Improve the Filing Process

#3 AUTHORIZE THE VOLUNTEER INCOME TAX ASSISTANCE GRANT PROGRAM

Present Law

The IRS administers important programs that provide free or low-cost assistance to lower income U.S. taxpayers. The Volunteer Income Tax Assistance (VITA) program provides assistance to low-to-moderate income, elderly, disabled, and limited English-speaking taxpayers in preparing and filing their federal income tax returns. The Low Income Taxpayer Clinic (LITC) program provides *pro bono* representation to low income taxpayers involved in controversies with the IRS, including audits, appeals, collection matters, and tax litigation, and provides information about taxpayer rights and responsibilities in multiple languages for taxpayers who speak English as a second language.[10]

As part of the IRS Restructuring and Reform Act of 1998, Congress created a federal grants program for LITCs. IRC § 7526 authorizes the Secretary, subject to the availability of appropriated funds, to make grants to provide matching funds for the development, expansion, or continuation of LITCs.

In contrast to the LITC grant program, Congress has not authorized the VITA program to receive grants through the tax-writing process. Since fiscal year 2008, however, Congress has used the appropriations process to provide funding for the IRS to administer a Community VITA matching grants program for tax return preparation assistance.[11]

Reasons for Change

The VITA grant program would stand on more solid, permanent, and predictable footing if it were authorized and not solely created and funded through the annual appropriations process. As with the LITC authorizing statute, the tax-writing committees could establish eligibility criteria for VITA programs to expand their provision of services. Absent such criteria, the IRS has administered the VITA grant program narrowly, restricting grantees' ability to use grant funds to hire experts to train volunteers and perform quality reviews, as well as to serve as Certified Acceptance Agents. As a result, few VITA grantees assist low income self-employed taxpayers who file a Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, or a Schedule F, *Profit or Loss From Farming*, or low income taxpayers with disaster losses. Moreover, few VITA grantees are open year-round or assist taxpayers in preparing amended returns.

Through an authorizing statute, Congress could provide direction to the IRS about the eligibility criteria for grantees, including their ability to operate year-round, and authorize the use of funds to develop expertise to

10 A third program, Tax Counseling for the Elderly (TCE), is similar to the Volunteer Income Tax Assistance (VITA) program in that it assists elderly taxpayers in preparing and filing their federal income tax returns. The IRS administers VITA and TCE jointly in most respects. The rationale for authorizing the VITA program probably applies to the TCE program as well. However, we have not studied the TCE program closely, so we are not making that recommendation at this time. In the Revenue Act of 1978, Congress authorized the TCE program. *See* Pub. L. No. 95-600, § 163, 92 Stat. 2763, 2810 (1978). Although that authorization only applied for fiscal years 1979 and 1980, Congress continues to appropriate funds for the TCE program annually through its appropriations acts. *See, e.g.*, Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, Division E, Title 1, 132 Stat. 348, 540 (2018).

11 *See, e.g.*, Consolidated Appropriations Act, 2008, Pub. L. No. 110-161, 121 Stat. 1844, 1976 (2007); Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, Division E, Title 1, 132 Stat. 348, 540 (2018). Not all VITA programs receive a grant from the IRS. For more details about the VITA grant program, see IRS Pub. 4671, *VITA Grant Program Overview and Application Instructions*.

assist taxpayers in preparing a broader range of forms and schedules than most VITA programs are currently able to handle.

Recommendation

Enact a new IRC § 7526A to authorize the Secretary, subject to the availability of appropriated funds, to provide grants for the development, expansion, or continuation of VITA programs, particularly VITA programs that will use the funds to prepare tax forms and schedules that are commonly needed by low income taxpayers but currently designated as "out-of-scope."[12]

12 For legislative language generally consistent with this recommendation, see Taxpayer First Act of 2018, S. 3246, 115th Cong. § 1001 (2018); Taxpayer First Act, H.R. 5444, 115th Cong. § 12001 (2018); Protecting Taxpayers Act, S. 3278, 115th Cong. § 502 (2018). These three bills are similar in substance and contain the same taxpayer eligibility criteria. However, the House bill differs from the Senate bills in the term it uses to describe eligible taxpayers. The Senate bills use the term "applicable taxpayer." The House bill uses the term "low-income taxpayer." We recommend Congress use the term "applicable taxpayer" to avoid creating inconsistent statutory definitions of the term "low-income taxpayer." In IRC §§ 7526(b) and 6159(f), the term "low-income taxpayer" is defined as a taxpayer with income at or below 250 percent of the Federal Poverty Level. The IRS has adopted 250 percent of the Federal Poverty Level as its proxy for low-income taxpayers as well, including to screen out taxpayers receiving Social Security benefits from the Federal Payment Levy Program. *See* IRM 5.19.9.3.2.3, *Low Income Filter (LIF) Exclusion* (Oct. 20, 2016). Notably, the VITA program does not use 250 percent of the Federal Poverty Level for its eligibility criterion. Instead, a taxpayer is eligible to use VITA services if his or her income does not exceed an amount equal to the completed Earned Income Tax Credit (EITC) phaseout amount for a married couple filing a joint return with three or more qualifying children. We have no concerns about using the EITC threshold for purposes of VITA eligibility, but we believe it would promote clarity to consistently use the term "low-income taxpayer" to refer to taxpayers with incomes at or below 250 percent of the Federal Poverty Level. Use of the term "applicable taxpayer" would address this concern without changing the substance of the proposal.

#4 AUTHORIZE THE IRS TO ESTABLISH MINIMUM COMPETENCY STANDARDS FOR FEDERAL TAX RETURN PREPARERS

Present Law

Current law imposes no competency or licensing requirements on tax return preparers. Attorneys, certified public accountants (CPAs), and enrolled agents are required to take courses and pass competency tests. Volunteers are required to pass competency tests as part of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs. But most preparers are non-credentialed and are not required to pass any competency tests or take any courses in tax return preparation.

