

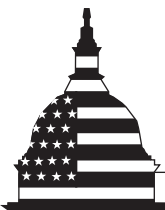
GAO

Report to the Subcommittee on
Financial Services and General
Government, Committee on
Appropriations, U.S. Senate

March 2011

ELECTRONIC TAX RETURN FILING

Improvements Can Be Made before Mandate Becomes Fully Implemented



G A O

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**United States Government Accountability Office
Washington, DC 20548**

March 7, 2011

The Honorable Richard J. Durbin
Chairman
The Honorable Jerry Moran
Ranking Member
Subcommittee on Financial Services and General Government
Committee on Appropriations
United States Senate

The Internal Revenue Service's (IRS) goal is to receive 80 percent of all major types of tax returns electronically by 2012.¹ Legislation passed in November 2009 supports the 80 percent goal for individual income tax returns by requiring tax return preparers who file more than 10 individual returns per year to file them electronically, or e-file.²

In 2009, IRS electronically processed nearly 95.5 million individual tax returns, or roughly two-thirds of all individual tax returns filed. IRS estimated that it saved \$3.10 for each e-filed return that it did not have to process on paper.³ If the remaining paper returns had been e-filed, IRS could have saved about \$148 million in processing costs for 2009 alone. In addition to reducing costs, e-filing provides higher accuracy rates, improved convenience, and faster processing and refunds for taxpayers. Furthermore, IRS officials said that having increased information available electronically could improve the effectiveness of IRS's compliance programs and bring in additional enforcement revenue.

You asked us to review IRS's implementation of the e-file mandate. In response to your request, this report assesses IRS's initial implementation

¹The major types of tax returns for the purpose of the 2012 e-file goal 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. In 2009, the majority (76 percent) of all major tax returns were individual returns. In addition to major returns, IRS received over 2 trillion information and withholding documents.

²Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No. 111-92, 123 Stat. 2984 (Nov. 6, 2009). A tax return preparer (called paid preparer in this report) is any individual who is compensated for preparing or assisting in the preparation of all or substantially all of a tax return or claim for refund of tax. 26 U.S.C. § 7701(a)(36).

³IRS estimated that processing a paper return in 2009 cost the service \$3.29 per return whereas an e-filed return only cost 19 cents.

of the mandate. It also provides our assessment of (1) the expected effect of the mandate on electronic filing rates and (2) early mandate implementation issues that could affect IRS's administrative costs, preparer burden, or rates of electronic filing. We plan to issue a related report this summer that provides additional information on IRS's implementation efforts and its use of electronic data.

To do our work, we analyzed IRS's planning documents, outreach materials, and weekly reports pertaining to the mandate, as well as the new legislation, IRS's proposed regulations and revenue procedure, and public comments received. We also interviewed IRS officials, including those who are a part of the Electronic Tax Administration, the group responsible for the mandate's implementation. We also analyzed historical e-filing rates and IRS projections. We found IRS's projections of individual e-filing rates to be sufficiently reliable for the purposes of presenting relative likely e-filing rates under different scenarios. We reviewed state-level e-file implementation documents, forms, and data to determine any lessons learned from the 22 states that had implemented an e-file mandate.

We conducted this performance audit from July 2010 through March 2011, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. (See appendix I for more information on our scope and methodology.)

Background

The IRS Restructuring and Reform Act of 1998 established a goal that 80 percent of tax returns be filed electronically by 2007.⁴ Electronic filing increased steadily after 1998, but IRS did not meet the goal. In 2007, the IRS Oversight Board recommended extending the time period to 2012 and expanding the scope so that the 80 percent goal be applied to each major type of return, including individual, business, and exempt organizations.⁵ As of 2009, IRS was well short of the goal for all major return types (shown in table 1).

⁴Pub. L. No. 105-206, title II, § 2001, 112 Stat. 685 (July 22, 1998).

⁵IRS Oversight Board, *Electronic Filing 2006: Annual Report to Congress*, Feb. 28, 2007.

Table 1: E-filing Rates for Major Return Types Subject to the 80 Percent Goal, Filing Season 2009

Returns in thousands

Type of return (form number)	Total number of returns filed	Total number of returns e-filed	Percentage of returns e-filed	Number of additional e-filed returns required to reach 80 percent goal
Individual (1040)	143,533	95,455	66.5%	19,371
Employment (940/941)	29,428	6,674	22.7	16,869
Corporate (1120)	6,706	1,766	26.3	3,599
Partnership (1065)	3,350	976	29.1	1,704
Fiduciary (1041)	3,047	781	25.6	1,657
Tax Exempt (990)	980	346	35.3	438
Total	187,045	105,998	56.7%	43,638

Source: GAO analysis of IRS data.

