we cannot consider extensions of the filing season, I bet you if you go back into the memorable notes of this Subcommittee, back in the thirties and forties, when we had a March 15 filing date, and we changed it to April 15, you had the same testimony from the Treasury Department you had this meeting, about moving it to May 15. So I think if you go back into your records you are going to find the same objections.

I was really concerned about the lack of responsiveness on the part of Treasury. I believe that the IRS people are being forced into a situation where they have to sort of go along with that because that is their boss, but we are not happy about that.

I think the 80-percent goal in the next 10 years is imminently achievable. We got to the moon in less time. Why they object to having specific goals and percentages is beyond comprehension to me. I think in any business you cannot get anywhere without setting a firm goal and shooting for it. And if we wind up going all the way down the track, and committing ourselves to that goal, and we only achieve 75 percent, I do not think that is a failure; I think that is a dramatic improvement in what we are doing.

So we support that. And quite frankly, I have to agree with Roger. I think the 800-pound gorilla in the electronic filing is the practitioner community. Fifty percent of your volume is with practitioners. If you incentivise the system so practitioners will get onboard with it, it will get you a long way to that 80 percent a lot sooner than the year 2005. The best way to incentivise that system is to turn around the attitude of practitioners.

We polled our members. Over 90 percent of our members prepare tax returns on computers; only 14 percent of them file electronically. The primary motivation and the primary reason why such a limited number participate is because of the fact that they cannot file all tax returns electronically. One of the most expensive things for practitioners to do, and anybody that is representing a practitioner organization on this panel can confirm this today, is to run parallel systems in their office. Most practitioners have 300 to 400 clients. They have to hire part-time people for the tax season. These are not people that come back every year. So when you hire someone and you teach them a process—here is how you process a tax return and get it outside of the office—if you have to have one system for electronically filed returns and one system for paper returns, you are going to look out and say, Well if only 30 percent of my returns can be filed electronically, and the other 70 percent have to be handled on paper, I am not going to do anything electronically.

I am going to set up one system, have one uniform way of processing this stuff so it goes out the door correctly. And if IRS ever gets around saying they will accept 100 percent, then I will consider switching over. That incentive is going to be the greatest incentive you can give, accepting all tax returns.

The way you motivate practitioners is to motivate taxpayers. And one of the suggestions we make at the end of our testimony is the easiest way we know to motivate taxpayers is to use the fear effect that IRS has on everybody today to your advantage, basically by changing the statute and saying, that if you file a timely filed return electronically, that your exposure for audit will be 24 months instead of 36 months, I guarantee you that will motivate taxpayers to create demand, and what practitioners will serve first before anything else is client demand.

If a taxpayer comes in to a practitioner and says, I want this filed electronically, because then IRS only has 24 months to audit me instead of 36 months, you have a couple of effects right away.

First, practitioners will get onboard. Second, practitioners' malpractice carriers will get onboard, because they will come back to the practitioner and say, you are going to tell us why you are not filing electronically, because we do not want the exposure for another year, if we do not have to have it unnecessarily. And the other thing quite frankly, if you put the provision in that if the return is filed timely electronically, and there are no mismatches with your IRP data, your information returns data, it also puts pressure on the filers of those 1099s and W–2s to get the data right, because they could leave themselves open to a tort claim from the taxpayer if they gave wrong information to the Service, and as a result it kept the statute open another year.

So you perfect your data all the way down the line, and as tax administrators, the Treasury and the IRS should be willing to accept this, because they can argue they are getting the data in purer form. They should be able to do a cross-reference much quicker on the electronically filed data that they are getting from the payers of the Information Return Program. Quite frankly, you only have a 1-percent audit rate, so what are you giving away? You really are not giving away much of anything.

The other suggestion we would urge the Treasury to consider or IRS, is to deal with the Federation of Tax Administrators, which is right here in Washington, which represents the 43 State tax administrators that are around and have income tax programs, and work out a unique program that allows an electronic filer to file one tax return to satisfy a State and Federal obligation. That would definitely attract taxpayers to lower their accounting costs. They have less tax returns to pay for in terms of preparation costs.

I think if those two things, coupled with the fact that IRS has to accept all tax return data, all tax schedules, and white paper schedules, submitted electronically would boost electronic filing.

The interim recommendation in the package is a good one. That is basically saying that if it cannot be accepted electronically, then that schedule or paper will be treated as a workpaper that will be maintained by the accountant and by the taxpayer.

That is a good suggestion, but it is only an interim suggestion. It cannot be a final suggestion. If it is the final suggestion, what IRS has done is move the documentation and filing responsibilities of the service centers into the taxpayer's offices and the practitioner's offices, and there is some real concern about that from the practitioner standpoint, in terms of client-record retention. And from a taxpayer standpoint—I mean, I cannot tell you how many times taxpayers call me up at work—I know my clients—and say, can you send me a copy of last year's tax return because I lost mine.

So we cannot rely on taxpayers to maintain their records. And to have sort of an open-ended liability for practitioners, you will not get any support on that. So as an interim measure it is a good idea, but I think basically if the IRS decides it is important enough to have a form or schedule, and they want the information, then they ought to be forced to take it electronically.

[The prepared statement and attachments follow:]

Statement of Joseph F. Lane, Enrolled Agent, National Association of Enrolled Agents

Madame Chair and members of the Oversight Subcommittee, my name is Joseph F. Lane, EA. I am an Enrolled Agent engaged in private practice in Menlo Park, California. I am the Chairman of the Government Relations Committee of the National Association of Enrolled Agents and I am pleased to have this opportunity to present testimony on behalf of NAEA's over 9,000 Members on the electronic filing provisions of H.R. 2292. NAEA receives no federal contracts or grants.

As you know, Enrolled Agents are licensed by the Treasury to represent taxpayers before the Internal Revenue Service. Enrolled Agents were created by legislation signed into law by President Chester Arthur in 1884 to remedy problems arising from claims brought to the Treasury after the Civil War. We represent taxpayers at all administrative levels of the IRS. Since we collectively work with millions of taxpayers and small businesses each year, Enrolled Agents are truly at the front lines of tax administration.

Representatives of NAEA testified at five public hearings conducted by the National Commission on Restructuring the IRS and we submitted written testimony for the record for a sixth hearing. In addition, our National staff attended numerous informal meetings with Commission staffers and Commissioners. We praise the work done by the Commission in focusing on constructive ways of improving our tax administration system and making the IRS more responsive to taxpayer input. Of all the Commission's recommendations, we believe those connected with electronic tax administration are among the most far-reaching and innovative. If adopted, they will revolutionize the way in which tax practitioners conduct their business in the next decade and beyond and will have a profound effect on American taxpayers as well.

The major focus of the Commission report was that the IRS must become more business-like and must adopt new strategies in handling its work, particularly in the area of electronic information systems. The Service has begun in the last year or so some major initiatives to help them reach these objectives.

As you know, in past testimony we have been critical of the Service for its lack of dynamic, innovative management in the area of electronic tax administration. However, we think the Service deserves to be recognized when it begins to transform its decision making process by making it more inclusive. Last year's executive appointment of Arthur Gross to be Chief Information Officer and last month's appointment of Bob Barr to be Assistant Commissioner of Electronic Tax Administration are solid indications that the Service has heard the complaints of taxpayers, tax practitioners, Congress and data processing professionals and has opened up its "inner sanctum" to outside input. We applaud these moves and encourage many more efforts to reach out and recruit individuals with the technical and marketing backgrounds necessary to once again make the Service a significant force in information systems expertise.

We believe the recently announced "blueprint" for implementing modernization of IRS data systems will take into account the views of numerous outside stakeholders to a much more serious degree than past plans. We expect the soon to be issued Request for Proposals seeking input from the practitioner, tax software and tax publishing industries will further the process of inviting the best minds to the table in formulating a methodology for enhancing electronic tax administration.

For the past two years, the IRS has operated a state of the art web site which makes available forms, publications, regulations, and press releases to anyone who can access the Internet. This is an extremely important service to taxpayers and practitioners because it is available 24 hours a day, 7 days a week.

IRS is reaching out more substantively to the practitioner community for ideas on how to operate more effectively and efficiently through the Commissioner's Advisory Group and the Information Reporting Program Advisory Committee as well as various task forces and focus groups. We especially endorse the establishment of a unique Electronic Commerce Advisory Group. The proposed E-CAG would serve as a focal point for IRS-industry communication in this vital area and we believe provide the necessary guidance and direction to the Service's efforts to move toward the goal of a paperless filing system by 2005. Given the revitalization of IRS' Electronic Tax Administration, we would recommend that the E-CAG be located within the Commissioner's office and aligned with ETA, rather than placed in Treasury.

We have been heartened to hear that IRS wants to put in place as much of the Commission's recommendations as it can administratively. This is indicative of an acceptance of some of the valid criticisms leveled over the past year and we commend the Service for its undefensive posture. We are concerned however that there be no lessening of the forward momentum toward enactment of the legislative proposals advancing the Commission's recommendations which cannot be administratively adopted without a law change. The Commission's recommendations in the electronic tax administration area are a continuously woven cloth. Each piece is critical to the achievement of the goal of a paperless filing system. It would not be possible to achieve the goal for instance if the IRS did not accept all tax forms and schedules and notes via electronic media or if it could not accept alternative forms of tax payment via electronic funds transfers or if it still insisted on actual taxpayer signatures rather than some other validation process.

One of the most important recommendations is that paperless filing should be the preferred and most convenient means of filing tax and information returns. The American taxpayers, their tax practitioners and the IRS are awash in paper, a situation which simply cannot continue unless we are prepared to see a complete breakdown in tax administration, not to mention the environmental consequences of the need for all that paper. Enrolled Agents, who are on the front lines of tax administration, are seeing the beginnings of this breakdown now. Our Members tell us that they are contending with more errors in IRS paperwork than ever before, and it takes a great deal of time and taxpayer money to untangle these errors. With electronic filing, the error rates can be as low as 1% versus as much as 20% for paper returns.

The benchmarks required in the Commission report—that within the next 10 years 80% of returns be filed electronically—are realistic only if certain changes are made to the way the Service and tax practitioners interact. I would like to share with you some demographic information reflecting the situation of NAEA Members. During our 1996 annual membership renewal period, we included a survey on the back of the renewal form. More than 75% of our Members replied. Of that group, almost all use a computer in tax preparation and the overwhelming majority have a modem and CD–Rom. (In fact it's pretty hard these days to find new computers

that don't have these items as part of the basic package.) One third of our Members are online so they have access to the Internet and have an e-mail address. We expect those numbers to increase dramatically in the very near future. To illustrate, two years ago, when NAEA began offering online communications to our Members, we had only a couple of hundred Members online. Today we have more than 3,000, ranging from our first President, Syd Schuldiner, who is in his eighties, to newly minted EAs in their twenties and thirties.

Since the vast majority of our Members use computers to prepare tax returns, the information is already in digital format. Yet our previous surveys have indicated that only 14% of our Members file electronically. We have been studying the reasons for this disparity for the past two years and have formulated a strategy to effect a change in practitioner perceptions about EF. In the course of our work we have identified the following areas as the primary contributing causes for practitioner nonparticipation in EF:

FORMS UNACCEPTABLE FOR ELECTRONIC FILING

Many forms are not available to be filed electronically. As one of our Members testified at the Commission's Des Moines field hearing, she could have sent many more tax returns in electronically if she had been able to handle the fuel excise tax form, a form that is particularly important to her clients who are farmers. Since it was not available electronically, she had to file paper returns. We later heard the reason that particular form was not available was because of revenue protection concerns. However, we were never told how widespread that problem was and were never asked to provide assistance in correcting the problem.

The Commission report neatly handles the problem of forms being unavailable for electronic filing by stating that those schedules and attachments not available in electronic format can be retained as worksheets in the taxpayer's files. We believe this will be an effective interim measure until the Service can reprogram the system to accept all forms and schedules in the near future but do not recommend this be seen as the final answer to this problem. There are too many concerns about practitioner liability issues, multi-year file retention requirements and client records retention habits. There is also the very real possibility that this procedure will trigger unnecessary audits because IRS will not be seeing a complete return. If the IRS wants the data, it designs a form or schedule for it. It should be required to accept it electronically and not shift the burden for keeping some of its records in the offices and files of practitioners and taxpayers.

LACK OF INCENTIVES FOR PREPARERS

The traditional view of most practitioners was there was no benefit to be derived by themselves or by taxpayers by filing electronically, with the possible exception of those clients interested in refund anticipation loans.

Indeed, their tax return processing costs were significantly increased by opting to support electronic filing because of the additional $.20 to $20.00 per return fees imposed by tax preparation software vendors for using their electronic filing option; by the initial insistence on expensive, non-standard modems by the IRS; by the number of tax forms the IRS would not accept electronically; and by the additional record keeping requirements imposed by program participation. These factors coupled with the primary IRS marketing thrust of "do it because it helps us" failed to elicit much response from the industry.

Today, the average practitioner with two or three hundred returns must, in most cases, pay a substantial fee relative to the average cost for their services to file electronically. This additional fee is the per unit cost charged by the tax preparation software vendor for utilizing the electronic filing option.

NAEA believes that there needs to be a clear delineation between the separate acts of preparing a tax return and submitting a tax return. No one argues that software publishers are entitled to be compensated for usage of their preparation program. But, to permit them to additionally control the method of submission is tantamount to permitting them to require that all income tax returns prepared using their software must be mailed via Federal Express at the cost of $15.00 per package rather than via US Mail for $.32. The current situation is akin to the early days of franchising when you had to buy all your cups and paper goods from the franchiser at exorbitant rates relative to the true market value.

We believe the IRS standard for electronic filing submissions should be written to an unencrypted, open document standard and that the practitioner-consumers be given the option of utilizing whatever electronic filing transmission service they select based on market place pricing. The process already is in place to require all tax preparation software vendors to make their program output conform to IRS

specifications. To add the additional requirement that they provide open access to the data file needed for electronic filing is relatively simple. The continuance of software vendors hegemony must end if electronic filing is to receive the fair test it deserves and the American taxpayers are to recognize the return on their investment made in IRS computing power.

The current bill provides incentives for preparers to submit returns electronically by requiring paid preparers to do so for all returns filed Jan 1, 2005. If we are going to reduce the error rate and halt the sea of paper being sent to IRS, then the move toward electronic filing incentives is praiseworthy. We would suggest that it doesn't go far enough and omits some details which can make a significant difference in participation rates. We also believe that the amounts of the proposed credits are too low to attract the support of the majority of tax practitioners who after all have average practice sizes of approximately 300 clients. For an average practice of 300 taxpayers the total credits available of $600.00 would do little to offset the tech support necessary to resolve all EF issues.

We have found in our talks with members over the past few years that there are many other incentives which would insure greater EF participation. We proposed these to the IRS last year in our pilot test proposal. They are:

1. Permit electronic communication between IRS offices and practitioners on client account issues. This would permit e-mail to be exchanged between IRS employees and practitioners to expedite resolution of account problems. This is not available in the vast majority of IRS offices!
2. Permit alternative forms of tax payments, including credit cards
3. Permit the online submission of the Installment Agreement request and Collection Information Statements
4. Permit the electronic submission of Powers of Attorney and Transcript Requests

Currently tax return preparers are required to list their personal Social Security numbers for identification on tax returns they prepare. As an access to the most confidential information, i.e., identity, credit and personal history, the Social Security number is potentially the most damaging of information to be disclosed in an uncontrolled environment. And in fact, several cases have come to light in which criminals lifted the SSN and used the information to create fictitious identities, acquire credit cards, and run up huge bills. The practitioners then had to hire legal counsel to straighten out the situation. If a way can be devised to permit tax practitioners who file electronically to avoid this requirement, it would certainly be a powerful inducement to use electronic filing.

