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TIMING OF REFUNDS: Direct the IRS to Study the Impact of Delaying the Issuance of Refunds to Allow Sufficient Time to Process Information Returns and Perform Document-Matching

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

PROBLEM

Refund fraud is a significant problem in tax administration. Not only do fraudulent refund claims impose a large financial burden on the government (and thus all taxpayers), but it also causes innocent taxpayers to become entangled in a complex and time-consuming set of procedures to resolve the issue. In December 2015, Congress enacted the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), which contained two key provisions that became effective in 2017 intended to help combat tax refund fraud.²

First, the PATH Act changed the due date for filing Forms W-2, *Wage and Tax Statement*, and certain Forms 1099-MISC, *Miscellaneous Income*. Prior to 2017, the due date for these information reporting forms was the last day of March (or February, if not filed electronically). The PATH Act moved up the due date for these information returns to January 31, starting in 2017.³ With the accelerated deadline, the IRS should be able to conduct matching and verify income much earlier in the filing season than in prior years.

Second, the PATH Act prohibits the IRS from issuing tax refunds before February 15 if the taxpayer has claimed either the Additional Child Tax Credit (ACTC) or the Earned Income Tax Credit (EITC).⁴ This provision provides time for the IRS to conduct upfront matching of the tax return information to the information return data before issuing refunds that include refundable credits.

The PATH Act provisions are a step in the right direction, but more could be done to protect from refund fraud and ensure the accuracy of returns. Due in part to delays in transcribing data from paper-filed information returns, the IRS completed verification on only a small portion of the wage and non-employee compensation information before it started paying out refunds in the 2017 filing season. Getting more employers and payors to electronically file information returns would enable the IRS to process this data much sooner in the filing season.

1 See Taxpayer Bill of Rights (TBOR), <http://www.TaxpayerAdvocate.irs.gov/Taxpayer-Rights>. The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).

2 Protecting Americans from Tax Hikes Act of 2015 (PATH Act), Pub. L. No. 114-113, Division Q, Title II, § 201, 129 Stat. 2242, 3076 (2015).

3 PATH Act, Pub. L. No. 114-113, Division Q, Title II, § 201(a), 129 Stat. 2242, 3076 (2015) (codified at IRC § 6071(c)).

4 *Id.* (codified at IRC § 6402(m)).

Example

Taxpayer, a wage earner, electronically files a tax year (TY) 2016 Form 1040 on January 23, 2017. Taxpayer is eager to file as early as possible because he is claiming a refund of \$2,000, none of which is from a refundable credit. Taxpayer receives a refund by direct deposit on February 5, 2017. However, in June 2017, the IRS discovers that Taxpayer overstated withholdings on the return. Once notified of this discrepancy, Taxpayer reviews his Form W-2 and realizes that he typed in the wrong amount of withholdings by inverting two numbers (he entered \$12,112 of withholding instead of \$11,212). As a result, Taxpayer received \$900 more than he was entitled to from the IRS. However, Taxpayer had used the full amount of the refund received four months ago to purchase new appliances that his family needed. After a series of discussions with an IRS Collections Officer spanning three months, Taxpayer enters into an installment agreement in September 2017 to pay off the amount owed (plus penalties) over one year, with interest. Had the IRS delayed issuing Taxpayer's refund until March, the IRS could have verified the correct withholding amount against the Form W-2 submitted by Taxpayer's employer by the January 31 due date. There are, however, considerations of taxpayer and employer burden that must be identified and addressed before delaying the issuance of refunds to all taxpayers.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress:

- Require employers with more than five employees to electronically file Forms W-2 and 941, and require payors who issue more than five Forms 1099-MISC with nonemployee compensation to electronically file Forms 1099-MISC.
- 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.
- In collaboration with the National Taxpayer Advocate, require the IRS to conduct a comprehensive study on the benefits and burdens of delaying the issuance of refunds until March, and then submit a Report to Congress with its findings and recommendations.

