

E-FILING BARRIERS: Electronic Filing Barriers Increase Taxpayer Burden, Cause Processing Delays, and Waste IRS Resources

WHY THIS IS A SERIOUS PROBLEM FOR TAXPAYERS

The inability to electronically file (e-file) tax forms, schedules, attachments, and other documents negatively impacts the timeliness of processing taxpayers' returns. Paper returns require manual processing, which leads to processing delays and potential transcription errors. In contrast, e-filing significantly benefits both taxpayers and the IRS. Taxpayers benefit from reduced transcription errors and quicker return processing and refund turnaround times. The IRS benefits because it takes fewer resources to process e-filed returns, which frees up much-needed resources to perform other filing season processing tasks, including processing paper returns filed by taxpayers who do not have the ability or desire to e-file. The IRS should remove barriers and provide all taxpayers the option to e-file their returns to lessen the delays and burdens associated with paper returns and to free up resources for those taxpayers who file by paper.

EXPLANATION OF THE PROBLEM

The COVID-19 pandemic reinforced the critical need for the IRS to further increase the electronic filing (e-filing) of tax forms, schedules, attachments, and other documents. During the pandemic, paper filers were in limbo for an extended period of time awaiting the processing of their returns and receipt of any refunds. Conversely, taxpayers who e-filed experienced significantly less burden because their tax returns did not sit waiting to be extracted and processed.¹

During the 2021 filing season, about 91 percent of individual returns and about 69 percent of business returns were e-filed through October 23, 2021.² While e-filing significantly benefits both taxpayers and the IRS, the IRS still receives a significant number of paper-filed returns. The IRS should remove barriers and provide all taxpayers the option to e-file their returns to lessen the delays and burdens associated with paper returns. We have identified a number of potential reasons some taxpayers continue to paper file:

- A significant number of commonly used forms can only be paper-filed;
- E-file rejections lead to paper filing;
- Inability to e-file returns with attachments;
- Inability to e-file returns with overrides of fields prepopulated by software; and
- Taxpayer preference to file by paper.

In addition, the IRS has not publicized an updated long-term e-file rate goal. As the IRS works to further increase the rate of e-filing, it should also strive to improve the processing of paper returns. Technology, such as optical character recognition (OCR) and 2-D barcoding, is available that would allow the IRS to scan paper returns prepared with software and capture the data accurately and efficiently.

ANALYSIS

During 2021, about 91 percent of individual returns and about 69 percent of business returns received by the IRS were e-filed.³ While the individual e-file rate is impressive, the number of paper-filed tax forms and other documents is also significant. In 2021, approximately 16 million individual tax returns were filed by paper.⁴ The e-file rate for business returns is significantly lower than the individual e-file rate; the IRS received about 17.7 million paper-filed business returns in 2021.⁵ This significant number of paper filings is a drain on IRS resources and is likely to cause negative impact to the entire filing season processing, which increases taxpayer burden resulting from processing delays and inaccurate transcription. The IRS must continue to take steps to increase e-filing options for both individual and business taxpayers who prefer to e-file.⁶

The method a taxpayer or preparer chooses to submit a tax return can have significant consequences. Both taxpayers and the IRS benefit from e-filing for a variety of reasons, including:

- *Taxpayer Convenience:* The taxpayer or preparer can typically accomplish the act of e-filing within a few minutes while sitting in front of a computer. The convenience of e-filing enables the taxpayer to avoid the additional steps associated with paper filing: printing out the document, placing it in an envelope, and in many cases, visiting the post office to purchase the appropriate mail delivery services (*e.g.*, certified, return receipt).
- *Faster Return Processing and Refund Issuance:* While the IRS accepts an e-filed return within hours, a paper-filed return can take days to arrive at an IRS facility. It can also take many more days for the IRS to open the mailed envelope and transcribe the document. At times during the pandemic, it took the IRS more than six months to process the return and issue any applicable refund. E-filing also allows continuous processing, even when IRS offices are closed due to weather or safety conditions.
- *Accurate Recording of Tax Return Information and Avoidance of Transcription Errors:* When a taxpayer e-files a tax return, the IRS receives the tax return information in an electronic format ready for processing. When the IRS receives a paper return by mail, it generally must manually enter or transcribe certain data included on the document. Transcription errors can impose significant burden on both taxpayers and the IRS. Such errors often lead to unnecessary compliance actions and result in wasted time and resources for both parties. During 2021 through the end of August, the IRS's quality reviews measured transcription accuracy rates of 78 percent for individual returns and 87 percent for business returns.⁷ For individuals, that means roughly one out of every four returns had a transcription error that could trigger an unwarranted compliance action or an erroneous refund that the IRS might later seek to recover.
- *Substantially Reduced Processing Costs:* The cost savings associated with e-filing are substantial for the IRS. Processing a paper-filed return is significantly more expensive for the IRS than processing an e-filed return due to the costs associated with training, recruiting, and staffing for manual data transcription. In fact, the cost to process a paper-filed Form 1040 in fiscal year (FY) 2020 was \$15.21, which is substantially higher than the \$0.36 cost to process an e-filed return.⁸

A Significant Number of IRS Forms Require Paper Filing

Increasing the availability and rate of electronic filing continues to be an important component of the IRS's efforts to improve service, enhance enforcement, and modernize technology and work processes.⁹ In most cases, the method a taxpayer or preparer uses to file a document with the IRS is based on taxpayer preference. However, certain IRS forms, schedules, and other documents still require paper filing.¹⁰ Figure 2.8.1 provides a partial list of commonly used forms that taxpayers and preparers can only file by paper.