We believe if these suggestions were adopted and the IRS is required to accept all forms and schedules electronically and the software publishers are forced to adhere to an open, unencrypted file output standard then the market forces alone will be sufficient to drive up EF participation rates. We also believe that once these obstacles are cleared away—a compelling case could be made in the name of good government and cost effectiveness to require EF submission of returns by practitioners who exceed a certain annual threshold in number of returns prepared.

OVERSIGHT OF ELECTRONIC FILING PREPARERS

One major IRS concern has always been the susceptibility of the electronic filing system to fraud. This has led to problems with the way electronic filing preparers have been treated and we have had member complaints about the means employed by IRS EF Revenue Protection efforts. While our Members' complaints have abated over the last filing period about the approach some IRS offices have taken in their revenue protection effort we have to note that in some cases the overzealousness of some IRS employees has fermented a very serious practitioner backlash against EF We believe that providing oversight for ALL paid preparers is an effective way to ensure the integrity of the system. NAEA has long advocated the registration and regulation of all paid tax preparers. IRS' own research repeatedly has shown that those tax practitioners regulated under Circular 230 are rarely involved in tax refund scams. An IRS study of EITC fraud done two years ago showed that 96% of the fraudulent cases involved unregulated tax preparers. There are tens of thousands of unregulated tax preparers each filing season. Many of them are what we call card table guys who show up in a storefront on January 1 and disappear on April 16. What kind of accountability do you think someone like that has? And yet they are involved in a system that collects $1.6 trillion in tax revenues annually. Does this make sense?

While over-regulation has been a problem in many government agencies for many years, I would argue that one of the basic rights of taxpayers is the right to have accurate and timely information so that they can be confident that they are in com-

pliance at all times. This includes the right to receive correct information from IRS and it includes the right to receive accurate returns and tax information from those who hold themselves out to the public as tax practitioners. We have the rather perverse situation in today's tax administration system where those of us who have made the most commitment to the tax profession: Enrolled Agents, CPAs and Attorneys, are the most regulated. While those who have not bothered to get the education necessary to stay current with the laws, have made no commitment to supporting a professional organization with established codes of ethics and standards of practice, and have no substantial investment in a practice in terms of equipment, libraries, etc. are completely unregulated by IRS. We require more qualifications from barbers than we do unregulated preparers and you can recover from a bad haircut in three weeks!

There must be a level playing field among all tax preparers. The Service should focus as much effort on paper filers as they do electronic filers. They should make more effort to listen to the problems their own procedures cause for EF participants and resolve to implement changes which would ease the burden on EF supporters. We look forward to working with Bob Barr in this effort as he is intimately aware of the marketplace concerns and problems with the IRS management of this effort.

We accept the Commission's recommendations as the starting point, but believe the current bill does not go far enough in ensuring the accountability of commercial tax preparers. For further information, we have attached the report of the IRS Commissioner's Advisory Group (CAG) on this subject, a report completed in 1994, prior to the outbreak of the fraudulent EITC activity in the 1995 filing season. We urge the Committee to consider inclusion of this recommendation in the current bill.

EXTENDED FILING DATES

We are aware that the Commission staff conducted taxpayer surveys which indicated a certain percentage of taxpayers would support EF if granted extended due dates for filing and paying taxes. Since we are in favor of increasing the number of EF returns we would concur with this change. However, we have several reservations about just what kind of volume increase could be expected from this modification. When we polled our members, we heard many concerns raised about how this would just provide the procrastinators with another month to get into their offices and about what liability there would be for tax practitioners who assumed clients could file electronically only to find in May they could not and now were faced with a delinquent return situation. We could see some benefits for this proposal only if the issue of IRS accepting all forms and schedules was resolved either along the work paper route or reprogramming to accept via EF. Additional concerns raised by our Members include the coordination of an extended filing date with filing deadlines for states and computation of estimated tax payments.

One of the reasons for extending the due date was to permit those filers of 1099s and K–1s to complete their work. In our opinion, Congress should revisit the question of requiring all partnerships and personal service corporations to have December 31 year ends. This change was implemented as a one year revenue fix several years back and it has caused immense problems for practitioners and taxpayers alike ever since. It would be far preferable to require June 30 year ends for these entities. This would insure that even on maximum extension that all K–1 data would be available before the individual tax filing date. It would also prevent any income shifting games since distributions would certainly fall in the taxpayer's tax year.

RELOCATION OF DIRECTOR OF PRACTICE TO TREASURY

Since the issue of moving the Director of Practice Office is one addressed in the electronic filing section of the bill, we felt the need to comment on it here, due to our prior recommendation that all practitioners who file electronically be covered under Cir. 230 and our frequent interaction with that office. We have had experience working with the DOP's office when it was part of Treasury and since it has been part of the IRS. In our opinion having it within the organizational plan of IRS works better than it did when it was headquartered at Main Treasury. The DOP is responsible for running the Special Enrollment Examination, background checks for the EA candidates, monitoring and auditing Continuing Professional Education reports, and enforcing the regulations under Cir. 230. Much of the administrative work is run out of IRS' Detroit Computing Center. The last renewal cycle was the smoothest we've ever experienced. It is our view that Detroit has performed well and proved itself. Since most of the work involves tax administration which is the focus of the IRS, rather than tax policy which is the focus of Treasury, then it seems

logical that the Director of Practice should remain at IRS and not revert back to the department.

ADDITIONAL NAEA RECOMMENDATIONS FOR LEGISLATIVE ACTION

We believe the Committee in the course of its deliberations should consider these additional suggestions for increasing Electronic Filing:

- modify the statutory period for examination of an income tax return from 36 months to 24 months provided that the return is filed electronically by the due date and there is no mismatch with other Information Returns Program data received by the Service. This achieves a triple effect: first—it motivates taxpayers to have their return filed electronically—practitioners will service client demand first above all else; second—it motivates IRP filers to perfect their data since they could be liable to their clients should they misreport information; and third—it motivates practitioner malpractice insurers to pressure practitioners to file electronically
- eliminate the requirement for an actual taxpayer signature on a tax return and for the submission of the Form 8453 by the EF preparer
- provide for joint Federal/State income tax filing on one return for electronic filers—this would motivate taxpayers who want to reduce their accounting costs each year and may prove attractive to states since many now receive copies of state and federal returns with all the attendant costs of paper handling and storage

We believe that if these changes were incorporated into this current bill that the 50% of all tax returns that are prepared by tax practitioners would rapidly be converted from paper submissions to electronic submissions well before 2005.

SUMMARY

We appreciate the opportunity to appear before you to offer our insights and views on the Commission's legislative recommendations. The IRS has long talked about partnerships in tax administration with the practitioner community. The time has come for this talk to become reality and foster true working relationships that provide for valued input and benefit to both sides. There are many hard working, dedicated employees within the IRS who share this desire for progress. We are confident this legislation will provide the necessary framework for more successful IRS/practitioner interactions and for a more effective electronic tax administration system.

I will be happy to respond to any questions you may have.

Attachment A

REGULATION AND REGISTRATION OF COMMERCIAL TAX RETURN PREPARERS

Executive Summary

CAG SUBGROUP CHAIR: Harvy L. Coustan, CPA
M. Leon Berk, EA

IRS EXECUTIVE: Leslie S. Shapiro

BACKGROUND: To propose a model program to identify, regulate and improve the expertise and professionalism of all individuals engaged in the preparation of federal tax returns for a fee. Practitioners currently regulated under Treasury Department Circular 230 (Enrolled Agents, attorneys and CPAs) would be exempt from this proposal.

CONTENT: This proposal has evolved after numerous meetings and extensive discussion and study. We recognize that the individuals covered by this proposal provide a vital service to the public. As a result, this program is not intended to limit or reduce the number of available tax return preparers. We have eliminated the second level of Commercial Tax Return Preparer (CTRP) which appeared in our proposal presented at an earlier CAG meeting. It became obvious that the second tier of Advanced CTRP posed many problems including setting limits and/or assigning different responsibilities to each level. We reached a unanimous conclusion that eliminating the Advanced CTRP would enable the program to achieve its goals, simplify its administration and minimize the disturbance to the present system.

REQUEST OF CAG or RECOMMENDATIONS:

Circular 230 would be amended to prescribe rules for the registration of "Commercial Tax Return Preparers."

NOTE: See more detailed discussion paper attached.

January 18, 1995 COMMISSIONER'S ADVISORY GROUP
Prepared by: Stephen W. DeFilippis, EA, (708) 858-6575 and
M. Leon Berk, EA (407) 795-0220

REGULATION AND REGISTRATION OF COMMERCIAL TAX RETURN PREPARERS

In 1989, the Commissioner's Advisory Group studied the matter of regulating and registering commercial tax return preparers. At the time, the reasons for considering this matter included the following:

1. Any person, regardless of training or experience, may prepare income tax returns for a fee.

2. Commercial tax return preparers generally are not required to subscribe to any rules of professional conduct or professional responsibility.

3. The complexities of the tax laws are such that doubts are raised relative to the overall competence of commercial tax return preparers.

All of these concerns are still valid. In addition, the February 1994 hearings on the IRS Refund Fraud Strategy, held by the Subcommittee on Oversight of the House Ways and Means Committee, indicate a strong need to address the competence and integrity of the commercial tax return preparer community. In fact, close examination of the testimony provided at these hearings reveals support for the regulation and registration concept.

In response to questions posed to them during the hearing, two witnesses who were convicted of preparing false Federal income tax returns made the following comments:

> "I am a tax preparer, but I didn't need to apply for any tax preparer (sic)..."

> "I filled out 1040s and signed as the preparer of the returns. That is all that is necessary in the system."

> "The idea would be for tax preparers, if they (IRS) could oversee them better. I am not an enrolled tax preparer (sic) with the IRS. I can go ahead and sign someone's return. Anyone in this room could sign another person's tax return as information supplied to them to the best of their knowledge and sign a return as a preparer."

REGULATION AND REGISTRATION OF COMMERCIAL TAX RETURN PREPARERS

The Subgroup also examined preparer penalty data and found the number of return preparer penalties assessed for fiscal year 1993 numbered 2,392. Interestingly, only 80 of these were assessed against Enrolled Agents, attorneys and CPAs (practitioners regulated under Circular 230). Thus, it can be inferred that 96.65% (2,312) of all return preparer penalties assessed for fiscal year 1993 were assessed against commercial tax return preparers. The 1989 CAG looked at similar data from fiscal year 1988 which indicated that 90.30% of all return preparer penalties assessed were assessed against commercial tax return preparers.

The Subgroup likewise took into consideration the recently released General Accounting Office (GAO) report which analyzed the compliance rates of sole proprietors. This report included a break-down of voluntary compliance, reported as a percentage, by type of preparer and was extracted from the 1988 Taxpayer Compliance Measurement Program (TCMP) data. The voluntary compliance percentage for the "other paid preparers" and "National Tax Service" categories, which include commercial tax return preparers, was among the lowest.

Finally, the states of Oregon and California currently have licensing programs in place for tax return preparers. The Ethics in Business Practices Subgroup has solicited input from the administrators of each of these programs to determine their success or failure. The Oregon State Board of Tax Service Examiners responded to several questions we posed to them. These questions and answers are attached to this report as Appendix A. In light of the current concern regarding refund fraud, the statement included in answer #2 "Since licensees can be easily found, fraud is generally low." is particularly interesting.

Having concluded that the regulation and registration of commercial tax return preparers is highly desirable, the Ethics in Business Practices Subgroup presents the following model program to regulate and register commercial tax return preparers.

REGULATION AND REGISTRATION OF COMMERCIAL TAX RETURN PREPARERS

DESCRIPTION:

Circular 230 would be amended to prescribe rules for the registration of "Commercial Tax Return Preparers".

1. "Commercial Tax Return Preparer" (CTRP) defined:

   The current definition of income tax return preparer found in Internal Revenue Code section 7701(a)(36)(A) would apply. Practitioners currently covered under Circular 230 (Enrolled Agents, attorneys and CPAs) would be exempt.

2. Registration and phase-in period:

   After the approval and implementation of this proposal, anyone meeting the definition of CTRP would have one year to register with the Internal Revenue Service without providing proof of continuing professional education (CPE). This one year period would constitute the phase-in period. The group of CTRPs, who would be grandfathered into the program, would be obligated to meet all the requirements of registration renewal as set forth below.

3. Post phase-in period:

   Persons desiring to register for the first time after the first year of the program would be required to meet the criteria listed below and submit proof of satisfying a minimum of 24 hours of CPE during the 18 months immediately preceding the receipt of the application for registration. Such proof, the completed registration form and required fee would be submitted to the Internal Revenue Service for acceptance.

4. Criteria for CTRPs:

   A. Be not less than eighteen (18) years of age;

REGULATION AND REGISTRATION OF COMMERCIAL TAX RETURN PREPARERS

B. Continuing professional education requirements must be adhered to as follows:

1. A minimum of 48 hours of approved CPE over a three year period with a minimum of 8 hours of CPE in any one year.

2. Qualifying CPE will be that which meets the definition of "Continuing Professional Education" as found in Treasury Department Circular 230, section 10.6(f).;

3. Evidence of continuing professional education and a renewal application would have to be submitted every three years commencing with the third anniversary of the initial registration.

C. The information submitted on each application for the registration would be subject to IRS verification and investigated in a manner consistent with that of applications for enrollment to practice before the IRS;

D. CTRPs would be subject to the standards set forth in Circular 230;

E. Violations of ethical standards would result in the assessment of monetary penalties as authorized and/or prohibition from further tax return preparation;

F. Limited fees would be paid for registration to make the program self-funding. A study is requested to ascertain the minimum fee requirement;

G. Opportunities for non-English speaking preparers will be made available to accommodate registration and continuing professional education.

H. The program would be administered by the IRS Office of Director of Practice with strong support and referrals from the District Directors' offices.

REGULATION AND REGISTRATION OF COMMERCIAL TAX RETURN PREPARERS

SUMMARY:

This proposal has evolved after numerous meetings and extensive discussion and study. We recognize that the individuals covered by this proposal provide a vital service to the public. As a result, this program is not intended to limit or reduce the number of available tax return preparers. We have eliminated the second level of CTRP which appeared in our proposal presented at an earlier CAG meeting. It became obvious that the second tier of Advanced CTRP posed many problems including setting limits and/or assigning different responsibilities to each level. We reached a unanimous conclusion that eliminating the Advanced CTRP would enable the program to achieve its goals, simplify its administration and minimize the disturbance to the present system.

APPENDIX A

May 4, 1994

STATE BOARD OF TAX SERVICE EXAMINERS

1. HAS LICENSING IMPROVED TAX PREPARATION QUALITY?

It is difficult if not impossible to measure. If you start with a significant education requirement and a comprehensive examination then the beginning level of competency of preparers is much higher. Add an annual continuing education requirement to maintain the competency. We have a 75% pass rate for the entry level examination and 35% pass rate for the advanced examination yet there is no shortage of licensees.

Officials in both the Oregon Dept. of Revenue and IRS, Oregon District, have said Oregon tax preparation quality is very good. They also report that licensee cooperation is high due to the fact that they are accountable to a state licensing authority.

2. HAS LICENSING REDUCED PREPARER FRAUD?

Licensees strongly support regulation and take pride in their profession. As a result they watch each other diligently and report improprieties. Since licensees can be easily found, fraud is generally low. Dishonesty results in license suspensions, revocations, and/or fines.

3. HAS THE ADMINISTRATIVE COST BEEN WORTH THE EFFORT?
Administrative costs are 100% funded by the licensing and examination fees. No general fund revenues are needed. The estimated cost to the client is 70 cents +/- per return prepared. Volunteer help is always available.

4. WHAT HAS BEEN YOUR EXPERIENCE WITH ENFORCEMENT?
It is far easier, faster, and less expensive to put someone out of business than to put them in jail. Civil penalties make it all work. Minor offenses are dealt effectively through assessment of penalties. Licensees are responsive to them and dislike the adverse publicity, perhaps, more than the monetary cost. Few are repeat offenders.

