



IRS Oversight Board

Electronic Filing 2012 Annual Report to Congress

DECEMBER 2012

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Executive Summary

In keeping with the *Internal Revenue Service (IRS) Restructuring and Reform Act of 1998* (RRA98), this report provides an update on the progress being made in electronic filing (e-file) through 2012. It also highlights other major developments in electronic tax administration (ETA)¹ during the year, along with key challenges to attaining the broader ETA vision. Electronic filing of tax returns is one component of the ETA concept in which the vast majority of pre-filing, filing, and post-filing interactions among taxpayers, tax professionals, and the IRS are conducted electronically.

The e-file progress made in 2012 is particularly noteworthy as the IRS, in partnership with private industry, has finally achieved the strategically important goal of an 80 percent e-file rate for individual income tax returns—a goal originally set in RRA98. Based on filing results for most of 2012, the Board estimates that individual e-file will reach at least 81 percent, up from 77 percent in 2011. This major milestone reflects a culmination of years of effort, and the chart on pages 8 and 9 provides a fuller picture of the concerted actions taken over

the years by the IRS, industry, and Congress to bring about the achievement of this strategic e-file goal.

2012 is particularly noteworthy as the IRS, in partnership with private industry, has finally achieved the strategically important goal of an 80 percent e-file rate for individual income tax returns.

While the IRS achieved the e-file goal for individual returns articulated in RRA98, it fell short of the subsequent e-file goal established in 2007, in conjunction with the *IRS Strategic Plan*, which called for an 80 percent e-file rate for all major individual, business, and tax exempt returns by the year 2012. The Board estimates that the e-file rate for all major tax returns in 2012 will be only about 71 percent, leaving the IRS nine percentage points below the target associated with its strategic plan. Nevertheless, the Board is generally satisfied with the overall steady progress being made in

the percent of major tax returns filed electronically, which grew more than four percentage points between 2011 and 2012, and which the Board expects to reach 80 percent in the near future.

Other major trends in 2012 e-file include:

- The total number of individual e-file returns grew about seven percent in 2012, to a little over 119 million—aided by a five percent growth in individual e-file returns submitted by paid preparers and a nine percent growth in self-prepared returns filed online.
- The total number of business and tax exempt e-file returns grew around 16 percent in 2012 to approximately 17 million—this increase was driven particularly by the growth in partnership and corporate e-file returns, which increased nearly 27 percent, as well as the growth in Form 1041 estate and trust returns impacted by the e-file mandate for paid return preparers.

There have been a number of other significant ETA advancements during 2012.

¹ Electronic tax administration is the foundation for a modernized IRS that provides secure, convenient, timely, and accurate services to taxpayers.

Among these are the start of daily tax account processing for individual returns under the Customer Account Data Engine (CADE) 2 program and the full implementation of the Form 1040 modernized e-file (MeF) application, which is now capable of accommodating virtually all individual income tax returns. The IRS has also introduced an enterprise-wide solution to the matter of e-authentication for IRS

online services, which addresses a particularly vexing challenge that is critical to ETA's future.

In terms of major challenges still remaining, the Board notes several key issues that must be addressed. Among these are the need to increase the electronic filing of employment tax returns in pursuit of the 80 percent e-file goal for all major tax returns; the need to address tax fraud, including

schemes based on identity theft; and the need to see the CADE 2 program through to full fruition so as to retire the antiquated Individual Master File system. Also important is the need to identify a new long-term goal, beyond the current 80 percent e-file target, that would enable the IRS and industry to focus their efforts on broader strategic outcomes that better reflect the full ETA vision.

Achievement of the 80 Percent e-File Goal for Individual Returns Called for in the *IRS Restructuring and Reform Act of 1998*

Recognizing the many benefits increased electronic filing (e-file) would provide taxpayers and tax administration, policymakers included in the *IRS Restructuring and Reform Act of 1998* (RRA98) a goal that 80 percent of returns (interpreted as individual income tax returns) be filed electronically by the year 2007.² That goal reflected an extremely challenging target given that, at the time, only 20 percent of individual income tax returns were filed electronically despite nearly a decade of individual e-file experience. The focus created by that plainly articulated goal in RRA98 has proven to be an effective catalyst for coordinated efforts by the IRS, the tax professional community, and Congress that has led to tremendous progress in electronic filing, as well as progress toward the broader vision of electronic tax administration (ETA). Based on filing results for most of 2012, the Board estimates that individual e-file will reach at least 81 percent in 2012, up from 77 percent in 2011.

While it has taken longer to achieve the 80 percent e-file goal for individual return filings than originally articulated in RRA98, this in no way diminishes the significance of this major milestone. Attainment of this challenging goal in 2012 reflects the culmination of an impressive degree of sustained concerted actions by multiple parties on a common public purpose. These actions include the direction and support of Congress, the ingenuity and initiative of the IRS and its partners in the tax professional industry, and the cooperation of American taxpayers.

Through RRA98, Congress provided strategic direction by explicitly stating that paperless filing should be the preferred means of filing Federal tax returns and by further providing the 80 percent e-file goal as the yardstick by which to measure progress. In response, the IRS and its partners in the tax professional community worked in a cooperative fashion

over many years to introduce new and innovative products and services to draw more and more taxpayers to e-file. Indeed, the Government Accountability Office (GAO) recently used the success of individual e-file as one of three case studies to demonstrate how Congress can use policy direction, legislative support, and performance information to foster a results-oriented culture in the Federal government.³

The IRS Oversight Board commends Congress, the IRS, the tax professional community, and America's taxpayers for achieving the 80 percent e-file goal for individual returns in 2012. This milestone reflects the culmination of years of effort, innovation, and adaptation. The chart on pages 8 and 9 provides a fuller picture of this success by illustrating major actions taken over the years by the IRS and key stakeholders to further the progress toward the 80 percent individual e-file goal articulated in RRA98.

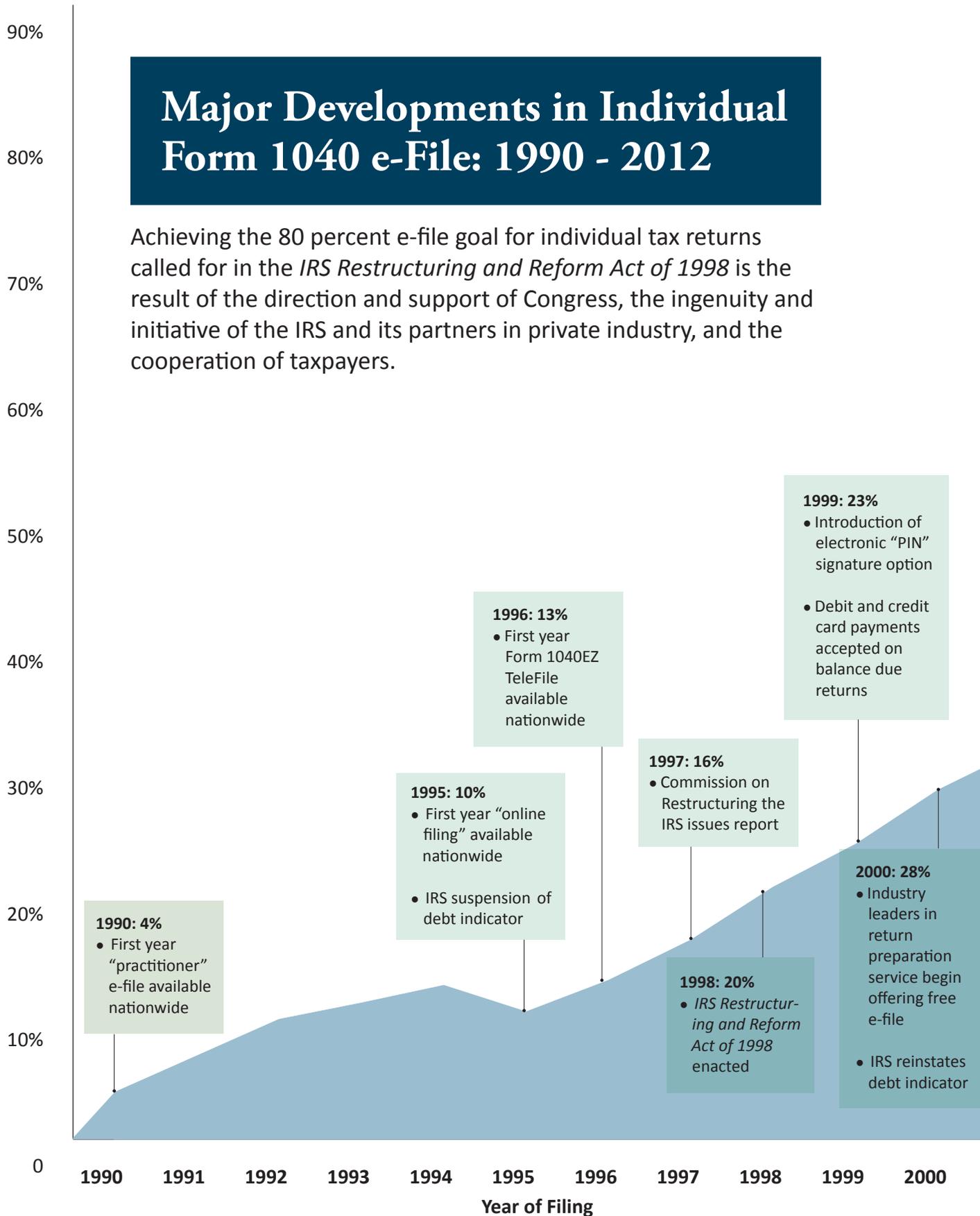
² Public Law 105-206, 105th Congress, July 22, 1998.