FIGURE 2.8.1, Filings of Forms Ineligible for E-Filing, Processing Years (PYs) 2019-2021 (Through September 29, 2021)¹¹

Forms That Taxpayers Can Only File by Paper	PY 2021	PY 2020	PY 2019
Form W-7, Application for IRS Individual Taxpayer Identification Number	1,301,750	1,119,836	1,526,880
Form 5472, Information Return of a 25 percent Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Currently e-filing is not available for Foreign-Owned U.S. Disregarded Entities)	264,396	275,676	286,100
Form 941-X, Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund	217,235	173,232	219,745
Form 14039, Identity Theft Affidavit	181,578	161,753	59,250
Form 1065-X, Amended Return or Administrative Adjustment Request (AAR)	94,117	92,899	103,264
Form SS-4, Application for Employer Identification Number (for foreign companies)	55,907	46,260	53,950
Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons	47,494	24,274	55,891
Form 1139, Corporation Application for Tentative Refund	30,986	34,823	39,191
Form 4768, Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes	18,024	15,291	15,182
Form 8038-G, Information Return for Tax-Exempt Governmental Bonds	16,635	7,446	22,000
Form 1120-RIC, U.S. Income Tax Return for Regulated Investment Companies	16,634	2,551	18,331
Form 730, Monthly Tax Return for Wagers	15,080	14,158	23,889
Form 843, Claim for Refund and Request for Abatement	12,127	6,968	5,486
Form 1120-REIT, U.S. Income Tax Return for Real Estate Investment Trusts	3,909	434	4,101
Form 8703, Annual Certification of a Residential Rental Project	2,412	3,555	6,226
Form 8038, Information Return for Tax-Exempt Private Activity Bond Issues	1,438	1,209	2,695
Form 14039B, Business Identity Theft Affidavit	163	181	232
Form 8328, Carryforward Election of Unused Private Activity Bond Volume Cap	44	193	225

The IRS continues to make progress converting paper-only forms to e-file. During 2021, for example, the IRS enabled taxpayers and their authorized third parties to electronically submit Form 2848, Power of Attorney and Declaration of Representative, and Form 8821, Tax Information Authorization, by launching two different applications: (1) Tax Pro Account and (2) Submit Forms 2848 and 8821 Online.¹² The launch of these two applications were significant developments considering that about 1.5 million Forms 2848 and more than 760,000 Forms 8821 were filed in PY 2021 through September 29.¹³

In August 2020, the IRS enabled taxpayers and preparers to e-file Form 1040-X, Amended U.S. Individual Income Tax Return.¹⁴ However, the IRS still manually processes e-filed Forms 1040-X, which eliminates some benefits of e-filing. The IRS has indicated that it is exploring the incorporation of automation into the processing of Forms 1040-X.¹⁵ This would be an important development considering that the IRS received about 3.6 million Forms 1040-X in FY 2021 through September 29.¹⁶

In addition, the IRS has stated that it plans to expand e-file to enable taxpayers to electronically file all business returns. This will allow the IRS to better integrate the returns and the information reported with the IRS submission processing and compliance functions.¹⁷

Despite these measures, the number of forms on the list in Figure 2.8.1 that taxpayers had to file on paper during PY 2021 totaled over two million. Unless and until the IRS can make these forms eligible for e-filing, it will continue to receive a large volume of paper forms that it must transcribe and that are subject to the same delays and transcription errors described earlier, at greater expense to taxpayers.¹⁸ Due to the sheer volume of Forms W-7 filed each year, we recommend that the IRS evaluate the Individual Tax Identification Number (ITIN) application process to determine the feasibility of digitizing the process in some manner, potentially by enabling certified acceptance agents to electronically submit the form and copies of any necessary documentation, to the extent possible. In addition, until the IRS enables taxpayers to e-file all IRS forms, it should explore the possibility of accepting such unsupported forms as attachments to e-filed tax returns.

E-File Rejections Lead to Paper Filing

Some taxpayers and preparers who intend to e-file are unsuccessful when they attempt to transmit a return electronically. The IRS will reject an electronically submitted return if it breaks one or more of the IRS Modernized e-File (MeF) business rules. Figure 2.8.2 shows the top five business rules broken for tax year (TY) 2020 individual returns.

