

Improve the Filing Process

#4 REVISE E-FILING PROCEDURES SO THAT TAXPAYERS ARE INFORMED OF E-FILING ERRORS AND ARE NOT SUBJECT TO FAILURE-TO-FILE PENALTIES WHEN THOSE ERRORS ARE TIMELY CORRECTED

Present Law

Internal Revenue Code (IRC) § 6651 imposes an addition to tax when a taxpayer fails to file a return by the return due date, unless the taxpayer can show the failure was due to reasonable cause and not to willful neglect (hereinafter, the “failure-to-file penalty”).

In the IRS Restructuring and Reform Act of 1998, Congress adopted a policy that “paperless filing should be the preferred and most convenient means of filing Federal tax and information returns” and directed the IRS to set a goal of having at least 80 percent of all tax and information returns e-filed by 2007.²²

IRC § 6011(f) provides the IRS with broad authority to issue regulations to promote e-filing. However, it does not establish standards for processing e-filed returns.

In the paper filing context, courts have held that a taxpayer’s submission to the IRS is presumptively valid as a tax return to be accepted for processing if it, among other things, contains sufficient information to calculate a tax liability.²³

Under current IRS policy, authorized e-file providers of business returns are given ten days to resubmit a return after an e-filed return is rejected.²⁴

Reasons for Change

Unlike with paper-filed returns, IRS procedures provide that e-filed returns may be rejected, and thus considered “not filed,” for a variety of reasons not essential to calculating tax liability.²⁵ If a taxpayer fails to timely refile a return after it is rejected, he or she will be subject to the failure-to-file penalty. Thus, a taxpayer who e-files a return may be subject to penalties in circumstances where the identical return submitted on paper would be accepted and deemed timely filed.

The IRS’s procedures that govern rejected e-filed returns raise the following concerns:

- *Taxpayers are not directly notified by the IRS if it rejects a return.* The majority of taxpayers file returns electronically and generally assume they have fulfilled their tax obligations unless they receive an IRS notice in the mail or a notification from the software provider or preparer they used. However,

22 Pub. L. No. 105-206, § 2001(a), 112 Stat. 685, 723 (1998).

23 See, e.g., *Beard v. Comm’r*, 82 T.C. 766, 777 (1984), *aff’d per curiam*, 793 F.2d 139 (6th Cir. 1986). Under the test, a return will be valid if (i) the information on the return is sufficient for the IRS to calculate the tax liability; (ii) the filed document purports to be a tax return; (iii) the return makes an honest and reasonable attempt to comply with the tax laws; and (iv) the taxpayer executes the return under penalties of perjury.

24 See IRS Pub. 4163, Modernized e-File (MeF) Information for Authorized IRS e-File Providers for Business Returns 53-54 (Dec. 2018).

25 See IRS Pub. 1345, Handbook for Authorized IRS e-File Providers of Individual Income Tax Returns (Feb. 2019). Reasons for rejections include missing forms, misspelled names, and duplicated or mismatched Social Security numbers. See IRS Pub. 4164, Modernized e-File (MeF) Guide for Software Developers and Transmitters (Nov. 2019).

the IRS does not directly notify taxpayers of rejected e-filed returns. Instead, it provides notification to the electronic return originator (generally, the software company). Moreover, when a taxpayer relies on a return preparer to prepare and e-file a return, as most taxpayers do, the electronic return originator provides notification of a rejection to the preparer — not the taxpayer. The IRS does not mail taxpayers a notification stating whether it received and accepted an e-filed return, so a taxpayer will not necessarily find out quickly if his or her return is rejected.

- *Taxpayers are limited in their ability to proactively determine whether their returns or other filings have been received by the IRS.* The IRS’s “Where’s My Refund” feature is not available for all forms or for taxpayers who are not claiming a refund. When taxpayers are unaware their returns have been rejected, they are unable to timely address the reason for the rejection and are at risk of incurring a failure-to-file penalty.²⁶
- *The IRS does not provide sufficient time for taxpayers to resubmit rejected returns.* If an e-filed return is rejected, the taxpayer must fix the underlying problem and resubmit a paper return by the latter of the return due date or ten days from the date the error notification was received. While ministerial errors, like misspelled names, can be corrected easily, other issues may require more time (*e.g.*, where a taxpayer must locate additional documentation or where a taxpayer needs to consult with a tax professional). Taxpayers in vulnerable populations that use free tax return preparation services, such as the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs, may face delays in scheduling a time to return for assistance. Taxpayers who are sick or traveling face similar challenges, as they may not have immediate access to documents required to correct mistakes.
- *Treating rejected returns as “not filed” and subject to a penalty discourages taxpayers from e-filing.* Although Congress has directed the IRS to facilitate and encourage e-filing, taxpayers who choose to do so are held to a higher standard than taxpayers who file paper returns. Unlike in the case of e-filed returns, if a taxpayer’s paper return contains an error, such as a mismatched Social Security number, the IRS will still accept the return for processing instead of rejecting it. The IRS has procedures for resolving errors of this nature through internal editing and correspondence with the taxpayer, thus precluding the risk of a failure-to-file penalty.²⁷ The fact that taxpayers who e-file their returns are at greater risk than paper filers of having their returns rejected and being subject to the failure-to-file penalty serves as a deterrent to e-filing, which undermines Congress’s and the IRS’s policy objective.

Recommendations

- Amend IRC § 6011(f) as follows:
 - Require the IRS to send taxpayers an “e-filing receipt” via the taxpayer’s chosen method of correspondence to indicate the IRS’s acceptance or rejection of a return and, in the case of a rejected return, to provide information about the steps necessary to resolve the problem.
 - Provide a ten-day window after an e-filed return is rejected for taxpayers to resubmit the return.
 - Convert rejected e-filed returns into paper-processible returns if they remain unresolved after the ten-day window closes.

26 For a related recommendation, see National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration (Extend Reasonable Cause Abatement of the Failure-to-File Penalty to Taxpayers Who Rely on Return Preparers to e-File Their Returns)*, *infra*.

27 See, *e.g.*, IRM 3.11.3.13.4, Dependent’s Name Control and TIN (Jan. 1, 2016).

- Amend IRC § 6651 as follows:
 - Provide that a return timely resubmitted and accepted by the IRS within the ten-day window (as proposed in the second recommendation to amend IRC § 6011(f) above) will be treated as timely filed and therefore not subject to the failure-to-file penalty.
 - Provide that the failure-to-file penalty will not be imposed when the IRS converts an e-filed return into a paper-processible return (as proposed in the third recommendation to amend IRC § 6011(f) above).