

## Improve the Filing Process

### #5 AUTHORIZE THE VOLUNTEER INCOME TAX ASSISTANCE (VITA) GRANT PROGRAM

#### Present Law

The IRS currently administers two major programs that provide free or low-cost assistance to lower income U.S. taxpayers. The Volunteer Income Tax Assistance (VITA) program assists 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 assist low income taxpayers in their controversies with the IRS, such as in audit and collection actions. (A third program, Tax Counseling for the Elderly (TCE), is similar to the 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.)

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.<sup>33</sup>

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

<sup>33</sup> See, e.g., Consolidated Appropriations Act, 2008, Pub. L. No. 110-161, 121 Stat. 1844, 1976 (2007); Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, 129 Stat. 2242, 2428 (2015). 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*.

**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 common but currently designated as “out-of-scope.”<sup>34</sup>

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34 H.R. 2901, 115th Cong. § 2 (2017); S. 3156, 114th Cong. § 111 (2016); S. 2333 and H.R. 4128, 114th Cong. § 201 (2015); and H.R. 5719, 110th Cong. § 7 (2008) are generally consistent with this recommendation.

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

### Present Law

The IRS currently 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. 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 in order to prepare returns as part of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs. But the majority of preparers are non-credentialed.

### Reasons for Change

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 attorneys, doctors, financial planners, actuaries, appraisers, contractors, motor vehicle operators, and even barbers and beauticians to obtain licenses or certifications, and in most cases, they are required to pass a competency test first. 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, the 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 10 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.<sup>35</sup>

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.<sup>36</sup>

**Treasurer Inspector General for Tax Administration (TIGTA).**<sup>37</sup> 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 the 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 returns involving EITC claims, *none* of the preparers exercised appropriate due diligence as required under IRC § 6695(g).

35 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).

36 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).

37 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).

**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.”<sup>38</sup> 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.<sup>39</sup>

**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 of the amount claimed on the return.<sup>40</sup>

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,<sup>41</sup> and on one occasion, the full Senate approved it by unanimous consent.<sup>42</sup> 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.<sup>43</sup>

In 2009, the Commissioner of Internal Revenue concluded that the IRS had the authority under section 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.<sup>44</sup> 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 legislation.<sup>45</sup>

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 House, Congresswoman Black and former Congressman Becerra, both members of the Ways and Means Committee, have sponsored authorizing legislation.<sup>46</sup> In the Senate, Senators Wyden and Cardin sponsored legislation, and Chairman

38 Statement of Jamie Woodward, Acting Commissioner, New York Dept. of Taxation and Finance, before IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009), [http://ftp.irs.gov/pub/irs-utl/ny\\_department\\_of\\_tax\\_statement.pdf](http://ftp.irs.gov/pub/irs-utl/ny_department_of_tax_statement.pdf) (last visited Oct. 18, 2009).

39 *Id.*; see Tom Herman, *New York Sting Nabs Tax Preparers*, WSJ (Nov. 26, 2008).

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

41 H.R. 1528 (incorporating S. 882), 108th Cong. § 141 (2004); S. 1321 (incorporating S. 832), 109th Cong. § 203 (2006).

42 H.R. 1528 (incorporating S. 882), 108th Cong. § 141 (2004).

43 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).

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

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

46 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). Cong. Becerra has since retired from Congress.

Hatch included language to authorize minimum standards as part of a larger bill designed to combat identity theft and refund fraud.<sup>47</sup>

Despite broad, bipartisan support for preparer standards, the American Institute of CPAs (AICPA) has opposed the bill<sup>48</sup> and, to date, the legislation has not advanced. The National Taxpayer Advocate believes the AICPA's concerns are partly misplaced and partly easy to address. Its main concern is about “marketplace confusion” — a sense that uninformed taxpayers will not be able to distinguish between a preparer who passes a simple competency test and a CPA with extensive training and knowledge, potentially leading some taxpayers who otherwise would engage the services of a CPA to go to a non-credentialed preparer instead.