Oregon's tax preparer licensing program is for the protection of the taxpayer against the dishonest, incompetent, or negligent practitioner. It does not represent the government's interest in tax law compliance.

Approximately 1% of the practitioners cause most of the problems.

In many cases, non-licensees respond well to warning letters. Penalties of up to $1,000 per return can be imposed for unlicensed preparation. There are always a few who are not responsive to the penalties and in those cases, court injunctions may be imposed.

5. IF YOU HAD TO DO IT OVER WOULD YOU?

Yes. Licensing promotes professionalism and provides the public with an agency to receive and resolve, (in most cases) their complaints. It must relieve state and federal government taxing departments of problems they don't want and can not resolve.

6. WHAT HAVE BEEN THE NEGATIVES (IF ANY) IN THE PROGRAM?

There is a tendency to over-regulate.

Volunteer assistance may be intrusive at the beginning, but it is easily controlled by being selective.

It causes licensees to take about a week of tax classes every year.

It is more difficult for someone to enter the business of tax preparation. That difficulty is more prevalent in rural areas and small communities but then that is the character of those areas in most endeavors.

In the beginning there is a shortage of education classes available to meet the basic and continuing education requirements but private and public schools quickly develop programs.

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Chairman JOHNSON. Thank you very much, Mr. Lane.

Ms. Kelley.

STATEMENT OF CAROLYN KELLEY, DIRECTOR, GOVERNMENT AFFAIRS, AMERICAN PAYROLL ASSOCIATION

Ms. KELLEY. Thank you Madam Chair, and the Subcommittee, for the important work you have done in this area of electronic filing. I am honored to be here.

The APA Reports represent more than 14,000 U.S. businesses on issues related to payroll tax reporting, withholding and depositing. As such, APA's members are responsible for submitting hundreds of millions of the more than 1.4 billion wage information and employment returns received annually by the IRS and Social Security Administration.

APA agrees with just about everyone here today; that electronic filing of individual tax documents will result in lower cost and increase compliance for both the public and private sector. However, we are here to urge Congress to aggressively broaden this goal of expanding electronic filing, to include the filings required of U.S. businesses. That is, the over 1.4 billion information and payroll tax returns submitted by U.S. businesses each year.

Many of these documents do not have the complex attachments that make automating individual tax returns difficult sometimes. APA recommends that any strategy for increasing electronic filing of business returns and information reports, should be developed with the input of private sector stakeholders, and I think we have heard that a lot here today.

Thus we believe that that creation of an Electronic Commerce Advisory Group is a good idea, and should be monitored by Congress to ensure its recommendations are implemented when appropriate.

I am the former chair of the Information Reporting Program Advisory Committee, and a member of the Commissioner's Advisory Group, and I am proud of the good work we did there, but I do feel that Congress should monitor these advisory Committees to make sure that suggestions can be implemented where appropriate.

APA's other recommendations for increasing electronic submission of business information and employment returns include nationwide standards should be developed for all electronic data formats, including signature alternatives and transmissions procedures.

Underscoring Mr. Cardin's earlier comment, these standards should be easy and inexpensive for taxpayers to implement and use, and should be tested by both the public and the private sector before being implemented. For instance, one of the most distressing parts of the EFTPS implementation before the first—was IRS' insistence that the system had been tested, when in fact not one single taxpayer had put a payment through the system about to be mandated. Internal testing of systems is not enough. We need to go out and test with the Nation's tax collectors and tax preparers.

Our second recommendation is we agreed that IRS should remove electronic signature barriers to electronic, PC modem to modem, and magnetic media filing of information and tax returns. We support the Commission's provision in the legislation calling for electronic signature development.

IRS should resolve the security barriers surrounding electronic filing of information returns specifically. IRS has stated that in no instance has the fate of a tax claim relied on the validity of a signature on an information return. To us this means that hundreds of millions of these documents can potentially begin to be transmitted electronically without a paper signature attachment, using a signature alternative.

APA believes that technological solutions exist today that do this with a PIN. And we direct you to examine the current automated W–4 program. EFTPS uses PINs and SSA is currently starting to develop its electronic infrastructure, using them for receipt of wage information.

I share the frustrations expressed today. The fact is, we can withdraw money everyday from our banks using PINs, so the technology must exist for us to give information, and we do not understand these barriers.

According to SSA, of the 5.5 million employers filing today, only about 10 percent are filing either returns or information reporting documents electronically. However, as Mr. Harris has pointed out, 50 percent of the remaining 5 million are filing on paper, which has been created by a computer.

Because this information is already in an electronic format, it could easily be submitted to IRS by modem. This is a tremendous opportunity, and is being blocked by the lack of an electronic signature alternative.

Further, we are very concerned that that States are beginning to develop methods for electronic signatures and programs to receive tax and information returns electronically that are not standard; they vary from State to State. We need to move to develop national procedures and standards quickly, and hopefully the States will follow.

Another recommendation is that, new electronic procedures for taxpayers should never be mandated under penalty. On this we agree with the Commission and appreciate your movement in this direction. Instead the pubic and private sector should work together to develop systems that work for businesses, and then businesses will flock to them to use the increased efficiency and the cost savings.

Using EFTPS again, the mandate did not work as the extremely harsh 10-percent penalty assessed for failure to use the system provoked a predictable public outcry and resistance to adopt it. Further, although U.S. businesses were mandated under penalty, the U.S. Government was not, and when the system was not ready on the effective date, taxpayers were set up to be penalized for reasons out of their control.

This is crazy. We should be working together to improve tax administration in this country, and we believe that the Commission's recommendations go a far way to facilitate that.

I want to be clear though; we do not object to mandates, just mandates of brandnew technology. Instead of these kinds of mandated situations new electronic processes should first be marketed to the segments of the business community where the most savings and increased compliance would be realized, using various incentives. Other segments will follow as they perceive the advantages, especially if this marketing is done in partnership with the private sector. Congress and IRS should allow realistic deadlines for compliance with new electronic requirements, and that means the system changes that the taxpayers have to go through.

IRS also should provide business with several choices of methods to use to file information and tax returns electronically, including magnetic media and PC modem to modem methods. For example, electronic data interchange equipment is expensive, and available for tax use and only a very small number of businesses. Larger businesses are reluctant to make that kind of investment in payroll departments, and the cost to small businesses could be prohibitive.

Our last recommendation I think has been discussed here, so I will skip it, and ask that you should provide the same kind of incentives to business filers as to personal filers. We want to applaud you for the legislation's provisions to allow businesses that file electronically an additional month to submit Form W–2 information to SSA. This was easier done than to move the individual date because the W–2 is still going to the employee on January 31, so the employee is not affected. But what this allows businesses to do, is catch the mistakes, and then submit cleaner information to SSA. It is a very good idea, and it was an innovative solution.

IRS should outsource when appropriate expertise is not available within IRS, and APA is also glad to hear Mr. Barr is coming on. Or when working on projects inside the agency is going to delay them. I started working on an electronic 941 4 years ago, and we are dumfounded as to why that is taking so long.

Finally, we support the Commission's recommendations on single point filing, and we thank the Subcommittee for the opportunity to comment today.

[The prepared statement follows:]

Statement of Carolyn Kelley, Director of Government Affairs, American Payroll Association

The American Payroll Association congratulates the National Commission on Restructuring the Internal Revenue Service on its important work and interest in expanding electronic filing of individual tax returns in the United States. The APA represents more than 14,000 U.S. businesses on issues relating to payroll tax reporting, withholding, and depositing. According to the Service's own calculations, more than 70 percent of all federal revenue is collected through income tax withholding. As such, APA's members are the nation's tax collectors. Moreover, payroll departments are responsible for submitting hundreds of millions of the more than 1.4 billion information returns received annually by the IRS and Social Security Administration (SSA). These include wage reporting forms (Form W–2, "Wage and Tax Statement" and Form W–3, "Transmittal of Wage and Tax Statements"), Forms 1099–MISC, "Miscellaneous Income," for reporting payments made to independent contractors, and employment tax returns, including quarterly Forms 941, "Employer's Quarterly Federal Tax Return," (covering income tax withholding and FICA taxes), and Form 940, "Employer's Annual Federal Unemployment Tax Return," (reporting unemployment taxes).

APA agrees with the Commission that electronic filing of individual tax documents will result in lowered costs and increased compliance for both the public and private sector. Insofar as individual tax returns are concerned, APA leaves comments to our colleagues who are expert in that area.

Instead, we urge Congress to broaden this expansion of electronic filing to include the filings required of U.S. businesses. Any strategy for expansion of electronic submissions should include the over 1.4 billion information and payroll tax returns submitted by U.S. businesses each year. Many of these documents do not have the kind of complicated attachments that make automating individual tax returns difficult.

APA recommends that any strategy for increasing electronic filing of business returns and information reports should be developed with the input of the private sector stakeholders. The strategy development team should include, at a minimum, U.S. businesses, payroll service bureaus (who process, report and deposit a significant percentage of U.S. payroll taxes), the software designers who supply U.S. businesses with the software needed to stay in compliance, tax practitioners, Treasury, IRS, the Social Security Administration (which administers some payroll taxes and performs complex balancing processes with IRS), and the state tax administrators.

As far as a business strategy is concerned, the 180-day period stated in the proposed legislation should be expanded at least six months to allow for the development of the kind of public/private partnership necessary for success. Congress should monitor this to ensure that public input is being acted upon where appropriate. We believe that the creation of an Electronic Commerce Advisory Group is a good idea and should include representatives expert in the processing of business information and tax returns and be monitored by Congress to ensure its recommendations are implemented where appropriate.

RECOMMENDATIONS:

• IRS should work with the private sector in articulating a strategy and invite users of the tax system and software designers to lend their expertise. Any organization that does not involve the expected users of processes before building them is setting itself up for predictable, but avoidable, failure. Only by involving the front-end users in the design process can serious implementation problems be avoided.

• The public and private sector must work together during all phases of system design, implementation, and testing. Congress should provide oversight of this process to ensure that the needs of the taxpayer are being met and should remove barriers in the Federal Advisory Committee Act and any other legislation which prevent such a process.

• Reasonable standards should be developed for all electronic data formats, signature alternatives, transmission procedures, etc. These standards should be easy and inexpensive for the private sector to implement and use, and should be tested by both the public and private sector before being implemented. One of the most distressing parts of EFTPS implementation was IRS' insistence that the system had been "tested" when in fact, not a single taxpayer had put a payment through the system about to be mandated.

• IRS should remove electronic signature barriers to electronic, PC modem-to-modem, and magnetic media filing of information and tax returns and work with the private sector and the states to ensure nationwide standards. We support the legislation's provision calling for electronic signature development. This standard signature alternative should be easy and inexpensive for the private sector to implement and use, and it should be tested before rolled out.

• IRS should resolve the security barriers surrounding electronic filing of information returns.

IRS has stated that in no instance has the fate of a tax claim relied on the validity of a signature on an information return. This means that hundreds of millions of these information reporting documents can potentially be transmitted electronically without a paper signature attachment. We thus believe that most, if not all, of the (perceived) security problems surrounding moving information returns electronically to and from the IRS should be resolvable, without adding to the years of delay that have already occurred. APA believes the technological solutions exist today. IRS has to articulate requirements, work with their "stakeholders," and create pilots in order to successfully implement programs.

For example, SSA already has begun receiving Forms W–2 electronically, using a bulletin board for smaller employers and high speed bulk data transfer processes for larger employers. It's our understanding that the growth of SSA's program has been inhibited by the Service's delay in establishing a method for electronic signatures and removing the perceived security barriers.

According to SSA, of the 5.5 million employers filing today, only about 10 percent are filing either returns or information reporting documents electronically. However, 50 percent of the remaining five million are filing on paper created by a personal computer. Because this information is already in an electronic format, it could easily be submitted to the IRS by modem. This is a tremendous opportunity. It should be pursued, not held up by lack of electronic signature methods or by concerns regarding security which may be unnecessary.

APA believes the technology exists to do this with the use of PINs. For example, EFTPS uses PINs. We are concerned that the states are beginning to develop methods for electronic signatures and programs to receive tax and information return documents electronically that are not standard. IRS should partner immediately with the SSA, the state tax and employment agencies, the private sector and American National Standards Institute (ANSI) to develop national procedures and standards.

Currently, the SSA is meeting with the private sector to develop its electronic infrastructure. As digital signatures and other methods are not yet available, SSA is examining the feasibility of a PIN system. Challenges include how to validate the employer's EIN and company name as it appears on the IRS' business masterfile. We understand that IRS is not yet ready to participate in developing a common system. We urge Congress to urge IRS to work with SSA on this project.

• After being designed, implemented, and tested in partnership with the private sector, new electronic processes should be marketed to the segments of the business community where the most savings and increased compliance would be realized. Other segments will follow as they perceive the advantages.

• New electronic procedures should never be mandated under penalty. Nothing will kill private sector cooperation more quickly than being penalized for making

mistakes in the new electronic environment. Mistakes will be made in any new system as taxpayers are educated in new processes. (See below.) If systems work for businesses, businesses will flock to use them to increase efficiency and lower costs. For example, the EFTPS mandate did not work, as the extremely harsh ten-percent penalty assessed for failure to use the system provoked the predictable public outcry and resistance to adopt the system. Further, although U.S. businesses were mandated under penalty, the United States government was not, and when the system wasn't ready, taxpayers were set up to be penalized for reasons out of their control. This is insanity. We should be working together to improve tax administration in this country.

• Congress and IRS should allow realistic deadlines for compliance with new electronic requirements. From our prior testimony on the Commission's report, we repeat the following list of time periods which must be incorporated into any successful implementation schedule:

1. The time it takes the regulatory agencies to produce regulations.

2. The time it takes to educate the business community about their obligations, especially in the case of small businesses that may not have access to information and professional expertise available to larger businesses. After regulations, it takes some time before taxpayers are educated about requirements, especially if regulations are complex or require significant changes to existing practices.

3. The amount of time it takes for software design and testing. Most U.S. businesses buy their tax processing software from outside vendors. If these vendors do not have enough time to develop products, businesses pay with costly custom systems changes and/or manual or exception systems. If the business does not buy commercial software, the amount of time it takes to assess and then make changes to existing systems must be taken into account. The more complex the regulations, the more time businesses need to prepare for compliance.

4. The amount of time it takes to test system changes to ensure correct deposits and/or the reporting of clean, accurate information to the government agencies.

5. The amount of time it takes for government to design of pilot programs to test transactions and transmission among the various users before roll out.

It is important to note that these processes must be accomplished in a linear fashion and cannot be accomplished at the same time. Congress should work with the private and public sectors to design realistic implementation schedules and then ensure that the IRS is able to build their systems, produce regulations, and train staff on schedule.

• IRS should provide businesses with alternative methods to file information and tax returns electronically including magnetic media and PC modem-to-modem methods.

It is important that the government provide users with alternative methods for automated filing. For example, Electronic Data Interchange (EDI) equipment is expensive and available for tax use in only a very small number of businesses. Businesses are reluctant to make that kind of investment in payroll departments, and the cost to small businesses could be prohibitive.

• Congress should provide businesses with incentives to file electronically.

We applaud the legislation's provision to allow businesses that file electronically an additional month to submit Form W–2 wage information to SSA. This will allow businesses to discover and correct any problems before they submit wage information to SSA. This saves both the SSA and employers the expense and inefficiency of going through the W–2c correction process.

APA recommends that similar incentives be provided to third-party processors of electronic business filings and reporting as has been suggested for third-party processors of electronic individual returns.

• IRS should outsource when appropriate expertise is not available within IRS, or, when working on projects inside the agency will delay critical pieces of an electronic implementation strategy.

