

Testimony for the IRS Oversight Board
*Streamlining Tax Administration:
How the IRS Can Streamline Its Own Processes and Decrease Taxpayer Burden*

National Payroll Reporting Consortium
February 1, 2005

Chairman Wagner and distinguished members of the Board: My name is Tony Tullo. I am the Director of Federal Compliance for Automatic Data Processing, Inc., and am speaking on behalf of the National Payroll Reporting Consortium (NPRC)¹ today. The NPRC is committed to working with the IRS to improve tax administration through electronic filing and related systems, and we appreciate the Board's role in helping to make this happen.

The NPRC represents businesses – “Reporting Agents” in IRS terminology – that provide human resource-related administrative services to employers, including payroll processing and employment tax payment and filing services. NPRC members serve more than one million employers with a combined total of more than 35 million employees, and process payroll for more than one-third of the private sector workforce. Reporting Agents transmit about 30 percent of all Federal depository taxes received by the U.S. Treasury, and have long served an important role in our nation's tax collection system as a conduit between employers and the IRS. Reporting Agents improve the efficiency of IRS tax collection and improve tax compliance.

We appreciate the ongoing efforts by the IRS to work with NPRC to resolve issues and problems, including the issues addressed in this testimony. We are pleased with IRS efforts to improve Reporting Agents' ability to provide better service to taxpayers. For example, over the past year the IRS developed new procedures for Reporting Agents to verify client names and Federal IDs via the IRS Practitioner Hotline, and added a section to the IRS website to explain the purpose and provide examples of notices related to business tax filings.

These improvements were facilitated by the SB/SE Taxpayer Education and Communication Division. TEC has acted as the liaison between Reporting Agents and IRS' functional areas responsible for various customer service programs. We understand the IRS, as part of its ongoing effort to ensure its organizational structure meets the needs of taxpayers and their representatives, is considering changes regarding TEC. Whatever their decision, we would hope that TEC will continue as the focal point for outreach to Reporting Agent industry.

We also would like to specifically single out the IRS' SBSE Office of Burden Reduction for their efforts this past year. Through their efforts, the IRS has developed an improved reporting procedure for employers to use when a consolidation, merger, or acquisition occurs. This new procedure will greatly reduce notices issued to employers regarding wage reporting reconciliation between the IRS and Social Security Administration.

Nevertheless, since our testimony before the Oversight Board in 2003 and 2004, despite IRS and NPRC efforts, little progress has been made to make e-services available to Reporting Agents. We are hopeful that progress may be made this year. This paper provides background on the role of Reporting Agents in tax administration, and discusses how the IRS can streamline

¹ The following companies are members of NPRC: Automatic Data Processing, Inc.; Ceridian Corporation; Compupay, Inc.; Federal Liaison Services, Inc.; Fidelity Employer Services Company LLC; Intuit, Inc.; Paychex, Inc.; PayMaxx, Inc., Payroll People, Inc.; PayCycle, Inc., and Primepay, Inc.

processes, reduce government costs and decrease taxpayer burden through expansion of e-services.

Electronic Tax Administration: Beyond E-Filing And Electronic Payments

Reporting Agents should be the model for all electronic tax filing programs. Reporting Agents have been paying and filing employment taxes electronically for many years: *All* federal tax returns are filed electronically, and *all* federal taxes are deposited electronically. In stark contrast, the IRS generates hundreds of thousands of notices annually that are handled using technology unchanged since the 1940's: written correspondence and telephone exchanges. Written correspondence means weeks or months of waiting for simple issues to be resolved. Telephone exchanges mean hours upon hours of hold time. These methods unnecessarily sap IRS and Reporting Agent resources -- a drain that is especially unfortunate because the vast majority of these inquiries relate to matters that could be easily and quickly resolved without any need for burdening IRS personnel if Reporting Agents had electronic access to client information through e-services.

The IRS is making "e-services" available to certain third parties such as tax practitioners, financial institutions, and 1040 electronic return originators. E-services include the ability to transmit client registrations, requests for client transcripts, and information to resolve client account issues (e.g., misapplied payments, penalties). Reporting Agents are not currently included in e-services and there is currently no concrete plan to include Reporting Agents in future phases. The IRS SB/SE division has made providing e-services to Reporting Agents a priority, but has been unable to provide even an estimated date by which such services might be available.