PRESENT LAW

Payors are required to file an information return concerning certain transactions with the payee.⁵ These information returns (such as Forms W-2 and Forms 1099) are intended to assist taxpayers in preparing their income tax returns and to help the IRS determine whether such income tax returns are correct and complete. If payments made in the course of business to a person⁶ amount to \$600 or more in any taxable year, the payor is required to file a return reporting these payments.⁷ Payments subject to this reporting requirement include rents, salaries, wages, premiums, annuities, compensations, remunerations, rewards, fees, benefits, and any other fixed or determinable gains, profits or income. There is also a reporting requirement for various types of investment income, including interest (threshold of \$10 or more), dividends (threshold of \$10 or more), and gross proceeds from brokered transactions.⁸

5 IRC §§ 6041-6050W.

6 The term "person" is broadly defined "to mean and include an individual, a trust, estate, partnership association, company or corporation." IRC § 7701(a)(1).

7 IRC § 6041(a); Treas. Reg. § 1.6041-1(a)(1).

8 IRC §§ 6041, 6042 (dividends), 6045 (brokered transactions), and 6049 (interest).

Payors are required to provide the payee with a written statement or information return showing the total payments made during the tax year and contact information for the payor.⁹ The statement must be supplied to payees by January 31 of the following calendar year.¹⁰ Payors generally must file the information return with the IRS on or before the last day of February of the following calendar year (the last day of March if filing electronically).¹¹ However, the PATH Act amended IRC § 6071 by inserting IRC § 6071(c), which provides that, beginning in 2017, Forms W-2 and W-3, and any returns or statements reporting nonemployee compensation shall be filed on or before January 31.¹² Therefore, the deadline to send these information returns to the government will be the same as the deadline to send to the payees.

Section 201(b) of the PATH Act prohibits the IRS from issuing refunds containing refundable credits (such as the ACTC or the EITC) before February 15. This provision became effective in 2017.¹³ The legislative history offers a simple rationale for this change — “At the time that the taxpayer files a return claiming a refundable credit, the Internal Revenue Service is generally not in possession of information needed to confirm the taxpayer’s eligibility for such credit...”¹⁴

REASONS FOR CHANGE

Upfront Matching Benefits Tax Administration by Protecting Revenue and Protects Taxpayers From the Burdens of Unwinding the Harm Caused by Identity Theft

While there are benefits to having the IRS deliver tax refunds quickly to taxpayers, this convenience comes at a steep cost. Refund fraud has cost the government (and thus, taxpayers) more than one billion dollars each year.¹⁵ Taxpayers who are ensnared by identity theft (IDT) schemes must spend months dealing with the IRS and creditors to unwind the harm caused by the perpetrators.¹⁶

Third-party information reporting is a crucial element in maximizing tax compliance and reducing overclaims. IRS tax gap data show when taxpayers have no choice about reporting their income, tax compliance rates are remarkably high. For example, workers classified as employees have little opportunity to underreport their earned income because it is subject to income tax withholding and information reporting on Form W-2. In fact, recent IRS data show that taxpayers report about

9 IRC § 6041(d).

10 *Id.*

11 IRC § 6071(b).

12 PATH Act, Pub. L. No. 114-113, Division Q, Title II, § 201(a), 129 Stat. 2242, 3076 (2015) (codified at IRC § 6071(c)).

13 PATH Act, Pub. L. No. 114-113, Division Q, Title II, § 201(b), 129 Stat. 2242, 3076 (2015) (codified at IRC § 6402(m)).

14 J. Committee on Tax’n, JCX-144-15, *Technical Explanation of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40)* at 120 (Dec. 17, 2015).

15 The Treasury Inspector General for Tax Administration (TIGTA) estimated that the amount of potentially fraudulent tax refunds for TY 2013 exceeded \$1.6 billion (down \$523 million from the previous tax year). TIGTA, Ref. No. 2017-40-2017, *Efforts Continue to Result in Improved Identification of Fraudulent Tax Returns Involving Identity Theft; However, Accuracy of Measures Needs Improvement* 7 (Feb. 7, 2017).