First, we are not convinced taxpayers will generally be confused. Members of other organizations, notably the National Association of Enrolled Agents (NAEA), also hold credentials that could be “devalued” by marketplace confusion, yet the NAEA has made the calculation that enhanced preparer oversight would be beneficial. Second, to the extent some taxpayers may be confused, we agree that the IRS can and should take additional steps to clarify the differences among categories of preparers to assist the public in making informed decisions. Third, we note that the most significant requirements of the oversight rules the IRS adopted — passing a competency test and taking annual continuing education courses — do not apply to CPAs, attorneys, or enrolled agents. The burden of passing the competency test and satisfying new continuing education requirements would fall exclusively on non-credentialed preparers.

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 this plan, 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 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 would help to raise ethical norms as well.

### Recommendation

Amend title 31, section 330 of the U.S. Code to authorize the Secretary to establish minimum standards for federal tax return preparers.

47 See 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).

48 Letter from Chair, AICPA Tax Executive Committee to the Chairman and Ranking Member of the Senate Committee on Finance (Sept. 15, 2015) (opposing the provision in Chairman Hatch's mark that would authorize preparer oversight); Letter from Chair, AICPA Tax Executive Committee to the Chairman and Ranking Member of the House Committee on Ways and Means (Dec. 4, 2015) (opposing Congresswoman Black's bill).

## #7 REQUIRE THE IRS TO UTILIZE SCANNABLE CODE OR SIMILAR TECHNOLOGY TO PROCESS INDIVIDUAL INCOME TAX RETURNS PREPARED ELECTRONICALLY BUT FILED ON PAPER

### 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. Of those submitted on paper, millions are prepared electronically using tax software. When the IRS cannot capture the tax return information 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 and capture the data in an efficient manner. Many states use scanning technology for paper-based returns. To allow the IRS to utilize scanning technology, a taxpayer or preparer would use tax return preparation software to complete the return. When the return is printed, a horizontal or vertical bar code containing the return information is imprinted on the paper. The IRS scans the return, captures the data, decodes it, and processes the return 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 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).<sup>49</sup> 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.<sup>50</sup>

49 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 Dec. 22, 2017).

50 For similar recommendations, see Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals* 227 (Mar. 2014); S. 2736, 113th Cong. § 4 (2014), which require taxpayers who paper file electronically prepared tax returns to print their returns with a scannable 2-D bar code.

## #8 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 assist them in resolving disputes with the IRS.

The Supplemental Standards of Ethical Conduct for Employees of the Department of the Treasury prohibit IRS employees from recommending or referring taxpayers to specific attorneys or accountants.<sup>51</sup> 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.<sup>52</sup>

The IRS publishes a list of LITCs, and employees often refer taxpayers to that publication or to the list available on [www.irs.gov](http://www.irs.gov);<sup>53</sup> 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 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, they are asked by a taxpayer if they can identify 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.<sup>54</sup>

51 “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.” 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.

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

53 See IRS Pub. 4134, *Low Income Taxpayer Clinic List* (Rev. 7-2017), and <https://www.irs.gov/advocate/low-income-taxpayer-clinics>.

54 There have been numerous similar proposals introduced in Congress over the last 15 years. See, e.g., Taxpayer Protection Act of 2016, H.R. 4912 114th Cong. § 303 (2016) (introduced in the House); Taxpayer Protection and Assistance Act of 2007, S. 1219, 110th Cong. § 2(b)(3) (2007) (introduced in the Senate); Taxpayer Protection and Assistance Act of 2005, S. 832, 109th Cong. § 2(b)(3) (2005) (introduced in the Senate).

## #9 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 flow-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.<sup>55</sup> For context, more than 4.8 million S corporation returns were filed in FY 2016, which accounted for about 69 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 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 the S corporation return for the lack of 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.

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

<sup>55</sup> Having a valid S corporation election became even more important 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 S corporations, 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 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.). Taxpayers may not understand that they have to make an S corporation election by March 15, 2018 in order for this provision to apply for taxable year 2018.

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*.<sup>56</sup>

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<sup>56</sup> For language that is generally consistent with this recommendation, see S Corporation Modernization Act of 2017, S. 711 and H.R. 1696, 115th. Cong. § 7 (2017).