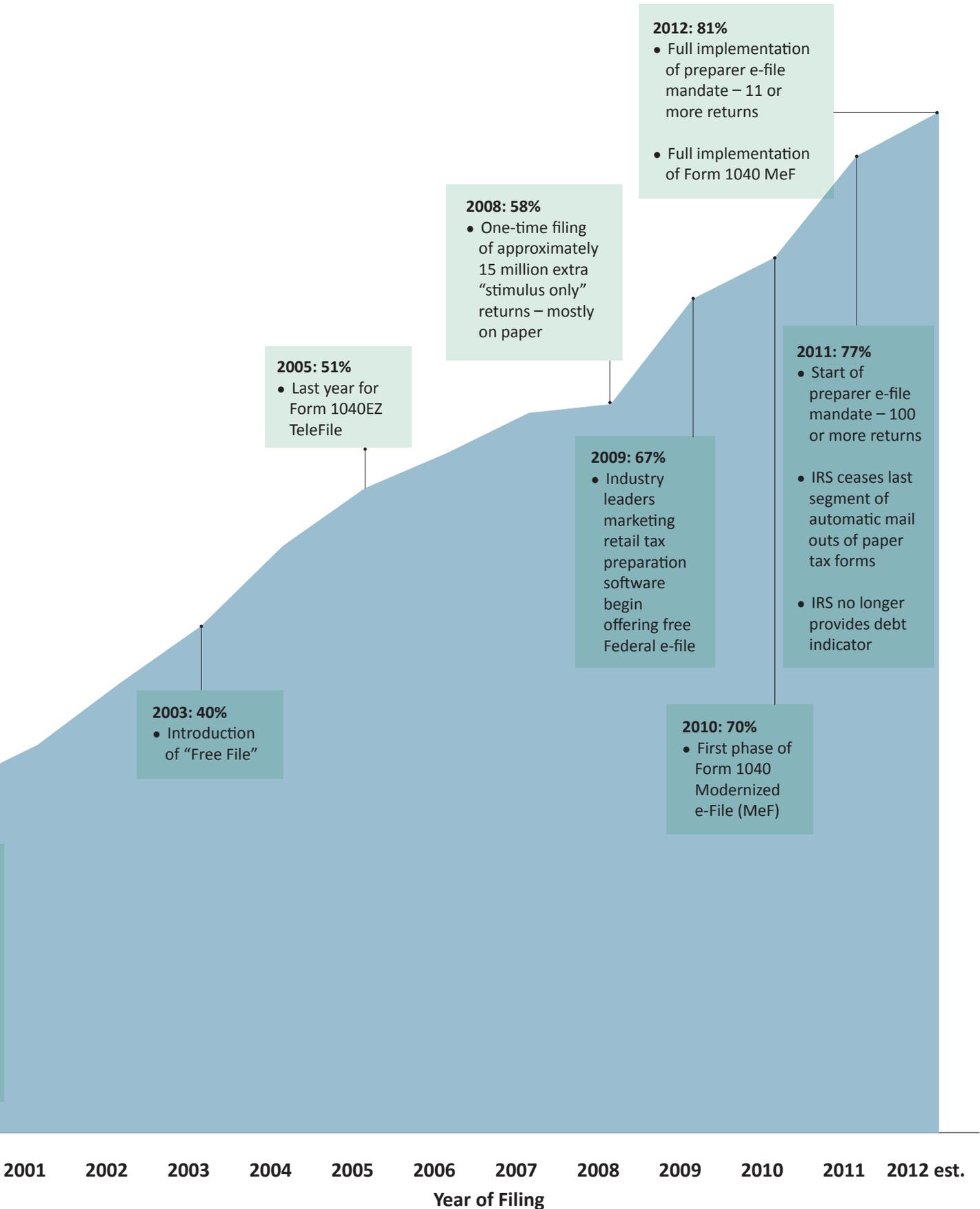
³ The U.S. Government Accountability Office, *Managing for Results: Opportunities for Congress to Address Government Performance Issues*, GAO-12-215R, December 9, 2011.

e-File Rate

Major Developments in Individual Form 1040 e-File: 1990 - 2012

Achieving the 80 percent e-file goal for individual tax returns called for in the *IRS Restructuring and Reform Act of 1998* is the result of the direction and support of Congress, the ingenuity and initiative of the IRS and its partners in private industry, and the cooperation of taxpayers.



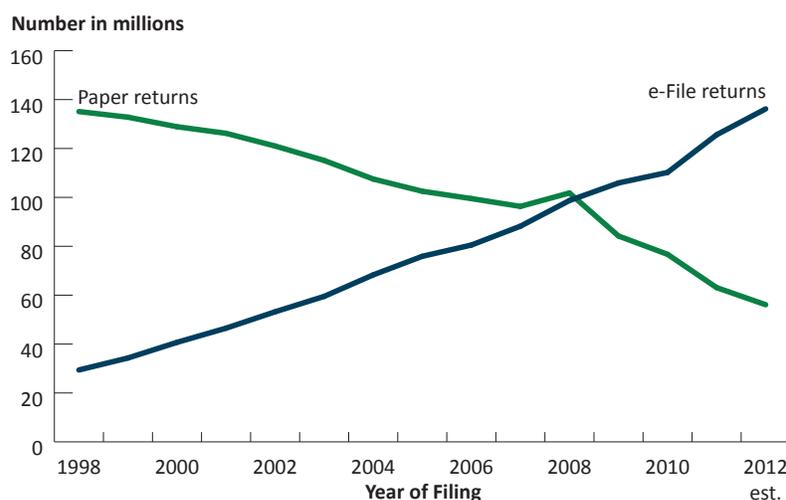


Trends in Electronic Filing through 2012

The IRS provides electronic filing options for the vast majority of individual, business, and exempt organization tax returns.⁴ The dramatic change in the submission of these returns that has been brought about by e-file, since the passage of RRA98, is illustrated in Figure 1. In 1998, only about 29 million individual, business, and tax exempt returns were filed electronically with the IRS, while over 135 million returns were filed on paper. However, for 2012, the Board estimates⁵ that over 136 million tax returns will now be filed electronically, compared to approximately 56 million filed on paper. Clearly, the filing of tax returns on paper is steadily becoming a thing of the past.