Reasons for Change

The IRS receives more than 150 million federal income tax returns every year, and the majority are prepared by paid tax return preparers. For that reason, both taxpayers and the tax system depend heavily on the ability of preparers to prepare accurate tax returns. Yet numerous studies have found that non-credentialed tax return preparers routinely prepare inaccurate returns, which has the effect of harming taxpayers, the public fisc, or both.

To protect the public, federal and state laws generally require lawyers, doctors, financial planners, actuaries, appraisers, contractors, motor vehicle operators, and even barbers and beauticians to obtain licenses or certifications, and in most of these cases, they are required to pass competency tests. Taxpayers and the tax system would benefit from requiring minimum standards of tax return preparers as well.

The following studies illustrate the extent of inaccurate return preparation:

Government Accountability Office (GAO). In 2006, GAO auditors posing as taxpayers made 19 visits to several national tax return preparation chains in a large metropolitan area. Using two carefully designed fact patterns, they sought assistance in preparing tax returns. On 17 of 19 returns, preparers computed the wrong refund amounts, with variations of several thousand dollars. In five cases, the prepared returns reflected unwarranted excess refunds of nearly $2,000. In two cases, the prepared returns would have caused the taxpayer to overpay by more than $1,500. In five out of ten cases in which the Earned Income Tax Credit (EITC) was claimed, preparers failed to ask where the auditor's child lived or ignored the auditor's answer to the question, and consequently prepared returns claiming ineligible children.[13]

The GAO conducted a similar study in 2014. It again found that preparers computed the wrong tax liability on 17 of the 19 returns they prepared.[14]

Treasurer Inspector General for Tax Administration (TIGTA). In 2008, TIGTA auditors posing as taxpayers visited 12 commercial chains and 16 small, independently owned tax return preparation offices in a large metropolitan area. All preparers visited by TIGTA were non-credentialed. Of 28 returns prepared, 61 percent were prepared incorrectly. The average net understatement was $755 per return. Of seven

13 Government Accountability Office (GAO), GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (Apr. 4, 2006) (statement of Michael Brostek, Director - Strategic Issues, Before the Committee on Finance, U.S. Senate).

14 GAO, GAO-14-467T, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors* (Apr. 8, 2014) (statement of James R. McTigue, Jr., Director - Strategic Issues, Before the Committee on Finance, U.S. Senate).

returns involving EITC claims, *none* of the preparers exercised appropriate due diligence as required under IRC § 6695(g).[15]

New York State Department of Taxation and Finance. During 2008 and 2009, agents conducted nearly 200 targeted covert visits in which they posed as taxpayers and sought assistance in preparing income or sales tax returns. In testimony at an IRS Public Forum, the Acting Commissioner of the New York Department of Taxation and Finance testified that investigators found "an epidemic of unethical and criminal behavior."[16] At one point, the Department reported that it had found fraud on about 40 percent of its visits, and it had made more than 20 arrests and secured 13 convictions.[17]

IRS Study on EITC Noncompliance. The IRS conducted a study to estimate compliance with EITC requirements during the 2006-2008 period. Among the findings of the study, unaffiliated unenrolled preparers (*i.e.*, non-credentialed preparers who are not affiliated with a national tax return preparation firm) were responsible for "the highest frequency and percentage of EITC overclaims." The study found that half of the EITC returns prepared by unaffiliated unenrolled preparers contained overclaims, and the overclaim averaged between 33 percent and 40 percent.[18]

In 2002, before these studies were published, the National Taxpayer Advocate began recommending that Congress authorize the IRS to conduct preparer oversight based on her experience in private practice. Her proposal received widespread support from stakeholders and Members of Congress. The Senate Committee on Finance twice approved legislation authorizing preparer oversight on a bipartisan basis under the leadership of Chairman Grassley and Ranking Member Baucus,[19] and on one occasion, the full Senate approved it by unanimous consent.[20] In 2005, the House Ways and Means Subcommittee on Oversight held a hearing at which representatives of five outside organizations expressed general support for preparer oversight.[21]

In 2009, the Commissioner of Internal Revenue concluded that the IRS had the authority under § 330 of Title 31 of the U.S. Code to impose minimum standards without statutory authorization. The IRS initiated an extensive series of hearings and discussions with stakeholder groups to receive comments and develop a system within which all parties believed they could operate.[22] The IRS began to implement the program in 2011, but it was terminated after a U.S. District Court rejected the IRS's legal position, concluding it does not have the authority to impose preparer standards without statutory authorization.[23]

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15 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008).

16 Statement of Jamie Woodward, Acting Commissioner, New York Dept. of Taxation and Finance, before IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009).

17 *Id.*; *see* Tom Herman, *New York Sting Nabs Tax Preparers*, Wall Street Journal (Nov. 26, 2008).

18 IRS Pub. 5162, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 24-26 (Aug. 2014).

19 Tax Administration Good Government Act, H.R. 1528 (incorporating Tax Administration Good Government Act, S. 882), 108th Cong. § 141 (2004); Telephone Excise Tax Repeal Act, S. 1321 (incorporating Taxpayer Protection and Assistance Act, S. 832), 109th Cong. § 203 (2006).

20 Tax Administration Good Government Act, H.R. 1528 (incorporating Tax Administration Good Government Act, S. 882), 108th Cong. § 141 (2004).

21 The organizations were the American Bar Association, the American Institute of Certified Public Accountants (AICPA), the National Association of Enrolled Agents, the National Society of Accountants, and the National Association of Tax Professionals. *See Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 109th Cong. (2005).

22 *See* IRS Pub. 4832, *Return Preparer Review* (Dec. 2009).

23 *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. 2013), *aff'd*, 742 F.3d 1013 (D.C. Cir. 2014).