Note: IRS's 2012 e-file goal also includes real estate mortgage investment conduits and excise tax returns. These returns are small in volume and are not included in this chart. Numbers may not sum to totals due to rounding.

In November 2009, Congress enacted legislation that requires tax return preparers to e-file if they expect to file more than 10 individual income tax returns per year, for calendar year 2011 and beyond.⁶ IRS is implementing the e-file mandate in two phases. In 2011, paid preparers who reasonably expect to file 100 or more individual, trust, or estate income tax returns are required to e-file.⁷ In 2012, the e-file mandate will apply to paid preparers who reasonably expect to file more than 10 individual, trust, or estate income tax returns. According to an IRS official, IRS decided to implement the law in two phases primarily to give paid preparers time to make any necessary changes to their business practices and help the agency prepare for the increased volume of anticipated e-file applications.⁸

⁶Worker, Homeownership, and Business Assistance Act of 2009, Pub. L. No.111-92, 123 Stat. 2984 (Nov. 6, 2009).

⁷75 Fed. Reg. 75,439 (Dec. 3, 2010). The proposed regulations and revenue procedure specify that reasonable expectations should be determined by adding together all of the individual tax returns the return preparer's firm reasonably expects to file in the calendar year, except for returns subject to administrative exemptions and returns for which the taxpayer chooses to file on paper.

⁸An IRS official noted that some paid preparers may have to change their existing business practices in order to e-file if they were previously only preparing and filing returns on paper. This could include purchasing computer systems and software.

The proposed regulations provide exceptions to the mandate for paid preparers who cannot e-file for certain reasons. First, preparers may request waivers for economic hardship and other reasons. Second, administrative exemptions are available for paid preparers who belong to certain classes of preparers or are filing certain types of returns such as those that include forms that cannot be filed electronically. Finally, paid preparers need not e-file returns for clients who choose to file in paper format.

As of January 1, 2011, tax return preparers must obtain Preparer Tax Identification Numbers (PTIN), and use them to sign all returns they prepare, paper and electronic. PTINs will allow IRS to identify the preparer and help ensure the preparer is compliant with rules relating to tax return preparers.⁹ In addition, a second number is required to electronically file. This Electronic Filing Identification Number (EFIN) is issued to firms. Multiple preparers within the same firm may share the firm's EFIN. Each preparer, on the other hand, will have a unique PTIN.

Summary of Findings

- IRS has taken several positive steps to implement the mandate, such as communicating the details of the implementation and publishing proposed regulations for public comment.¹⁰ However, paid preparers raised concerns regarding the proposed regulations, especially with respect to their timing. The proposed regulations were issued approximately 1 month before the effective date. IRS officials told us that preparers should have been aware of the mandate's implementation date and that IRS plans to be flexible with enforcement for the first year.
- The e-file mandate may affect fewer paid preparers and e-file rates may be lower than IRS originally anticipated because of its legal interpretation of the word "file." The e-file mandate applies to paid preparers who file returns. IRS interpreted this to mean that a preparer whose clients choose to file finished paper returns themselves will be relieved of the mandate if the preparer does not file more than 10 returns for other clients. Even if the preparer files more than 10 returns, the clients can still choose to file paper returns as long as the preparer does not submit them to IRS. After making its legal

⁹26 C.F.R. § 1.6109-2.

¹⁰75 Fed. Reg. 75,439 (Dec. 3, 2010).

interpretation, IRS revised its initial projection of e-file rates in 2011 from 82 to 75 percent, and its projection for 2012 from 84 to 77 percent. The mandate could have a greater impact if the word “file” were replaced with “prepare or file” or similarly broader language. Fifteen out of the 22 states with e-file requirements use either the word “prepare” alone or the term “prepare or file” in their requirements.

- Multiple identification numbers may burden paid preparers and raise administrative costs for IRS. The EFIN and PTIN will have similar application processes and suitability tests once new PTIN requirements are fully effective. Because PTINs identify each preparer, whereas EFINs will not always do so, it might be possible to use only preparers’ PTINs as the authorizing numbers to e-file their taxpayers’ returns, with no loss of ability to track preparers. IRS has not studied whether it would be cost effective to do so.
- IRS may be missing opportunities to educate taxpayers about the benefits of e-filing. Currently, neither the Form 8948, “Preparer Explanation for Not Filing Electronically,” nor the statement IRS suggests preparers ask taxpayers to sign to assert that they are choosing to file on paper, describes the benefits of e-filing. A few states use such statements on their forms.

Appendix II provides more detail on each of our objectives and related findings.