The strategic importance of e-file derives in part from its benefits to taxpayers. These benefits include no need to mail paper returns; faster refunds; greater return accuracy; confirmation that the tax return has been received; and secure and confidential submission of highly personal return information.

FIGURE 1.
Number of Major Tax Returns: e-File versus Paper



SOURCE: IRS with IRS Oversight Board 2012 estimates

Filing of tax returns on paper is steadily becoming a thing of the past.

Electronic filing also substantially reduces IRS submission processing costs, resulting in productivity savings that are typically reinvested into other IRS programs that provide additional services to taxpayers. Further, the lower error rate on e-file returns reduces burden on taxpayers

and avoids additional processing costs for the IRS. In addition, e-file lays the groundwork for further improvements in tax administration because it enables 100 percent capture of the information on returns in a digital fashion.

⁴ The major tax return form types considered in this report are those in which the filers account for income, expenses, and/or tax liabilities. In general, these consist of individual income tax returns; employment tax returns; corporation income tax returns; partnership returns; trust, estate and gift tax returns; real estate mortgage investment conduits; exempt organization returns; and excise tax returns. Returns excluded from this universe include amended returns, payment vouchers, and requests for filing extensions.

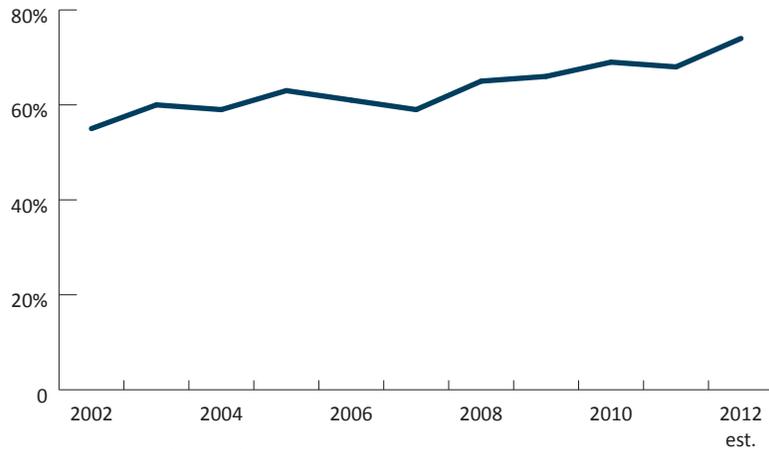
⁵ At the time this report was prepared, the Board had access to actual 2012 return filings through early Fall for most, but not all, electronically filed returns. Also, the available data on year-to-date filings to estimate total returns (i.e., both paper and electronic) generally reflected counts through Summer 2012. These available data were used to develop the full year 2012 estimates in this report, primarily on a fiscal year of filing basis.

Taxpayers recognize the importance of e-file. As shown in Figure 2, the Board’s annual taxpayer attitude survey reveals that over the past decade, the share of the general public who say it is “very important” that the IRS provides opportunities for electronic filing has grown from 55 percent to 74 percent. In addition, as shown in Figure 3, individuals who file their returns electronically consistently report a much higher satisfaction level with the filing process than do the individuals who file their returns on paper—based on the American Customer Satisfaction Index (ACSI) score for individual return filers compiled by the University of Michigan and its associates.

Individuals who file their returns electronically consistently report a much higher satisfaction level with the filing process than do the individuals who file their returns on paper.

FIGURE 2.

Percent of Public Who Say It Is Very Important That the IRS Provides Opportunities for Electronic Filing

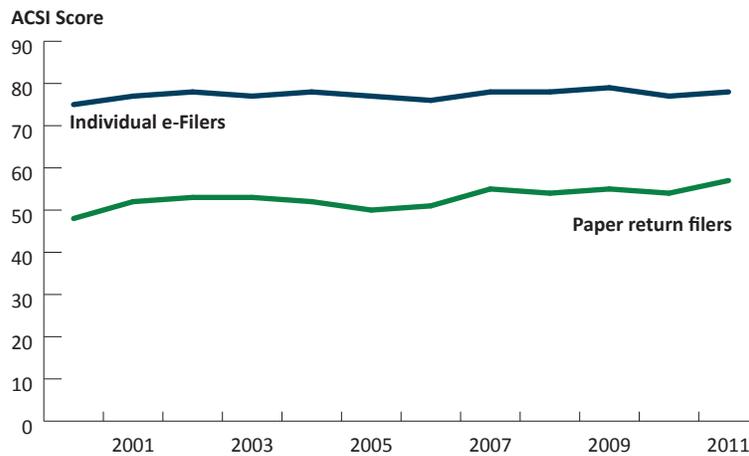


SOURCE: IRS Oversight Board Taxpayer Attitude Surveys

A large and growing majority of the public believes it is very important that the IRS provide opportunities to e-file.

FIGURE 3.

American Customer Satisfaction Index Scores: Individual e-Filers vs. Paper Return Filers



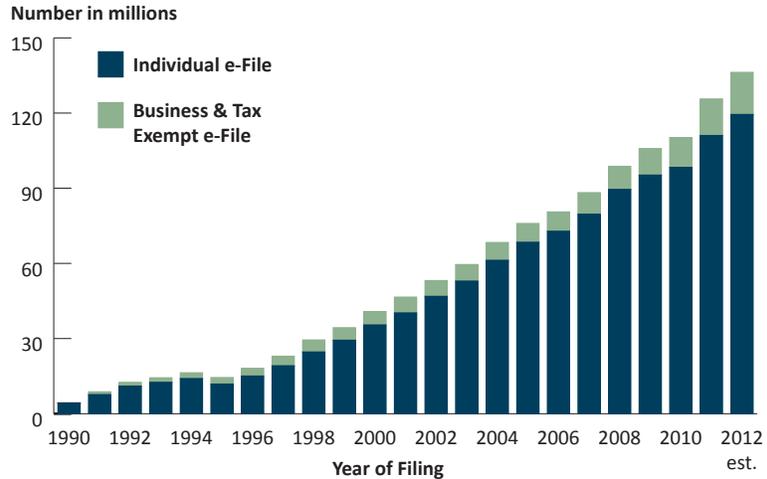
SOURCE: www.theacsi.org

Individuals who e-file consistently report higher satisfaction.

The latest trends in individual, business and tax exempt e-file through filing year 2012 are depicted in the following time-series graphs. Data on the number of e-file returns received by the IRS are presented in Figures 4 through 6. These data depict both total volumes and selected segments, including individual returns by preparation method (i.e., self-prepared versus paid preparer) and business/tax exempt returns by major return types.

FIGURE 4.

Number of Electronically Filed Returns: Individual, and Business and Tax Exempt

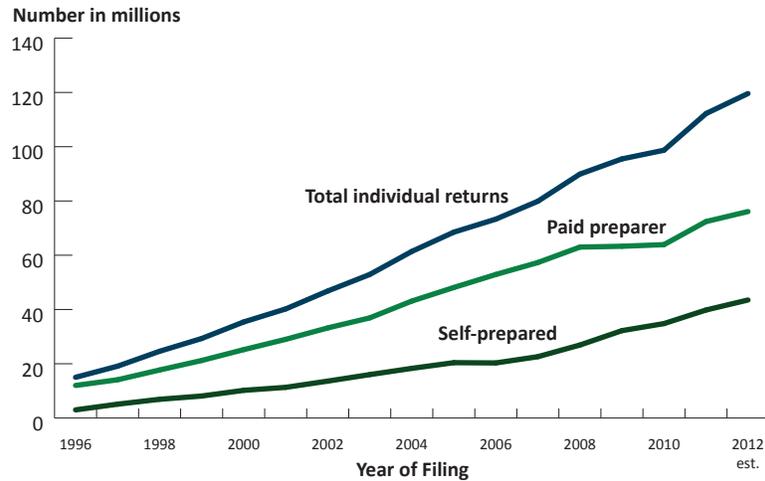


SOURCE: IRS with IRS Oversight Board 2012 estimates

Individual income tax returns make up the vast majority of all major tax returns filed electronically (about 119 million out of 136 million in 2012), but the share comprised of business and tax exempt e-file has been growing in recent years.