Expanding IRS electronic services is a prime example of the E-Government mandate expressed in the President's Management Agenda. E-services will cut government operating costs by allowing authorized self-service, reduce the expense and difficulty of doing business with the government, and provide customers with readier access to high quality government services.

In terms of potential to enhance IRS efficiencies through e-services, Reporting Agents are the "low-hanging fruit". Providing Reporting Agents with e-services access would result in immediate use of the system on behalf of more than one million business taxpayers, and would significantly reduce the IRS' burden. For example, many interactions are preventative pre-filing activities, such as confirming an Employer Identification Number before making a payment or filing a return. The IRS should be aggressively enabling such pre-filing services in order to *prevent* problems and notices that would otherwise result. Most of these activities would also be on a self-service basis.

The IRS issues over *8 million* penalty notices annually related to employment taxes; more than one per employer per year. Although the payroll service industry represents 20% of employers (and one-third of employees are paid through payroll services), such organizations receive about 200,000 notices annually. (A proportionate number would be 1.6 million, but higher accuracy of such service providers results in fewer notices.)

If just *half* of the 200,000 notices took a conservative 30 minutes of IRS staff time to resolve, *e-Services would eliminate workload equivalent to 25 IRS full-time staff (FTEs), or some \$2 million annually* - - just for the small proportion of notices handled by authorized payroll service organizations. For example, a significant proportion of the calls made are to obtain

details on what caused an assessment or a notice; or to determine the disposition of credits applied or offset, or deposits or other returns posted. Transcript delivery would make it unnecessary for an IRS staff member to field and respond to such calls.

Instead, Reporting Agents mostly resolve such notices by calling the IRS Practitioner Priority Service (a telephone-based system), which requires an average of 3 to 7 minutes² of unproductive waiting time per call, before even reaching an IRS staff member. It also obviously absorbs IRS staff time.

An important part of the IRS' strategy has been to provide e-services as a reward or inducement to increase participation in electronic filing. From the magnetic tape programs of the early 1980's to the current e-file and EFTPS programs, Reporting Agents have demonstrated strong support of IRS electronic filing and payment programs. Reporting Agents file over 95% of electronically filed IRS employment tax returns, for example, and in 2004, generated over 27 million EFTPS payments out of a total of roughly 100 million EFTPS transactions processed from all sources. The omission of Reporting Agents from e-services means that the IRS has *penalized* -- not rewarded -- the sector that has contributed the most in terms of helping IRS to reach their goals for electronic filing of business tax deposits and returns.

IRS e-filing systems and formats have evolved significantly, from magnetic tape files, to structured Electronic Data Interchange, and recently to XML. Data security and file management systems have changed equally rapidly. Each IRS change has meant additional costs and workload for Reporting Agents to implement the latest version. Each change (i.e., mag tape, to EDI, to XML) also meant that prior investments in e-filing systems had to be discarded. Direct costs to industry to implement and maintain IRS electronic filing systems are conservatively in the tens of millions of dollars in recent years alone. Electronic services would help Reporting Agents justify the substantial costs of developing and maintaining electronic filing systems. If the IRS wishes taxpayers and tax professionals to file electronically, the IRS should make it beneficial to do so.

NPRC supports adding appropriate e-services functionality for Reporting Agents, with the recognition that some elements of IRS electronic services were designed for income tax practitioners, and may not be relevant or appropriate for Reporting Agents. E-services for Reporting Agents should include the following:

- Ability to verify that the Reporting Agent has an authorization on the Reporting Agent File (RAF)
- Online access to client IRS accounts by Reporting Agent associates
 - Secure environment to submit and receive information
- Individual and bulk access/transaction capability
 - Any registered employee of the Reporting Agent should be able to work on any client account
 - Ability to submit requests and information related to multiple accounts
- Pre- and post-filing research capability
 - Online viewing of client account activity, modules, transcripts, etc.