Conclusions

E-filing is an important part of the foundation for a modernized IRS. IRS has made significant progress increasing e-filing rates, but it still has a way to go until it reaches its 80 percent goal. The e-file mandate should help increase e-filing, but the use of the word “file” instead of “prepare” limits its effect, covering fewer preparers than originally expected. Even with IRS’s positive steps to implement the mandate, opportunities may exist to reduce costs by investigating the potential for eliminating duplication, and to increase e-filing rates by educating taxpayers about the benefits of e-filing.

Matter for Congressional Consideration

If Congress wants to expand the applicability of the e-file mandate beyond those preparers who file tax returns, then Congress could amend paragraph 6011(e)(3)(B) of the Internal Revenue Code by replacing the word “file” with broader language, such as “prepare or file.”

Recommendations for Executive Action

To improve implementation of the e-file mandate, we recommend that the Commissioner of Internal Revenue direct IRS officials to take the following two actions:

1. determine whether it would be practical and cost effective to use preparers' PTINs as the authorizing numbers to e-file their taxpayers' returns. If IRS determines it is advantageous, it should create a timetable and plan to modify e-file systems accordingly; and
2. update the taxpayer choice statement discussed in Notice 2010-85 as well as Form 8948, "Preparer Explanation for Not Filing Electronically," to include information about the benefits of e-filing.

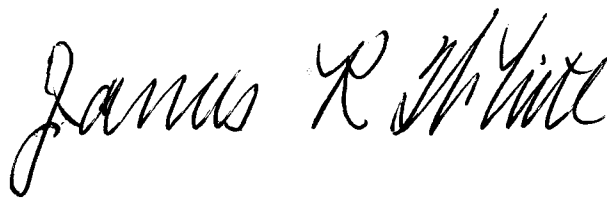
Agency Comments and Our Evaluation

We provided a draft of this report to the Commissioner of Internal Revenue for his review and comment. The Deputy Commissioner for Services and Enforcement provided written comments, which are reprinted in appendix III. IRS also provided us with technical comments, which we incorporated into the report as appropriate.

In response to our draft report, the Deputy Commissioner expressed appreciation to GAO for recognizing IRS's achievements toward implementing the mandate and agreed with both of our recommendations. In response to the first recommendation, the Deputy Commissioner stated IRS will determine whether it would be practical and cost effective to use preparers' PTINs as the authorizing numbers to e-file after the PTIN system is fully implemented at the end of 2013. IRS would require lead time to make this change, in part because it would require significant programming changes. In response to our recommendation to include the benefits of e-filing on Form 8948 and in the sample taxpayer choice statement, IRS will add language about the benefits of e-filing.

We plan to send copies of this report to the Chairmen and Ranking Members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We are also sending copies to the Commissioner of Internal Revenue, the Secretary of the Treasury, the Chairman of the IRS Oversight Board, and the Director of the Office of Management and Budget. The report is also available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staffs have any questions or wish to discuss the material in this report further, please contact me at (202) 512-9110 or WhiteJ@gao.gov. Contact points for our offices of Congressional Relations and Public Affairs may be found on the last page of this report. Individuals making key contributions to this report can be found in appendix IV.

A handwritten signature in black ink that reads "James R. White". The signature is written in a cursive style with a large, prominent initial "J".

James R. White
Director, Tax Issues
Strategic Issues

Appendix I: Scope and Methodology

To compare the Internal Revenue Service's (IRS) initial implementation of the e-file mandate to program implementation criteria, we reviewed IRS's planning documents and outreach to paid preparers, monitored weekly status reports, and reviewed the public comments on the proposed regulations and revenue procedure and compared them to program implementation criteria from prior GAO reports and IRS documents. To assess the expected effect of the mandate on e-file rates, we reviewed and analyzed section 17 of the Worker, Homeownership, and Business Assistance Act of 2009 and the proposed Treasury regulations relating to the provision.¹ We also reviewed and analyzed IRS historical data and compared IRS's original and revised e-file projections.

To determine the reliability of these projections, we interviewed the IRS officials who made the projections and reviewed IRS's mean percent errors for past years' projections. We found IRS's methodology for calculating the e-file rates under different scenarios to be sufficiently reliable for the purposes of presenting them in this report.

To identify and assess early mandate implementation issues we reviewed and analyzed draft forms, planning documents, and outreach materials. We compared the steps taken to criteria from prior GAO reports, IRS's strategic plan, and the Internal Revenue Manual.² We shared these criteria with IRS officials, who were generally in agreement with their relevance, noting that the relative weight of each criterion could differ. We also reviewed state-level e-file implementation documents, forms, and data to determine any lessons learned from the 22 states that had implemented e-file requirements.