Total individual e-file grew about 7% in 2012; Self-prepared online filing grew about 9%, while Paid preparer e-file grew about 5%.

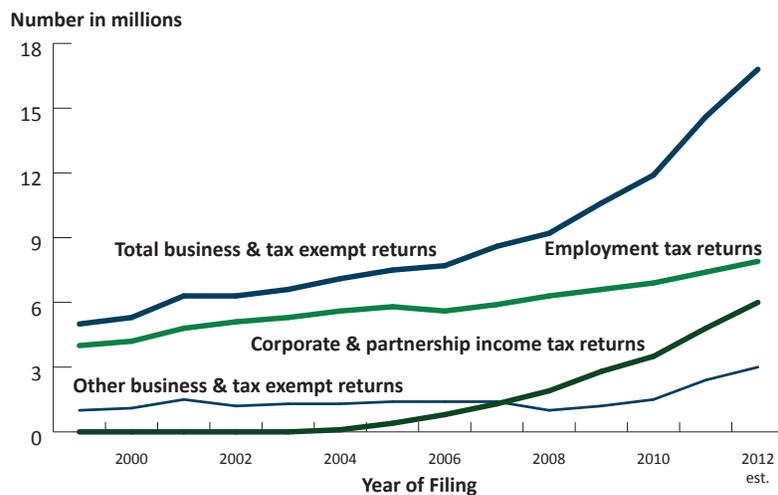
FIGURE 5.
Number of Individual e-File Returns by Preparation Method



SOURCE: IRS with IRS Oversight Board 2012 estimates

Total business & tax exempt e-file grew around 16% in 2012—driven particularly by the growth in Corporate & partnership (nearly 27%) and the Other business and tax exempt⁶ (around 26%). Meanwhile, the 2012 growth in Employment tax e-file was a more moderate 7%.

FIGURE 6.
Number of Business and Tax Exempt e-File Returns by Return Type



SOURCE: IRS with IRS Oversight Board 2012 estimates

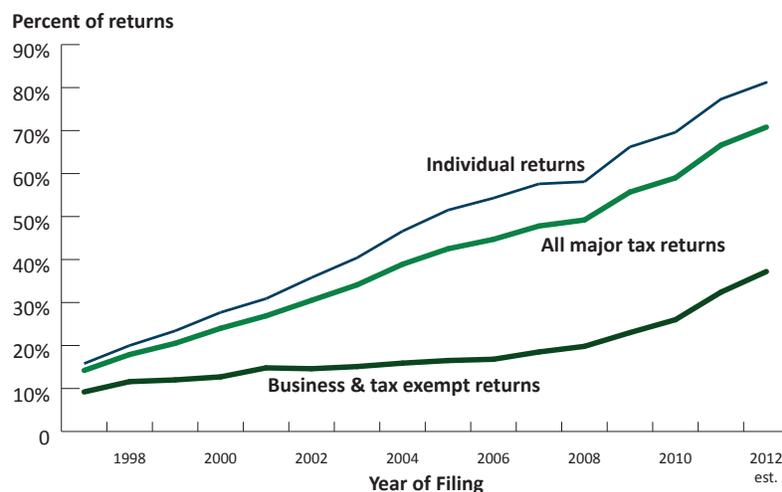
⁶ Other business and tax exempt e-file consists primarily of estate and trust Form 1041 returns, excise tax returns such as Form 2290, and the exempt organization Form 990 series returns. In addition, the e-file mandate for paid preparers of individual returns, now set at 11 or more returns, also applies to preparers of Form 1041 returns. This mandate has contributed to a noticeable increase in Form 1041 e-file in 2011 and 2012 (and the associated return segment for other business and tax exempt e-file presented in this report).

Overall, trends indicate steady continual progress, both in the volume of e-file returns received and the associated rate of e-file participation.

Figures 7 through 9 present the data on the percentage of returns filed electronically (i.e., e-file rates)—again considered in total and by selected segments. Overall, the trends indicate steady continual progress, both in the volume of e-file returns received and the associated rate of e-file participation. More specific findings are noted in the highlights accompanying each figure.

FIGURE 7.

Percent of Major Tax Returns Filed Electronically



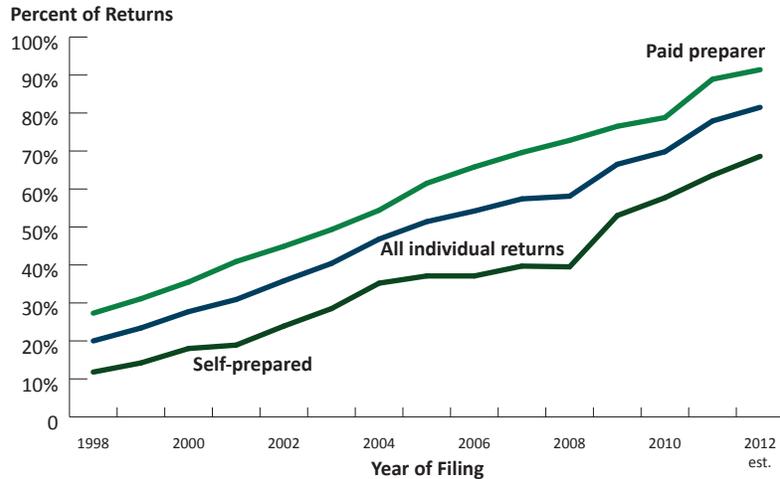
SOURCE: IRS with IRS Oversight Board 2012 estimates

The e-file rate for Individual tax returns was about 81% in 2012—up four percentage points from 2011 and achieving the goal originally called for in RRA98; the e-file rate for Business & tax exempt returns grew five percentage points in 2012 to around 38%; the 2012 e-file rate for All major tax returns combined rose to about 71%.

The 2012 e-file rate for Paid preparer individual returns was approximately 91%, up about 2.5 percentage points from 2011 and aided in part by the lowering of the e-file mandate threshold to preparers filing 11 or more returns; the e-file rate for Self-prepared returns rose about five percentage points to nearly 69% in 2012.

FIGURE 8.

Percent of Individual Returns Filed Electronically by Preparation Method

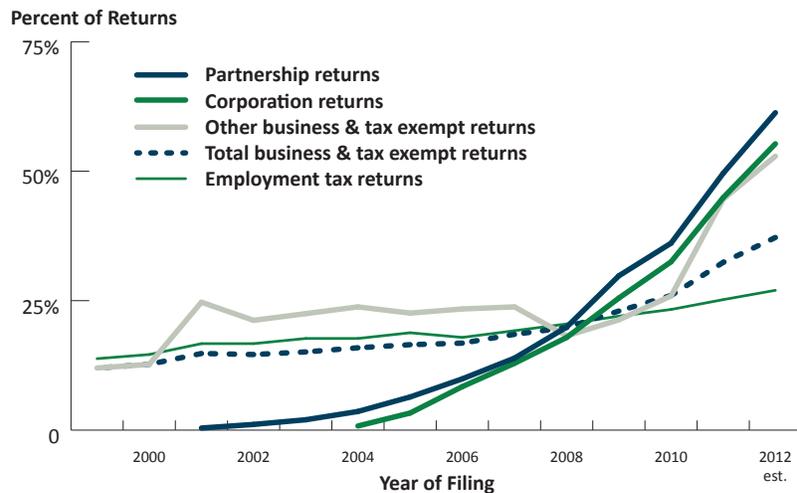


SOURCE: IRS with IRS Oversight Board 2012 estimates

The estimated 2012 e-file rates for Partnership returns (63%), Corporation returns (57%) and Other business & tax exempt returns (53%) all continue to exhibit particularly strong growth trends in recent years, and have served to raise the e-file rate for Total business and tax exempt returns to 38% in 2012; in contrast, the estimated e-file rate for Employment tax returns is a more modest 27%, up only slightly from 2011.