We thank the Subcommittee for the opportunity to comment today, and I'm happy to answer any questions you may have.

Chairman JOHNSON. Thank you. And I thank the panel for your excellent testimony. It was really very helpful, and will provide a lot of food for thought.

I would like to ask those on the panel that support a delayed date for electronic filing to discuss why they think that will be ef-

fective in more detail. I understand the opponent's argument. I do not understand as well the proponent's argument.

Mr. Wolfe.

Mr. WOLFE. We believe that right now there are very few incentives for balance-due filers to file electronically. The extension of the filing date would be one huge incentive for them to do that.

Chairman JOHNSON. Why is that an incentive for them to do that, when they can just file for an extension of their due date, and not have the month limitation?

Mr. WOLFE. Our understanding is that an extended deadline permits taxpayers to wait if they are procrastinators, for another couple of weeks before they actually filed a return. Another reason—it is a little more complex to explain—is that if we keep an April 15 deadline for both electronic and paper filers it actually penalizes electronic filers. Because if we allow them to electronically pay their taxes that are due, that debit would happen on April 15. And if they filed with paper the check would probably wait a minimum of 1 week before it would get to their bank account. So it would take away a barrier, to some extent, by delaying the filing date.

Chairman JOHNSON. Thank you, that is very helpful.

Mr. LANE. Could I come in on that as well?

Chairman JOHNSON. You certainly can, Mr. Lane.

Mr. LANE. I believe it not only calls for the extension of filing, but also the payment of the tax. Is that not correct? So you have a real savings there of someone not having to pay for the additional 30 days the balance due. So there is a real incentive for someone then to file electronically, knowing that they will be deferring the payment of whatever taxes would be due without penalty or interest for that 30-day period.

And obviously, as I agree with what the Intuit spokesman said, the issue is that there were very few incentives in here to get the 30 percent of taxpayers who have balances due. Quite frankly, our suggestion about limiting the audited exposure period would be very attractive to balance-due taxpayers, since they are the bulk of the people that get audited. They tend to be the more complex returns. They tend to be the people who have the higher audit rate than the one-tenth of 1 percent of 1040–EZs or 1040–As, that get audited.

So I think incentivising the balance-due taxpayer, which is a big area of concern for anybody who is trying to get more people to file electronically; that whole shortening of that audit window would have a very very dramatic impact on those taxpayers.

Chairman JOHNSON. Are there other comments?

Mr. Langer.

Mr. LANGER. In the standard filing season some 30 million returns are filed within the last 2 weeks, so I would suggest that even refund filers would take that extra time and file electronically if they had another month. And it does sort of play into the day of filing mentality that people have, but at the same time it will be attractive to refund filers and balance-due filers as well. If they have an additional month if they file electronically, I believe they would take that time.

Chairman JOHNSON. Mr. Harris.

Mr. HARRIS. I think the extended deadline is one of many reasons that we can approach these balance-due filers and encourage them. There are a certain group of people who always want to wait until the last minute to do everything, and giving them 30 more days, only if they file electronically will clearly motivate that group of people. It is not, I think, enough to get to the 80 percent, but I think it is one of the many issues that we have to address. And I have heard nothing but really good suggestions here today.

Chairman JOHNSON. And would you eliminate their right to ask them for the right to file later, to defer their filing?

Mr. LANGER. I think that that is the problem. If you do not offer them an extension on May 15 to be equal to a paper extension, you may in fact hurt some of the incentive, in that now they are faced with a 30-day window, and they have no options after that. So I would like to see that they still have an option on May 15, if factors exist, that they could still get an extension beyond that.

Mr. HARRIS. I agree with that. You need to provide the provision someplace—it may be in the Code or just in the regulations that come out afterward. But you need to provide the opportunity on May 15. If they are not in the position of filing a tax return at that point, because there is a K–1 missing or whatever, that they would be able to secure an extension, even though they are committing to file that extension electronically; that is fine. The return will come in electronically, but you cannot have it—if you leave it set up the way it is now, where, either they file for an extension on April 15, or they just do not file for the extension and assume that they have until the May 15 filing date, and then they do not have all the data.

Or worse, you get to a point where for some reason they cannot file electronically. This all assumes, before you implement this, that the IRS has to accept all returns that can now only be filed using paper. I assume that is what the thinking of the Subcommittee is. The way the legislation is drafted, they would have to be able to accept all tax returns. You need to provide something for that person or you are going to kill the incentive, because they will instead go back and get a protective extension.

Chairman JOHNSON. Thank you. Mr. Carver, what is your evaluation of the estimate that has been made, that a paper return costs $7 for the IRS to process?

Mr. CARVER. This is a real snakepit. I have been working some with the Commission. I spent a lot of time working in the Service before that, trying to come up with a cost.

My budget to run the 10 service centers was about $1.3 billion a year. Of that, about half—I am saying $700 to $800 million of that was for the returns processing, and that is taking returns in, stacking them and sorting them to transcribe the information in the usual format. That includes this error loop that was discussed earlier.

But if you have 200 million returns—the 1040s are the main cost factor. There are business returns, the 941 returns are processed very inexpensively because there is not much data, so most of the cost is 1040s. If you take that $700 or $800 million, and said there are 100 million tax returns, you are pretty close to $7 or $8 a piece for labor costs. It does not include the capital costs of those service

center buildings; the capital costs of the equipment that is purchased.

The budget I have was maintenance, some power and water, and mostly salaries. So the cost of $7 or $8 is in my mind pretty close. The danger to IRS though, by saying $7 to $8, and have somebody cut their budget, that is too big a risk because you do not know what the volume of returns are coming in. You cannot close one of those service centers if you get a 10-percent volume decline. You have to do something like saying, OK, in 5 years, this is the plan, this is the volume you will have, and you must close five service centers in that period of time and be ready for it at that time. That is why I really agree with setting goals, because it forces these capital goals to come along with it. It is a tough figure though.

Chairman JOHNSON. In other words the effect on the whole structure, the bureaucracy and its physical facilities, will be so dramatic by the time we reach the 80 percent that it needs to be planned for in advance.

Mr. CARVER. Yes, ma'am, carefully and in phases. Some of the numbers we developed earlier on a failed modernization effort that was supposed to be in place by 1996. The numbers that we were using for service center employees; that is, the temporary people that we hire to transcribe and so forth, those numbers are running $20,000 to $28,000. The system that was not delivered last year and was supposed to be, would have eliminated it.

So the numbers are much higher than that for electronic filing, because it saves all of that work in the centers.

Chairman JOHNSON. And last, and then I will yield to my colleagues. It does seem to me that 10 years is a long time to reach 80 percent, given how may people are already doing a lot of this that could be translated.

I think you look at the pace of technological change, and the amount we at least know about what is currently happening, it seems to me that our goal should be 5 years.

Mr. CARVER. I agree. I think the 10-year figure is probably going to be good for people who do not now have computers, and cannot see themselves ever becoming automated. That gives them enough cushion that they be will be comfortable for the rest——

Chairman JOHNSON. Does the 20 percent not give them cushion anyway?

Mr. CARVER. Yes, I think 5 years is good.

Chairman JOHNSON. Mr. LANE.

Mr. LANE. Can I just add something on? It seems to me—I have been coming to these hearings for about 1½ years, and I have heard the IRS asked what it costs to process a tax return, at almost every one of those hearings. It is inconceivable to me that 1½ years later we do not have a firm number on that.

GAO ought to look into it. If they cannot come up with a number then somebody someplace has to be able to say, Here is what it costs to process this paper return. And we have heard numbers. I agree with Bob, you take his number and it is $7 or $8 a piece. If you say that to IRS, they say Well, no, somebody said it was $1.17 at the Commission hearings. And the reaction on that was, well, where did that number come from?

You know, there is an answer here, and it is not that difficult to get at. I am sure there are going to be qualifiers that go on, and explaining what the numbers should be, but if they can't come up with it in 1½ years, then maybe you ought to send GAO in, or ask for a committee of volunteer auditors from our organizations; we would be happy to provide it. But somebody ought to come up with that number so we can know what we are talking about.

Chairman JOHNSON. I was disappointed in Mr. Lubick's comment this morning, about the $7 being way way high. Because when you look at the impact on the hiring of temporary employees, I mean known high costs investments, it is really hard to imagine that it is not going to save an enormous amount of money, and increase the accuracy of the whole process. This Subcommittee has spent years on how we should help taxpayers protect themselves when they have a difficulty with the IRS. Anything we can do to reduce the error rate is going to be very good, not only for the taxpayers but for the bureaucracy.

When you look at the impact that complexity has had on our tax system, it is very discouraging. That is only going to dissolve slowly and over time. So anything we can do to ensure accuracy of data going into the system, protection for the taxpayer, I think this issue of guaranteeing 24 months protection from audit instead of 36 months exposure is a very thoughtful recommendation. You are right, that will motivate people. And you only qualify if your data is accurate, and that that accuracy is affirmed by the IRS through its own matching processes so you are exposed to an intense scrutiny to be sure that your data is accurate.

Frankly, I do not think we have a right to keep people in jeopardy for 3 years in today's world, and that I think is a very thoughtful suggestion. We appreciate your comments today. While there are many more questions that could be asked by me, I am going to yield to my Ranking Member, Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairman. I would like to address my question to the preparers or people who are representing preparers.

Is there any category of the 120 million filers that electronic filing is not necessary for or not desirable for, or just is the wrong ticket for them?

Mr. HARRIS. Under the current system I think the numbers speak for themselves. There is a great many people right now that see no advantage in filing electronically. What we have to do is create incentives for all of those people now to find benefits in electronic filing. We see it working in the refund market. There is a benefit to the taxpayer. There is a benefit to the preparer to build their business.

Outside of that right now, most practitioners and most taxpayers see absolutely no benefit in it. I think we should be able to create benefit for all taxpayers if we really are thoughtful in thinking in the future.

Mr. COYNE. What would our motive be for doing that? Why would we want to do that?

Mr. HARRIS. To motivate all taxpayers?

Mr. COYNE. Yes.

Mr. HARRIS. Well, I think clearly, whatever the savings is, whether it is $1 or $6, I think certainly we have a more effective system.

I think also one of the things that we have to recognize is one of the efforts of this Commission was to offer a better service IRS, more service oriented. I think taxpayers play a role in that. I think if they expect answers on a timely and efficient manner, they should always be willing to furnish information the same way. And it is not practical to be able to ask someone to give me information immediately when I file my tax return in a very inefficient manner. So I think the taxpayers, if they really want good service, have a role to play.

Mr. COYNE. And when you say save money by encouraging electronic filing, you mean save money for the Service, for the government.

Mr. HARRIS. Certainly there is a savings there. I think we have to offer some incentive to others. Certainly it cannot cost more to file electronically to the taxpayer. The tax practitioners must be able to either find a way to save money or use electronic filing as an incentive to build their practice.

One of the problems with electronic filing initially was that the initial focus was on the refund taxpayers. IRS could input millions of 1040–As in the time it takes to do a couple hundred thousand complex 1040s. So what the Service did was focus on volume, which is all the little stuff—the 5 or 6, or 15 data elements.

For example, not a single tax return I prepared last year could be filed electronically

Mr. COYNE. Could be.

Mr. HARRIS. Could be. They did not qualify, primarily because the type of tax returns I do tend to have more Schedule Cs or more partnerships than are allowable. There were tolerance levels built into the system. So really what the IRS needs to do is focus on—to answer your first question. There is no segment of that $120 million that we would not benefit by having go in electronically. Everybody would benefit from it. The practitioners benefit from it because there is one path to get everything in. You get a benefit you do not get now, which is a confirmation back IRS got it.

I think I alone support the post office on certified mail receipts. I mean, we send everything certified, return receipt requested. I think everybody at the table probably does the same thing. So there are real incentives to have everything going electronically. The bigger the returns—the more complex the data entry elements for IRS, the more expensive it is for IRS to process that return. I think Bob Carver could back that up. So why not emphasize on getting those tax returns first. So there are real incentives for everybody to do it.

Mr. COYNE. Mr. Zimmerman, I wanted to clarify something that I think you said. You had offered a free electronic filing service and only 60 percent of your clients took advantage of it, is that right?

Mr. ZIMMERMAN. Forty percent of our clients took advantage of it, 60 percent did not. What we have to come up with is a way to show that there is a perceived value to the clients to file electronically. They have to want to do this. There has to be a reason to do this. Just to save the IRS money is not a good enough incentive

for a taxpayer. There has to be something in it for them. And I think it is part of the education procedure.

One of the things that we find is a majority of our younger clients will take electronic filing. The older clients are much more hesitant to file their returns electronically. That is why it is an education procedure. That is why we suggest that the IRS mount a massive campaign to educate the public on why it is important to do so and what the benefits are.

People just get into the habit of mailing that tax return. They like to take it home. They like to review it before they drop it into the mailbox. When it is electronically filed, we push the button, it is gone, and for all intents and purposes, they do not get another opportunity to look at that tax return. So, again, it is just educating the general public on the benefits of electronic filing. And certainly one benefit is those returns are correct. The paper error rate of 20 percent is reduced to less than 1 percent on electronic returns. That really gives a client peace of mind, knowing that that return is accepted, has been received by the IRS, and it is, for all intents and purposes, correct.

Mr. LANE. Can I add something to that? There is a tremendous—and we talked about this before in hearings—There is a tremendous mythology among the taxpayers about their dealings with IRS, and a sizable percentage out there will say, Well, I do not want it to go electronically to IRS because I have a higher chance of getting audited, that is true. We still, 25 years later, are explaining to people, if you use the label from the tax package it does not mean you have a higher chance of audit. But they absolutely believe those three codes up there, that are basically a check digit so IRS can save some keystrokes, actually code their return for audit, so they throw it away.

We have this tremendous mythology built up. It is almost like saying, as long as I have had this Ways and Means pitcher here, a bat has not flown into the room, so that keeps bats away, and it is crazy. But that is the logic they have. So what we have to do is focus on educating the taxpayers, and the best thing the Service could do would be to come out and say, We have less audits on electronically filed returns than we do on other returns, you would get a stampede of people in to file electronically, and they need to publicize that. The problem is that the Service would be reluctant to do that because they would think they would be putting out a full-page ad for anybody that wanted to do a tax refund fraud scheme to just start filing electronically.

But that is the case. Tom is right. It is an education issue with taxpayers.

Mr. COYNE. Thank you.

Chairman JOHNSON. Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair, and thanks to all of you for being here. I noticed in looking at the Commission testimony in preparation for this, that each one of you also has testified before the Commission, with the exception of Mr. Wolfe and Mr. Zimmerman, who were represented by your able senior executives. One of them is sitting behind you, Mr. Zimmerman, who did a great job for H&R Block. But I appreciate all the time and effort that you have put into this.

This is really exciting because there are very few things in the world that are truly win-win, and this is win-win for the taxpayer and the IRS. It is unbelievable to me that we are in this situation where we have not made more progress, because it is so clearly a classic win-win situation. And Joe Lane mentioned that it took us less time to get to the moon than we are laying out for this 80-percent filing. It took us 8 years to get to the moon, and since Joe is surely as charismatic as John Kennedy, maybe we should shift from 10 to 8 years.

But this is just a great example, I think, of being able to do something that is good for the taxpayer, that also happens to help the government and the IRS quite a bit.

Let me just ask Mr. Carver one general question, because you have been great before this Subcommittee and the Commission on arriving at cost data and so on. I have a more general question though, because you did run the service centers and have real institutional knowledge of the Service.

Just personally, if you do not mind—we are off the record here, right? Why has the IRS not moved more aggressively over the last decade and a half in the electronic filing area? What is your personal view of that?

Mr. CARVER. I have probably a half dozen personal views. I think the simplest reason was, the beginning of their modernization effort, the technology they envisioned was scanning and optical recognition. Every return that came in electronically removed returns from that, and their business case and how to pay for it. I think that was some of the beginning.