16 See Most Serious Problem: *As Tax-Related Identity Theft Schemes Evolve, the IRS Must Continually Assess and Modify Its Victim Assistance Procedures*, *supra*.

99 percent of their wages and salaries.¹⁷ In contrast, those taxpayers whose income is not subject to information reporting, report about 37 percent on their returns.¹⁸

Thus, the government will benefit from the revenue protection aspect of upfront matching. Enabling the IRS to conduct upfront data matching would reduce tax refund fraud, identity theft, and inadvertent errors by stopping the refund associated with a mismatch. Further, the IRS would devote fewer resources to collection activities on basic omission and understatement cases, and could use the savings to provide better taxpayer service and resolve more complex issues.

At the time the taxpayer files a return, the IRS may not have access to the information necessary to match the information reported on the returns to the third party data from the information returns — despite the accelerated deadline for filing certain information returns that came into effect for the 2017 filing season. The tables below show the volume of various information returns received for TYs 2015 and 2016, along with the percentage of such information returns received by February 15 of the following year.

FIGURE 2.1.1, 2016 Filing Season (TY 2015)¹⁹

	Count	Received by 2/15	Percent Received by 2/15
W-2	247,811,203	95,492,467	39%
1099-MISC with NEC ²⁰	55,607,682	1,159,619	2%
1099-INT	138,071,455	8,323,929	6%
1099-R	94,144,144	5,791,434	6%
1099-G	73,683,026	12,518,761	17%

FIGURE 2.1.2, 2017 Filing Season (TY 2016)²¹

	Count	Received by 2/15	Percent Received by 2/15
W-2	248,235,492	214,724,338	87%
1099-MISC with NEC ²²	54,236,251	2,594,902	5%
1099-INT	134,259,297	7,779,343	6%
1099-R	95,779,078	6,274,828	7%
1099-G	79,946,205	16,122,112	20%

17 IRS, *Tax Gap Estimates for Tax Years 2008–2010: Attachment 3, Figure 1, Effect of Information Reporting on Individual Income Tax Reporting Compliance, Tax Years 2008–2010* (Apr. 2016), <https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>.

18 IRS, *Tax Gap Estimates for Tax Years 2008–2010: Attachment 3, Figure 1, Effect of Information Reporting on Individual Income Tax Reporting Compliance, Tax Years 2008–2010* (Apr. 2016), <https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>.

19 IRS, Compliance Data Warehouse (CDW), Information Returns Master File (IRMF) (TY 2015).

20 This includes Forms 1099 showing nonemployee compensation greater than zero.

21 IRS, CDW, IRMF (TY 2016).

22 This includes Forms 1099 showing nonemployee compensation greater than zero.

By Week 7 (the week closest to February 15) of the 2017 filing season, the IRS had received 87 percent of the Forms W-2 that it would ultimately receive related to TY 2016.²³ That is a significant increase over the prior year, before the accelerated information return filing due date was in effect, when only 39 percent of the Forms W-2 filed for TY 2015 was received by the IRS by February 15.²⁴

Despite having received 87 percent of the information documents by February 15,²⁵ the IRS was able to verify by February 15 only 35 percent of the wage information for returns where the taxpayer claimed the ACTC or EITC during the 2017 filing season, according to the Government Accountability Office (GAO).²⁶ One reason for the difficulties verifying the wage information is the volume of paper-filed information returns, which takes weeks for the Social Security Administration (SSA) to process and transmit to the IRS.²⁷

Electronic Filing of Forms 941 Would Provide the IRS Real-Time Access to Data and Enable It to Combat Employer-Related Identity Theft

Employers currently are not required to file Forms 941 electronically but can do so voluntarily.²⁸ Many perpetrators are now targeting businesses via large-scale data breaches and some are targeting employers to fabricate falsified Forms W-2.²⁹ In some schemes, an identity thief uses the victim's Employer Identification Number (EIN) to file fraudulent employment tax returns along with fabricated Forms W-2 in an attempt to substantiate individual returns claiming refunds. In other instances, an identity thief uses a victim's EIN to file tax returns claiming falsified refundable credits.³⁰ According to the IRS, employment-related identity theft has increased three-fold in 2017 as compared to the 2016 filing season.³¹