For each objective, we also interviewed officials at IRS offices of Electronic Tax Administration and Return Preparer Implementation. Our work was done primarily at IRS Headquarters in Washington, D.C. and its

¹Pub. L. No. 111-92, 123 Stat. 2984 (Nov. 6, 2009) and 75 Fed. Reg. 75,439 (Dec. 3, 2010).

²Criteria were developed from sources such as: GAO, *Digital Television Transition: Increased Federal Planning and Risk Management Could Further Facilitate the DTV Transition*, [GAO-08-43](#) (Washington, D.C. : Nov. 19, 2007); *Results Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, [GAO-03-669](#) (Washington, D.C.: July 2, 2003); *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: August 2001), *Executive Guide: Effectively Implementing the Government Performance and Results Act*, [GAO/GGD-96-118](#) (Washington, D.C.: June 1996); IRS [Publication 3744](#), IRS [Strategic Plan 2009-2013](#), and the Internal Revenue Manual [Exhibit 1.5.1-5](#).

division offices in New Carrollton, Maryland, and Atlanta, Georgia, where the IRS officials who manage the e-file mandate implementation are located.

We conducted this performance audit from July 2010 through March 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Briefing Slides



Objective

Assess IRS's initial implementation of the e-file mandate.

Background

As of January 1, 2011, certain paid preparers are required to file returns electronically.¹ In 2011, IRS is applying the mandate to paid preparers who file 100 or more returns. In 2012, IRS is applying the mandate to paid preparers who file more than 10 returns. IRS published proposed regulations and a notice of proposed revenue procedure in December 2010 detailing the requirements of the mandate. The proposed regulations provide exemptions from the mandate for paid preparers who cannot e-file for certain reasons and allow taxpayers to choose to file on paper.

IRS Has Taken Positive Steps to Implement the E-file Mandate, but Preparers Have Concerns with the Proposed Regulations

IRS's initial implementation of the e-file mandate is consistent with criteria for new programs listed in prior GAO and other reports that call for dedicating a management team, establishing a communications strategy, providing necessary staff, and developing a time line.² In mid-2010, IRS assigned executive leadership and formed a team to implement the e-file mandate. IRS linked the team with the Return Preparer Implementation Project Office that was created to manage a separate, broader set of new requirements for paid tax return preparers.

IRS communicated with paid preparers and industry groups about the mandate, including information sessions at forums and conferences. It also published notices, forms, and frequently asked questions on IRS.gov,³ and held monthly teleconferences with software developers. Until the program is fully implemented, the effectiveness of these efforts will not be known.

IRS plans to use about 38 additional full time equivalent (FTE) staff to process anticipated new e-file applications, and has already added 27 FTEs. In the first 3-1/2 months of fiscal year 2011, IRS received 25,013 e-file applications, a 19 percent increase from last year in the same time period. IRS officials are projecting about 18 percent more new applications in fiscal year 2011 than in fiscal year 2010. An IRS official noted that because of the increase in staff, so far this year IRS has processed applications within 45 days of receipt, the same as prior years.

In December 2010, IRS invited public comment on its proposed regulations and revenue procedure. IRS received comments from 49 different industry groups and private firms. One concern cited several times was the short time frame between the issuance of the proposed regulations and the effective date of the mandate (approximately 1 month), as shown in figure 1. One commenter noted that a midyear implementation could result in a disruption of the filing season. Another commenter wrote that a short implementation period may pose problems for some paid preparers, particularly those paid preparers who have never e-filed. IRS officials told us that paid preparers have been aware that the e-file mandate requirements were coming due to their prior and ongoing outreach efforts. Further, IRS officials noted at the January 7, 2011, public hearing that Congress did not enact a specific penalty related to the

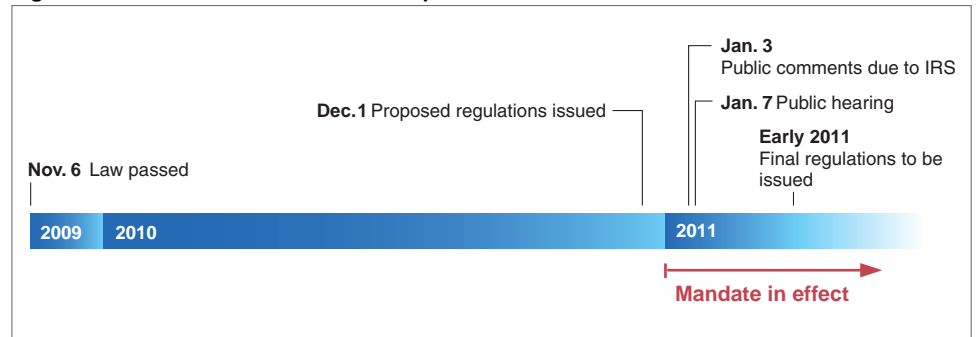
¹26 U.S.C. § 6011(e)(3).