FIGURE 9.

Percent of Business and Tax Exempt Returns Filed Electronically by Form Type



SOURCE: IRS with IRS Oversight Board 2012 estimates

Tracking Progress on the 80 Percent e-File Goal for All Major Tax Returns

RRA98 called for an 80 percent e-file goal for individual returns by the year 2007. Recognizing the value of having such a clearly articulated goal but also acknowledging that the IRS and tax professional community were unlikely to reach that challenging target by the year originally specified, the Board approved a new long-term e-file goal in early 2007. That new goal, developed in conjunction with an update of the *IRS Strategic Plan*, recommitted the IRS to the 80 percent e-file target, but expanded the challenge by broadening the types of returns covered. The new goal called for a combined e-file rate of 80 percent for all major tax returns filed by individuals, businesses, and tax exempt organizations by the year 2012.

The Board has been tracking progress toward the 80 percent

The new goal called for a combined e-file rate of 80 percent for all major tax returns filed by individuals, businesses, and tax exempt organizations by the year 2012.

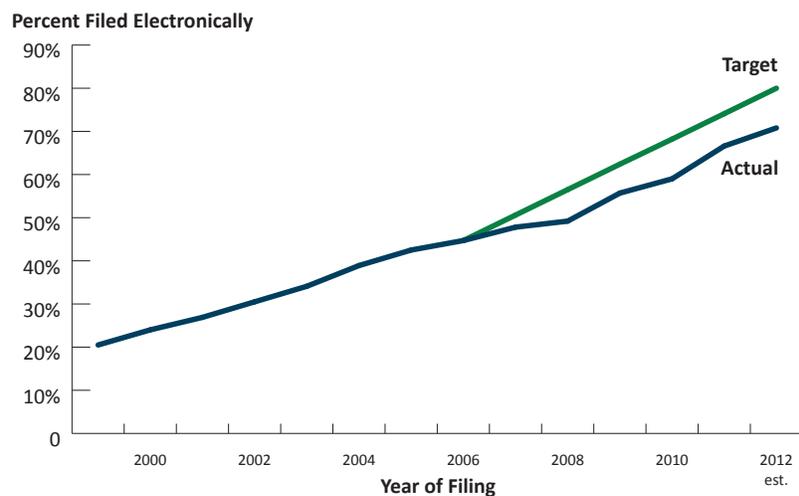
e-file goal for all major tax returns since 2007 using a trend analysis graph. That graph, which has been presented in prior Board reports, is included again this year as Figure 10. This figure presents the “target” linear trend line for e-file participation for the years 2007 through 2012, contrasted with the actual filing results. The base year

of 2006 was selected to measure progress as it reflects the last year of actual e-file experience prior to the Board approving the long-term IRS measure recommitting the agency to the 80 percent goal.

As indicated in Figure 10, the Board estimates that around 71 percent of all major individual,

FIGURE 10.

e-File Rate for All Major Tax Returns Combined: Actual vs. Target



SOURCE: IRS and IRS Oversight Board analysis

The 2012 e-file rate for all major tax returns is approximately 71%; while short of the *IRS Strategic Plan* goal of 80 percent, the Board is confident that the goal will eventually be reached because of the continued efforts of the IRS, industry, and Congress.

business, and tax exempt returns will be filed electronically in 2012, leaving the IRS about nine percentage points below the target goal. While the Board is disappointed that the 80 percent e-file goal for all major tax returns will not be realized in 2012, it is generally satisfied with the steady progress that has been made to date and is optimistic about achieving the 80 percent goal for all major tax returns in a few more years. Part of that optimism comes from the underlying historical upward trend in the share of major returns filed electronically. However, the Board is also optimistic because it believes the IRS, private industry, and Congress remain committed to increasing the share of returns filed electronically and will continue to deliver the enhancements, innovations, and support that will eventually meet and exceed the 80 percent e-file goal for all major tax returns.

Electronic Tax Administration: Notable Developments during 2012

Electronic filing is extremely important to good tax administration. However, e-file is only one component of a broader range of tax-related technology applications embedded in the concept of electronic tax administration. Electronic tax administration (ETA) is the foundation for a modernized IRS that provides secure, convenient, timely, and accurate services to taxpayers, and to the tax professionals and IRS employees who serve them. The full vision for a modern ETA environment goes beyond just e-filing and seeks to make electronic interactions among taxpayers, tax professionals, and the IRS the norm. Such electronic interactions must include the entire range of pre-filing, filing, and post-filing tax activities, which taxpayers and their representatives may engage in with the IRS, including the ability to resolve taxpayer account issues using the Internet.

Such a comprehensive vision is in keeping with RRA98 and with the *E-Government Act of 2002*,⁷ which seeks to promote the use of the Internet and other information technologies to improve government services for

citizens and internal government operations. The ETA vision is further embedded in key IRS long-term planning initiatives including the *IRS Strategic Plan* and the agency's Business Systems Modernization (BSM) program, which is delivering such key technological foundations as the Customer Account Data Engine (CADE) 2 capabilities and the various Modernized e-File (MeF) systems. In short, ETA is a central part of the IRS' strategic thinking and remains the means by which IRS can evolve into a truly modern organization that can deliver world-class service and save taxpayers money by working more efficiently.

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In future editions of this report to Congress, the Board expects to devote more attention to ETA matters and provide somewhat less detail on e-file. This is partly in recognition that e-file is only one part of the broader strategic focus of electronic tax administration. This is also because the IRS has now achieved the 80 percent e-file goal for individual returns articulated in RRA98—the progress toward which was a key reason this annual report from the Board was required under that law.

The IRS and its partners in the tax professional community have introduced many innovative and useful ETA products and services over the years. As it has in the past, the Board wishes to highlight some of the major ETA developments during the year that impacted taxpayers and tax professionals.

Start of Daily Tax Account Processing Under CADE 2

As reported by the Treasury Inspector General for Tax Administration (TIGTA), the mission of the CADE 2 program

⁷ Public Law 107-347, 107th Congress, December 17, 2002.

is to provide state-of-the-art individual taxpayer account processing and technologies to improve service to taxpayers and enhance IRS tax administration.⁸ In January 2012, the IRS delivered one of the major components of the CADE 2 program, i.e., daily processing of individual taxpayer accounts. This was accomplished by enhancing the computer code within the legacy Individual Master File (IMF) system and by successfully revamping decades-old practices and procedures within IRS' submission processing operations that were previously based on weekly tax account updating.

The IRS transition to daily account processing provides several tangible benefits to taxpayers. These include faster IRS issuance of refunds for millions more taxpayers; faster availability of taxpayer information on IRS web-based applications; and more efficient resolution of taxpayer account issues as tax information is made available to IRS representatives within 48 hours, compared to two weeks under the prior processing routine.

Implementation of the CADE 2 Relational Database

In July 2012, the IRS delivered another major component of the CADE 2 program, i.e.,

successful implementation of the CADE 2 relational database⁹ in a production mode. Through the execution of a complex series of computer programs involving the application of over 5,000 transformation rules and 28 days of processing, the IRS successfully extracted and transformed all the data from the legacy IMF system and loaded it on to the new CADE 2 database. This "initialization" process involved transforming hundreds of billions of specific data fields for over 270 million taxpayer accounts, yet was handled with such precision that IRS officials reported that the results placed on the CADE 2 database "balanced to the penny."