Having earlier access to Form 941 data would enable the IRS to scrutinize the wages and withholding data and conduct matching with Forms W-2. Currently (as of the third quarter of 2017), fewer than half of employers file their quarterly employment tax returns electronically.³²

Congress Should Promote Electronic Filing of Information Returns to Avoid Costly and Time Consuming Data Transcription of Paper-Filed Returns

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

23 IRS, CDW, IRMF (TY 2016).

24 IRS, CDW, IRMF (TY 2015).

25 IRS response to TAS information request (Oct. 17, 2017).

26 Government Accountability Office (GAO), GAO-17-525T, *New Wage Verification Process Holds Promise but IRS Faced Implementation Challenges* 7 (Apr. 26, 2017).

27 GAO, GAO-17-525T, *New Wage Verification Process Holds Promise but IRS Faced Implementation Challenges* 8 (Apr. 26, 2017).

28 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).

29 See Most Serious Problem: *As Tax-Related Identity Theft Schemes Evolve, the IRS Must Continually Assess and Modify Its Victim Assistance Procedures*, *supra*.

30 See Internal Revenue Manual (IRM) 25.23.9.2, *BMF Identity Theft – Overview* (Sept. 12, 2017).

31 The Return Integrity and Compliance Services (RICS) function reported 5,497 incidents of business identity theft in processing year 2016, compared to 16,394 such incidents in processing year 2017. IRS response to TAS information request (Nov. 3, 2017).

32 Through the third quarter of 2017, 44 percent of the 6,158,941 Forms 941 were electronically filed. IRS, CDW (TY 2017). Most employers file Form 941, *Employer's Quarterly Federal Tax Return*. See Treas. Reg. § 31.6011(a)-1(a)(1). See also Treas. Reg. § 31.6011(a)-1(a)(2) through (5) (details about when an employer must use something other than Form 941).

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.”³³ Under Treasury regulations, taxpayers must file Forms W-2 and 1099-MISC electronically when they must file 250 or more information returns.³⁴ “[T]he 250-threshold applies separately to each type of form required to be filed.”³⁵ In this day and age, a threshold of 250 seems much too lenient for the requirement to electronically file information returns.

FIGURE 2.1.3, 2017 Filing Season (TY 2016)³⁶

	Count	eFiled	Percent eFiled
W-2	248,235,492	227,284,625	92%
1099-MISC with NEC ³⁷	54,236,251	29,694,348	55%
1099-INT	134,259,297	133,686,059	100%
1099-R	95,779,078	95,534,263	100%
1099-G	79,946,205	79,927,825	100%

The chart above shows that 92 percent of Forms W-2 and 55 percent of Forms 1099-MISC with non-employee compensation were electronically filed in filing season 2017. However, that still means 21 million Forms W-2 and 25 million Forms 1099-MISC were paper filed. Transcribing data from paper-filed information returns is a labor-intensive task and is much more expensive than electronic data processing. For example, the SSA reports a cost of \$0.53 to process each paper W-2, as compared with a cost of \$0.002 for each electronically filed W-2.³⁸

Not only is transcribing paper-filed information returns an inefficient use of IRS and SSA resources, but the length of time it takes to get the data in usable form prevents the IRS from performing the document matching prior to issuing refunds. For example, in 2017 the SSA estimated that it had processed and transmitted less than 22 percent of paper-filed Forms W-2 to the IRS by March 31, which is well after the IRS started issuing refunds.³⁹

Out of the 6.5 million employers who filed Forms W-2 for TY 2016, 56 percent issued them to five or fewer employees.⁴⁰ Given the advances in software and digital accounting systems, there is no reason that all but the smallest of employers need to file paper information returns. There are still 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 is required to file Forms W-2s

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

34 Treas. Reg. § 301.6011-2(c)(1)(i).

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

36 IRS, CDW, IRMF (TY 2016).

37 This includes Forms 1099-MISC showing nonemployee compensation greater than zero.

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

39 The Social Security Administration estimated that it had processed and transmitted to the IRS 3.8 million of approximately 17.4 million paper-filed Forms W-2 by Mar. 31, 2017. GAO, GAO-17-525T, *New Wage Verification Process Holds Promise but IRS Faced Implementation Challenges* 8 (Apr. 26, 2017).