²Criteria were developed from sources such as: GAO, *Digital Television Transition: Increased Federal Planning and Risk Management Could Further Facilitate the DTV Transition*, [GAO-08-43](http://www.gao.gov/products/GAO-08-43) (Washington, D.C.: Nov. 19, 2007); *Results Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, [GAO-03-669](http://www.gao.gov/products/GAO-03-669) (Washington, D.C.: July 2, 2003); *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](http://www.gao.gov/products/GAO-01-1008G) (Washington, D.C.: August 2001), *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](http://www.gao.gov/products/GAO/AIMD-00-21.3.1) (Washington, D.C.: November 1999); IRS [Publication 3744](http://www.irs.gov/pub/irs-soi/093744), IRS [Strategic Plan 2009-2013](http://www.irs.gov/pub/irs-soi/093744), and the Internal Revenue Manual [Exhibit 1.5.1-5](http://www.irs.gov/pub/irs-soi/093744).

³See <http://www.irs.gov/taxpros/providers/article/0,,id=223832,00.html>; <http://www.irs.gov/newsroom/article/0,,id=231931,00.html>; and <http://www.irs.gov/taxpros/article/0,,id=231871,00.html>.

mandate and that IRS plans to be flexible with enforcing the e-file requirement for the first year.⁴

Figure 1: Time Line for E-file Mandate Implementation



Source: IRS.

Another frequent concern was that under the proposed regulations, paid preparers would be prohibited from mailing returns for taxpayers who choose to file on paper.⁵ Paid preparers noted that they routinely mail returns for clients who are elderly, infirm, or want this service for various other reasons, and that they would like to continue to do so. Other comments noted that some administrative questions were not settled by the proposed regulations. For example, a finalized [Form 8948](#), “Preparer Explanation for Not Filing Electronically,” along with guidance on how and when paid preparers should use this form, had not been issued before the end of the public comment period. IRS officials said that they may make some revisions to the proposed regulations based on the public comments.

⁴IRS has proposed regulations to amend Circular 230 Standards of Practice to make willful failure to e-file a violation subject to sanctions. Preparers could have their PTIN revoked and thus be prohibited from preparing and e-filing returns if they do not comply with the mandate. 75 Fed. Reg. 51,713 (Aug. 23, 2010).

⁵Under the definition of “file” in the proposed regulations, if a taxpayer chooses to submit a paper return, it must be the taxpayer and not the preparer who will submit the return to IRS. 75 Fed. Reg. 75,439 (Dec. 3, 2010).



The Mandate May Affect Fewer Paid Preparers and Increase the E-file Rate Less Than IRS Originally Anticipated

Objective

To assess the expected effect of the mandate on electronic filing rates.

Background

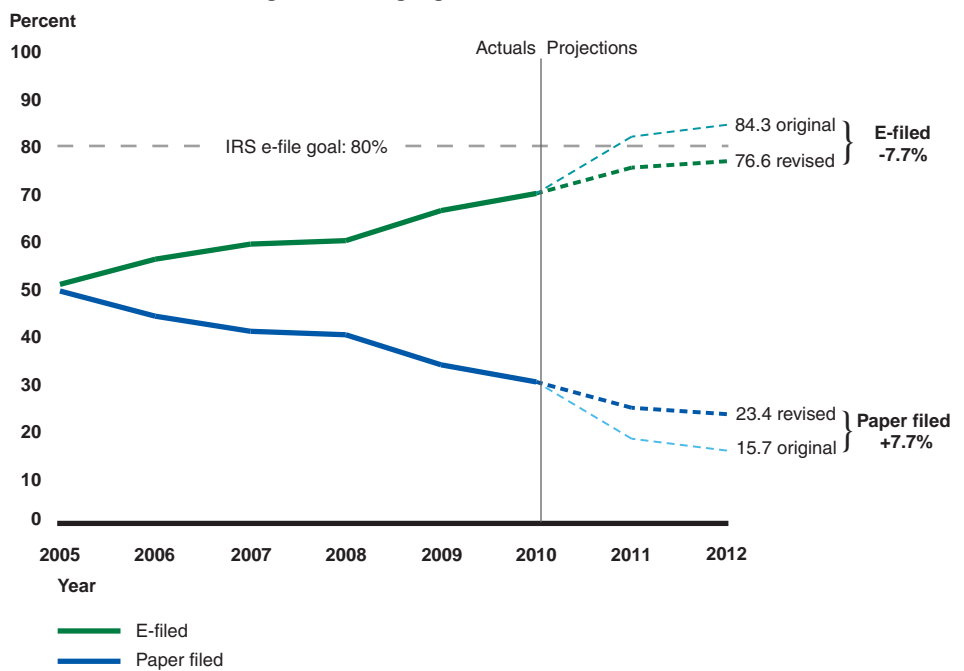
Under the proposed regulations for the e-file mandate, an individual income tax return is considered to be “filed” by a paid preparer if the preparer submits the tax return to IRS on the taxpayer’s behalf, either electronically or in paper form.⁶ Tax return preparation, as distinct from filing, is the act of filling out a tax return.

