

Internal Revenue Service’s Real Time Tax System Initiative (“RTTS”)
Oversight Board Public Forum
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Commissioner Miller, Chairman Cherecwich and members of the IRS Oversight Board, thank you for the opportunity to discuss the Real Time Tax System Initiative.

My name is Harry Cooper and I am the Executive Deputy Director of the South Carolina Department of Revenue.

The Internal Revenue Service (“IRS”) envisions a “Real Time Tax System” (“RTTS”) in which third party information returns (e.g., W-2s and 1099s) would be electronically available to the IRS during the income tax filing season rather than after. The idea is to move from an “After the Fact” business model to a “Real Time” business model.

By operating with a RTTS, the IRS would be able to identify discrepancies and permit individuals to address problems at the time of filing. The hope is that this would make dramatic improvements to the US tax system in terms of efficiencies and accuracy as well as reduce the burden on taxpayers.

From the states’ perspective, it is hoped that such an initiative can help validate information at the time of filing. This could provide many benefits for the states, such as:

- Real time fraud detection
- Obtaining levy information in a more timely fashion
- Savings of postage for notices associated with CP2000
- Revenue in the bank sooner
- Upfront verification of income items or payments
- Fewer amended returns to process each year. (Some taxpayers file a return prior to receiving all of their W2s.)
- Return issues would be resolved sooner.

Costs associated with a RTTS may include:

- Due dates may need to change in order to accommodate the collection of informational returns needed for verification.
- Assuming this process would be used on electronically filed returns, there is a risk for a negative impact on electronic filing if taxpayers who file paper are not subject to the verification and correction process.

- If original returns are delayed in processing, taxpayers may send multiple copies of the returns thinking that the initial return was not received

The implementation of a RTTS could also impact how the process works between taxpayers, practitioners, and the IRS:

- Some taxpayers may not be able to resolve issues on their own and would need the assistance of practitioners, etc.
- Practitioners may have to accept more responsibility in regards to return preparation and corrections.
- The process may take multiple contacts between practitioner and taxpayer. The cost of this may be passed along to the taxpayer. The process for the taxpayer to grant authority to the practitioner would have to be simple and quick. Records would need to be maintained regarding who can have access to taxpayer information.
- The RAL (Refund Anticipation Loan) process may be impacted. The return may need to be “accepted” by the IRS prior to the preparer giving the RAL to the taxpayer. There may be additional delays in the process.
- It appears that the process for assigning ITINs to those taxpayers that cannot get a SSN would be impacted by this process, as well as the wage and withholding verification for these taxpayers.

The RTTS could also impact the online services of the IRS:

- The automated “Where’s My Refund?” program may need to include a status telling the taxpayer that their return is being held for verification and possible correction.
- FASFA (Free Application for Student Financial Aid) allows IRS information to be imported once filed, and this program may have an impact on that process.
- If the electronic filing population is targeted, taxpayers may go back to filing by paper if there are perceived delays in receiving their refund.

To address the many issues that could arise with a Real Time Tax System, and to begin the program in a time of limited budgets, a pilot program with a specific restricted population of taxpayers - EZ filers could be a base group to target.

From a taxpayer’s perspective and a tax professional perspective, it has been suggested that taxpayers and tax preparers should have access to the information. If available, access to this information could greatly assist taxpayers and their tax preparers, with taxpayers benefiting from having their pertinent tax information upfront prior to filing their returns.

However, regardless of how the tax system evolves to become more “real time,” one overriding consideration must be at the forefront of the development of a “Real Time Tax System.”

SECURITY

The Security Breach

As you know, in South Carolina last year, we were the victims of a cyber attack. As a result of this cyber attack, the following were exposed in the security breach:

- 3.8 million Social Security numbers
- 387,000 credit and debit card numbers (5,700 unencrypted)
- 657,000 business tax filings
- 3.3. million bank records

The cost to South Carolina has exceeded \$20 million. In addition, this \$20 million does not include the cost of upgrading security at other state agencies who also received a “wake-up call” as a result of the security breach at the Department of Revenue.

So, the first and the last consideration on any system gathering this much information must be SECURITY.

Since the security breach was revealed, the cyber attacks on the Department of Revenue per month have increased by 3,500% to 57,000 per month. A system as large as the Real Time Tax System envisions by the IRS would be a prime target for cyber criminals.

Lesson Learned

Under the category of “Lessons Learned,” we have learned the hard way:

- Security is Non-Negotiable
- Relying on technology creates a false security
- People with access to a system create the greatest risk
- Continuous Education/Training/Communication is the key to reducing risk
- Security must be woven into the fabric of every aspect of an organization and its processes
- Meaningful Risk Assessment allows for process improvement, procedural reviews, management reporting and hardware and software implementation
- Effective security governance ensures the Chief Information Security Officers reports directly to the Chief Executive Officer

In developing a Real Time Tax System, consideration should be given to:

- Meeting with both small and large providers of information returns to understand how they conduct their business on a day-to-day level
- Meeting with tax preparers and software developers to better understand how they conduct their business on a day-to-day level

Understanding how these stakeholders conduct their businesses on a “day-to-day” level will improve security of the system. It is extremely important that the Information Technology professionals who will design the system understand these stakeholders’ operations.

Consideration should also be given to discussing security of such a system with the federal agencies that monitor and combat cyber attacks. These agencies have described cyber attacks as the #1 threat to the United States. Lessons learned by these agencies could be invaluable in designing the system.

A Real Time Tax System containing the name, address, social security number, the employer, and income of nearly every citizen in the United States would be a prime target for cyber criminals from around the world and security must be a prime consideration. In addition, security will be even more important if the system will allow taxpayers and tax preparers access to their information or their client’s information as part of an online service.

Disclosure

If the Real Time Tax System will allow taxpayers and tax preparers access to their information or their client’s information as part of an online service, consideration should be given to:

- What is required to gain access
- Will access be limited to a specific time period (e.g., 1 month, filing season)
- How does a third party (e.g., tax preparer) gain or lose authorization for access
- How can it be assured that a third party does not have access if they are no longer employed by the taxpayer
- Who is the responsible party within a tax preparation firm – staff preparer, manager, partner

Conclusion:

The concept of a Real Time Tax System is intriguing and could be a positive change in tax administration. But, the experience of South Carolina should be a reminder to all stakeholders in this project that security must be a prime consideration – especially if the system evolves into an online service for taxpayers, tax preparers, payroll reporting companies and others. As tax administrators, we not only have a legal obligation to protect the taxpayer information entrusted to us, but we also have a moral obligation to protect that information. The foundation of the country’s model of voluntary tax compliance depends on it.