Much work still remains to be done under the CADE 2 efforts before the IRS can fully retire the IMF and the many legacy software applications embedded in it that service other IRS processing systems. Nevertheless, a major foundational step has now been achieved through successful initialization of the CADE 2 relational database. The new CADE 2 database meets the information retention needs for the IRS' main tax account records for individuals and enables the use of modern software tools and applications in the years ahead that will ultimately deliver significantly better products and services to taxpayers, as well as greatly enhance IRS' financial management and data security controls.

The migration to daily account processing and the implementation of the CADE 2 relational database reflect incredibly important milestones for tax administration. The Board wishes to commend both former Commissioner of Internal Revenue Doug Shulman and IRS Chief Technology Officer Terry Milholland, whose effective leadership and focus were instrumental in bringing about the new CADE 2 modernization approach and these systems advancements associated with it.

The migration to daily account processing and the implementation of the CADE 2 relational database reflect incredibly important milestones for tax administration.

Full Implementation of Form 1040 Modernized e-File (MeF)

The 2012 filing season marked the first year of the full implementation of the Form 1040 MeF application for processing individual tax returns. The Form 1040 MeF application was deployed in January 2012 and can now accommodate virtually

⁸ Treasury Inspector General for Tax Administration, *The Customer Account Data Engine 2 Is Making Progress Toward Achieving Daily Processing, But Improvements Are Warranted to Ensure Full Functionality*, Report Number: 2011-20-109, September 28, 2011.

⁹ A relational database refers to an organized way to store information electronically, via a set of formally described tables reflecting a rows and columns format, which enables the data to be accessed easily.

all individual income tax returns, including roughly 150 forms and schedules that can be filed with Forms 1040. Over 60 percent of the roughly 119.5 million individual e-file returns submitted during 2012 were processed through the new Form 1040 MeF system. Furthermore, with the planned retirement of the decades-old legacy e-file system by the end of 2012, Form 1040 MeF is now expected to be the sole e-file system for all individual electronic filings during 2013 and beyond.

Compared to the legacy e-file system for individual returns, the new Form 1040 MeF platform is a much more flexible and modern application that provides better service to taxpayers and preparers. It does so by enabling the IRS to receive and process returns in an Internet format, provide real-time processing of e-file acknowledgements, and streamline error detection and explanation. The Form 1040 MeF application also gives taxpayers the capability to attach PDF documents, and accommodates e-filing of certain prior year returns.

Launch of An Improved IRS Website

In early Fall 2012, the IRS launched an upgraded Internet portal for its official website, IRS.gov, migrating to a new platform and site design. In addition to replacing the underlying system infrastructure with more current

and robust technology, the upgrade also provides taxpayers with better service. This includes an improved search function, streamlined content, and navigation which allows for a more taxpayer-friendly online experience. The site also now includes many more videos and social media options for visitors who prefer those forms over traditional text, an intuitive forms download feature, and simplified online payment options. The upgrade will also allow the IRS to deliver more online service options, and at a faster pace, in the years ahead.

Introduction of an Enterprise-wide Solution for e-Authentication

In August 2012, the IRS began use of a new online e-authentication approach as part of a limited proof of concept effort referred to as the *Send My Transcript to Bank* application. As being explored, this pilot effort provides a new self-service application on IRS.gov that will allow taxpayers to authenticate their identities online and securely send their IRS tax transcript to designated third parties using the Internet. The current pilot effort involves a limited number of banks in which an electronic transcript (e-transcript), summarizing a taxpayer's tax return or account, is being sent by the IRS to the bank, in conjunction with the taxpayer's application for a mortgage or other loan.

What makes this *Send My Transcript* pilot effort particularly important is that it is based on a new security application and set of standards for IRS e-authentication that will serve as the basis for other online applications in the future whenever those applications require the IRS to first substantiate the authenticity of the individual seeking the electronic transaction. This enterprise-wide solution to the matter of e-authentication addresses a major challenge for the IRS previously identified by TIGTA¹⁰ and will now enable the IRS to deploy new online service applications more expeditiously and with the requisite security.

Some Tax Refunds Delayed Early in the Filing Season

Not all the ETA-related developments in 2012 were positive. Over seven million individuals filing their tax returns in the first few weeks of the 2012 filing season experienced a delay in receiving their refunds, typically one week, compared to the time they were originally told to expect receipt of their money. Two problems led to this development. One was tied to computer coding glitches which interrupted the flow of data from the MeF system to the IRS fraud detection system. The other arose from an enhanced process to filter returns for potential fraud, which initially flagged more returns for review than was necessary. According

¹⁰ Treasury Inspector General for Tax Administration, *Changing Strategies Led to the Termination of the My IRS Account Project*, Report Number: 2009-20-102, August 12, 2009.

to the IRS, both problems were diagnosed and corrected by February 7, 2012, and affected only a small proportion of the roughly 117 million individual refunds the IRS would issue in total during 2012.

The Board has been informed that the IRS has taken actions to avoid a repeat of such problems at the start of the 2013 filing season. Among these actions

are more extensive IRS testing of its systems; a closer working relationship between the IRS and key stakeholders to better inform taxpayers as to when to expect receipt of their refunds; and improved communications between the IRS and industry on other refund matters. The Board has also been informed of improvements the IRS has planned in 2013 for the *Where's My Refund* telephone and online applications, which should be

more helpful to taxpayers eager for receipt of their refunds.

Other ETA Advancements

There were a number of other major ETA advancements during 2012, including additional services for victims of tax-related identity theft and new applications on the IRS website. The accompanying table provides a summary of the major ETA advancements in 2012.

Major Advancements in Electronic Tax Administration during 2012

- Start of daily account processing via the Customer Account Data Engine (CADE) 2 program
- Implementation of the CADE 2 relational database
- Full implementation of Form 1040 Modernized e-File (MeF)
- Launch of the new IRS.gov website
- Introduction of an enterprise-wide solution to online e-authentication
- Implementation of the Identity Protection Personal Identification Number (IP PIN) for victims of tax-related identity theft
- Threshold for paid preparer e-file mandate lowered to 11 or more individual returns
- Pilot testing of *Virtual Service Delivery* in 15 locations providing taxpayers access to live IRS assistants via video communications
- New applications on IRS.gov such as tools to calculate applicable repayment amounts for certain prior home-buyer credits; to find key information about tax-exempt organizations; and to find local volunteer return preparation sites
- Expanded IRS offerings on YouTube, Twitter, and the IRS2GO smartphone app
- Additional online tools in support of the roll out of the IRS return preparer regulatory initiative, including applications to certify completion of the new 15-hour continuing education requirement in 2012 and to register for the new Registered Tax Return Preparer competency test
- IRS public meetings seeking input from key stakeholders on the concept of real-time tax administration in which electronic third-party information reports are leveraged in a proactive fashion during the filing process

Major Challenges and Opportunities to Attain the Electronic Tax Administration Vision

To attain a modern ETA environment in which most tax interactions among taxpayers, tax professionals, and the IRS are handled electronically requires meeting major challenges, pursuing key opportunities, and establishing and meeting more comprehensive long-term goals. The discussion below and accompanying tables highlight a number of these challenges, opportunities, and potential goals.