Since that time, Members of the House and Senate have introduced legislation that would provide the IRS with the statutory authorization to establish and enforce minimum standards. In the Senate, Senators Portman and Cardin sponsored authorizing legislation in 2018.[24] Previously, Senators Wyden and Cardin sponsored authorizing legislation, and Chairman Hatch included language to authorize minimum standards as part of a larger bill designed to combat identity theft and refund fraud.[25] In the House, Congresswoman Black and former Congressman Becerra, both members of the Ways and Means Committee, have sponsored authorizing legislation.[26]

The IRS's evolving "Future State" plan provides an important additional basis for establishing preparer standards. The IRS envisions giving preparers access to taxpayer information through online accounts. The security risks of this plan are significant, and if the IRS proceeds with it, steps must be taken to mitigate the risks. Minimum standards for preparers are one important step. Some have argued that requiring preparers to pass a competency test and take annual continuing education courses would address only the issue of competence and would not ensure preparers conduct themselves ethically. The National Taxpayer Advocate agrees that competency and ethical conduct are distinct issues. However, we think preparer standards would serve to raise ethical conduct as well as competency levels. A preparer who learns enough about tax return preparation to pass a competency test and takes annual continuing education courses would be demonstrating a commitment to return preparation as a profession. As such, the preparer would be more likely to understand and feel like a part of the tax system and would have more to lose if he or she is found to have engaged in misconduct.

In sum, the GAO, TIGTA, and other compliance studies described above suggest that tax returns prepared by non-credentialed preparers are often inaccurate. Minimum standards would directly improve preparer competency levels and are likely to raise ethical norms as well.

Recommendation

Amend Title 31, § 330 of the U.S. Code to authorize the Secretary to establish minimum standards for federal tax return preparers.[27]

24 Protecting Taxpayers Act, S. 3278, 115th Cong. § 202 (2018).

25 *See* Taxpayer Protection and Preparer Proficiency Act, S. 137, 114th Cong. (2015); J. Comm. on Tax'n, *Description of the Chairman's Mark of a Bill to Prevent Identity Theft and Tax Refund Fraud*, JCX-108-15, at 16-21 (2015).

26 *See* Tax Return Preparer Competency Act, H.R. 4141, 114th Cong. § 2 (2015) (Cong. Black) and Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. § 202 (2015) (Cong. Becerra).

27 For legislative language generally consistent with this recommendation, see Taxpayer Protection and Preparer Proficiency Act, S. 137, 114th Cong. (2015) and other bills cited herein.

#5 REQUIRE THAT ELECTRONICALLY PREPARED PAPER TAX RETURNS INCLUDE A SCANNABLE CODE

Present Law

Present Law does not address the treatment of tax returns that are prepared electronically but filed on paper.

Reasons for Change

In recent years, more than 85 percent of individual income tax returns have been submitted electronically. While this percentage is relatively high, almost 20 million returns are still submitted on paper. When the IRS cannot capture the data from a tax return electronically, IRS employees must enter the data from paper-filed returns manually. The manual transcription of millions of lines of return data is expensive, produces transcription errors, and delays return processing.

Scanning technology is available that would allow the IRS to scan paper returns prepared with tax return preparation software and capture the data in an efficient manner. Many states have been using scanning technology for paper-based returns for many years. To allow the IRS to utilize scanning technology, a horizontal or vertical bar code containing the return information would be imprinted on paper copies of a return prepared with tax return preparation software. Upon receiving the paper return, the IRS would scan it, capture the data, decode it, and process the return just as if it had been transmitted electronically.

While scanning technology does not convert taxpayers to e-file, it produces significant advantages over paper filing, including: (1) faster processing of tax returns; (2) more accurate recording of tax return information; and (3) cost savings due to the reduction in manual data transcription. Despite these benefits, the IRS has not fully availed itself of this or similar technology for individual income tax returns. The IRS can achieve savings by working with tax software companies to incorporate scannable bar codes into their individual tax return preparation software. The IRS already provides scanning technology as an option for filers of Schedules K-1 (Form 1065).[28] The IRS is also using character recognition software to capture data on some paper returns. It is unclear whether character recognition software is more accurate than scannable technology in the context of tax return data.

Recommendation

Require the IRS to report to Congress, within 180 days of enactment, on its plans to reduce the monetary costs and transcription errors associated with the processing of individual income tax returns prepared electronically but filed on paper.[29]

28 *See* IRS, *2-D Bar Coding for Schedules K-1 is the Preferred Method*, https://www.irs.gov/e-file-providers/two-dimensional-bar-coding-for-schedules-k-1-is-the-preferred-method (last visited Oct. 23, 2018).

29 For legislative language that would impose this requirement, see Taxpayer First Act of 2018, S. 3246, 115th Cong. § 2104 (2018); *see also* Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals* 227 (Mar. 2014).

#6 CLARIFY THAT IRS EMPLOYEES MAY HELP TAXPAYERS LOCATE A SPECIFIC LOW INCOME TAXPAYER CLINIC

Present Law

Pursuant to IRC § 7526, the IRS may award matching grants for the development, expansion, or continuation of Low Income Taxpayer Clinics (LITCs), subject to the availability of appropriated funds. LITCs are programs that provide representation to low income taxpayers for free or a nominal fee to help them resolve disputes with the IRS.

IRS employees are prohibited from recommending or referring taxpayers to specific attorneys or accountants under Department of the Treasury ethical conduct standards.[30] The Office of Government Ethics' Standards of Ethical Conduct for Employees of the Executive Branch further limit IRS employees' ability to refer taxpayers to representatives.[31]

The IRS publishes a list of LITCs, and employees often refer taxpayers to that publication or to the list available on irs.gov.[32] However, there is no provision in the law that permits IRS employees to provide information about the nearest LITC without violating the applicable standards of conduct.

Reasons for Change

Congress created the LITC grant program so low income taxpayers, who otherwise could not afford representation, could obtain assistance in resolving disputes with the IRS. IRS employees receive training about LITCs and the valuable resources they provide for low income taxpayers. Taxpayers with tax problems often call the IRS for help. In some cases, a taxpayer asks the IRS to provide information about organizations that can provide assistance. In other cases, an IRS employee recognizes on his or her own that a taxpayer would benefit from LITC assistance. The inability of IRS employees to refer taxpayers to a specific LITC undermines the usefulness of the LITC program by impeding—rather than advancing—taxpayer awareness of the program.