FIGURE 2.8.2, Top Five Business Rules Broken in TY 2020 Individual Tax Returns Through September 29, 2021¹⁹

Business Rule Rejection Code	Number of Times Rule Broken	Percentage of All Rejections	Description of Business Rule
IND-031-04	8,395,325	30%	Primary taxpayer's prior year personal identification number (PIN) or adjusted gross income (AGI) reported on the return did not match IRS records
IND-032-04	2,178,415	8%	Spouse's prior year PIN or AGI reported on return did not match IRS records
R0000-507-01	1,550,214	6%	A dependent's Social Security number (SSN) reported on the return was used in a previously filed return for the same tax year
R0000-504-02	1,440,462	5%	Each dependent's name and SSN entered on return did not match IRS records
R0000-194	1,301,731	5%	Submission is a duplicate of previously accepted submission

While the business rules that result in e-file rejections are meant to prevent more downstream compliance problems, the IRS should review the most frequently broken business rules to determine a way to minimize the rate of occurrence without increasing the risk of identity theft and the filing of potentially fraudulent returns. The IRS may be able to reduce certain rejections by educating taxpayers and continuing to work closely with the tax return preparation software industry to ensure taxpayers receive clear and timely warnings of potential issues and instructions on how to resolve any rejections that occur during the preparation and filing process.

For example, as shown in Figure 2.8.2, in TY 2020, the top two related business rules, which require the primary taxpayer and the taxpayer's spouse to accurately enter the AGI reported on the prior year return or a self-select PIN, were tripped over ten million times, impacting over five million taxpayers. If the taxpayer

used the same commercial software to prepare the prior year return, the software typically automatically provides the prior year AGI. Otherwise, taxpayers entered the information themselves. This issue received media attention in the 2021 filing season because of the large number of unprocessed TY 2019 returns.²⁰ If the IRS had not yet processed the taxpayer's TY 2019 return and the software or the taxpayer provided the AGI amount reported on the filed but unprocessed return, the IRS prevented the taxpayer from e-filing his or her TY 2020 return. To prevent confusion, the IRS provided guidance that taxpayers with unprocessed TY 2019 returns should enter "0" as their TY 2019 AGI.²¹ Many preparers and taxpayers were unaware of the guidance, did not enter "0," were prevented from e-filing, and filed TY 2020 returns by paper.

When taxpayers and preparers attempt to e-file, but the return is rejected because it broke a business rule, it is important that they have the ability to conveniently access taxpayer transcripts, ideally through an online account application. In addition, the most effective way to communicate with taxpayers and preparers at the time of filing is through the tax return preparation software products. Partnership with the software industry is key to ensuring that taxpayers and preparers receive the most recent guidance on how to address an error that causes an e-file rejection.

Additionally, the IRS should evaluate the overall need to reject an e-filed "imperfect tax return." Ideally, the rejection of an e-filed tax return provides a taxpayer the opportunity to correct a clear error at the filing stage. However, if the rejection forces the taxpayer to paper file the return with the uncorrected error, the taxpayer and the IRS are in no better position. The taxpayer experiences all the delays associated with paper processing, and the transcription process can introduce even more errors, which will result in downstream enforcement action. The IRS should evaluate whether it is feasible to accept the imperfect tax return upon filing and direct the return to a treatment stream for further review. Even if this treatment requires some level of manual processing, at least the IRS has captured the return information electronically, which is an improvement over the paper filing of such imperfect tax return. The IRS can work closely with the tax return preparation software industry to ensure that the software provides the taxpayers and preparers the necessary upfront opportunity to correct any potential errors before transmitting the tax return.

Inability to E-File Returns With Attachments

There are a variety of circumstances in which a taxpayer is required or encouraged to submit documentation in support of a return position (*e.g.*, statements, disclosures, explanations, appraisals). It is our understanding that individual taxpayers have been unable to e-file their tax return when it includes at least one attachment. The IRS has stated that its MeF system allows both individual and business taxpayers to e-file tax returns with attachments of most IRS forms and other documentation (*e.g.*, statements, appraisals) if the files are in the proper PDF/Binary format. The taxpayer also has the option to paper file certain supporting documents for an e-filed return by mailing the documents with IRS Form 8453, U.S. Individual Income Tax Transmittal for an IRS e-File Return. This mail-in option is limited to only those forms specifically designated on Form 8453.²²

The IRS's Enterprise Digitalization Office has expressed the need for multiyear funding to enable the IRS to accept all attachments through e-file.²³ It is our understanding that some individual tax return preparation software companies may also place limits on the taxpayer's ability to attach a document to the return, even if it is in the proper PDF/Binary format. The software may not clearly state or locate the instructions on how to properly attach a document to the tax return. Moreover, some taxpayers may not have the necessary equipment to scan and upload documents in the proper format because many taxpayers have become accustomed to capturing images of documents using their cell phones. Because the inability to attach a document is preventing taxpayers from e-filing, we recommend that the IRS collaborate with the software industry to determine how to remove barriers to attaching documents to minimize the paper filing of these tax returns.²⁴

Inability to E-File Returns With Overrides of Prepopulated Fields

Most tax return preparation software products use a question-and-answer (Q&A) format and then populate IRS forms based on user responses. However, there are times when the Q&A format does not produce the correct result, and informed users have the option to override the entries populated onto IRS forms to produce a correct result. Some overrides come with a warning essentially stating that such override will prevent the user from e-filing. According to the IRS, some software products may prevent the user from changing certain prepopulated fields to prevent the IRS from rejecting the e-filed return due to an incorrect value.²⁵ For example, a software product may populate a field on the return based on prior year data, instructions on the forms, or calculations based on other entries. This makes sense when the user attempts to insert an incorrectly calculated number for prepopulated fields based on pure calculations. It does not make sense in other fields not based on pure calculations. In such a case, the software product should clearly warn the user of the risk that a questionable override could result in a potential rejection or subsequent compliance issue, and the user can make the decision whether to accept the risk based on his or her confidence level in the override. The IRS should continue to collaborate with the tax return preparation software industry to determine a workable solution to enable the e-filing of accurate and complete tax returns.