Matter for Congressional Consideration

If Congress wants to expand the applicability of the e-file mandate beyond those preparers who file tax returns, then Congress could amend paragraph 6011(e)(3)(B) of the Internal Revenue Code by replacing the word “file” with broader language, such as “prepare or file.”

IRS originally projected that the e-filing rate would reach about 82 percent by 2011 and 84 percent by 2012 with the implementation of the e-file mandate. However, the mandate as currently worded does not cover all paid preparers. The legislation specifies that “any tax preparer unless such preparer reasonably expects to *file* 10 or fewer individual income tax returns during such calendar year” must e-file returns.⁷ In practice, many paid preparers who do not e-file give prepared returns back to the taxpayers, who file them. If these preparers’ clients choose to continue filing on paper, the preparers will be relieved of the mandate if they do not file more than 10 returns. Due to its interpretation of the word “file,” IRS revised its 2011 e-file projections downward to about 75 percent and its 2012 projections to about 77 percent (see figure 2).

Figure 2: IRS’s Original and Revised Electronic Filing Rate Projections for Individual Income Tax Returns Based on Legislative Language



Source: GAO analysis of IRS historical data for 2005-2010 and IRS projections for 2011 and 2012.
 Note: IRS reports that its 2-year projections of the number of individual e-filed returns have been within an average of 2.45 percent of the actual number of returns filed for the four most recent projection cycles.

The mandate could have a greater impact if the word “file” were replaced with “prepare or file” or similarly broader language. Fifteen out of the 22 states that have e-filing requirements for preparers use either the word “prepare” alone, or the term “prepare or file,” in their requirement. When IRS officials studied the likely results of using the word “file,” they revised their projections for 2012 downward by almost 8 percentage points because they thought a lower percentage of paid preparers would change their current practices and e-file returns in the future. If the mandate used language similar to that used by the states, e-filing in 2012 might be closer to the rate of the original projections and help IRS achieve its e-filing goal for individual returns. We determined that this change could reduce

⁶75 Fed. Reg. 75,439 (Dec. 3, 2010).
⁷26 U.S.C. § 6011(e)(3)(B).

Appendix II: Briefing Slides

administrative costs by as much as \$64 million for 2011 and 2012 combined, with continued savings in future years.

Furthermore, an improvement in e-filing rates could eventually increase the revenue collected from IRS's enforcement programs. Officials told us that shifting staff from paper return processing to compliance programs could increase revenue collected by at least \$175 million annually.⁸ Additionally, an increase in e-filing rates could bring IRS closer to the point where it is cost effective to transcribe all lines of data from the remaining paper returns. Since IRS only uses data in its compliance programs if it is available from all returns, full transcription could increase the effectiveness of those programs.

While a change to the mandate's language could help increase the e-filing rate, reduce costs for IRS, and provide higher accuracy rates and faster refunds for taxpayers, it could result in transition costs for some paid preparers. Officials from one industry group noted that small businesses that currently do not e-file could incur costs such as purchasing software for electronic filing. According to IRS data, about 13 percent of all preparers could incur these costs.

⁸We previously reported that although we have not independently verified IRS's methodology, IRS officials said that if all data from paper tax returns were transcribed, the Automated Underreporting Program could eliminate some human screeners. IRS officials estimated that if the screeners could be reallocated to performing audits, they could bring an additional \$175 million annually. This figure is an estimate for a single program, the Automated Underreporting Program, so an estimate that included other enforcement programs might be larger. See GAO, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Tax Compliance Should be Evaluated*, [GAO-08-38](#) (Washington, D.C.: Nov. 15, 2007).



Objective

Analyze early mandate implementation issues that could affect IRS's administrative costs, preparer burden, or rates of electronic filing.

Background

As of January 1, 2011, paid preparers must obtain a Preparer Tax Identification Number (PTIN), an exclusive number to identify each preparer. This number allows IRS to track paid preparer compliance, competence, and adherence to ethical standards.⁹ Currently, paid preparers cannot use a PTIN to submit a return electronically. To submit a return electronically, IRS requires the use of a second number, an Electronic Filing Identification Number (EFIN). EFINs are assigned to tax preparation firms, not necessarily to a single preparer. Each preparer must have a unique PTIN. Preparers within the same firm may share the firm's EFIN. EFINs are also used by firms such as tax software companies that do not prepare tax returns, but instead transmit returns to IRS on behalf of preparers.