Recommendation

Amend IRC § 7526(c), *Special Rules and Limitations,* to clarify that, notwithstanding any other provision of law, IRS employees may refer taxpayers to LITCs receiving funding under this section.[33]

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30 "Employees of the IRS or TIGTA (Treasury Inspector General for Tax Administration) shall not recommend, refer or suggest, specifically or by implication, any attorney, accountant, or firm of attorneys or accountants to any person in connection with any official business which involves or may involve the IRS." Supplemental Standards of Ethical Conduct for Employees of the Department of the Treasury, 5 C.F.R. § 3101.106(a). A Low Income Taxpayer Clinic (LITC) is similar enough to a firm of attorneys or accountants to fall within the scope of the regulation.

31 *See* 5 C.F.R. § 2635.702(c)(1) and 5 C.F.R. § 2635.101(b)(8).

32 *See* IRS Pub. 4134, Low Income Taxpayer Clinic List (Rev. 1-2018), and https://www.irs.gov/advocate/low-income-taxpayer-clinics.

33 For legislative language generally consistent with this recommendation, see Taxpayer First Act, H.R. 5444, 115th Cong. § 14001 (2018); Protecting Taxpayers Act, S. 3278, 115th Cong. § 503 (2018); Taxpayer Protection Act of 2017, H.R. 2171, 115th Cong. § 303 (2017); Taxpayer Protection Act of 2016, H.R. 4912, 114th Cong. § 303 (2016); Taxpayer Protection and Assistance Act of 2007, S. 1219, 110th Cong. § 2(b)(3) (2007); Taxpayer Protection and Assistance Act of 2005, S. 832, 109th Cong. § 2(b)(3) (2005).

#7 EXTEND THE TIME FOR SMALL BUSINESSES TO MAKE SUBCHAPTER S ELECTIONS

Present Law

IRC § 1362(b)(1) provides that small business corporations ("S corporations") may elect to be treated as pass-through entities by submitting Form 2553, *Election by a Small Business Corporation*, at any time during the preceding taxable year or at any time on or before the 15th day of the third month of the current taxable year.

The due date for an S corporation to file Form 1120S, *U.S. Income Tax Return for an S Corporation*, is the 15th day of the third month after the end of its taxable year.

Reasons for Change

Many small business owners are not familiar with the rules governing S corporations, and they learn about the effects of S corporation status for the first time when they hire a tax professional to prepare the corporation's tax return for its first year of operation. By that time, the deadline for electing S corporation status has passed. The failure to make a timely S corporation election can cause significant adverse tax consequences for businesses, such as taxation at the corporate level and the inability to deduct operating losses on shareholders' individual income tax returns.[34] For context, more than 4.8 million S corporation returns were filed in FY 2017, which accounted for about 70 percent of all corporate returns.

Taxpayers may seek permission from the IRS to make a late S corporation election under the provisions of Revenue Procedure 2013-30 or through a private letter ruling (PLR) request. Under the revenue procedure, a corporation that failed to timely file Form 2553 may request relief by filing Form 2553 within three years and 75 days of the date the election is intended to be effective. In addition, the corporation must attach a statement explaining its reasonable cause for failing to timely file the election and its diligent actions to correct the mistake upon its discovery.

Finally, each shareholder, during the period between the date the S corporation election was to have become effective and the date the completed election form is filed, must sign a statement affirming that they have reported their income on all affected returns consistent with the S corporation election for the year the election should have been filed and for all subsequent years. If an entity is unable to comply with the requirements of the revenue procedure, it may request relief through a PLR, for which the IRS charges a user fee ranging from $5,800 to $28,300 per request.

The current S corporation election deadline burdens small businesses by requiring them to pay tax professionals and often IRS user fees to request permission to make a late election. It also burdens shareholders, because when the IRS rejects an S corporation return due to the absence of a timely election, the status of the corporation is affected, and that, in turn, may result in changes on the shareholders' personal tax returns. In addition, the current deadline and relief procedures require a commitment of significant resources on the part of the IRS to process late-election requests.

34 The value of an S corporation election increased for many taxpayers with the passage of Pub. L. No. 115-97 (2017), which generally allows an individual taxpayer to deduct 20 percent of domestic "qualified business income" (QBI) from a pass-through business, including an S corporation, effectively reducing the individual income tax rate on such income by 20 percent. The deduction is subject to certain income thresholds (first $315,000 of QBI for joint filers and $157,500 for single returns), phase-outs for professional services, and limitations based on W-2 wages paid or capital invested by a business owner for larger pass-through entities. *See* Pub. L. No. 115-97, § 11011 (2017); H.R. Rep. No. 115-466, at 205-224 (2017) (Conf. Rep.). Some taxpayers will not realize they must make an S corporation election by March 15, 2018 to obtain the benefits of this provision for taxable year 2018.

Because small business owners often consider the S corporation election for the first time at the end of the taxable year in connection with the preparation of their company's first tax return, the burdens described above would be substantially eliminated if corporations could make an S election on their first timely filed tax return.

Recommendation

Amend IRC § 1362(b)(1) to allow a small business corporation to elect to be treated as an S corporation by checking a box on its first timely filed (including extensions) Form 1120S, *U.S. Income Tax Return for an S Corporation*.[35]

35 For legislative language generally consistent with this recommendation, see Protecting Taxpayers Act, S. 3278, 115th Cong. § 304 (2018); S Corporation Modernization Act of 2017, S. 711 and H.R. 1696, 115th. Cong. § 7 (2017).