The second part of it though is, we talk about taxpayers being reluctant to do electronic filings; revenue agents and criminal investigators who do statistics of income are having a tough time figuring out how not to have a piece of paper that somebody signed, knowing what they were signing, with that penalty of perjury. They just do not believe you are going to get the truth, and they are having a tough time managing their world of audit, or statistics, or criminal investigation without paper and evidence. And that is a smaller group, but that smaller group is at the senior levels of every organization. And it is the large car/small car syndrome, I think. I really believe that is it.

Mr. PORTMAN. One of the outcomes of successful enhanced electronic filing would be fewer temporary employees at the service centers, and fewer service centers, I suppose.

Mr. CARVER. Yes.

Mr. PORTMAN. And I honestly do not think that is the reason we have not moved as aggressively although one might surmise that having more employees at the IRS might have been one of the motivations for not moving to this, because you will have a smaller and more efficient IRS—I do not think that was the reason. I think there are other reasons. You stated cultural reasons; the fact that certain technologies were viewed as the preferred method. But again, we have an opportunity here to meet all of those concerns, and I think have benefits to the Service, the taxpayer and so on.

There are a lot of questions I would love to ask, and maybe I can talk about them in private later. But this Subcommittee has to come up with this report, and Ms. Johnson has asked most of the

good questions. I think we have gotten good answers. The two key ones are the fee and the extension, I think, that we still need a little more input on.

Let me just be clear. I think H&R Block stated its position clearly on the fee and the extension. In terms of the general notion—let us stick with the fee for a second—of paying a fee—forget who it is paid to—do we have agreement from the other panelists that that would be a good incentive to put in place?

Mr. HARRIS. The payment to the practitioner or the transmitter?

Mr. PORTMAN. Yes.

Mr. HARRIS. I think there needs to be an incentive. That would help. I mean it would certainly move some people to give them $2 or $3, or whatever the number is for each return they file electronically.

Mr. PORTMAN. In the legislation though there is no stipulation as to the amount; it is a fair market cost.

Mr. HARRIS. I think there has to be clear incentive to the practitioner community that this is in their best interest. I do not know what that number is. I am not even sure what that incentive is. It could be something as out of the box as furnishing them the software at no charge to electronically file the returns, but there needs to be incentive to move people into electronic filing.

Mr. PORTMAN. OK. Extension of deadline. I am sorry. Mr. Carver.

Mr. CARVER. Just a quick one. The realities of those people that work in the service centers now—the temporary employees—if you do that same entry work, because you have to sit there and enter every item in the software, whether it is at your home PC or whether it is in the H&R Block office of a practitioner's office, there is a labor cost. And I think it is fair, that if the government is getting a much better quality product, and able to do their job better, that they split some of the savings they are having for not doing that labor, back with the people they are transferring the labor costs to. That is my personal feeling about it.

Mr. LANE. Can I come in under fee issue? The fee issue, as we have pointed out in our testimony, there are other ways to incentivise practitioners to get involved in this. The fee is an interesting concept, and as I said, we see the package as a consistently woven cloth. It is a toolbox, and there are 10 tools in it, and they are all needed for different things.

The problem you have with the restriction on $2 or $3, whatever it is, but if they cannot be charging the client for electronic filing—The problem you have with that, is that for a small practitioner with 200 or 300 clients, you are talking about a $600 payment, and in exchange for taking on all of this additional processing work, which if they are not able to charge the fee to the client, they are going to be paying a transmitter, because they do not transmit themselves; they are going to be paying a fee to some transmitter.

So the problem you have is the technical support, if it is not bundled into their software package—some software packages provide the electronic filing option for no additional charge. And I think what will happen is—we happen to support a marketplace resolution to this problem. I think what will happen is, if the IRS accepts all forms, and incentivises it along the lines that are suggestions

we proposed in our pilot test—let us file powers of attorney electronically, let us file transfer requests electronically, let us file balance-due returns on March 15, and not transfer the credit until April 15. I mean there are all sorts of incentives you can build in. The market will exist. You will get a tremendous increase in electronic filing, without the necessity of having to have the Treasury shell out this money.

I have some concerns and our members have some concerns, about taking away the ability to get the technical support you need to support filing these things electronically, because they are complicated processes; they are not just pushing a button and sending it off in many cases. Sometimes they bounce back, and then somebody has to do the work on resolving that.

That whole issue for the average firm, of $600 that they would get back is probably not worthwhile. It would be a disincentive to the practitioner. But as we see it; there are some cases it is going to be an incentive, so we did not object to it, but I think we have some problems the way it was worked.

Mr. PORTMAN. It is part of the woven fabric, plus over time those fee structures will adjust to take that into account.

Mr. LANE. Exactly. The marketplace will determine what the pricing structure will be.

Mr. PORTMAN. My time is up. Just on the extension, and Mr. Zimmerman, I understand you are opposed to the fee and opposed to the extension. Let me just ask a general question on the extension.

As part of this woven fabric as Joe said, because it is a combination of many different incentives, is there any objection specifically to the extension as part of this series of incentives?

If I have a moment, Mr. Zimmerman, I will let you speak, subject to the Chair's cutting me off because my time is up, as to your concerns on the extension.

Chairman JOHNSON. You can respond.

Mr. PORTMAN. Your concerns on the extension, and again, I thank you all for your work.

Mr. ZIMMERMAN. Yes, I think there is excess capacity in the system now, certainly in the many operations out there. It is certainly true in H&R Block offices. We've got excess capacity from the middle of February clear to the 1st of April to file more returns electronically, prepare more returns electronically. So I do not believe moving the deadline is going to be that large of an incentive or that it is really going to dramatically increase the number of returns.

The fee issue is something that I think is important, and the first step that we need to do, before any incentives are discussed, is to figure out exactly what we are dealing with. How much does it actually cost us to process a return at the IRS? Before we can start divvying up the money and the savings, it would really be nice to know exactly how many dollars that is. And then, if there are sufficient dollars, and it makes good business sense to do that, incentives might be the way to go. But certainly, just throwing this out on the table, and not knowing where to start does not seem to be too prudent to me.

Chairman JOHNSON. Ms. Thurman.

Ms. THURMAN. You have not really had much input into this, and you actually are one of those that proposed the $3 or whatever fee. Maybe you would like to explain to us, and I realize your position is a little different because you are a transmitter, and not necessarily one who puts everything together. You just kind of bundle it and send it to us. So maybe you would like to give us some explanation on your reason.

Mr. WOLFE. This idea is something that the Commission came up with. We supported the Commission's position.

We believe that cost is the number one, or most significant reason people do not file electronically. We would like to get that cost down to zero. One of the ways that we think would be most effective is to pay an incentive. Specifically we believe the incentive should be paid to the transmitter, because the costs of electronic filing—not what taxpayers pay, but the real costs of doing it—are primarily incurred by the transmitters. Transmitters have the computer systems, the programmers, the customer service staff, the technical support staff that make this happen. We believe over time volume will increase so that we can get the actual cost of transmitting the returns down to just several dollars. Our belief is that if that can happen, and if an incentive then is paid to cover those costs, there is no reason that we as a company should not provide that free to all of our customers, including professional preparers, as well as in consumers. If electronic filing is provided for free, then hopefully that will extend all the way out to the individual taxpayers.

Ms. THURMAN. I am not sure that I understand all of this. If my accountant decides to send my tax return by electronic transfer, he cannot just do that? Do I have to go through somebody? Is that by law?

Mr. HARRIS. Some can. Some have made the decision to have the ability to do it themselves.

Ms. THURMAN. What is the cost to them to do that if they decide to do it in-house, without anybody else in the middle?

Mr. LANE. It depends on the software product they have.

Ms. THURMAN. I am sorry?

Mr. HARRIS. It can vary from software product to software product.

Mr. LANE. It depends on the software product. It can be 20 cents, it can be $20, depending on the package that you purchase. Some of the software vendors have an additional charge for each tax return that is submitted electronically. And it also depends on whether or not there are any financial products in connection with it. For example, if there is a refund anticipation loan that is connected with it, there are additional fees on top of that. And then that has to go through a transmitter because there is not a direct transmission from the practitioner's office to the Service, because there is a bank involved, and then there is a financial product involved. So it has to go through a transmission source, and then the bank. So there is a controlling element that is outside the practitioner's office when that refund comes back through.

I confused you more.

Ms. THURMAN. I do not know that I am confused necessarily, as much as that I think there is a lot more to this whole idea of trans-

mitting electronically that is outside of the realm of IRS, as much as it is within the business world in itself.

Mr. LANE. That is right.

Mr. HARRIS. It is more than just pushing a button. I think the perception is the software that we use to prepare manual returns or paper returns, all you would have to do is push a button and it would go electronically, and it is not that simple. There is more work involved. There is more cost involved that the practitioners now have to charge for to make money, or they have to have the increase in business, which right now the refund marketplace provides.

Ms. THURMAN. So who then controls all of this? I think what I am trying to get to is that it seems that it is easy for us to talk about IRS on this end as far as the electronic filing, but what I am hearing you say is there are a lot of other steps that are incurred that really have nothing to do with IRS at all, and so then, if that is controlled, who controls that, and who stops those barriers from happening, and how do I get to that point that I can push that button and send my filing?

Mr. HARRIS. I think that the ECAG that this bill is putting in place is extremely important. It has to bring all parties together to develop a program that is beneficial to everyone, including the taxpayer, the practitioner, and the IRS. And I just do not think that program exists today.

Ms. THURMAN. So where is Bill Gates when we need him?

Mr. LANGER. That program really does exist today with many of the software packages. There is a lot of integration done with tax packages and transmitters and all electronic filers, trying to make that as easy as possible. There is a cost to develop the software; there is a cost for support, which is mentioned here. And the cost for the telephone communication is actually probably the smallest cost of that whole process. And so that can happen today. Companies like Intuit, other tax preparation companies, actually do have it, where you can basically press a button; the file is created. It goes through validation. It is transmitted either directly to the IRS or to the transmitter, and then goes on from there. So that really does happen today.

Mr. WOLFE. To give you a quick example, with TurboTax and people who file from home, our costs last year to actually process a complete electronically filed return were $10. We believe that we can drive those costs down dramatically. But those costs included computer costs, costs that we paid to outside companies, such as Nelco and NUTS, as well as the significant costs of Intuit personnel in call centers that take calls, and are answering questions from individual taxpayers about how electronic filing works.

Ms. KELLEY. And if I can make the comment, that is true in businesses as well, business taxpayers. They cannot just flip a switch, and there is a significant amount of internal preparation that goes into that as we saw with the EFTPS.

Mr. LANE. Let me give you an example, just of some of the additional strokes you have to do. When you file a paper return most practitioners do not key in all of the W–2 data; they only key in the wage data on there, because for calculation purposes that is all you need. But if you file an electronic return you have to rekey ev-

erything that is on the W–2 because that has to get transmitted electronically. So there are additional keystrokes in the practitioner's office.

This is what I was talking about before, where when you start to do parallel systems in an office you have a tremendous potential to mess up and have it come back, if the part-time person you have working for you does not understand the difference between an electronically filed return, what path that follows once it leaves the preparer's office as opposed to a paper return. So there are additional steps that complicate it.

Mr. ZIMMERMAN. Let me run down just a couple of things here. These are some of the steps in the electronic filing process. We have our preparers, 85,000 of them, that we have to train and educate on how to electronically file returns. We have our software development group that develops our electronic filing package. We have our support group which supports that electronic filing package because the returns that we send to the IRS are bounced back because of errors, and we have to correct those.

We have all of our phone lines in our 8,500 offices, several thousand of them out there that we use to file directly from our offices to our third-party transmitter. We have all of our advertising that I mentioned, that we spend up front to get people interested in coming in to electronically file their return. We have our transmitter cost that we pay to a third party. We've got all of our back office costs of bundling up all the 8453s, attaching the W–2s, and mailing all that information to the IRS; getting letters back from them saying that we are missing 8453s and W–2s; going back out to the client, getting that information; remailing that information back in to IRS so they can do their verification. And the paperwork nightmare of the 8633s. Every time we move a district manager around I have to sign off on all of these forms so that we can electronically file returns.

So, if you start putting all those costs together, and if you have a good high quality electronic filing product, it is not inexpensive.

Mr. CARVER. I just need to add one thing. This is a transition cost. As the IRS is going to have downsize as electronic goes up, and change the way they do it, the industry on the outside is going to do it. I think Joe's case is very clear about two filing lines. When it gets to be one all the software people in the country will have to provide that, and so it will be seamless at that point. But in the meantime there is some transition costs. So I think if you make it 10 years, these costs will hang around a long time. If it is a shorter period of time than that it is amazing how fast the software and the rest of the industry can adapt to what their customers want. It is incredibly fast.

Ms. KELLEY. And the same thing is true with businesses, and I say with complete confidence, that to the extent that business can work with government on these electronic programs, their costs will go down.

Chairman JOHNSON. Will the gentlelady yield.

Ms. KELLEY. All right.

Chairman JOHNSON. I understand the point about two systems and the problems that that creates, and the inevitability of the two systems situation during the transition. But I do not quite under-

stand Mr. Zimmerman's comments in the light of Mr. Wolfe's comments.

Many of the costs that you point to, Mr. Zimmerman, you also have with paper filings. And what are the unique costs, over and above, for an electronically filed return, and are there any offsetting savings?

And Mr. Wolfe, when you say $10, are you saying that it cost you $10 over and above what it would cost you to file that same return manually, through paper?

Mr. ZIMMERMAN. It is very hard right now for us to break out these costs between our electronically filed returns and our paper returns, just because they are dual systems, and most of it is all blended together. So I cannot give you an exact cost of what it cost to file a return electronically versus on paper.

Hopefully, once we get systems that are integrated, it will be less expensive, we can charge less, and certainly we are going to lower our fees this year and we are going to see if that helps drive more business in, and helps us increase the number of electronically filed returns.

Chairman JOHNSON. But for instance in advertising, you are going to advertise anyway. It is a question of what you say in the advertisement, and you are going to advertise in a way that you think will maximize your position in the market. And if you are advertising electronic filing in your advertising, it is because you think it is going to expand your customer base.

So I do not know that we can attribute your advertising costs to the cost of electronic filing.

Mr. LANE. Could I add something? He does have a cost. The way the current system is set up, if he does a 1040–EZ for somebody, and files it, that is a 1-page form. If he files it electronically, he still has to send IRS the 8463—I mean the thing with the signature, and the W–2s, so he has in effect doubled his costs by sending that to you electronically, because he still has to send in a piece of paper and a W–2 attached to it, which he might as well just have done with the 1040–EZ. So he has incurred twice the costs to file that return electronically than it would have been to just sent it to you on paper.

Mr. ZIMMERMAN. There are incremental costs to doing this, and again, I think as we work together we can drive those costs down, so it becomes cost effective for both the IRS and for taxpayers to transmit their returns electronically.

Mr. LUTES. Our company only does electronic filing, and we create software only to electronic file. And we have a development center of about 25 programmers that do Federal and State electronic filing software, and that is all we do. And we also have support staff to have customers call in about only electronic filing issues. We work with companies like Intuit. They handle all of the tax preparation calls; we handle the electronic filing costs. And so the costs of what we have done really is the electronic filing cost alone. So we can identify that cost very easily.

Chairman JOHNSON. And what is your cost per return?

Mr. LUTES. It kind of varies, based on the company a little bit, but it can range from anywhere from $4 to $7.

Chairman JOHNSON. Mr. Wolfe.

Mr. WOLFE. The $10 number that we quoted is for people using our product at home. We find that people that use it the first time generally have more questions, and it costs money to answer their questions. When electronic filing is being done through a professional preparer, they get very good at it, and so there are fewer questions that are asked of us.