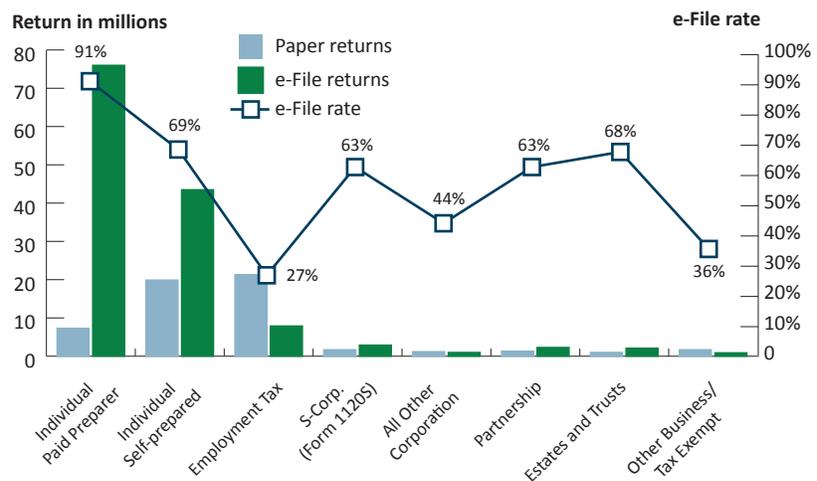
Need to Increase Electronic Filing of Employment Tax Returns in Pursuit of the 80 Percent e-File Goal for All Major Returns

Based on 2012 filings, the Board estimates that the IRS needs to convert approximately 17 million of the remaining 55 million paper tax returns by individuals, businesses, and tax exempt organizations to e-file to reach the 80 percent e-file goal for all major tax returns embedded in the *IRS Strategic Plan*. In attempting to achieve that 80 percent e-file target, the IRS, its partners in the tax professional community,

and policy makers must give careful consideration to those types of tax returns that comprise the bulk of the remaining paper and their relative e-file rates. The results in Figure 11 indicate that

employment tax returns (Forms 940, 941, et. al.) reflect both a major challenge and a great opportunity, in terms of the potential for significant progress toward the 80 percent e-file goal.

FIGURE 11.
Number of Paper vs. e-File Returns, and e-File Rates by Major Return Type - Estimated Filing in 2012



SOURCE: IRS Oversight Board estimates based on partial year IRS data

The large volume of returns still filed on paper, along with the lowest relative e-file rate, make employment tax returns both a challenge and an opportunity in reaching the 80 percent e-file goal for all major tax returns.

This is because employment tax returns account for the largest share of the remaining volume of returns still filed on paper (over 21 million or 38 percent), yet have the lowest e-file rate among the major return groupings (i.e., approximately 27 percent).

One step that could prove helpful in the efforts to increase e-file participation among filers of employment tax returns is the IRS plan to introduce a modernized e-file application for employment tax returns (i.e., “Form 94x MeF”) in filing year 2014. While still a few years away, the flexible and responsive nature of an MeF application could enable the development of more customer-friendly e-file software for employment taxes that might entice more users. However, previous research on employment tax filers compiled by the Electronic Tax Administration Advisory Committee (ETAAC) has also indicated that the employment tax return filing community is highly fragmented, with many who submit only a few such returns and see little economic incentive to e-file.¹¹ Thus, it will be incumbent on the IRS and industry to develop strategies, products, and services that can address such barriers and attract more employment tax filers to e-file, once the Form 94x MeF system is put in place.

Need to Address Tax Fraud Including Schemes Based on Identity Theft

Through June 2012, the IRS reported that it had stopped more than \$8 billion in fraudulent refunds from being issued, an amount greater than the year before. The IRS has also identified more than 460,000 taxpayers who have been victimized by identity thieves since 2008. Not all tax refund fraud is based on identity (ID) theft; nor is refund fraud solely limited to electronically filed returns. Nevertheless, the IRS faces a major challenge in preventing thieves from using the e-file system to commit refund fraud on a large scale, including schemes based on ID theft. The IRS also faces the challenge of providing responsive assistance to taxpayers who have been victims of tax-related ID theft.

The IRS has taken actions to address both these challenges, including continual refinements of its electronic “filters” used to screen returns for fraud and the introduction of the Identity Protection Personal Identification Number (IP PIN) for past victims of tax-related ID theft. The IP PIN stops the processing of future fraudulent refunds with those stolen identities yet enables the victims to file electronically in subsequent years and receive their

refunds within normal processing times. The IRS and the Justice Department have also taken steps to work more effectively with state and local officials to combat stolen identity refund fraud.

In addition, the Board has been informed of promising steps in the future, based on improved ETA capabilities, that could provide significantly better fraud prevention along with better service to ID theft victims. These steps include improvements based on more advanced data analytical processes, greater use of e-authentication in real time, and various cooperative actions with professionals in private industry. Nevertheless, the IRS must remain vigilant to the challenges of refund fraud and tax-related ID theft and seek continual improvements in these areas.

Need to Remain Focused on Delivering the Customer Account Data Engine 2 Program

While the IRS has moved to daily account processing for individual returns and implemented a relational database under the CADE 2 program, there is still much work to be done in the years ahead before the IRS can end its dependency on the antiquated master file systems and associated computer code. This

¹¹ The Electronic Tax Administration Advisory Committee, *Electronic Tax Administration Advisory Committee Annual Report to Congress*, IRS Publication 3415, June 2011.

work includes bringing the CADE 2 relational database into full production mode so that it feeds all applicable downstream IRS processing systems; replacing the IMF-based service and compliance processing applications written in outdated computer languages with new applications built on modern programming languages that leverage the CADE 2 relational database; retiring the IMF entirely; and ultimately turning attention to replacing the Business Master File (BMF) and related systems—drawing from the lessons learned from the IMF CADE 2 program.

The Board strongly supports the CADE 2 program underway and encourages the IRS and policymakers to continue to devote the necessary resources and management attention to this

strategically important program to bring it to full fruition. Until the old master file systems are replaced, they will continue to handicap the achievement of the broader ETA vision. Meanwhile, as progress is made under the CADE 2 efforts, taxpayers will continue to reap further service and compliance benefits that this modern technology enables.

Long-Term Goal for Electronic Tax Administration Beyond 80 Percent e-File

While the Board is disappointed that the IRS did not achieve the 80 percent e-file goal for all major tax returns by 2012, it believes this goal and its predecessor specified in RRA98 were instrumental in

bringing about the steady rise in e-file participation over the years and that an 80 percent e-file rate will be achieved in the not too distant future. Furthermore, as the IRS and industry approach the targeted 80 percent e-file rate, and as the IRS takes steps to update its strategic plan, a logical question arises as to what the new goal for ETA should be beyond the 80 percent milestone. For example, should any such new goal within an updated IRS strategic plan merely reflect a higher numerical e-file target percentage, or should the IRS and industry focus instead on broader ETA measures that encompass much more than electronic filing? Consideration of such issues, in turn, gives rise to another fundamental question: what should electronic tax administration look like over the next 5-to-10 year horizon?

Major Challenges in Electronic Tax Administration

- Increasing e-file among employment tax filers in pursuit of the 80 percent e-file goal for all major tax returns
- Addressing tax fraud including schemes based on identity theft
- Delivering the CADE 2 program and replacing the Individual Master File system
- Protecting IRS systems and taxpayer data from unauthorized access and cyber-attacks
- Delivering the computer systems needed to implement the Affordable Care Act
- Providing a replacement system for the IRS' electronic filing system for information and withholding documents
- Leveraging increased volumes of electronic data more strategically
- Maintaining and furthering beneficial electronic tax administration partnerships with private industry
- Providing an e-file option for amended individual returns
- Making it easier to submit electronic payments to the IRS
- Responding to legislation passed late in the year

In reviewing the recommendations contained in the 2012 ETAAC report to Congress¹², the Board discerned one such possible future vision for ETA. The report makes 12 recommendations designed to drive five specific outcomes. The recommendations put forward by ETAAC are thoughtful, and the Board finds merit in all of them. In addition, while not presented as such, the five outcomes the ETAAC recommendations seek to achieve provide a future vision for ETA worth considering. It is a vision in which the IRS has met its 80 percent e-file rate for all major tax returns; has delivered the MeF and CADE 2 modernization programs; and has articulated the standards and fostered the partnerships with industry that have resulted in a wide range of new and innovative Internet-based services for taxpayers.