Some Taxpayers Continue to Choose to Paper File

Some taxpayers who have the ability to e-file their return still choose to paper file. While we acknowledge the significant benefits of e-file and implore the IRS to remove barriers to e-file, we respect the preferences of taxpayers who make an informed decision to paper file their returns.

In 2010, the IRS commissioned MITRE to conduct the Phase 2 of the Advancing e-File Study, which included an evaluation of the reasons taxpayers and preparers paper file. The study produced the following reasons:²⁶

- Concern over the security and privacy of internet and e-file;
- Confusion about how e-file works;
- Actual or perceived inability to e-file forms, schedules, and attachments;
- No need for quick refund (or owes taxes);
- Lack of technology necessary to e-file;
- Cost to e-file;
- Recordkeeping concerns (storing electronic copies);
- Unaware e-file is more accurate; and
- Fear of greater risk of audit.

Surveys conducted in 2015 and 2020 by the IRS's Small Business/Self-Employed (SB/SE) Division found similar reasons.²⁷

To reduce these concerns and encourage taxpayers to make informed decisions to e-file, the IRS frequently conducts outreach and education, including annual pre-filing season outreach campaigns, to alert taxpayers to the benefits of e-file.²⁸ The IRS should conduct comprehensive research of individual and business taxpayers as well as their preparers, broken down by demographics, to determine the reasons they continue to paper file and whether they would convert to e-file if they were more informed about the benefits of e-file. The IRS can use the findings of this research to conduct a data-driven outreach campaign to address taxpayers' concerns.

The IRS Does Not Publicize an Updated Long-Term E-File Goal

Section 2001(a) of the IRS Restructuring and Reform Act of 1998 (RRA 98) directed the IRS to set a goal of achieving an 80 percent e-file rate by 2007.²⁹ Since that time, the IRS has not publicized an updated long-term e-file rate goal.³⁰ The IRS previously included e-file rate targets in its budget reporting but discontinued this practice in FY 2019 for the individual e-file rate and in FY 2021 for the business e-file rate.³¹ Two of the

three main goals of the IRS Digitalization Strategy are to (1) reduce paper volume and (2) increase access to data, but the strategy does not include a specific e-file rate goal.³²

The IRS achieved an overall e-file rate of 81.3 percent in FY 2020.³³ In its 2021 annual report, the Electronic Tax Administration Advisory Committee (ETAAC) recommended that the IRS increase its electronic filing goal now that it surpassed an 80 percent e-file rate for major returns in 2017.³⁴ ETAAC did not provide a specific number but recommended that the IRS reset its goal to better match progress since 1998. ETAAC suggested the IRS either raise the 80 percent goal or expand the types of forms included in the 80 percent goal. We support ETAAC's recommendation and encourage the IRS to work with ETAAC to set a new long-term e-file rate goal.³⁵ The IRS should factor into any new e-file goals its planned implementation of e-file mandates included in the Taxpayer First Act.³⁶ Such mandates will increase the overall rate of e-file. However, we recommend that the IRS couples any implementation of e-file mandates with a fair hardship waiver process for taxpayers and preparers who cannot reasonably comply with such mandates.³⁷

Scanning Technology Is Necessary to Efficiently and Accurately Process Electronically Prepared and Paper-Filed Returns³⁸

During the 2021 filing season (through August 26), about six million paper-filed individual tax returns were electronically prepared using commercial tax return preparation software.³⁹ Ideally, the IRS will succeed in its efforts to convert many of these taxpayers to e-file; however, achieving a 100 percent e-file rate is not realistic in the foreseeable future, and we are not suggesting it should be, as the IRS will continue to receive some of these returns on paper.

Both taxpayers and the IRS would benefit by improving the efficiency and accuracy of paper return processing, particularly since transcription errors occur in connection with nearly one quarter of individual paper tax returns.⁴⁰ Technology is available that would allow the IRS to scan paper returns prepared with software to capture the data more accurately and efficiently than manual transcription. To enable the IRS to utilize one form of scanning technology, known as 2-D barcoding, tax return preparation software would generate and imprint a horizontal or vertical barcode containing all return information on the return. The IRS, upon receiving the paper return, would scan the barcode, capture the data, decode it, and process the return as if it had been transmitted electronically. Many states have used 2-D barcoding for paper-based income tax returns for more than a decade.⁴¹ The IRS itself has partnered with the software industry to enable taxpayers to file Schedules K-1 with a 2-D bar code.⁴²

The IRS has adopted another type of scanning technology known as OCR to process certain forms filed on paper. With this technology, the IRS scans the paper-filed return (without a barcode), captures the data, stores the tax form images and data in an electronic format, and processes the return as if it had been e-filed.⁴³ A major advantage of OCR technology is that it is not limited to digitizing returns prepared with software and prevents the need for manual data entry. OCR is, admittedly, less accurate at capturing data from handwritten returns, but it is our understanding that such accuracy will increase with the integration of artificial intelligence technology.⁴⁴