## #10 REQUIRE EMPLOYERS FILING MORE THAN FIVE FORMS W-2, 1099-MISC, AND 941 TO FILE ELECTRONICALLY AND PROVIDE A BREAKDOWN BY EMPLOYEE OF THE AMOUNTS REPORTED ON FORM 941

### 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.”<sup>57</sup> Under Treasury regulations, 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.<sup>58</sup> “[T]he 250-threshold applies separately to each type of form required to be filed.”<sup>59</sup> 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.<sup>60</sup>

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.<sup>61</sup> 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.<sup>62</sup> Employers currently are not required to file Forms 941 electronically but can do so voluntarily.<sup>63</sup> In contrast, a corporation required to file a corporate income tax return must 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).<sup>64</sup>

### 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),

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

58 Treas. Reg. § 301.6011-2(c)(1)(i).

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

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

61 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.

62 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.).

63 See <https://www.irs.gov/businesses/small-businesses-self-employed/e-file-form-940-941-or-944-for-small-businesses> (last visited Dec. 28, 2017).

64 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 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 information about a taxpayer's wages and withholding is processed before the IRS processes a taxpayer's tax return, the IRS can match the data on the tax return with the data reported on the information returns. If there are significant disparities, the IRS can review the tax return more carefully before paying a refund. 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 that at least \$14.59 billion in IDT tax refund fraud was attempted in calendar year 2015. It estimates that it prevented at least \$12.35 billion (85 percent) but paid at least \$2.24 billion (15 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. For example, the SSA reports a cost of \$0.53 to process each paper Form W-2, as compared with a cost of \$0.002 for each electronically filed Form W-2.<sup>65</sup>

The current threshold of 250 returns that triggers the requirement for electronic filing was established in 1989.<sup>66</sup> 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). In light of 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 still some employers for whom an electronic filing requirement would impose disproportionate burden. An elderly individual who pays one or several health aides and is required to file Form W-2s may not have the technological skills to file electronically without help. But a threshold of five should provide most of the benefits of electronic submission of these forms without imposing undue burden on very small employers.

65 See GAO, GAO-14-633, *Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud* (Oct. 20, 2014).

66 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).

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.<sup>67</sup> The IRS should develop a similar fillable Form 941, *Employer's Quarterly Federal Tax Return*, and a fillable Form 1099-MISC for those small businesses that may not have access to tax software to electronically file. By doing so and making it easier for businesses to file electronically, the IRS will then 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 payors who issue more than five Forms 1099-MISC with nonemployee compensation to electronically file Forms 1099-MISC.<sup>68</sup>

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.

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<sup>67</sup> See [www.ssa.gov/employer/what.htm](http://www.ssa.gov/employer/what.htm) (last visited Dec. 1, 2017).

<sup>68</sup> In 2016, Senator Hatch introduced a bill proposing a staggered reduction over five years of the 250 return threshold triggering the requirement for electronic filing. Stolen Identity Refund Fraud Prevention Act, S. 3157, 114th Cong. § 203 (2016). Under the terms of the bill, for calendar years after 2022, electronic filing would be required if the person was required to file at least 20 returns during the calendar year.

## #11 AUTHORIZE THE IRS TO WORK WITH FINANCIAL INSTITUTIONS TO REVERSE MISDIRECTED DEPOSITS

### Present Law

Title 12, United States Code, § 3402 generally bars government authorities from accessing financial information of any customer from a financial institution unless the records are reasonably described and are disclosed as enumerated in 12 U.S.C. §§ 3404 through 3408, which include customer authorizations, administrative subpoena or summons, search warrants, judicial subpoenas, or formal written requests. Section 3402 also provides for limited exceptions, one of which includes 12 U.S.C. § 3413. Section 3413(c) provides that “[n]othing in this chapter prohibits disclosure of financial records in accordance with procedures authorized by [the IRC].” The IRC does not currently include procedures through which the IRS can 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.<sup>69</sup> An erroneous refund is defined as “the receipt of any money from the Service to which the recipient is not entitled.”<sup>70</sup> However, the IRS may not use its erroneous refund procedures to recover the refund (assess and collect it) if it does not know the identity of the account owner.

### Reasons for Change

Every year, some taxpayers who request that their tax refunds be paid through direct deposit place the wrong bank account or routing number on their tax returns. As a result, the refund is sometimes deposited into the account of an unrelated third party. In a small number of cases, 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. Existing regulations provide the general rule that when federal payments (other than vendor payments) are deposited, the account at the financial institution shall be in the name of the recipient.<sup>71</sup> However, financial institutions are not required to verify whether the name on the designated account matches the name of the depositor/taxpayer,<sup>72</sup> 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 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.<sup>73</sup> As a result, a taxpayer who enters a wrong digit may lose his tax refund in entirety.