Another future vision for ETA reflects a “real time” tax administration system in which the IRS would leverage third party information reports (such as Forms W-2 and 1099) to electronically screen returns at the time of filing.¹³ However, while the IRS secured formal input from stakeholders on this concept during 2012, it remains largely a notional idea with no specified time frame for development. Nevertheless, as one part of a possible long-term vision for ETA, the Board retains interest in the concept of some type of pre-validation filing process,

The Oversight Board finds merit in the latest recommendations from the 2012 Electronic Tax Administration Advisory Committee Annual Report to Congress and the following outcomes those recommendations seek to advance:

- IRS reinforcement of the software technology and infrastructure standards expected of industry to promote and safeguard taxpayer information
- Continual improvement toward the 80 percent electronic filing goal for all major tax returns
- Empowered taxpayers and tax professionals who submit more accurate returns through effective leveraging of Internet-based tools and tax industry relationships
- IRS sponsorship and participation in forums among tax software developers and return preparation companies to facilitate further IRS-industry partnering on improved service delivery to taxpayers
- Continued budgetary support for the modernized e-File (MeF) and Customer Account Data Engine (CADE) 2 modernization programs

whether handled by the IRS or in partnership with taxpayers or their representatives, which uses available third-party information reporting documents. Such a system could provide significant benefits to tax administration including much greater fraud prevention and reduced burden on taxpayers.

In terms of identifying other possible quantifiable long-term measures and goals for ETA, the Board has received suggestions along several dimensions. Some focus on measures similar to the e-file goal, including suggestions to ratchet-up the various percentages of returns, information documents, and/or tax payments received

electronically. Another suggestion, tied to the concept of real time tax administration, recommended consideration of a measure that would center on the percentage of applicable information documents matched to return submissions in a pre-filing validation process. Still others suggested measures that assess the extent to which taxpayer interactions with the IRS are accomplished through online service applications, along with some type of customer assessment of the quality of those services provided online.

The idea of a measure assessing IRS’ online services may be an idea worth closer consideration as one possible long-term measure for ETA—given the increasingly

¹² Electronic Tax Administration Advisory Committee, *Electronic Tax Administration Advisory Committee Annual Report to Congress*, IRS Publication 3415, June 2012.

¹³ Internal Revenue Service, *Prepared Remarks of IRS Commissioner Doug Shulman at the National Press Club*, Press Release IR-2011-38, April 6, 2011.

central role Internet-based tax products and services play in the ETA environment today and in the future. The data in Figure 12 illustrate one source for such a measure and the role this measure could potentially play to foster and track improved online services that taxpayers value. This figure contrasts the University of Michigan-based ACSI scores for the IRS website (IRS.gov), with the average for all Federal websites and for two top industry leaders in “e-commerce” (i.e., Internet-based brokerage firms and Internet-based retail companies).

As Figure 12 indicates, the IRS must improve its relative ACSI score for its website, if it wishes to consistently outperform the average rating for Federal agencies and begin to approach the customer satisfaction levels of industry leaders in the private sector. Such improvement by the IRS could potentially be the basis for a new ETA long-term goal. The data in Figure 12 also reveal a noticeable drop in satisfaction with IRS.gov in 2012 that may reflect the negative impact from the delay in processing most refunds during the first few weeks of the 2012 filing season. It will be interesting to see if the IRS score improves in 2013, assuming

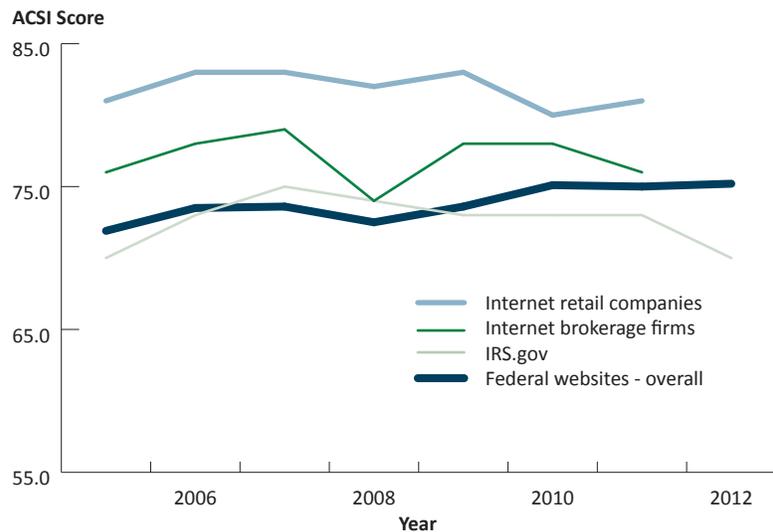
no significant problems with the timeliness of refunds in 2013, and in the wake of the new IRS website launched in the latter part of 2012.

The Board remains committed to the exploration of a more definitive vision for electronic tax administration going forward,

including new potential long-term ETA measures and goals. While the Board has no formal proposals on these issues at this time, it hopes policymakers, IRS officials, tax industry professionals, and other key stakeholders will continue to give these matters serious consideration.

FIGURE 12.

Selected e-Government and e-Commerce American Customer Satisfaction Index Scores



SOURCE: www.theacsi.org

The Board remains committed to the exploration of a more definitive vision for electronic tax administration going forward, including new potential long-term ETA measures and goals.

Selected Views of the IRS Oversight Board

- The Board commends Congress, the IRS, the tax professional community, and America's taxpayers for achieving, in 2012, the 80 percent e-file goal for individual tax returns originally established under the *IRS Restructuring and Reform Act of 1998*.
- Although the electronic filing rate for all major individual, business, and tax exempt returns in 2012 is nine percentage points below the 80 percent goal embedded in the *IRS Strategic Plan*, the Board is generally satisfied with the steady upward trend in the share of major tax returns filed electronically and believes the IRS will achieve the goal in the near future.
- Increasing the share of employment tax returns filed electronically is key to making significant future progress toward the 80 percent e-file goal for all major tax returns.
- While the Board has no formal proposals at this time on a more definitive ETA vision or new potential long-term ETA measures and goals, it hopes policymakers, IRS officials, tax industry professionals, and other key stakeholders will continue to give these matters serious consideration.

Conclusion

The Board views electronic tax administration, in which the vast majority of tax-related interactions are handled electronically, as the foundation for a truly modern IRS that serves taxpayers, tax professionals, and IRS employees efficiently and effectively. Having secure, comprehensive, and easy-to-use systems for the electronic filing of major tax returns is an extremely critical component of that vision. So too is having a secure and robust range of electronic tax services available online.

The IRS achieved an approximate e-file rate of 81 percent for individual income tax returns in 2012, up from 77 percent in 2011, meaning it has finally reached the critical milestone originally articulated in RRA98. The electronic filing rate for all major individual, business, and

tax exempt returns combined also grew this year, from nearly 67 percent in 2011 to approximately 71 percent in 2012. However, this result is nine percentage points below the 80 percent e-file goal for all major tax returns in 2012 established in conjunction with the *IRS Strategic Plan*. Still, the Board is generally satisfied with the overall e-file progress made to date, which reflects continuing steady growth in the share of major tax returns filed electronically. The Board also

The Board is generally satisfied with the overall e-file progress made to date, which reflects continuing steady growth in the share of major tax returns filed electronically.

believes the IRS, in conjunction with initiatives from industry and the support of Congress, will achieve the 80 percent goal for all major tax returns in the near future.

The Board further emphasizes that the ultimate goal of electronic tax administration is not just to receive more information electronically, but to improve service to taxpayers and enhance tax compliance. With steps now underway to update the *IRS Strategic Plan*, it is important for IRS officials and all the major stakeholders in tax administration to give careful consideration to the long-term vision for electronic tax administration, including possible new goals that could shape a positive ETA future, much as the 80 percent e-file goals have done since 1998.

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