What GAO Recommends

The Commissioner of Internal Revenue should direct IRS officials to determine whether it would be practical and cost effective to use preparers' PTINs as the authorizing numbers to e-file their taxpayers' returns. If IRS determines it is advantageous, it should create a timetable and plan to modify e-file systems accordingly.

Multiple Identification Numbers May Burden Paid Preparers and Raise Administrative Costs for IRS

PTINs and EFINs may be duplicative for paid preparers. Once the new PTIN system is fully implemented, EFINs may not add any additional identifying information beyond that provided by PTINs. The numbers will have similar application processes and suitability tests including background checks and fingerprinting.¹⁰ IRS's strategic plan seeks to streamline processes, and recent legislation requires GAO to identify program overlap and duplication.¹¹ Reducing the duplication between PTINs and EFINs may provide such an opportunity.

Although similar, there are some inconsistencies in the application processes for the two numbers, which IRS officials recognized could cause problems for preparers. For example, the minimum age to apply for a PTIN is 18, while for an EFIN it is 21. In October 2010, IRS established a working group that developed an action plan to reconcile the differences between the PTIN and EFIN requirements. However, the working group was not tasked with determining whether it would be practical or cost effective to authorize preparers to e-file returns using only their PTINs.

IRS administrative costs and preparer burden could be reduced by allowing preparers to use only their PTINs to e-file. Of the two numbers, PTINs should be considered for use as the authorizing number for e-filing because PTINs identify each preparer. In contrast, EFINs are assigned to firms and will not always enable IRS to identify the preparer. Although self reported, both preparer and firm information is captured on the PTIN application, and IRS could identify both using just the PTIN.

⁹ 26 C.F.R. § 1.6109-2. IRS will be phasing in these requirements over the next few years. See Publication 4832, *Return Preparer Review* (Rev. 12-2009).

¹⁰ For the EFIN, evidence of professional status such as being an attorney, Certified Public Accountant, or Enrolled Agent may substitute for fingerprinting.

¹¹ Statutory Pay-As-You-Go Act of 2010, Pub. L. No. 111-139, title II, § 21,124. Stat. 8 (Feb. 12, 2010).



Objective

Analyze early mandate implementation issues that could affect IRS's administrative costs, preparer burden, or rates of electronic filing.

Background

Under the new mandate, certain paid preparers are required to e-file all returns that they file. However, under the proposed regulations, individual taxpayers working with paid preparers may choose to file on paper if they file their returns themselves. IRS outlined the steps a paid preparer should use to document taxpayers' decisions not to electronically file their returns.¹² The proposed regulations require taxpayers to sign a taxpayer choice statement that paid preparers keep in their files, with suggested language provided by IRS. The return filed with IRS must include Form 8948, "Preparer Explanation for Not Filing Electronically."

What GAO Recommends

The Commissioner of Internal Revenue should direct IRS officials to update the taxpayer choice statement discussed in Notice 2010-85 as well as Form 8948, "Preparer Explanation for Not Filing Electronically," to include information about the benefits of e-filing.

IRS May Be Missing Opportunities to Educate Taxpayers about the Benefits of E-filing

As previously noted, IRS has taken steps to educate paid preparers about the e-file mandate, but it could take additional steps to educate taxpayers about the benefits of e-filing, such as faster refunds and reduced chance of errors. When reviewing state e-file requirements, we found that some provided information about the benefits of e-filing on the taxpayer opt-out form. This provided taxpayers an additional opportunity to learn how e-filing can benefit them, without further burdening paid preparers. For example, as shown in figure 3, [New Jersey's Form NJ-1040-O](#) notes several benefits. E-filing benefits are also mentioned on [Virginia's Form 8454T](#) and [Alabama's Form EOO](#).

Figure 3: New Jersey E-file Opt-Out Request Form

Statement on benefits of e-filing

STATE OF NEW JERSEY
Division of Taxation
E-File Opt-Out Request Form

An Important Message to NJ Taxpayers from the NJ Division of Taxation

N.J.S.A. 54A:8-6.1 requires most tax preparers to electronically file (E-file) New Jersey Income Tax Resident Returns. By having your return filed electronically, you receive the following benefits:

- A faster refund. Most E-filers get their refund in two weeks. Paper return filers can wait up to 12 weeks for their refund.
- Direct Deposit Option. Refunds can be directly deposited into your bank account.
- Reduced chance of errors. E-filed returns have fewer errors which may delay the processing of your return.