#8 REQUIRE EMPLOYERS FILING MORE THAN FIVE FORMS W-2, 1099-MISC, AND 941 TO SUBMIT THEM ELECTRONICALLY

Present Law

IRC § 6011(e)(1) authorizes the IRS to issue regulations that provide standards for determining which returns must be filed on magnetic media or in other machine-readable form. IRC § 6011(e)(2) provides that when issuing regulations, the IRS cannot require any person to file returns on magnetic media unless the person is required to file at least 250 returns during the calendar year, except that partnerships having more than 100 partners must file returns on magnetic media. The term "person" is broadly defined to include "an individual, a trust, estate, partnership, association, company or corporation."[36]

Treasury regulations provide that taxpayers must file IRS Forms W-2, *Wage and Tax Statement*, and 1099-MISC, *Miscellaneous Income*, electronically when they file 250 or more information returns.[37] "[T]he 250-threshold applies separately to each type of form required to be filed."[38] Taxpayers may request waivers of the electronic filing requirement if they cannot comply due to technological constraints or if compliance with the requirement would result in undue financial burden.[39]

Every employer is generally required to make a return on Form 941, *Employer's Quarterly Federal Tax Return*, for the first calendar quarter in which the employer pays wages subject to the tax imposed by the Federal Insurance Contributions Act and for each subsequent quarter (whether or not wages are paid therein) until the employer has filed a final return.[40] Employers report the number of employees, total wages paid, and federal income tax withheld from employees' wages in the aggregate. Employers are not required to provide an employee-specific breakout of this information.[41] Employers are not required to file Forms 941 electronically but can do so voluntarily.[42] In contrast, a corporation required to file a corporate income tax return is required to file Form 1120, *U.S. Corporation Income Tax Return*, electronically if it files at least 250 required returns of any type during the calendar year in the aggregate (including Forms W-2, 1099-MISC, and 941).[43]

Reasons for Change

Increasing the electronic filing of information returns and requiring the electronic filing of Forms 941 with a breakdown of the amounts reported by employee would significantly benefit taxpayers and the IRS in several ways.

First: Effective data matching is an indispensable tool in the IRS's battle to combat identity theft (IDT) and refund fraud. Requiring employers to provide each employee's name, address, Social Security number (SSN),

36 IRC § 7701(a)(1). *See also* Treas. Reg. § 301.6011-2(a)(3).

37 Treas. Reg. § 301.6011-2(c)(1)(i).

38 Treas. Reg. § 301.6011-2(c)(1)(iii).

39 *See* IRS Pub. 8508, *Request for Waiver from Filing Information Returns Electronically* (Rev. 9-2017).

40 Treas. Reg. § 31.6011(a)-1(a)(1). *See* Treas. Reg. § 31.6011(a) -1(a)(2) through (5) for details about when an employer must use something other than Form 941.

41 Although the final version of Pub. L. No. 115-97 (2017) did not include a provision modifying the reporting requirements of Form 941, a proposal to include the name, address, and wages of each employee was included in the version of the tax reform bill approved by the House. *See* H.R. Rep. No. 115-409, at 142-144 (2017). *See also* H.R. Rep. No. 115-466, at 235 (2017) (Conf. Rep.).

42 See https://www.irs.gov/businesses/small-businesses-self-employed/e-file-form-940-941-or-944-for-small-businesses (last visited Oct. 4, 2018).

43 Treas. Reg. § 301.6011-5(a)(1) and (d)(5).

and wages on a quarterly basis on an electronically filed Form 941 would allow the IRS an opportunity to gather information for purposes of data matching in advance of the filing season.

The earlier availability of Forms W-2 and 1099-MISC via electronic filing also would provide the IRS with real-time data on wages and withholding, without the delays and errors associated with transcribing data from paper-filed forms. When the IRS is able to receive and process information about a taxpayer's wages and withholding before it processes the taxpayer's tax return, the IRS can match the data on the tax return with the data reported on the information returns before paying a refund. If there are significant disparities, the IRS can review the tax return more carefully. Similarly, the IRS could more quickly match wages and withholding reported on information returns against the employer's Forms 941. From the government's perspective, data matching reduces the revenue loss associated with unpaid employment taxes, improper payments, and stolen refunds. From the taxpayer's perspective, the IRS helps the legitimate taxpayer either avoid a refund delay or resolve a delay more quickly by spotting an IDT return before a refund is paid.

The potential benefits of earlier access to taxpayers' wages and withholding information are significant because of the magnitude of the IDT problem. The IRS estimates at least $12.24 billion in IDT tax refund fraud was attempted in calendar year 2016. It estimates it prevented at least $10.56 billion (86 percent) but paid at least $1.68 billion (14 percent). Business IDT is a growing subset of the IDT problem. The IRS handled nearly three times as many business IDT cases in 2017 as it did in 2016, an increase of more than 10,000 cases. Yet in 2017, less than half of Forms 941 were filed electronically. Greater electronic filing of Forms 941 would allow the IRS to match Form 941 data against Form W-2 and Form 1099-MISC data to identify instances of potential business IDT fraud.

Second: Data submitted on paper returns must be manually entered into Social Security Administration (SSA) or IRS computer systems, and manual data entry necessarily produces transcription errors. When a transcription error on an information return or on an employer's Form 941 occurs, the IRS's document matching process will identify a disparity that may delay a refund or initiate an erroneous adjustment notice, causing needless hassle for the taxpayer and unnecessary work for the IRS.

Third: Manual data entry of information returns is much more expensive than electronic data processing. According to SSA estimates, the cost to transcribe and process 24.2 million paper W-2s in 2016 was about $13.3 million, or $0.55 per paper W-2. SSA officials estimated that lowering the W-2 paper filing requirement to ten or fewer W-2s would save the SSA between $9.7 and $11.3 million per year.[44]

The current threshold of 250 returns that triggers the requirement for electronic filing was established in 1989.[45] The electronic filing requirement applies to Form 1120, *U.S. Corporation Income Tax Return*, if a corporation files at least 250 required returns of any type during the calendar year in the aggregate (including Forms W-2, 1099-MISC, and 941). Considering the significant advances in technology and digital capability that have taken place since that time, the National Taxpayer Advocate believes the threshold should be reduced substantially.

There are some employers for whom an electronic filing requirement would impose disproportionate burden. For example, an elderly individual who pays one or several health aides and must file Forms W-2 may not have

44 *See* GAO, GAO-18-224, *Tax Fraud and Noncompliance: IRS Can Strengthen Pre-Refund Verification and Explore More Uses* (Jan. 30, 2018).