40 IRS CDW, IRMF (TY 2016).

may not have the technological skills to file electronically without help.⁴¹ 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.

Employers with more than five employees, and payors who issue more than five Forms 1099-MISC containing non-employee compensation, should be required to electronically file their information returns. The GAO made a similar recommendation, suggesting that Congress should “lower the threshold for electronic filing of W-2s from 250 returns annually to between five to ten returns, as appropriate.”⁴² This would avoid the cost and delay with transcription and processing, and enable the IRS to gain access to this data in time to verify wages and non-employee compensation before paying out refunds.

The IRS Should Develop Fillable Forms 941 and Forms 1099-MISC That Can Be Electronically Filed at No Cost

The IRS should do all it can to make electronic filing easier. For example, the SSA currently has a fillable Form W-2 available on its website that employers can use to submit Forms W-2 electronically for free.⁴³ This easily accessible, free fillable form may account for the high e-filing rate of Forms W-2. 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 in order 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 income reporting at the time of return filing and preventing the release of improper refunds.

The IRS Should Conduct a Comprehensive Study Exploring the Benefits and Drawbacks of Delaying the Issuance of All Refunds

There is a constant tension between the desire to get refunds out to taxpayers quickly and the need to protect against refund error or fraud. One way for the IRS to ensure it has sufficient time to determine the validity of refund claims is to push back the date the IRS will start to issue tax refunds. For instance, the IRS could follow the lead of some states that moved the beginning date for issuing tax refunds to March 1 of the year following the close of the tax year.⁴⁴ If the IRS did not begin to issue refunds until March of each year, it would have a minimum of a four-week window from the information return filing deadline of January 31 to cross-check the reported income before releasing refunds. However, such a significant shift in the timeframe for refund issuance raises concerns about the burden placed on various stakeholders. Thus, the IRS should study the impact of moving back the refund issuance date on taxpayers, the tax practitioner community, the IRS, and other affected stakeholders.

Pushing back the issuance of refunds likely would not receive an initial favorable reaction from the taxpaying public. Many taxpayers use the tax system as a savings mechanism and expect to receive their refunds quickly. Tax refund season has been ingrained in American culture, so some taxpayers have

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

42 GAO, GAO-16-578T, *IRS Needs a Comprehensive Customer Service Strategy and Needs to Better Combat Identity Theft Refund Fraud and Protect Taxpayer Data* 13 (Apr. 19, 2016).

43 See www.ssa.gov/employer/what.htm (last visited Dec. 1, 2017).

44 See, e.g., New Jersey Division of Tax’n, https://www20.state.nj.us/TYTR_TGI_INQ/jsp/prompt.jsp (last visited Dec. 14, 2017); Utah State Tax Commission, <https://tax.utah.ov/commission/releases//2015-10-22.pdf>.

become conditioned to rely on receiving tax refunds early in the filing season — particularly, low income taxpayers whose tax refunds may represent a significant portion of their adjusted gross income.

In addition, retailers have also come to rely on the delivery of tax refunds early in the filing season to spur consumer spending, and may oppose any delays in the IRS delivering refunds. Moreover, delaying issuance of refunds may cause some taxpayers to seek out payday-loan type vehicles to receive a portion of their refund earlier.⁴⁵

Pushing back the date for issuing refunds without also pushing back the due date for filing returns will compress the filing season, leading to a host of other issues. If refunds were held until March 1, then that leaves just 45 days until the end of the filing season, which could have a negative impact on the tax practitioner community. Tax professionals discussed these concerns at the National Taxpayer Advocate Public Forum held on April 8, 2016.⁴⁶ Compressing the tax filing season creates additional stress on the preparer and practitioner community, since clients will likely delay requesting return preparation assistance until closer to the refund-issuance date. Consequently, preparers and practitioners must assist their existing client base within a narrower timeframe.