Our software is perfectly capable out of the box of printing a paper return, so the costs that we incur, the $10 that we incur for electronic filing, are all incremental costs. We believe, as several others have testified, that we can drive those costs down dramatically. We are implementing new systems that will be fully functional this year, and even more functional next year, if that is possible. And we think that those costs are going to come down to the $3 range very very quickly as volume increases.

Chairman JOHNSON. Thank you.

Ms. THURMAN. I think you made a very good point about this issue, that the longer we linger, the longer it is going to take people to really get into this. And so, with the Commission—and there have been these recommendations for IRS and what they should be doing—if you were given the opportunity to tell those people out there in the world that were trying to get this done electronically, what would you tell them that they needed to do quickly? What kind of recommendations would you be giving them?

Mr. CARVER. Of the 70 percent that are already in electronic format today—and we are talking about practitioners, we are talking about the business returns and so forth. And I would start this meeting process, this committee process, to meet with those people to find out what it would take them—how quickly they could do it.

Ms. THURMAN. And they have not done that to this point.

Mr. CARVER. They have not done that, and they need to hear from those people, what it would take to get there in 2 years, or 3 years, or 5 years. And if you want to pay what it takes for 2 years, then you could do that. If you think the 5 year or the 3 year is a better one, then that is the way you go.

Then the next step would have to be for those people who are not presently filing electronically, or do not have a computer, and then you need a separate kind of scale for them. But to say 10 years for everybody misses this opportunity of 70 or 80 percent of the volume that is there, ready for some significant work; some hard work, but some quick work.

Ms. THURMAN. I want to ask Mr. Lane one other question because you emphasize this point in your testimony about the issue of the window period of time, from the 24 to 36 months.

Quite frankly, what I do not know is what the answer from IRS would be. Maybe you can help me with this, since they are not here. But if we were to say that that was the incentive instead of money incentives or other, which is a lot easier probably to carry out, why would they tell you that that is—or they may not tell you that that is not something that could happen.

Mr. LANE. Well, putting myself, in the guise of speaking for the IRS—I did that at one point; I do not do it anymore.

Ms. THURMAN. Oh, but give it a shot.

Mr. LANE. I would suggest that their initial reaction from a cop perspective would be to resist it. The reality is, they are giving

away nothing if they analyze it with a cold eye, and look at it unemotionally.

Very few tax audits are started in the third year of the statute, most of them are started in the year after filing or the second year after filing. Very few are open in the third year after filing. Very few electronically filed returns are audited to begin with, and they have an overall audit rate at 1 percent. So you are not looking at a significant giveaway. I think they would resist it, but if they were forced to look at it and really consider it, they might go along with it.

Mr. CARVER. If I may just add a quick comment. I think they would be very supportive of it. They cannot do their audit until they get the data through, and that data takes 18 months today. When you guarantee them the data is there in 6 months they will be ready and willing to change it, but not until.

Ms. THURMAN. Mr. Carver, I agree, and in fact that has been a contention that I have talked with some other folks about, because there has been some legislation that has been introduced. But some are saying, well, if we do not get the information how can you do this, and why would you limit us. So there is a lot of controversy over that.

Madam Chairperson, I appreciate you giving me this opportunity to do extended questions, and thank the panel.

Chairman JOHNSON. Thank you, Ms. Thurman. I do want to just ask you one other question. Repeatedly the issue of the forms that cannot be received electronically have come up, and Mr. Lane, you particularly have mentioned over and over again that we need to be able to get all the forms on. And clearly the whole 1040 community is the biggest community, and their forms are not acceptable yet.

I do not see that we can reach the 80 percent unless we can get more forms on, because 80 percent of the taxpayers are not going to be eligible. So at what pace do you think the forms could be accepted by the IRS. What timeframe would we be looking at? Because clearly 100 percent of form acceptance is going to be really important to getting this system moving, and all the taxpayers involved.

Mr. Carver, do you have any thoughts of that, and then I will open it to all of you.

Mr. CARVER. Yes, I do. The reason that there are so many forms and schedules now that are not on there, is because of the state of the equipment they have inside the service centers. It is old computer equipment that cannot handle any more complexity——

Chairman JOHNSON. But just to stop right there 1 minute. That is going to take us quite a few years to fix, is it not?

Mr. CARVER. No, ma'am. I think that the equipment they need to replace it with is off-the-shelf kind of equipment that exists today. It is a matter of putting enough programmers on it to include that into the program. If you wanted to farm it out to the private community, they could probably do it a lot quicker. I mean, I just think it is a matter of how many resources you can get——

Chairman JOHNSON. Do you think this is a couple of years project to get all the forms on?

Mr. CARVER. Absolutely. At the outside?

Chairman JOHNSON. At the outside. The rest of you.

Mr. LANGER. I made a recommendation to the Service this spring, on how they could accept all forms electronically this year. They have the ability to accept what they call unformatted statement. And with any software company they have the ability to print the return, and print it basically in an unformatted way, much like the form would appear, but only in a text format. And that would allow any form to be filed electronically, and really not change the process that they already have; just allow more statements to be attached to the form electronically.

They like the idea; they have not acted on it at this point.

Ms. KELLEY. Ms. Johnson, if I may. I think as well the expansion of electronic filing into business returns and business information documents, can really spike up what IRS is receiving, because as I stated before, some of those returns do not have the kind of complex schedules that some of these individual tax returns have.

Also, if you take a look at market segmenting, when I was on IRPAC, the IRS Information Reporting Program Advisory Committee, there was a gentleman from a major financial institution that raised his hand and said they could give IRS 50 million returns tomorrow, if they had the equipment to accept it. So, I think if the IRS looked at, instead of mandating everyone, look at the kind of companies that are willing to give them large volumes, and go after things in an incremental fashion, which seems to go against their implementation philosophies to date, that you might see a very large return in a shorter amount of time, than trying to figure out the entire universe. And again, working with the gentlemen here and other kinds of companies that can provide you with that large return on a smaller investment, I think I would be beneficial to upping your volume.

Chairman JOHNSON. I appreciate your patience in this rather long hearing, but we do very much appreciate your input. Thank you. The hearing is adjourned.

[Whereupon, at 2:28 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of American Bankers Association

The American Bankers Association (ABA) is pleased to submit this statement for the record in connection with the September 9, 1997 hearing before the Subcommittee on Oversight of the Committee on Ways and Means of the United States House of Representatives on the recommendations of the National Commission on Restructuring the Internal Revenue Service (Commission) to expand electronic filing of tax returns.

The ABA brings together all elements of the banking community to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, savings banks and thrifts—makes ABA the largest banking trade association in the country.

At the outset, we would like to commend Chairman Nancy Johnson (R–CT) for holding this hearing to further examine the June 25, 1997 report of the Commission. We would also like to commend Representative Rob Portman (R–OH) for his work as co-chairman of the Commission and for the introduction, along with Ben Cardin (D–MD), of the "Internal Revenue Service Restructuring and Reform Act of 1997" (H.R. 2292). This important legislation would provide a number of incentives to encourage the electronic filing of tax and information returns. It would also authorize appropriate amendments to the Internal Revenue Code to "facilitate paperless electronic filing."

The ABA has worked closely with the Commission to develop proposals to improve compliance through the effective use of advanced technology. The ABA particularly

supports the Commission's recommendations to expand electronic filing of tax and information returns. Electronic filing would significantly improve efficiencies and promote the goals of the financial services industry to expand new products and services while also promoting Internal Revenue Service (IRS) efficiency and other objectives.

The Taxpayer Relief Act of 1997 (P.L. 105–34) [hereinafter TRA] contains a provision, which if left uncorrected, will impede rather than encourage electronic filing. A critical component of the streamlining of the electronic filing process is reducing the number of paper checks written by taxpayers to the IRS. The payment of taxes by credit card is an important subcomponent of reaching that goal. Permitting taxpayers to make tax payments by credit card is also expected to improve taxpayer convenience and satisfaction. The TRA permits the payment of taxes by credit card but prohibits the payment of any fees by the IRS for use of a credit card tax payment service. By contrast, the instant legislation, H.R. 2292, introduced prior to passage of the TRA, contains a comparable provision that would also provide for a separate budget appropriation for payment of credit card fees. ABA urges you to correct the current law and pass legislation that would allow the IRS to pay appropriate merchant fees in connection with credit card payment of taxes.

We believe that most taxpayers will not be able to use their credit cards to pay taxes under the TRA provisions. Typically, one bank is responsible for processing a merchant's charges and for servicing the merchant's account. Credit card companies incur costs and receive payments from merchants for those services, and we believe the IRS will not be able to receive those services free of charge.[1]

It is axiomatic that anyone buying a service should pay a fair value for said service. There should be no special legislative exception made for the IRS. We believe that the implication that corporate taxpayers should provide financial services to the IRS, at no cost to the IRS, establishes a dangerous precedent with respect to the financial services industry and others. It has been suggested that the costs of providing credit card services be passed on to the taxpayer/customer. We do not believe that is the proper solution. The IRS will likely receive a negative reaction from taxpayers that will only serve to increase taxpayer dissatisfaction with the IRS and the entire income tax process. Our proposal to permit IRS payment of credit card merchant fees would not provide any special treatment for banks. Indeed, it would simply restore the level business playing field that the TRA inadvertently upset.

Currently, governmental entities at all levels, state and local as well as federal, are allowing taxpayers to make payment by credit card. The TRA provision prohibiting the IRS from paying ordinary merchant fees departs from current practice and prevents credit card banks from being able to offer card services to the IRS and, ultimately, to consumers who wish to expedite the filing and payment of federal taxes through the use of credit cards.

CONCLUSION

The ABA urges you to pass legislation that will allow the IRS to pay the appropriate merchant fees in connection with tax payments made by credit card. Without modification, the current law will continue to impede and discourage the full implementation of electronic filing of tax and information returns.

We appreciate having this opportunity to present our views.

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[1] By way of background, there are generally two parts to a bank credit card transaction. The credit card "issuing bank" handles card issuance and the cardholder relationship. It receives income from consumers to cover its operational and processing expenses. The "acquiring bank" handles processing for the merchant (in the instant case, the IRS) and receives income primarily from a "merchant discount fee" to cover operational and processing expenses, credit risk, and expenses to support the merchant (including authorization, merchant accounting, customer service and supplies).

AMERICAN SOCIETY FOR PAYROLL MANAGEMENT
NEW YORK, NY 10025
September 18, 1997

A. L. Singleton
Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Honorable Ways and Means Committee Members:

ASPM is a professional association of the senior managers who control the preparation of payroll and employment taxes for large employers in the United States. We represent large employers, systems vendors and tax service providers. As a group, we collect and account for a major proportion of the income and employment taxes the Internal Revenue Service receives.

We take great pride in collecting and paying the taxes exactly as required by law in a cost-efficient and timely manner. However, Congress and the IRS could make our tasks easier by changing many of the ways they do business.

Although there are many areas in which IRS restructuring may be appropriate, ASPM would like to see them attack Simplification and Reduction of Reporting Burden first. There are several initiatives which could significantly reduce employer burden as well as streamline IRS into a more effective operation. Some of the best initiatives, such as the Simplified Tax and Wage Reporting System (STAWRS) have stalled before the complexity of reforming the existing system and because of the inability of federal and state agencies to agree to standardized approaches. We believe that Congress must keep initiatives to simplify and standardize reporting systems alive, if the cost of tax collection is to be reduced. It is not desirable for Congress to issue mandates for new reporting programs to the states and employers. However, it is very important that Congress empower the IRS and SSA with the ability to set standard formats and definitions for all employers and federal and state agencies to use. State and federal agencies should be encouraged to exchange data in these standard formats, where appropriate, rather than require employers to report the same information repeatedly to different agencies in slightly different formats. Tax simplification will be difficult, if not impossible to achieve without standardization of formats or input requirements. SSA and IRS have a partnership in the collection of wage and tax information that needs to be streamlined and strengthened. We believe that state and federal agencies, such as INS, should leverage their efforts from these existing systems and not require additional, duplicate layers of reporting. Congress, not IRS, is responsible for ensuring duplication does not happen. No real progress will be made on tax simplification and reduction of employer reporting burden until Congress mandates a national harmonized wage code.

ASPM believes a steady program of systems modernization must be pursued at IRS. Employers are rapidly changing and developing new technologies for exchanging data, imaging and networking. We have readily partnered with IRS and SSA in moving to new technologies, but IRS must pursue its upgrades in a deliberate fashion. We can support a limited number of enhancements each year, so it is incumbent upon IRS to move ahead steadily and avoid falling behind the current technologies and then trying to suddenly leap ahead. It is the crash modernization program that leads to millions of dollars of wasted modernization efforts. We strongly urge Congressional, OMB and IRS budget makers to keep IRS systems modernization efforts funded at consistent and proper levels, while requiring IRS to rationalize and automate these systems. This modernization effort is a partnership between employers and the government agencies, because it reduces the administrative cost and it lessens the burden of tax collection. Goals for electronic filing will not be met if IRS does not pursue a measured and planned systems modernization effort.

ASPM believes IRS should strengthen its out-reach programs aimed at employers. Since employers collect the vast majority of the tax, it is clear employers must have timely, accurate and understandable regulations, guidance and publications, if we are to fully comply with the law. Without its partnership with the employer community, the IRS could not function. Yet, much of IRS regulation is aimed at levying egregious penalties for minor compliance failures, such as the late or insufficient deposit penalties. Severe penalties should be limited to chronically non-compliance em-

ployers, the fraudulent taxpayer, or grossly negligent taxpayer. The consistently compliant employer should not be subject to egregious penalties for minor or rare human errors. The complexity of the laws that employers are expected to administer is mind-boggling to anyone who is not regularly involved. It requires a great deal of effort to know all of the restrictions, reporting and deposit requirements. Compliance and collections can be helped only by the IRS taking a proactive and positive role in educating employers about current requirements and involving employers in pending changes. Improvement in the numbers of employers using electronic filing options can increase only if outreach programs educate them about the advantages and technical requirements of electronic filing. It is very interesting that IRS is proposing closing its Martinsburg Computing Center telephone support center at the same time it is starting initiatives aimed at improving customer service. The Martinsburg phone support center has traditionally been very responsive and has delivered high quality customer service to employers and other electronic filers. Martinsburg is widely considered to be one of IRS's most successful call sites.

With OMB and Congress constantly searching for new revenue sources, such as non-cash employee benefits and ever faster deposit deadlines, the complexity and difficulty of the payroll and employment tax job is increasing all the time. It is extremely difficult to withhold more than an employee was paid to cover a non-cash employee benefit and to make that deposit on time. Congress and IRS in writing the legislation and regulations need to keep in mind the business systems that underlie these processes. It is very difficult for a payroll system to process payments made from the Accounts Payable department, which may be in another office or even in another city. While payroll withholding is an extremely effective tax collection tool, it cannot be used in such a way that it requires the employer to take on the employee's role in proper withholding election, nor can it require the employer to use information that it does not have. Out-reach programs, such as employer conferences, improved publications, improved communications and high quality telephone support more than pay for themselves in improved compliance and reduced efforts spent on error correction and prompt tax collection. ASPM believes that Congress should either encourage or require the IRS to work with industry representatives, such as ASPM, in designing processes, developing procedures, and implementing legislation that affects a specific industry or segment of industries. Too often, IRS develops a process or writes a regulation and then asks for public reaction after the fact. It would be far more efficient for the IRS to have those affected working with the IRS. This would reduce the likelihood of major flaws, the need to rewrite or redesign and would increase industry buy-in.

The Internal Revenue Service frequently takes the blame for things that Congress does. It is very tempting for Congress to use tax penalties or loss of tax exemption for benefits in order to enforce social causes. This places IRS in the position of enforcing provisions, such as discrimination testing of benefits plans. ASPM urges you to place enforcement of social goals with the enforcement organization in the department or agency responsible for that function, such as DOL or INS. It is important for the cost-effectiveness and efficiency of the IRS that it stay focused on its core mission; revenue collection. Such unrelated regulatory requirements make electronic filing of information and tax returns from employers much more difficult and error prone.