For this reason, a taxpayer has 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

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

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

71 31 C.F.R. § 210.5(a).

72 “It is important to note that [a financial institution] is not required to manually verify that the name on the [Automated Clearing House] 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>.

73 See 31 CFR § 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).

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.<sup>74</sup>

By contrast, taxpayers who elect to receive their refunds by direct deposit have no such support. BFS guidelines state, 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, and the taxpayer is free to pursue civil action."<sup>75</sup>

Despite its efforts to persuade taxpayers to elect to receive their refunds via direct deposit, the IRS has insufficient procedures for replacing misdirected direct deposit refunds. As a result, taxpayers who elect to receive their refunds electronically have no backstop if they make a mistake (or if their preparer redirects the refund). As compared with the ability to obtain a replacement check, the current procedures undermine the IRS's goals by providing a strong incentive for taxpayers to elect to receive their refunds by check.

### Recommendation

Amend the IRC to require the IRS to create a process through which the IRS can work with financial institutions to identify the account holder of a misdirected tax refund deposit. In addition, amend Title 31 of the United States Code to require the return of misdirected funds by the account holder of the account that incorrectly received the funds.

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74 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, issues denial letters. IRM 21.4.2.4.13 (Jan. 13, 2016).

75 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>.

## #12 REVISE THE “MAILBOX RULE” TO APPLY TO ELECTRONICALLY SUBMITTED DOCUMENTS AND PAYMENTS IN THE SAME MANNER AS IT APPLIES TO MAILED SUBMISSIONS

### Present Law

IRC § 7502(a)(1) provides that if the requirements set forth in the section are met, 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 referred to 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.<sup>76</sup> To date, the only regulations the Secretary has promulgated dealing with electronically filed documents cover documents filed with an electronic return transmitter.<sup>77</sup>

### 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 electronic filing of time-sensitive documents (except documents filed electronically with an electronic return transmitter).<sup>78</sup> If the IRS does not receive an electronically submitted document (including a facsimile transmission) or payment until after the due date, it is considered late even if the taxpayer can produce a confirmation that she 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.”<sup>79</sup> (Emphasis in original.) This limitation applies to all payments. Assume a taxpayer owes a balance that is due on April 15. If she 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 she submits the payment on EFTPS, the payment will be considered late if she submits the transaction after 8:00 p.m. on April 14 (28 hours earlier), even though the payment would be debited from her account on April 16 — about one week earlier than if she submits it 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

76 IRC § 7502(c)(2).

77 Treas. Reg. § 301.7502-1(d).

78 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.

79 See [www.eftps.gov](http://www.eftps.gov) (last visited Dec. 17, 2017).

eliminates the risk a mailed check will be lost or misplaced. Yet rather than encouraging taxpayers to use EFTPS, the relative deadlines serve as a deterrence.

**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.

## #13 AMEND IRC § 6654(c)(2) TO 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.

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.<sup>80</sup>

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80 H.R. 3717, 115th Cong. § 2 (2017) contains language that is generally consistent with this recommendation.

## #14 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 foreign accounts 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).<sup>81</sup>

The Foreign Account Tax Compliance Act (FATCA)<sup>82</sup> 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. Under FATCA, IRC §§ 1471-1474, foreign financial institutions (FFIs) that do not register with the IRS and agree to report certain information about their U.S. accounts,<sup>83</sup> including the 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.<sup>84</sup> 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).<sup>85</sup> 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.<sup>86</sup>

However, the IRS has repeatedly declined to adopt the recommendations of the National Taxpayer Advocate, supported by other stakeholders, including the Government Accountability Office, to eliminate duplicative FATCA reporting where assets have already been reported on an FBAR,<sup>87</sup> 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, and on FFIs, some of whom are declining to do business with U.S. expatriates because of the significant costs and regulatory risks

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

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

83 See IRC § 1471(d)(1) for a definition of “United States account.”

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

85 Treas. Reg. § 1.6038D-7(a)(1).

86 Treas. Reg. § 1.6038D-7(c).

87 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).

associated with ongoing FATCA compliance. In addition, 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 to eliminate duplicative reporting of assets on Form 8938, *Statement of Specified Foreign Financial Assets*, if an asset is or has been reported or reflected on an FBAR and 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.<sup>88</sup>

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88 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*).