45 Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7713, 103 Stat. 2106, 2394 (1989) (codified as amended at 26 U.S.C. § 6011).

the technological skills to file electronically without help. A threshold of five avoids burdening very small employers.

We note that the SSA has a fillable Form W-2 available on its website that employers can use to submit Forms W-2 electronically at no cost.[46] The IRS should develop a similar fillable Form 941, *Employer's Quarterly Federal Tax Return*, and a fillable Form 1099-MISC, *Miscellaneous Income,* for small businesses that may not have access to tax software to electronically file. By developing fillable forms and thereby making it easier for businesses to file electronically, the IRS will be in a better position to protect revenue by identifying and resolving inaccurate reporting at the time of return filing and preventing the release of improper refunds.

Recommendations

Amend IRC § 6011(e)(2), *Requirements of Regulations*, to require employers with more than five employees to electronically file Forms W-2 and Forms 941, and require payers who issue more than five Forms 1099-MISC with non-employee compensation to electronically file Forms 1099-MISC.[47]

Amend IRC § 6011 to require that Form 941 contain information about each employee's name, address, SSN, and wages.

To promote electronic filing, direct the IRS to create fillable Forms 941 and Forms 1099-MISC that can be electronically filed, at no cost, directly from the irs.gov website.[48]

46 See https://www.ssa.gov/employer/what.htm (last visited Dec. 1, 2018).

47 For legislative language generally consistent with our recommendation to reduce the mandatory e-file thresholds, see Taxpayer First Act, H.R. 5444, 115th Cong. § 18401 (2018); Taxpayer First Act of 2018, S. 3246, 115th Cong. § 2102 (2018).

48 For legislative language generally consistent with our recommendation to create an Internet platform for filing Forms 1099, see Taxpayer First Act, H.R. 5444, 115th Cong. § 18203 (2018); Taxpayer First Act of 2018, S. 3246, 115th Cong. § 2103 (2018).

#9 AUTHORIZE THE TREASURY DEPARTMENT TO RECOVER MISDIRECTED DEPOSITS OF TAX REFUNDS AND PAY THEM TO THE CORRECT TAXPAYERS

Present Law

The IRC does not currently authorize procedures through which the IRS may obtain information about an account holder who receives a misdirected direct deposit refund. The IRS has erroneous refund procedures to recover a direct deposit that has been applied to the wrong taxpayer's bank account due to IRS error.[49] An erroneous refund is defined as "the receipt of any money from the Service to which the recipient is not entitled."[50] However, the IRS may not use its erroneous refund procedures to recover a refund if it does not know the identity of the account owner.

Existing regulations provide that when federal payments (other than vendor payments) are deposited, the account at the financial institution shall be in the name of the recipient.[51] However, financial institutions are not required to verify whether the name on the designated account matches the name of the depositor/taxpayer,[52] and the IRS has no authority to take money out of the incorrect account or receive confidential information from the financial institution regarding the owner of the incorrect account.

The relevant guidelines provide, in part: "If the taxpayer or the taxpayer's agent gave incorrect account information, neither Fiscal Service nor IRS will assist the taxpayer with recovering the funds."[53]

Reasons for Change

When a taxpayer or a preparer requests a tax refund via direct deposit, the taxpayer or preparer must enter the bank routing number and the taxpayer's account number on the return. Bank routing numbers are nine digits, and bank account numbers vary in length but generally are comparable. When entering roughly 18 digits, transcription errors sometimes happen. As a result, tax refunds are sometimes erroneously directed into the account of an unrelated third party. In a small number of cases, moreover, dishonest tax return preparers change the routing information on a return and the taxpayer's refund is deposited into the preparer's account.

There currently are no procedures that allow the IRS to recover a misdirected direct deposit and reissue it to the correct taxpayer. Thus, the IRS can do little more than contact the financial institution and ask that it attempt to persuade the incorrect account owner to return the misdirected funds. While the financial institution is required to take corrective action when the mistake is its own, it is generally not required to take action if the mistake is made by the taxpayer.[54] As a result, a taxpayer may lose his tax refund in entirety if he or his preparer inadvertently enters a wrong digit. This is an unacceptable and avoidable outcome.

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49 *See* IRM 21.4.5.5.5, *Overview of Category D Erroneous Refunds* (Oct. 1, 2016).

50 *See* IRM 21.4.5.2, *Erroneous Refunds Overview* (Oct. 9, 2015).

51 31 C.F.R. § 210.5(a).

52 "It is important to note that [a financial institution] is not required to manually verify that the name on the [Automated Clearing House (ACH)] entry matches the name on the account at the time the payment is posted." Bureau of the Fiscal Service (BFS), Green Book: *A Guide to Federal Government ACH Payments* 2-6 (Rev. May 2013), https://www.fiscal.treasury.gov/fsreports/ref/greenBook/pdf/greenbookchapter2.pdf.

53 BFS, Green Book: *A Guide to Federal Government ACH Payments* 1-9 (Rev. May 2013), https://fiscal.treasury.gov/fsreports/ref/greenBook/pdf/greenbookchapter1.pdf.

54 *See* 31 C.F.R. § 210.8(d) (providing that if a financial institution becomes aware that an agency has originated an Automated Clearing House credit entry to an account that is not owned by the payee whose name appears in the ACH payment information, the financial institution shall promptly notify the agency).

By contrast, a taxpayer has substantially greater recourse if he requests that his refund be paid by paper check. If a taxpayer elects to receive his refund by check and the check does not arrive, the taxpayer may notify the IRS, and the Treasury Department's Bureau of the Fiscal Service (BFS, formerly Financial Management Service) will determine whether the check has been negotiated. If it has not been negotiated, BFS will issue a replacement check to the taxpayer. If BFS finds the paper check has been negotiated, it will conduct additional research and, if it determines the taxpayer was not involved in negotiation of the check, it will issue a replacement to the taxpayer and charge the Check Forgery Insurance Fund.[55]

Current procedures providing recourse for taxpayers who elect to receive their tax refunds by check but not for taxpayers who elect to receive their tax refunds electronically make little sense. Direct deposit is a faster, more secure, and less expensive way of transmitting refunds than paper checks, and for those reasons, the IRS strongly encourages taxpayers to elect to receive their refunds in that way. The current procedures undermine the IRS's objective by providing a strong incentive for taxpayers to elect to receive their refunds by check.