It is important that Congress pass legislation that is clear and enforceable. It is just as important that IRS write timely regulations that allow employer compliance to be effectively and efficiently implemented. It is important that Congress empower IRS to reward compliance and punish noncompliance. The worst thing Congress can do from a compliance perspective is to pass retroactive changes to the tax law. This almost always rewards the non-compliance employer and punishes the compliant employer. The repeated lapsing of the tax exemption for educational assistance and its retroactive extension has encouraged employers to take a wait and see approach toward compliance. It has also greatly complicated the job of developing automated systems to perform electronic filing.

We would like to recognize the progress SSA and IRS have made in electronic reporting of W2 information, especially the download of state information from SSA/IRS files to state revenue offices. Currently, employers are sending W2 information by magnetic media or paper to the Social Security Administration (SSA). SSA captures federal and state data from the W2s, then passes the data to the IRS. SSA or IRS could transmit the data directly to the States. Getting the information in bulk and a standard format would have to be much more efficient and effective for the states than receiving large numbers of separate transmissions from thousands of employers. The current process utilizes very old technology requiring the manual loading of tapes and the processing of batch programs. This causes long delays. IRS frequently does not get the electronic submission information until six months after

we submit the information. This time lag needs to be greatly reduced. The transmission from the federal agencies could be made via electronic file transfers and automated to eliminate a large number of what are now manual tasks. It would also benefit employers, especially large employers that do business in many states. Currently, employers must create magnetic tapes, cartridges or paper for each state and file this information separately with a different set of requirements for each state. This is a very costly year-end mandate for employers and for the states receiving the information. It would take federal leadership to mandate a standard format, but would not require significantly more federal or state effort.

Electronic submission of W2 information is in pilot and should be put on a fast track, so it could be made available to all employers. Many employers are rapidly moving into newer, client-server technologies and the old tape formats are not even available on their newer equipment. When budget cuts were made last year, the IRS systems modernization project was heavily reduced. This makes no sense for employers nor for the federal government. Meaningful modernization of these systems is essential, if IRS is to continue to receive electronic information from employers without placing an extreme burden on employers to keep and maintain obsolete equipment solely to report to SSA and IRS. Budget funds should be redirected to meaningful modernization efforts and not just reduced.

For all reporting requirements, the form of the reporting should follow the function being performed. Employers do not mind reporting at the state level, but such reports should be submitted to the employer's state who should in turn distribute the information to the other states. Things like child support should be sent to one central state agency, not to counties. Each state should distribute to the other states and to its own counties. If information is required to go to the federal government, then it should only go to one place in the federal government and then be distributed electronically to the other federal agencies, the states, and their agencies.

ASPM would like to see IRS and SSA work more closely together. SSA and IRS also need to work more closely with the states. For example, SSA has asked IRS to accelerate W2 filings for employers going out of business. Paper forms for 1997 have been issued, but magnetic media formats have not been issued and won't be until July or August, 1997. The TY 1996 magnetic media format cannot be used because of 1997 format changes. When an employer with more than 250 employees goes out of business, they must still file on magnetic media. SSA recommends that the employer going out of business go back to IRS and apply for an exemption to allow them to file on paper. This is a lot to expect of an employer going out of business.

On the pilot W2 magions for 1998, pilot project employers will be using the magnetic media specifications. Has SSA coordinated with the states that are still expecting the old federal format? Anyone helping IRS and SSA with a pilot must now consider if they will be incurring an extra expense of filing with both formats. This is still in the early "discovery stage" as bulk filers contemplate participating in the pilot TY 1998 SSA program, but these questions should already have been answered.

IRS should continue and emphasize development of a unified reporting standards specification for federal and state wage forms as they have done in the past with the TIGERS group within ANSI X12. Currently, federal and state specifications vary from agency to agency. This causes employers to spend endless hours in maintaining and conforming to the different specifications. The continued development of Electronic Data Interchange (EDI) is recommended. Also, federal and state ID numbering is just as varied. It would be more efficient to replace the current federal and state agency IDs, with a single employer ID.

The Simplified Tax And Wage Reporting System initiative (STAWRS) was making great progress toward standardization and automation of reporting. There has been a tendency in the current administration to de-emphasize this effort because of the changing political climate and resistance from the state government agencies.

ASPM and the members involved with STAWRS strongly support this initiative and recommend that it not only be continued but re-emphasized. This program has been supported and funded by both Democratic and Republican administrations and is essentially a nonpartisan issue. It is a program that would greatly reduce tax and information reporting burden on large employers and bulk reporters who collect the great majority of taxes and report the greatest volumes of information to government.

STAWRS really consists of two primary proposals:

1.) Single-point filing and processing of tax related information.

Congress needs to mandate that a single federal agency (like IRS, the most logical choice), be the sole collection point for all tax related information. If this mandate is given to IRS, the legislation would have to make it a specific part of the agency's

mission, so any funds at the agency's disposal could be used to pay for the costs of collecting and distributing the information. Specific empowerment to distribute the information for legitimate governmental purposes to other government agencies with specific safe-guards on the confidentially of the information would need to be included. All other agencies would need to have a mandate to cooperate with the effort to build the centralized collection point and would need to be given incentives for using the centralized collection agency.

There are significant disparities between the interests of federal agencies and various state agencies and they will not willingly cooperate unless there is something in it for them. Low cost or no cost distribution and rapid distribution of revenues collected through centralized single-point filing would be required to overcome state objections. If incentives are provided and data dissemination is rapid, then the various states would have substantial reasons for joining voluntarily, especially in areas that have traditionally resisted single-point filing proposals in the past, such as state unemployment tax agencies.

Any single-point filing project would need to be phased in over a period of years as state agencies choose to join. We would recommend starting with W2 and Unemployment information and operating a pilot for large employers and bulk filers. Then expand the program to increasingly larger numbers of employers. Such participation would have to be voluntary, but we think a surprising number of businesses would participate.

Each state could have one record for each employee in a standardized format that every state would have to accept. The format would include income tax and unemployment data. The content of the data in the fields could be calculated differently for each state. The record format of the data would be exactly the same. Any state participating would have to use the standard file format, such as the'S record in the current W2 filing. In this manner, a 50 state employer would submit 4 files each year for processing all of the tax related information, instead of the 251 tapes that presently can be required. Most large employers do not have employees in all 50 states, but even an employer who does business in only 16 states would see a reduction to 4 files from 81 files. The cost savings to business and government would be very substantial resulting in higher profits, more employment, more productivity, lower tax rates, and increased tax collections. It will also result in better relationships between employers and the government. More profits and more employment income results in more federal revenue, while lower government costs should result in lower tax rates. This results in a big win for state and federal government and a big win for employers.

2.) Harmonized federal and state wage code.

The main reason that STAWRS has politically stalled out is the lack of a standardized or harmonized national wage code. The federal government and each state have set their own definition of taxable wages. Each state has also set up its own definition of wages that are covered for fement taxes. This has resulted in 51 different systems and methods for calculating unemployment wages. Each is reported quarterly. Many of the states have independently settled on the same calculations and many states already use the federal definition of taxable income for income tax purposes. Many states have voluntarily moved toward using federal information in the ANSI X12 program, because it makes so much sense to do so. Unfortunately, many other states have not. The Congress has the power to mandate that the states use a uniform calculation and format for calculating unemployment wages and taxable income wages for income tax purposes. The Congress could also mandate that the states convene and settle amongst themselves upon a standard format and calculation by a certain date or face the federal government deciding for them. This would allow businesses to use the same calculations for every state and would greatly reduce the cost and complexity of the computer programs used to produce the information, while greatly reducing errors and noncompliance. Reduced costs and improved collections would have many of the same economic benefits discussed under single-point filing above.

For state and federal income taxes, the federal taxable income is the obvious standard that should be used. We believe the Congress should mandate that states with income taxes must use the federal taxable wage as the starting point for their own income taxes. They could make whatever adjustments they wanted from that point, but this should be the only taxable wage that they could demand of employers and would be required to accept the standard format. Once they are required to use the standard format and the federal wage, using a single-point filing service is a smart move.

It is difficult or impossible for any one state or even a group of states to show the leadership necessary to bring all of the states together, especially when there are so many diverse interests involved. Therefore, it falls to the Congress to show

the leadership necessary to remove unnecessary costs and reporting burdens from business and taxpayers. It is a compelling national interest that our economy and tax systems operate as efficiently as possible, if we are going to compete effectively in world markets through the next century.

It is our understanding that Form 941 is in a pilot test for electronic filing. It should be opened up to all employers. Also, an electronic vehicle should be developed to file 940 and 945. The primary employer concern about 941 filing is how IRS calculates penalties. IRS applies penalties based upon applying the amount necessary to make up the short payment from a portion of the next payment received. This has the effect of making each subsequent payment also delinquent. Under the current method the penalties can be pretty egregious. If a mistake was made early in a quarter the error (underpayment), if not found, could create enormous penalties. There needs to be some kind of relief on the penalties for late deposit procedures under the IRS regulations. IRS needs a better process for determining if payments are timely. There is potential for re-engineering this process that would be a win for both the IRS and employers.

The magnetic filing of Form 945 has been dropped by IRS for lack of volume and cost-efficiency. Thus, EDI filing of 945 is unlikely. IRS asked the bulk return filers to do a pilot magnetic media filing for Form 940 and bulk filer test partners declined, until IRS has worked out the bugs on the EDI for Form 941 and has it ready for a wider release. The bulk filers also needed to get beyond the implementation of EFTPS. The employer/taxpayer community can only support a limited number of system changes each year, so it is extremely important that IRS maintain a steady continuing modernization program rather than sudden massive changes.

Respectfully submitted,

CLARK G. CASE
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cc: Dan Glum, ASPM President
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Statement of Harriet Bograd, Attorney, New York, New York

INTRODUCTION:

I am Harriet Bograd, attorney and consultant to nonprofit organizations. I am the founder and coordinator of the "Nonprofit Cyber-Accountability" listserv, an e-mail discussion group on how information technology can help make nonprofit organizations more accountable. In the past two years I collaborated with Peter Swords of the Nonprofit Coordinating Committee of New York on a research project on "Accountability in the Nonprofit Sector." I am also a Research Affiliate at Yale University's Program on Nonprofit Organizations.

The ideas submitted here are my own, but they have been informed by three years of daily discussions with hundreds of people. The Nonprofit Cyber-Accountability listserv, currently with 280 members, makes it possible for an ever-widening circle of state and federal officials, nonprofit leaders, scholars, accountants, attorneys, journalists, grantmakers, fundraisers, and ordinary citizens to engage in a consensus-building dialogue on nonprofit accountability.

This testimony starts by stating my recommendations, discusses why these are important, answers possible objections to these proposals, and finally lists resources for learning more about "nonprofit cyber-accountability."

I endorse today's testimony of the National Council of Nonprofit Associations, which discusses in greater depth the Form 990 and its uses.

RECOMMENDATIONS: ELECTRONIC FILING OF FORM 990, PUBLISHING FORM 990 DATA ON THE WEB, AND A STAGGERED SCHEDULE FOR MANDATORY ELECTRONIC FILING OF FORM 990.

H.R. 2292 offers a great opportunity for Congress to take steps which would cost little but would make a big difference to the nonprofit sector. I urge you to direct the IRS to accept electronic filing of Form 990 very soon, to publish all electronically filed data from Form 990's on the World Wide Web, and to make electronic filing mandatory for charitable nonprofits and private foundations, according to a staggered schedule based on gross receipts.

Here is a more detailed statement of these recommendations.

Congress should:

1) Direct the IRS to accept electronic filing of Form 990 for 501(c)(3) organizations starting with fiscal years ending on or after 12/31/98;

2) Require the IRS to make all electronically filed data from Form 990's and Form 990–PF's available to the public on the Internet, in a searchable database [exception: data about donors need not be disclosed by nonprofits, and should not be published on the Web]; and

3) Require nonprofit organizations to file electronically, according to a timetable staggered by the gross receipts of the organization. Electronic filing of Form 990 and Form 990–PF (for private foundations) should be mandated at least for those "charitable" nonprofits which are tax exempt under Section 501(c)(3).

The following is a suggested schedule for mandatory electronic filing of Form 990:

IRS should accept electronic filing of Form 990 and Form 990–PF for fiscal years ending on or after 12/31/98. For the first year, all electronic filing should be voluntary, as groups get used to the system, and problems are worked out.

After this, electronic filing should be mandatory according to the following schedule [a similar schedule should be developed for private foundations]:

Nonprofits with annual gross receipts over $10 million should be required to file electronically for fiscal years ending on or after 12/31/99.

Nonprofits with gross receipts over $1 million should be required to file electronically for fiscal years ending on or after 12/31/2000.

Nonprofits with gross receipts over $500,000 should be required to file electronically for fiscal years ending on or after 12/31/2001.

Starting with fiscal year ending on or after 12/31/2002, all groups which are required to file Form 990 or Form 990 EZ should be required to file electronically.

The IRS Commissioner should have discretion to delay the effective date of mandatory electronic filing for the last two groups (the groups not over $1 million) if the Commissioner concludes that such a requirement would impose a hardship on such groups. In making this decision, the Commissioner should consider the accessibility of computers, necessary software, Internet connections, or other services which would facilitate electronic filing for such groups.

I am suggesting that this schedule of mandatory electronic filing be included in the legislation itself, rather than in regulations. It has been distressing that the Treasury has not yet been able to issue even draft regulations on disclosure of Form 990, even though more than a year has passed since Congress called for these regulations in the Taxpayer Bill of Rights 2. Because of the risk of similar delays, I suggest that Congress simply set the schedule for mandatory electronic filing in the legislation.

WHY THESE RECOMMENDATIONS ARE IMPORTANT:

As members of Congress consider issues of electronic filing and the IRS, I urge you to pay attentio opportunities related to electronic filing of Form 990. Form 990 is the annual information return which nonprofits must file each year with the Internal Revenue Service, and the information in it is of great importance for nonprofit accountability. In contrast to other tax forms which are confidential, the information on the Form 990 (except for lists of donors) is required to be made available to the public. Yet it has been notoriously difficult to obtain copies of Form 990 either from many nonprofits or from the Internal Revenue Service. Furthermore, many people (such as employees, clients, or board members) who have concerns about nonprofit accountability issues are hesitant to ask for copies of Form 990 from the organization, for fear that they might be risking their jobs or benefits or confronting socially awkward situations.

Information technology offers a powerful and inexpensive solution to this problem. Form 990's can be filed electronically, and the information collected can automatically be posted in a searchable database on the World Wide Web. With such a system in place, valuable data about nonprofits would be easily accessible to board members, employees, journalists, state government officials, and scholars. Easy ac-

cess to Form 990 data would help people prevent, identify, and correct abuses, make better decisions, and find out more about the nonprofit sector.

ALLEGED OBSTACLES TO MANDATORY ELECTRONIC FILING OF FORM 990:

What are the obstacles that have made it difficult for the IRS to move forward with electronic filing of Form 990?

First, as H.R. 2292 recognizes, the Exempt Organization Division has had inadequate resources to do its current job, let alone to work on new initiatives. As of 1996, the Exempt Organizations Division was responsible for supervising 1.2 million nonprofits with only 400 agents and a budget of $62 million per year. In other words, the IRS had one agent for every three thousand nonprofits. Since the 1996 data was compiled, IRS staffing has rther staffing cutbacks are planned. The contrast with the Securities and Exchange Commission is daunting; the SEC has a budget of about $300 million to supervise between 9,000 and 14,000 publicly-traded corporations.