The NJ Division of Taxation strongly urges you to allow your tax preparer to electronically file your NJ Resident Return. However, if you do NOT want your return filed electronically, you can "opt out" by completing Part I of this form and giving it to your preparer to authorize him or her to file your 2010 NJ Income Tax Return on paper.

Part I: Taxpayer Information (to be completed by Taxpayer)

Last Name _____ First Name _____

Source: New Jersey Division of Taxation form.

IRS does not provide information about the benefits of e-filing in its suggested statement to be signed by taxpayers who are choosing to file on paper, nor on Form 8948, "Preparer Explanation for Not Filing Electronically," the form that paid preparers must include with a paper filed tax return. According to an IRS official, due to the short time frames for implementing this mandate, IRS did not have a chance to research all the lessons learned from the states that have implemented e-filing requirements.

Inserting a sentence in the taxpayer choice statement that affirms that a preparer discussed the benefits of e-filing with the client could help encourage such conversations. Even if the preparer does not in fact discuss the benefits of e-filing, a sentence included in the statement a taxpayer is required to sign would convey the desired information. Similar statements on Form 8948 could include somewhat more detailed information. Taxpayers who chose to file on paper would have the opportunity to see it because it is required to be included in the tax packages that they review and mail.

While we have not determined the extent to which such information could increase e-filing rates, an official from the New Jersey Division of Taxation said the statement posed no additional costs for them. Thus, IRS risks missing an opportunity to educate taxpayers who do not yet e-file in an easy, low-cost, and targeted way. Providing information on the benefits of e-filing on papers that taxpayers review could encourage them to e-file.

¹²[Notice 2010-85](#).

Appendix III: Comments from the Internal Revenue Service



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DEPUTY COMMISSIONER

February 28, 2011

Mr. James R. White
Director, Tax Issues
U.S. Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. White:

I have reviewed your draft report entitled "Electronic Tax Return Filing: Improvements Can Be Made before Mandate Becomes Fully Implemented" (GAO-11-344). I appreciate your recognition of our significant achievements taken to implement the mandate, such as communicating the details of the implementation and publishing proposed regulations for public comment.

E-Filing provides benefits to taxpayers and to the IRS by improving accuracy, reducing processing costs and delivering refunds more quickly. Today, e-Filing is the norm rather than the exception as approximately 70% of tax returns were filed electronically in 2010. The IRS has for years sought to increase the rate of electronic filing and recently concluded a two-part, congressionally-mandated study of ways to advance e-Filing. The current mandate was enacted before that study was concluded, but it is clear that the single most effective way to increase e-Filing is to mandate the practice among tax professionals. We are committed to implementing the e-File mandate as effectively and equitably as possible.

We will take appropriate actions to address or further review issues as they are identified. We agree with the two recommendations and look forward to continued engagement by the Government Accountability Office on the next phase of implementation. Our specific comments to your recommendations are enclosed. If you have any questions, please contact me, or a member of your staff can contact David R. Williams, Director, Return Preparer Program, at (202) 622-7990.

Sincerely,

Steven T. Miller
Deputy Commissioner for
Services and Enforcement

Enclosure

ENCLOSURE

Recommendation 1

The Commissioner of Internal Revenue should direct IRS officials to determine whether it would be practical and cost effective to use preparers' PTINs as the authorizing number to e-file their taxpayers' returns. If IRS determines it is advantageous, it should create a timetable and a plan to modify e-file systems accordingly.

Corrective Action

The IRS agrees with this recommendation. We will determine whether it would be practical and cost effective to use preparers' PTINs as the authorizing number to e-file their taxpayers' returns after the PTIN system is fully implemented. Full implementation is scheduled for December 31, 2013. If IRS determines it is advantageous, IRS will create a timetable and plan to enable preparers to e-file based solely on having a current and valid PTIN. Because a change of this type requires significant programming changes and new system interfaces, as well as extensive coordination with the tax software industry and communications and outreach to the tax return preparer community, the implementation plan will need to have sufficient lead time to ensure that these precursors are accomplished.

Recommendation 2

The Commissioner of Internal Revenue should direct IRS officials to update the taxpayer choice statement discussed in Notice 2010-85 as well as Form 8948, "Preparer Explanation for Not Filing Electronically," to include information about the benefits of e-filing.

Corrective Action

The IRS agrees with this recommendation. We will add language to Form 8948 that includes information about the benefits of e-filing. The sample taxpayer choice statement will also include this language.

Appendix IV: GAO Contacts and Staff Acknowledgments

GAO Contact

James R. White, (202) 512-9110, or whitej@gao.gov

Staff Acknowledgments

In addition to the contact named above, Libby Mixon, Assistant Director; Amy Bowser; Michele Fejfar; Justin Reed; Cynthia Saunders; Robyn Trotter; and Meredith Trauner made key contributions to this report.

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