The same pressure will be felt by the IRS, as it must re-examine their allocation of employees during the compressed filing season. With presumably more accurate information reporting, should the IRS shift employees from its Automated Underreporter function to Accounts Management? When the IRS discovers problems with information return data matching, should it create a “soft notice” to send out to taxpayers as a way of dealing with resource limitations? By doing so, it could track how many taxpayers opt to self-correct their return information, without the IRS undergoing a real (as opposed to an “unreal”) audit.⁴⁷ Can the IRS continue to rely on seasonal employees during a shortened filing season, especially if there are exam issues that arise?

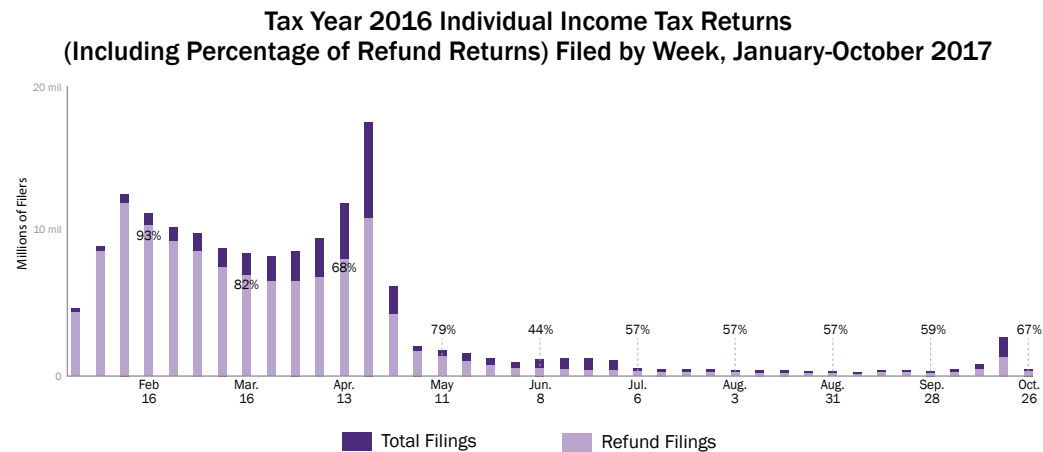
Taxpayers will also be impacted by the compressed filing season. The table below shows the number of tax returns filed by week in the 2017 filing season, as well as the percentage of taxpayers seeking tax refunds.

45 See Most Serious Problem: *Refund Anticipation Loans: Increased Demand for Refund Anticipation Loans Coincides with Delays in the Issuance of Refunds*, *supra*.

46 National Taxpayer Advocate Public Forum Transcript 47-57, 78 (Harrisburg, PA; Apr. 8, 2016).

47 See Most Serious Problem: *Audit Rates: The IRS Is Conducting Significant Types and Amounts of Compliance Activities That It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of Its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections*, *supra*; National Taxpayer Advocate Blog, *What's an Audit Anyway* (Jan. 25, 2012), <https://taxpayeradvocate.irs.gov/news/what%E2%80%99s-an-audit-anyway>.

FIGURE 2.1.4, TY 2016 Individual Tax Returns Filed by Week, 2017 Extended Filing Season⁴⁸



With 78 percent of taxpayers expecting refunds, certainly many of them have come to rely on receiving tax refunds in late January or early February. Particularly for lower income taxpayers whose refunds may account for a significant percentage of their annual income, delaying the issuance of refunds may lead to them seeking short-term loans with unfavorable terms. Such lending practices could be an unintended consequence of the IRS delaying the issuance of refunds.