I strongly support those provisions in H.R. 2292 which would provide the Exempt Organization Division with more adequate resources. Yet the IRS resources will continue to be much more modest than those of the SEC, for example. Making Form 990 accessible on the Web (with mandatory electronic filing) will allow many citizens to become "voluntary auditors" who assist the IRS and the state regulators in the oversight of the nonprofit sector.

Second, there has been an erroneous fear that mandating electronic filing would be politically unpopular—that the nonprofit groups would object to such a requirement. I have discussed this issue with hundreds of people, including people who work with nonprofits of all sizes, and I expect that there would be surprisingly little resistance if electronic filing were mandated on a staggered schedule. The vast majority of nonprofit groups are ethical and responsible, and want to support systems of accountability that will give the public greater confidence in the nonprofit sector. More and more nonprofits are rapidly gaining access to computers and to modems or the Internet, either in their own offices or in the offices of their tax preparers. As people get used to electronic filing of personal and corporate tax returns, electronic filing of Form 990 will become a simple and inexpensive step to take.

Third, when the IRS forms processors set a "queue" for which forms to convert for electronic filing, they start with the forms that the IRS spends the most time processing. Since the Exempt Organizations Division has not had the resources to keypunch the paper forms it receives, Form 990 becomes low on the "queue. But this means that the information in Form 990's has been inaccessible and, in essence, squandered. The IRS personnel have not even keypunched them, let alone reviewed them, and the public has had difficulty getting to see them.

Although the volume of Form 990's processed by the IRS may be lower than the volume of some other forms, the public nature of these documents, and their importance for the health and integrity of the nonprofit sector must be reckoned in setting priorities for electronic filing. Although it is true that they are not now keypunching much of the Form 990's, IRS and state government agencies which oversee nonprofits could do a much more efficient and effective job if they had all the data from Form 990's accessible in a searchable database. An electronic filing/Web posting system would dramatically reduce the costs of making Form 990 data available to government he public. It would ease the burdens for nonprofit filers and eliminate keypunching errors introduced when government officials process these forms. Form 990's would be more accurate and complete, because preparation software would handle calculations and check that essential fields were completed.

Statement of Ann Mitchell Sackey, Executive Director, The National Council of Nonprofit Associations

We offer this testimony to urge Congress to assign the Office of the Assistant Commissioner of Employee Plans and Exempt Organizations responsibility for the development of a system through which nonprofit organizations would electronically file their Form 990 (Return of Organization Exempt From Income Tax), thus creating complete accessibility to all filed Form 990s on the Internet. We believe that the filing and disclosure requirements for nonprofit organizations should be a high priority for Congress. Our focus is limited to nonprofits which are organized and operated for the public benefit, as described under section 501(c)(3) of the Internal Revenue Code of 1986, as amended.

We believe that the filing and disclosure requirements of public-benefit nonprofits should receive a high priority in Congress because of their importance to the nation. In 1992, over one million nonprofits existed and nonprofits generated more than $500 billion in annual funds. They created 6.5 percent of the national income in 1992. Including full time employees and full time equivalent volunteers, nonprofits employed nearly 11 percent of the total U.S. employment in 1992. In 1994, nonprofits employed 15.1 million people. (These are the most recent statistics on the sector as documented by the INDEPENDENT SECTOR, an umbrella group of national nonprofit organizations.)

Electronic filing (posting all Form 990s on an IRS Web site) would provide enormous benefits for detecting and stopping abuses, for supporting better decision-making about nonprofits, and for conducting research. Electronic access would save money for the IRS and state charities regulators, who now spend large amounts of time shuffling and filing papers and keypunching data for analysis.

Each year, every nonprofit must file an IRS Form 990, an annual information return. About forty states also require some or all charitable nonprofits to file a copy of the Form 990 with them. With its attached Schedule A, the form is 10 pages long. It includes a variety of information about the organization, including: identifying information (e.g., name, address, phone, employer identification number); detailed financial information; program service accomplishments; list of officers; directors; trustees; and key employees; executive compensation; payments to independent contractors; relationships with other taxable and tax-exempt entities; and more.

The Form 990 is a valuable data collection tool and must be viewed as such. The U.S. Internal Revenue Service, state charities officials, and representatives of the nonprofit community have worked together over the years to refine and improve Form 990. The data in the collected Form 990s provides a uniform baseline of information about individual nonprofits and the nonprofit sector in general. Many efforts seek to continuously improve the quality of the data and to enable people to more effectively use the reported information.

There are three basic uses of 990 data. First, the information can help identify, prevent, and punish abuses. State charities officials, journalists, concerned board members, employees, and clients can find valuable information in Form 990 to prevent or uncover abuses such as self-dealing, quasi-looting, excessive compensation or improper engagement in political activities. These users must be able to review Form 990s without nonprofits knowing that they are being investigated.

Second, stakeholders can use the information to make better informed decisions. With Form 990 information, potential donors, managers, and board members (as well as all the other players listed above) can compare present and past financial performance and benchmark one group's financial performance with others in its field.

Third, practitioners, policy-makers, and researchers can apply Form 990 data to investigations on the composition and history of the nonprofit sector, its sources and uses of funds, its financial vulnerability and debt management, and its economic performance.

A public-benefit nonprofit must show its Form 990s, for its most recent three years, to those who come into its office and ask to see them. Soon, they will have to be mailed out upon request. These means of accessing the Form 990, however, take time and have the further disadvantage of revealing to the organization who is asking to see their Form 990. The system we are urging you to consider answers both these objections.

To summarize, the Form 990 is the basic nonprofit disclosure form that is used by both the IRS and state charities offices. It provides the base of nonprofit accountability. We believe that providing all 990s on the Internet will promote nonprofit accountability and will enable everyone to access an organization's 990 without notifying the organization. Staff, board members, or other semi-insiders who suspect improper activities will be able to look at the 990 to see whether the activities have been disclosed or whether the 990 has been filed fraudulently. Would-be malefactors, knowing that their 990 is electronically available to the public, may approach filing their 990 more seriously. Many refer to such a system as cyber-accountability. While cyber-accountability might be implemented through a number of means, we offer a simple, inexpensive explanation. (It enjoys the further virtue of being almost developed.) Cyber-accountability would be constructed through the following process:

1. The EO Division of the IRS would maintain a 990 Web site, available to anyone with access to the Internet. By going to the Web site, a user could request a 990 form for completion. It would appear on the user's screen in a format similar to the paper-copy Form 990. S/he could then complete the 990 by key-punching in the data elicited. When the 990 is completed, the user could electronically transmit it to the IRS.

2. The 990 Web site would receive and store in a database each 990 filed.

3. By accessing the 990 Web site, any 990s could be viewed by the public immediately after it was filed. This could be done by entering the organization's name or Employer Identification Number (E.I.N.)

4. Seconds later, the organization's 990 would appear on her screen. She would be able to download it and print it out. At the end of this process, she would have a hard-copy of the organization's 990. This could be done for one organization or for many. For example, all of the day care centers located in three or four contiguous zip codes could be accessed at once. The user could easily copy the data on the 990 Web site to a file, using a standard database format. The data could then be sent anywhere. The Exempt Organizations Division of the Office of the Assistant Commissioner of Employee Plans and Exempt Organizations and state charities offices could easily transfer this data to their system.

As of this writing, the pages of the 990 have been encoded into the language of the Web, converted to HTML. The next step will involve writing programs to store and retrieve submitted information. A demonstration project, now underway, will help to produce the system. If requested, the completed system could be loaded into a computer and made available to the IRS for less than $25,000, requiring nothing more than plugging into a power outlet and connecting to the Internet via a phone line. Several states have expressed an interest in the system; New Hampshire will most likely install it next spring.

A little over a year ago, the Taxpayers Bill of Rights (H.R. 2337) was signed into law. Among other things, it requires public-benefit nonprofits to give or mail copies of their annual Form 990s to anyone who requests them via mail or in person, for a reasonable cost. A group risks hefty penalties if it does not comply. However, this disclosure requirement will not go into effect until the Secretary of the Treasury issues regulations that spell out an exception: if a group makes its Form 990 "widely available," then it does not have to give out or mail copies. We believe the system described above would largely satisfy this "widely available" requirement.

Statement of Robert M. Tobias, National President, National Treasury Employees Union

Madam Chairwoman, Members of the Subcommittee, thank you for this further opportunity to present the views of the National Treasury Employees Union (NTEU), the exclusive representative of IRS employees, on the Report of the National Commission on Restructuring the Internal Revenue Service. As NTEU's National President, I welcome this opportunity to share our thoughts on the electronic filing of tax returns at the Service.

The IRS processes 205 million tax returns each year; l20 million of these are individual tax returns. In order for the IRS to effectively collect the taxes that run our government, the taxpaying public must find the IRS to be not only fair, but efficient. Although it still has a ways to go, the IRS has come a long way in improving its operations in recent years. The IRS, and the employees who make it run, perform remarkably well despite its faults.

The guiding principle of the Commission Report was that customer service and taxpayer satisfaction must become paramount at the Internal Revenue Service (IRS). NTEU wholeheartedly agrees. Customer service must become the engine which drives the Service. Expanding, demystifying and removing the barriers to electronic filing not only carries with it the ability to improve service to IRS customers, but compliance as well.

But, Madam Chairwoman, I must tell you that I remain deeply troubled by reports in the press that indicate this whole exercise may be little more than a political smokescreen and fundraising tool based on ridiculing the Service. Today's *Wall Street Journal* makes clear that IRS bashing is alive and well, quoting the Senate Majority Leader as stating in a recent radio address, "The IRS is intrusive, abusive and out of control." Senator Lott's comments are by no means the first of this nature, but they ought to be the last. How do we restore the IRS' credibility with the public when their elected officials routinely, unfairly and unjustly denigrate the agency and its mission?

The purpose of today's hearing is to explore ways to encourage electronic filing. I do not believe any of us have the power to inspire commitment to electronic filing and confidence in the IRS while remaining silent when elected officials unfairly bash the IRS as if it is collectively abusive, inefficient and can only be improved by being scrapped.

The Members of Congress who introduced IRS restructuring legislation, based on the Restructuring Commission's report, recognize that they have a responsibility to educate their colleagues that disparaging remarks have an effect opposite to that which their legislation suggests. They know IRS bashing promotes the view that the government's tax collection agency is to be ridiculed and that paying one's federal taxes need not be taken seriously.

Hearing comments such as Senator Lott's, why then would an individual be compelled to even try electronic filing? Why would they believe the IRS can be trusted to receive and accurately process their return electronically? Why would they believe the assurances they have been given that electronic filing does not lead to additional audits? What they hear from their elected representatives is just the opposite—the IRS cannot be trusted.

As the President of NTEU, I am committed to the path which my colleagues on the Commission and I have embarked on—to make the IRS a world class, respected organization. It is time for Congress to make a similar commitment and to leave the rhetoric behind.

There are several specific recommendations contained in the Commission Report on which I wish to comment relevant to today's hearing. While the Commission Report suggests that expanding the number of taxpayers who file electronically has the potential to increase cost savings and compliance, it also points out that it cannot be accomplished without a comprehensive plan. NTEU believes that it also cannot be accomplished without the appropriate financial resources. While the Commission Report states that electronic filing "holds great potential to increase cost savings and compliance with only a small investment by the IRS," NTEU believes that to reach its goal of more universal acceptance of electronic filing, the IRS will require a sizable investment—both financially and in terms of a comprehensive overhaul of how the IRS promotes the benefits of electronic filing and how it interacts with its customers.

The Internal Revenue Service reports that 14 million taxpayers filed their tax returns electronically in 1997, a 19 percent increase over 1996. Moreover, the IRS estimates that 19.2 million Americans will file electronically in 1998, almost double the number who filed electronically in 1995. The IRS is clearly moving in the right direction.

The Commission Report rightly suggests that only a comprehensive plan that appeals to all segments of the taxpayer and practitioner population will make electronic filing the preferred method of tax return filing. The Commissioners envision formation of a partnership between the IRS and practitioner community, elimination of the necessity to file a signature form with electronic returns, the establishment of uniform requirements for preparers, and electronic acceptance of all tax forms as good starting points. The Report also emphasizes the need to establish paperless payment methods and realigned due dates as inducements to electronic filing. I note that the IRS has expressed some concern regarding the proposal to extend due dates for electronic filers, adding that this is the one area where there is presently no confusion—tax returns are due on April 15. I urge the Committee to review this area carefully.

Those currently taking advantage of electronic filing methods typically are due a refund and tend to be clustered in the lower income levels. A 1991 IRS research study showed that the ability to receive an earlier refund was the greatest inducement to filing electronically. There is currently little or no incentive for taxpayers owing taxes to file by this method.

In March of 1995, the publication *Tax Notes* reported that taxpayers filing forms 1040A and 1040EZ represented almost 77 percent of electronic returns. These, they reported, are also the returns with the lowest processing cost savings for the IRS. The greatest savings potential lies with the Form 1040 returns, however, this same report found that only 2.8 million of the 62.7 million taxpayers in this group chose to file electronically.

The Commission Report also states that financial incentives may be necessary to induce a greater number of individuals to file electronically. For many individual taxpayers, there is little or no incentive to file electronically. Fees for ELF filing are usually in the neighborhood of $25, yet it only costs .32 cents to mail a paper return. Clearly, cost is one of the largest disincentives to electronic filing and may be a key barrier preventing more taxpayers from taking advantage of ELF. A May, 1997 national survey of 1,035 adults by The Mellman Group found that "interest in electronic filing increases dramatically when it is positioned as a no cost option to the taxpayer." Twenty-two percent of their respondents reported that they would be almost certain to file electronically if it were free.

The Commission recommendation that transmitters receive a financial incentive that is shared with taxpayers is worthy of further consideration. However, there are

other electronic filing inducements that I believe make even more sense and encourage Congress to consider as well.

To establish electronic filing as the preferred method of tax filing, it must be made available to a much broader segment of taxpayers. It must be easily understood, simple to accomplish and available at free and convenient locations. For example, terminals with user friendly software could be made available to taxpayers at local IRS walk-in offices. Customer service personnel staffing these offices could be available to answer questions and provide guidance. Even libraries, post offices, and banks could be outfitted with IRS-connected terminals. These venues typically make IRS forms available now, it only makes sense that as part of a comprehensive plan to stress both customer service and encourage electronic filing, these same locations should provide electronic filing capability.

Moreover, what could be more customer-service oriented than providing taxpayers with free and convenient locations to file their taxes electronically? To promote acceptance of electronic filing among a broader group of individual taxpayers, customer service must be part of the equation. For those taxpayers wishing to file electronically from their homes, user-friendly software should also be considered. Just as tax forms are distributed free of charge, free electronic filing software for use with home computers should also be considered.

While some seek expansion of electronic filing because of the allure of the possibility of reduced labor and overhead costs, they ignore the main principle underlying the Restructuring Commission's Report: Customer Service and Taxpayer Satisfaction must become paramount. Electronic filing holds the potential to improve both, but only if the savings achieved from its expansion are reinvested in the Service. To do otherwise ignores the basic principles of the Commission Report.

NTEU supports the expansion of electronic filing. It is the future. We believe equally as strongly that the efficiency savings that result must be reinvested in compliance and customer service functions at the agency. It is not as though the compliance rate is so high that there is nothing further to accomplish. And, it is not as though the IRS' customer service effort is so complete that we can afford to remove staff resources from the agency. Positions that become excess to the agency's needs with advances in electronic filing should be shifted to customer service functions. That is the answer to improving IRS customer service satisfaction and compliance levels while simultaneously improving acceptance of electronic filing.

NTEU is committed to making the IRS the world-class, respected organization it must become. I hope that Congress is equally committed to providing the resources necessary to make this a reality. Funding shortfalls and the vagaries of the annual budget process have played havoc with the IRS and its ability to effectively plan in the past. I look forward to working with this Committee and the others that oversee the IRS to insure that our joint goals become reality.

Thank you.

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