While scanning technology is not considered e-filing and still involves the submission of a paper return, it produces many of the benefits of e-filing for the taxpayer and the IRS, including: (i) faster tax return processing and delivery of refunds, (ii) more accurate recording of tax return information, and (iii) return processing cost savings. Despite these benefits, the IRS does not have updated scanning technology (*e.g.*, 2-D barcoding, OCR, or similar data extraction technology) for many paper-filed returns, including individual income tax returns. In addition, adoption of these (or similar) technologies will require the IRS to: (1) update the applicable forms (*e.g.*, to add a 2-D barcode and provide the requisite spacing for OCR) and (2) closely coordinate with the tax return preparation and filing software companies.

The IRS has indicated an interest in adding 2-D barcodes on all IRS forms and outgoing correspondence, due to the industry-proven efficiencies associated with extracting machine-readable data from paper returns and correspondence. It has worked on this issue with the software industry as part of the Technology Verticals of its Pilot IRS program.⁴⁵ Because the IRS has indicated a low adoption rate of 2-D barcode technology to Schedules K-1 by software companies, it should meet with industry representatives to determine how to minimize any barriers to further expansion of such technology, while at the same time obtaining statutory authority requiring the adoption of 2-D barcodes (or similar technologies). The IRS is also considering new OCR technology through its Pilot IRS program. However, widescale expansion of both 2-D barcode and OCR technologies will require additional multiyear funding.⁴⁶

To further increase e-file, the IRS must evaluate and address the barriers taxpayers face to facilitate e-filing for taxpayers.

CONCLUSION AND RECOMMENDATIONS

The IRS still receives a significant number of paper-filed returns from individual and business taxpayers. To achieve the significant benefits of e-file, the IRS must evaluate the current obstacles taxpayers and the agency face to increase the e-file rate. It must focus on and prioritize expanding e-file to commonly used forms that taxpayers and preparers can only paper file. To further increase e-file, it must evaluate and address the barriers taxpayers face to facilitate e-filing for taxpayers. Such efforts include evaluating e-file rejections to determine how the IRS can partner with the tax return preparation software industry to minimize errors causing such rejections and whether rejections are necessary at all. In addition, it must partner with the industry to determine how to reduce the e-file obstacles for returns with attachments and overrides. Because it has surpassed the 80 percent e-file goal set by RRA 98, the IRS should reset its goal, especially as it plans to implement e-file mandates in the Taxpayer First Act. Finally, the IRS must conduct research to determine why some taxpayers continue to paper file their returns. For those taxpayers and preparers who continue to paper file, the IRS should strive to improve the accuracy and efficiency of processing paper returns.

Preliminary Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Evaluate the overall need to reject an e-filed “imperfect tax return” and determine the feasibility of accepting the imperfect tax return upon filing and directing it to a treatment stream for further review.
2. Work closely with the tax return preparation software industry to ensure that the software provides the taxpayers and preparers the necessary upfront opportunity to correct any potential errors before e-filing that would currently result in an e-file rejection.
3. Meet with tax return preparation software industry representatives to determine how to minimize the paper filing of software-prepared tax returns that include attachments. The goal of such discussions should be to devise a workable solution that permits taxpayers to e-file returns.
4. Meet with tax return preparation software industry representatives to determine how to minimize the paper filing of software-prepared returns with overrides of some prepopulated fields. The goal of such discussions should be to devise a workable solution that permits the e-filing of these returns.
5. Conduct comprehensive research to determine the reasons individual and business taxpayers and their preparers, broken down by demographics, continue to paper file and whether they would convert to e-file if they are more informed about the benefits of e-file. The IRS can use the findings of this research to conduct a data-driven outreach campaign to address taxpayers’ concerns.

6. Meet with tax return preparation software industry representatives to determine how to minimize any barriers to incorporating 2-D barcode technology into electronically prepared returns that are printed and filed on paper.
7. Utilize 2-D barcoding and optical character recognition (or similar) technology to improve the accuracy and efficiency of processing of paper tax returns.
8. Collaborate with ETAAC to set a new long-term electronic filing rate goal. Any implementation of e-file mandates to achieve these goals must be coupled with a fair hardship waiver process to accommodate taxpayers and preparers who cannot comply.

Legislative Recommendation to Congress

The National Taxpayer Advocate recommends that Congress:

1. Provide multiyear funding for the IRS to expand the use of 2-D barcoding and optical character recognition technology to improve the accuracy and efficiency of paper return and correspondence processing.⁴⁷

RESPONSIBLE OFFICIALS

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IRS COMMENTS

Through October 23, 2021, the IRS processed 151.6 million individual electronically filed (e-file) returns, which was 91.2 percent of all individual returns processed. As of November 29, 2021, the IRS also processed 41.2 million e-filed business returns. The IRS continues to see increases in e-filed tax returns, and we continue to expand the scope of service by adding more forms available for e-file, building on paperless processing capabilities, and leveraging Free File services to promote e-file.