² Treasury Inspector General for Tax Administration: The Practitioner Priority Service Was Successful in Its First Year of Operation, but Action to Reduce Caller Wait Time Is Needed, July 2003 2003-30-143

- Entity verification, e.g., confirmation of taxpayer EIN, name, assigned tax deposit schedule, etc.
- Account resolution
 - Online submission of correspondence and adjustments
 - Requests for holds on accounts pending research to avoid unnecessary notices
 - Online case tracking (e.g., received, in process, closed)
 - Ability to submit requests for penalty waivers on a pre-assessment basis
- Electronic Notices: Online access to view and download notices

EFTPS - A Prime Example of IRS Administrative Improvements Benefiting Taxpayers

The Oversight Board is undoubtedly aware that the IRS is considering alternatives to provide oversight over unenrolled return preparers. Congress and the IRS are also considering whether oversight over Reporting Agents ('payroll tax deposit agents') may improve the safety of client tax funds. However, in recent years the IRS has already administratively done more to improve the safety of client funds than any regulatory oversight program could ever accomplish, through the design and implementation of the Electronic Federal Tax Payment System (EFTPS).

EFTPS enables businesses, including clients of such agents, to view their tax account online via secure Internet connection. Clients can confirm that tax payments have been received by the IRS and posted to their account as soon as the day after the tax deposit due date. This represents a vast improvement in enabling businesses to protect their assets, as there was previously no convenient way to know if tax payments were being received or not. We applaud the IRS in their thoughtful design and implementation of this feature of EFTPS. In fact, the NPRC has recently been highlighting EFTPS as a possible model for state revenue agencies.

We appreciate the opportunity to provide input to the IRS Oversight Board.

The Role of Reporting Agents and Their Contributions to Improving IRS Tax Collection

Background

- Reporting Agents assist employers in making required tax deposits and tax information filings to the Federal Government and to state and local governments. With respect to Federal tax requirements, Reporting Agents perform the following services:
 - Preparation and electronic filing of Form 941, Employer's Quarterly Federal Tax Return; Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, and Form 945, Annual Return of Withheld Federal Income Tax; and
 - Electronic submission of Federal Tax Deposit (FTD) payments and related information.

Reporting Agents Remit Nearly 30 Percent of All Depository Taxes Received by the United States Treasury

- Of the roughly \$1.5 trillion in total federal depository taxes paid in 2002, almost 30 percent was deposited by Reporting Agents.
- The vast majority of Reporting Agents' EFTPS transactions represent deposits for taxpayers who are not required to submit tax payments electronically.

Tax Compliance Is Significantly Enhanced for Businesses That Utilize Reporting Agents

- The ever-increasing complexity of the Internal Revenue Code is a significant challenge for businesses that do not use Reporting Agents. For example, the wide and poorly understood array of fringe benefits and monetary and non-monetary compensation can often cause considerable confusion. Reporting Agents offer the expertise to ensure that such types of income are automatically taxed and reported correctly.

IRS Resources Are Spared Because of Payroll Reporting Agents

- Reporting Agents shoulder much of the burden of IRS tax administration by filing all tax deposits and returns electronically. In fact, over 95% of electronically filed IRS employment tax returns are filed by Reporting Agents.
- Reporting Agents help ensure that business owners are kept up-to-date on tax law, tax regulations, and IRS procedural changes.

Reporting Agents Have Been Key Partners With the IRS in Helping to Achieve Electronic Filing Goals

- Reporting Agents transmit all tax deposits and related information electronically through the Electronic Federal Tax Payment System (EFTPS) Bulk or Batch Filer programs. The inclusion of all Reporting Agent tax deposit activity is critical to the IRS' ability to reach EFTPS goals. The EFTPS Bulk and Batch Filer programs were developed and implemented through an exemplary cooperative effort to enhance EFTPS.

- Many Reporting Agents have helped to facilitate electronic filing of individual income tax returns, by enabling all employees of client companies to electronically “import” the more than 34 fields of W-2 data — including salary and withholding information — into electronically prepared individual income tax returns. Direct electronic importing of such data facilitates computer-assisted tax preparation, increasing the chances that such returns will be filed electronically, and helping to eliminate income tax return transcription errors.
- Many Reporting Agents promote electronic filing of individual tax returns by printing the IRS e-file logo on employee copies of Form W-2. As a result, roughly 40 million taxpayers are reminded of the benefits of electronic filing (e.g., "*Safe, Accurate, FAST*") and provided with a reference to the IRS website, at the very moment they are preparing their tax return.