If the filing season is shifted back to ease the stress of a compressed filing season, the IRS should also study the potential impact on the federal fisc. What would be the anticipated filing patterns for taxpayers seeking refunds and taxpayers with balance due returns if refunds were held until March 1 and the filing season was extended to May 31? For a government that has relied on a certain influx of monies coming in on or around the April 15 filing deadline, what would be the impact on the federal government's cashflow if the due date for filing returns and making payments was extended by 45 days?

EXPLANATION OF RECOMMENDATION

The earlier availability of Forms W-2 and 1099-MISC would help the IRS in its efforts to combat identity theft and refund fraud. 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. Where information returns such as Forms W-2 and 1099s are 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. From the government's perspective, data matching reduces the revenue loss associated with 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.

⁴⁸ IRS, CDW, IRMF (TY 2016). The distribution of the dark purple bars shows the count of total filings by week of the filing season. The light purple bars show the count of the total filings that were refunds.

For similar reasons, earlier availability of Forms 941 would help the IRS combat business IDT, 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.⁴⁹ Yet in 2017, less than half of Forms 941 were filed electronically.⁵⁰ Greater electronic filing of Forms 941 would allow the IRS to match Form 941 data against W-2 and 1099 data to identify instances of potential business IDT fraud.

Lower Threshold for Electronic Filing

Each filing season, the IRS receives and processes hundreds of millions of information returns. Most of these information returns are filed electronically — 227 million of the approximately 248 million Forms W-2 and 62 million of the 91 million Forms 1099-MISC received in 2017 were filed electronically.⁵¹ However, that still leaves 21 million Forms W-2 and 29 million Forms 1099-MISC that must be manually entered into SSA or IRS computer systems, and manual data entry necessarily produces transcription errors. When a transcription error on an information return 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.

This manual transcription process can take months — well after the IRS has started to issue refunds. If the IRS is unable to validate data reported on certain information returns, that defeats the purpose of the accelerated due date for those information returns.

The current threshold of 250 returns that triggers the requirement for electronic filing was established in 1989.⁵² 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. Thus, we recommend that Congress require employers with more than five employees (and payors issuing more than five Forms 1099-MISC) to electronically file their information returns.

Fillable Forms Remove Barriers to Electronic Filing

Some smaller businesses may not want to or cannot incur the expense of purchasing or licensing tax compliance software that would enable them to electronically file information returns. Through the third quarter of 2017, nearly 3.5 million Forms 941 (56 percent of all Forms 941 filed) were paper filed. To discourage these businesses from filing information returns on paper, the IRS should develop free, fillable Forms 941 and Forms 1099-MISC on its website, and allow businesses to electronically file these forms for free, without the use of any tax software. 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.⁵³ The IRS should be able to develop a fillable Form 1099-MISC with similar functionality to facilitate electronic filing. The increase in electronically-filed information returns will be well worth the IRS investment in developing the fillable forms.⁵⁴

49 The RICS function reported 5,497 incidents of business identity theft in processing year 2016, compared to 16,394 such incidents in processing year 2017. IRS response to TAS information request (Nov. 3, 2017).

50 IRS, CDW, IRMF (TY 2017).

51 IRS, CDW, IRMF (TY 2016).

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

53 See www.ssa.gov/employer/what.htm (last visited Dec. 1, 2017).

54 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 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. Conf. Rep. No. 115-466, at 235 (2017).

Delaying Issuance of All Refunds Will Allow the IRS More Time to Verify Refund Claims Against Information Reporting

The National Taxpayer Advocate believes that the IRS should be given a sufficient window of time to verify data before it issues tax refunds. The PATH Act provides the IRS with a two-week window for the IRS to perform matching before issuing refunds that include refundable credits. Based on data and experience gained from the 2017 filing season, the IRS needs more than two weeks to perform its data matching. In order to better understand the complexities attendant with gaining more time, the National Taxpayer Advocate recommends that the IRS, in conjunction with the Taxpayer Advocate Service, should conduct a comprehensive study to weigh the benefits and burdens of delaying the issuance of all refunds, and of extending the filing season. The IRS should report its findings and recommendations in a report to Congress.