In 2021, the IRS added five new forms to the modernized e-file platform including Form 990-T, Exempt Organization Business Income Tax Return and Schedule LEP (Form 1040), Request for Alternative Language Products by Taxpayers With Limited English Proficiency. We also redesigned Form 1040-NR, U.S. Nonresident Alien Income Tax Return, to reflect updates made to the Form 1040 due to legislative changes. For 2022, the IRS is developing 14 additional e-fileable forms, including Schedules K-2 and K-3 for Form 1065, 8865, and 1120-S returns, and Form 9000, Alternative Media Preference, which provides taxpayers options for future communications with the IRS including Braille and audio formats. These efforts not only increase e-file capabilities, but provide assistance to those with specific needs.

Pending funding approval, during Fiscal Year (FY) 2022 the IRS will expand e-file capabilities for Form 1040-X, Amended U.S. Individual Income Tax Return, by allowing e-filing of amendments for non-electronic original returns and offer e-filing of Form 1040-X for all 1040-family returns.

Additional funding for FY 2023 will precipitate discussions on automating backend processing for Form 1040-X adjustments. These changes are another step to improve the taxpayer experience, although the required funding must compete with numerous legislative needs and other IT service demands.

We actively encourage taxpayers to use IRS Free File services to file electronically. To expand awareness, we mailed 2.5 million postcards to taxpayers who previously filed on paper. Free File continues to trend upwards with a 12.9 percent increase in processing year 2021, and a 59.6 percent increase in use of Free File Fillable Forms. Free File companies also offered the ability for taxpayers to e-file amended individual tax returns in 2021. We also developed a successful strategy to assist taxpayers by delivering free tax preparation services through our Volunteer Income Tax Assistance (VITA)/Tax Counseling for the Elderly (TCE) partners using multifaceted approaches, including virtual services.

The IRS is assessing additional ways to reduce paper processing and provide more efficient service for our customers. One option being considered is optical character recognition (OCR). An OCR pilot found returns successfully scanned and processed electronically, thus reducing processing times, errors, and labor-intensive tasks.

Removing electronic barriers and expanding technology to improve the taxpayer experience is a collaborative and complex effort. The IRS evaluates and prioritizes forms for e-file capability, while simultaneously balancing new legislatively required programming, IT priorities, and limited resources. The IRS continues to work with the Taxpayer Advocate Service to review and implement recommendations related to Free File and e-file to continually improve the customer experience.

TAXPAYER ADVOCATE SERVICE COMMENTS

In recent years, the IRS needed to prioritize e-file initiatives given limited resources and increasing legislatively mandated information technology programming requirements. Additional funding would enable the IRS to further evaluate and address the current obstacles preventing taxpayers from e-filing.

Collaboration with the tax return preparation software industry is also necessary to increase e-filing. The IRS can partner with the industry to evaluate e-file rejections and devise a plan to reduce their occurrence. Such discussions with the industry should also address how to enable taxpayers to e-file returns with attachments and/or overrides of prepopulated fields.

Despite the IRS's efforts to increase the e-file rate, it will continue to receive millions of paper returns for the foreseeable future. Additional funding would enable the IRS to utilize 2-D barcode and optical character recognition technology to effectively process those paper returns. While such technology does not convert paper filers to e-file, it improves the taxpayer experience by providing more efficient and accurate processing of paper returns.

RECOMMENDATIONS

Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that IRS:

1. Evaluate the overall need to reject an e-filed “imperfect tax return” and determine the feasibility of accepting the imperfect tax return upon filing and directing it to a treatment stream for further review.
2. Work closely with the tax return preparation software industry to ensure that the software provides the taxpayers and preparers the necessary upfront opportunity to correct any potential errors before e-filing that would currently result in an e-file rejection.
3. Meet with tax return preparation software industry representatives to determine how to minimize the paper filing of software-prepared tax returns that include attachments. The goal of such discussions should be to devise a workable solution that permits taxpayers to e-file returns.
4. Meet with tax return preparation software industry representatives to determine how to minimize the paper filing of software-prepared returns with overrides of some prepopulated fields. The goal of such discussions should be to devise a workable solution that permits the e-filing of these returns.
5. Conduct comprehensive research to determine the reasons individual and business taxpayers and their preparers, broken down by demographics, continue to paper file and whether they would convert to e-file if they are more informed about the benefits of e-file. The IRS can use the findings of this research to conduct a data-driven outreach campaign to address taxpayers’ concerns.
6. Meet with tax return preparation software industry representatives to determine how to minimize any barriers to incorporating 2-D barcode technology into electronically prepared returns that are printed and filed on paper.
7. Utilize 2-D barcoding and optical character recognition (or similar) technology to improve the accuracy and efficiency of processing of paper tax returns.
8. Collaborate with ETAAC to set a new long-term electronic filing rate goal. Any implementation of e-file mandates to achieve these goals must be coupled with a fair hardship waiver process to accommodate taxpayers and preparers who cannot comply.

Legislative Recommendation to Congress

The National Taxpayer Advocate recommends that Congress:

1. Provide multiyear funding for the IRS to expand the use of 2-D barcoding and optical character recognition technology to improve the accuracy and efficiency of paper return and correspondence processing.