One way to remedy a misdirected deposit is to grant the Treasury Department the authority to recover the mistakenly directed deposit from the bank and post the funds to the correct taxpayer's account. More specifically, when the BFS makes a direct deposit to a bank, the transmittal information would include both the taxpayer's name and account number. The bank would be required to verify that the account number into which the funds are deposited matches the taxpayer's name. If the bank does not do so, the BFS could require the bank to return the funds and the BFS could then issue the refund to the taxpayer.

Recommendation

Require financial institutions to verify that the name of the taxpayer matches the name on the account prior to processing a federal payment via the Automated Clearing House network.[56] If a financial institution fails to match the taxpayer's name with the name on the account, the Bureau of the Fiscal Service shall have the authority to demand that the financial institution return the funds, and shall use those funds to make the taxpayer whole for any loss sustained as a result of the institution's failure to conduct the name-matching.[57]

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55 *See* 31 U.S.C. § 3343. Once it is determined a refund check has been cashed and the BFS determines whether or not the payee endorsed the check, BFS may issue a replacement check or, when appropriate, may issue a denial letter. IRM 21.4.2.4.13 (Jan. 13, 2016).

56 There may be circumstances in which financial institutions cannot precisely match an account number with a taxpayer name. For example, if the guardian of an incapacitated taxpayer files a return and receives a refund, the refund may be directed to the taxpayer, but the account may be titled in the name of the guardian "for the benefit of" the taxpayer. Therefore, it may be necessary for Congress to provide the Secretary with flexibility to provide exceptions from the matching rule, where warranted.

57 This recommendation may fall within the jurisdiction of the banking committees (Senate Committee on Banking, Housing, and Urban Affairs; House Committee on Financial Services). For legislative language generally consistent with this recommendation but taking a different approach, see Protecting Taxpayers Act, S. 3278, 115th Cong. § 203 (2018).

#10 TREAT ELECTRONICALLY SUBMITTED TAX PAYMENTS AS TIMELY IF SUBMITTED BEFORE THE APPLICABLE DEADLINE

Present Law

IRC § 7502(a)(1) provides that if certain requirements are satisfied, a document or payment is deemed to be filed or paid on the date of the postmark stamped on the envelope. If the postmark date is on or before the last day of the period prescribed for filing the document or making the payment, the document or payment is considered timely filed or paid, even if it is received after the due date.

IRC § 7502(b) and (c) provide that this timely mailed/timely filed rule (commonly known as the "mailbox rule") applies to documents sent by U.S. postal mail, private delivery services, and electronic filing through an electronic return transmitter. The Secretary is authorized to promulgate regulations describing the extent to which the mailbox rule shall apply to certified mail and electronic filing.[58] To date, the only regulations the Secretary has promulgated relating to electronically filed documents cover documents filed with an electronic return transmitter.[59]

Reasons for Change

The statutory mailbox rule in IRC § 7502 does not apply to the electronic transmission of payments to the IRS. In addition, the mailbox rule does not apply to the electronic filing of time-sensitive documents (except documents filed electronically with an electronic return transmitter).[60] If the IRS does not receive an electronically submitted document (including a facsimile transmission) or payment until after the due date, the document or payment is considered late, even if the taxpayer can produce a confirmation that they transmitted the payment or document before the due date. The comparatively unfavorable treatment of electronically submitted documents and payments undermines the IRS's efforts to encourage greater use of digital services and creates additional cost and burden for taxpayers and the IRS alike.

Along similar lines, the IRS encourages U.S. taxpayers to make payments electronically using the Treasury Department's Electronic Federal Tax Payment System (EFTPS). However, the EFTPS website displays the following warning: "Payments using this Web site or our voice response system must be scheduled by **8 p.m. ET the day before the due date** to be received timely by the IRS. The funds will move out of your banking account on the date you select for settlement"[61] (emphasis in original). This limitation applies to all payments.

Example: If a taxpayer owes a balance due on April 15 and mails the payment to the IRS before midnight on April 15, the payment will be considered timely, even though it will probably take about a week until the IRS receives, opens, and processes the check. If the same taxpayer submits the payment on EFTPS, the payment will be considered late if submitted after 8:00 p.m. on April 14 (28 hours earlier), even though the payment would be debited from the taxpayer's account on April 16—about one week earlier than if submitted by mail.

This disparity in the treatment of mailed and electronically submitted payments makes little sense. As compared with a mailed check, an electronic payment is received more quickly, is cheaper to process, and eliminates the risk that a mailed check will be lost or misplaced. Yet, rather than encouraging taxpayers to use EFTPS, the relative deadlines serve as a deterrence.

58 IRC § 7502(c)(2).

59 Treas. Reg. § 301.7502-1(d).

60 See Treas. Reg. § 301.7502-1(d)(3)(i) for a definition of an electronic return transmitter. See also Rev. Proc. 2007-40, 2007-1 C.B. 1488, for a list of documents that can be filed electronically with an electronic return transmitter.

61 *See* www.eftps.gov (last visited Oct. 23, 2018).

Recommendation

Amend IRC § 7502 to direct the Secretary to issue regulations that apply the mailbox rule comparably to documents and payments submitted by a taxpayer regardless of whether they are submitted electronically or by mail.

#11 ADJUST ESTIMATED TAX PAYMENT DEADLINES TO OCCUR QUARTERLY

Present Law

Under IRC § 6654(c)(2), taxpayers are required to make estimated tax payments in four required installments on the following dates: April 15, June 15, September 15, and January 15.