Endnotes

- 1 See National Taxpayer Advocate Fiscal Year 2022 Objectives Report to Congress 1-23 (*Review of the 2021 Filing Season*); National Taxpayer Advocate 2020 Annual Report to Congress 2-8 (Most Serious Problem: *Introduction: The Most Serious Problems Encountered by Taxpayers*).
- 2 IRS, Filing Season Statistics Report for Week Ending October 22, 2021, <https://www.irs.gov/newsroom/filing-season-statistics-for-week-ending-october-22-2021>.
- 3 *Id.*
- 4 *Id.*
- 5 *Id.*
- 6 The Taxpayer First Act provides for e-file mandates applicable to partnerships, corporations, exempt organizations, and information returns. Taxpayer First Act, Pub. L. No. 116-25, §§ 2301, 3101, 133 Stat. 981, 1012-013, 1015-016 (2019). Implementation of these provisions will certainly increase the e-file rate for business returns.
- 7 IRS response to TAS information request (Sept. 16, 2021).
- 8 IRS, Document 6746, Cost Estimate Reference FY 2020, Exhibit 40 (June 2021). The cost to process a paper Form 1040 in FY 2020 was significantly higher than the cost in FY 2019 (\$5.49) due to the pandemic. IRS, Document 6746, Cost Estimate Reference FY 2019, Exhibit 40 (June 2020).
- 9 IRS response to TAS information request (Sept. 16, 2021).
- 10 See IRS, Pub. 5316, Internal Revenue Service Advisory Council Public Report 32-36 (Nov. 2020) (IRSAC recommends paper-only forms the IRS should prioritize).
- 11 IRS, Compliance Data Warehouse (CDW) (Sept. 29, 2021). Data compiled from the IRS CDW Individual Returns Transaction File, Business Returns Transaction File, Individual Master File (IMF), Business Master File, Modernized Tax Return Data Base, Electronic Tax Administration Research and Analysis System (ETARAS), Entity Application Programs, and Centralized Authorization File (CAF) databases. The count for the PY 2021 Form W-7 is IRS, 2021 Individual Taxpayer Identification Number (ITIN) Comparative Report (Week ending 10/23/21 v. 10/24/20). Some forms listed in Figure 2.8.1 are submitted multiple times for the same purpose before the IRS processes them properly. E-filing would cut down on repeated submissions and the overall volume of mail and follow-up calls. There are other forms that must be filed on paper but which are not transcribed (or for which complete data is not readily available) including Form 211, Application for Award for Original Information; Form 1045, Application for Tentative Refund; Form 1310, Statement of Person Claiming Refund Due a Deceased Taxpayer (when Part 1 Boxes A and B are present); Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax; Form 4506, Request for Copy of Tax Return; Form 5074, Allocation of Individual Income Tax to Guam or the Commonwealth of the Northern Mariana Islands (CNMI); Form 8288-B, Application for Withholding Certificate for Dispositions by Foreign Persons of U.S. Real Property Interests; Form 8802, Application for United States Residency Certification; Form 8809-I, Application for Extension of Time to File FATCA Form 8966; Form 8822, Change of Address; Form 8898, Statement for Individuals Who Begin or End *Bona Fide* Residence in a U.S. Possession; Form 8918, Material Advisor Disclosure Statement; Form 56, Notice Concerning Fiduciary Relationship; and Form 12153, Request for a Collection Due Process or Equivalent Hearing.
- 12 See IRS, IR-2021-20, New IRS “Submit Forms 2848 and 8821 Online” Offers Contact-Free Signature Options for Tax Pros and Clients Sending Authorization Forms (Jan. 25, 2021); IRS, IR-2021-154, IRS Improves Services to Taxpayers with Digital Authorizations and Launch of New Tax Pro Account (July 19, 2021).
- 13 IRS, CDW, CAF, CAF Source Table (Sept. 29, 2021).
- 14 IRS, IR-2020-182, Major IRS Milestone Helps Taxpayers Correct Tax Returns With Fewer Errors, Speeds Processing (Aug. 17, 2020).
- 15 IRS response to TAS information request (Sept. 16, 2021).
- 16 IRS, CDW, IMF Transaction History Table (Sept. 29, 2021).
- 17 IRS response to TAS information request (Sept. 22, 2021).
- 18 See also IRS, Pub. 5316, Internal Revenue Service Advisory Council Public Report 137-144 (Nov. 2021).
- 19 IRS, CDW, ETARAS MEF 1544 Table (Sept. 29, 2021).
- 20 See, e.g., Howard Gleckman, *Are IRS Security Tools Blocking Millions of People From Filing Electronically?*, FORBES (Apr. 26, 2021), <https://www.forbes.com/sites/howardgleckman/2021/04/26/are-irs-security-tools-blocking-millions-of-people-from-filing-electronically/>.
- 21 IRS, Validating Your Electronically Filed Tax Return, <https://www.irs.gov/individuals/electronic-filing-pin-request> (last visited Sept. 12, 2021).
- 22 IRS response to TAS information request (Sept. 16, 2021). The Form 8453 instructions say, “Don’t attach any form or document that isn’t shown on Form 8453 next to the checkboxes. If you are required to mail in any documentation not listed on Form 8453, you can’t file the tax return electronically.” IRS Form 8453, U.S. Individual Income Tax Transmittal for an IRS e-file Return, General Instructions 2 (2020). Form 8453 is limited to the following designated forms: Form 1098-C, Contributions of Motor Vehicles, Boats, and Airplanes; Form 2848, Power of Attorney and Declaration of Representative; Form 3115, Application for Change in Accounting Method; Form 3468, Investment Credit; Form 4136, Credit for Federal Tax Paid on Fuels; Form 5713, International Boycott Report; Form 8283, Noncash Charitable Contributions; Form 8332, Release/Revocation of Release of Claim to Exemption for Child by Custodial Parent; Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs); Form 8864, Biodiesel and Renewable Diesel Fuels Credit; Form 8885, Health Coverage Tax Credit; and Form 8949, Sales and Other Dispositions of Capital.
- 23 IRS response to TAS information request (Sept. 22, 2021).
- 24 IRS response to TAS information request (Sept. 16, 2021).
- 25 *Id.*
- 26 MITRE Corporation, Document No. 0221.A2b, *Internal Revenue Service: Advancing e-File Study Phase 2 Report: An Examination of Options to Increase Electronic Filing of Individual Returns* 24-25, 34-35 (Dec. 15, 2010).
- 27 IRS response to TAS information request (Sept. 17, 2021) (SB/SE response details the FY 2020 SB/SE Customer Experiences, Expectations, and Needs Survey and the Employment Tax e-File Survey for Tax Practitioners, November 2015).
- 28 See, e.g., IRS, IR-2021-35, Avoid Pandemic Paper Delays: Use e-File With Direct Deposit for Faster Refunds as IRS Prepares to Open 2020 Filing Season (Feb. 11, 2021); IRS, IR-2020-02, IRS Opens 2020 Filing Season for Individual Filers on Jan. 27 (Jan. 6, 2020).
- 29 RRA 98, Pub. L. No. 105-206, § 2001, 112 Stat. 685, 723 (1998).
- 30 IRS response to TAS information request (Sept. 16, 2021).

Most Serious Problem #8: E-Filing Barriers

- 31 IRS response to TAS information request (Sept. 16, 2021).
- 32 IRS response to TAS information request (Sept. 22, 2021); IRS, Enhancing Systems and Processes to Better Serve Taxpayers (July 22, 2021), <https://www.irs.gov/about-irs/enhancing-systems-and-processes-to-better-serve-taxpayers>.
- 33 IRS, Pub. 55-B, Internal Revenue Service 2020 Databook 2 (June 2021).
- 34 IRS, Pub. 3415, Electronic Tax Administration Advisory Committee Annual Report to Congress 36 (June 2021).
- 35 See also IRS, Pub. 5316, Internal Revenue Service Advisory Council Public Report 141 (Nov. 2021).
- 36 The Taxpayer First Act provides for e-file mandates applicable to partnerships, corporations, exempt organizations, and information returns. Taxpayer First Act, Pub. L. No. 116-25, §§ 2301, 3101, 133 Stat. 981, 1012-013, 1015-016 (2019). Implementation of these provisions will certainly increase the e-file rate for business returns.
- 37 For an example of e-file mandate administrative exemptions and waiver processes, see IRS Notice 2011-26, 2011-17 I.R.B. 720 and Rev. Proc. 2011-25, 2011-17 I.R.B. 725, respectively.
- 38 See National Taxpayer Advocate 2022 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 12 (Require the IRS to Work With Tax Software Companies to Incorporate Scanning Technology for Individual Income Tax Returns Filed on Paper)*.
- 39 IRS, CDW (Jan. 1, 2021 through Aug. 26, 2021).
- 40 IRS response to TAS information request (Sept. 16, 2021).
- 41 Federation of Tax Administrators, 2-D Barcode Frequently Asked Questions (June 19, 2007).
- 42 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 Sept. 16, 2021).
- 43 See Internal Revenue Manual (IRM) 3.41.274, General Instructions for Processing via SCRIPS (Nov. 5, 2019); IRM 3.41.275.1, Program Scope and Objectives (Nov. 14, 2017).
- 44 Meeting Between the Council for Electronic Revenue Communication Advancement and TAS on the topic of e-File Barriers (Nov. 10, 2021); Meeting Between the Pennsylvania Department of Revenue and TAS on the topic of e-File Barriers (Nov. 10, 2021).
- 45 IRS response to TAS information request (Sept. 22, 2021); Department of Treasury, Pilot IRS Informational Posting (Apr. 2, 2021), <https://sam.gov/opp/5eb4fcfbdf342bd94c0af400dbcca38/view?index=opp&naics=541&page=9>.
- 46 See IRS response to TAS information request (Sept. 22, 2021); Department of Treasury, Pilot IRS: Enterprise Digitization and Case Management Office (EDCMO) Digitalization Technology Pilot OCR Awards (July 26, 2021), <https://sam.gov/opp/3d9a450e51df4bc9b3f75ddc12b9a578/view>.
- 47 National Taxpayer Advocate 2022 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 12 (Require the IRS to Work With Tax Software Companies to Incorporate Scanning Technology for Individual Income Tax Returns Filed on Paper)*.