Reasons for Change

Although estimated tax installment payments are sometimes referred to as "quarterly payments," they do not coincide with calendar-year quarters. Nor are the payment dates evenly spaced. The April 15 and June 15 installments are due two months apart; the June 15 and September 15 installments are due three months apart; the September 15 and January 15 installments are due four months apart; and the January 15 and April 15 installments are due three months apart.

These dates are not intuitive and create compliance burdens. Small business owners and self-employed taxpayers are disproportionately affected by the estimated tax rules because their incomes generally are not subject to wage withholding. Yet, small businesses are far more likely to keep their books on the basis of regular three-month quarters than on the basis of the seemingly random intervals prescribed by IRC § 6654. These uneven intervals make it more difficult for many taxpayers to calculate net income and save appropriately to make payments. They also cause confusion, as taxpayers struggle to remember the due dates. This confusion affects traditionally self-employed workers as well as workers in the gig economy.

Setting due dates to fall 15 days after the end of each calendar quarter would be substantially easier for taxpayers to remember and comply with.

Recommendation

Amend IRC § 6654(c)(2) to set the estimated tax installment deadlines on April 15, July 15, October 15, and January 15.[62]

62 For legislative language generally consistent with this recommendation, see Protecting Taxpayers Act, S. 3278, 115th Cong. § 305 (2018); Small Business Owners' Tax Simplification Act, H.R. 3717, 115th Cong. § 2 (2017).

#12 HARMONIZE REPORTING REQUIREMENTS FOR TAXPAYERS SUBJECT TO BOTH FBAR AND FATCA BY ELIMINATING DUPLICATION AND EXCLUDING ACCOUNTS A U.S. PERSON MAINTAINS IN THE COUNTRY WHERE HE OR SHE IS A *BONA FIDE* RESIDENT

Present Law

The Currency and Foreign Transaction Reporting Act of 1970 (commonly known as the Bank Secrecy Act) requires U.S. citizens and residents to report any foreign account with an aggregate value of $10,000 or more at any time during the calendar year on FinCEN Report 114, *Report of Foreign Bank and Financial Accounts* (FBAR).[63]

The Foreign Account Tax Compliance Act (FATCA)[64] added IRC § 6038D, which requires U.S. citizens, resident aliens, and certain non-resident aliens to file Form 8938, *Statement of Specified Foreign Financial Assets*, with their federal income tax returns to report foreign assets exceeding specified thresholds. As codified by FATCA, IRC §§ 1471-1474 provide that foreign financial institutions (FFIs) that do not register with the IRS and agree to report certain information about their "United States accounts,"[65] including accounts held by U.S. persons and accounts of certain foreign entities with substantial U.S. owners, are subject to a 30 percent withholding tax on certain U.S. source payments they receive.

IRC § 1471(d)(1) authorizes the IRS to issue regulations to eliminate duplicative reporting requirements. IRC § 6038D similarly authorizes the IRS to issue regulations or other guidance to provide appropriate exceptions from FATCA reporting when such reporting would be duplicative of other disclosures.

Reasons for Change

Many U.S. taxpayers, particularly those living abroad, face increased compliance burdens and costs as a result of FATCA reporting obligations that significantly overlap with the FBAR filing requirements.[66] The IRS has exercised its regulatory authority to eliminate duplicative reporting of assets on Form 8938 if an asset is reported or reflected on certain other timely filed international information returns (*e.g.*, Forms 3520, 3520A, 5471, 8621, 8865, or 8891).[67] It has also provided an exception from the reporting rules for financial accounts held in U.S. territories for *bona fide* residents of such territories.[68]

However, the IRS has repeatedly declined to adopt the recommendations of the National Taxpayer Advocate and supported by other stakeholders, including the Government Accountability Office, to eliminate duplicative FATCA reporting where assets have already been reported on an FBAR[69] and to provide a same-country exception for reporting financial accounts held in the country in which a U.S. taxpayer is a *bona fide* resident. The recommendations, if adopted, would reduce the compliance burdens on U.S. taxpayers, who now must file complex, additional forms themselves or pay higher tax return preparation fees. They would also reduce the compliance burdens on FFIs, some of which are declining to do business with U.S. expatriates because of the significant costs and regulatory risks associated with ongoing FATCA compliance. In addition,

63 *See* 31 U.S.C. § 5314(b)(3) and 31 C.F.R. § 1010.306(c).

64 Pub. L. No. 111-147, Title V, Subtitle A, 124 Stat. 71, 97 (2010).

65 *See* IRC § 1471(d)(1) for a definition of "United States account."

66 IRS, *Comparison of Form 8938 and FBAR Requirements*, http://www.irs.gov/Businesses/Comparison-of-Form-8938-and-FBAR-Requirements.

67 Treas. Reg. § 1.6038D-7(a)(1).

68 Treas. Reg. § 1.6038D-7(c).

69 *See, e.g.*, GAO, GAO-12-403, *Reporting Foreign Accounts to the IRS: Extent of Duplication Not Currently Known, but Requirements Can Be Clarified* (Feb. 2012).

the unwillingness of certain FFIs to do business with U.S. expatriates makes it difficult for U.S. citizens to open bank accounts in some countries.

Recommendations

Amend IRC § 6038D (i) to eliminate duplicative reporting of assets on Form 8938, *Statement of Specified Foreign Financial Assets,* where an asset is or has been reported or reflected on an FBAR and (ii) to exclude financial accounts maintained by a financial institution organized under the laws of the country of which the subject U.S. person is a *bona fide* resident from the specified foreign financial assets required to be reported on Form 8938.

Amend IRC § 1471 to exclude financial accounts maintained by a financial institution organized under the laws of the country of which the subject U.S. person is a *bona fide* resident from the definition of "financial account" subject to reporting by FFIs.[70]

70 For additional information on the National Taxpayer Advocate's recommendations, see National Taxpayer Advocate 2015 Annual Report to Congress 353-363 (Legislative Recommendation: *Foreign Account Reporting: Eliminate Duplicative Reporting of Certain Foreign Financial Assets and Adopt a Same-Country Exception for Reporting Financial Assets Held in the Country in Which a U.S. Taxpayer Is a Bona Fide Resident*).