

**WRITTEN STATEMENT OF  
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BEFORE THE COMMITTEE ON GOVERNMENT REFORM  
SUBCOMMITTEE ON  
ENERGY POLICY, NATURAL RESOURCES,  
AND REGULATORY AFFAIRS  
UNITED STATES HOUSE OF REPRESENTATIVES  
HEARING ON  
PAPERWORK BURDEN REDUCTION  
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**INTRODUCTION**

Mr. Chairman and honorable Members of the Subcommittee, thank you for the opportunity to testify on the Internal Revenue Service's continuing efforts to reduce unnecessary taxpayer burden.

Our goal at the IRS is to impose the least amount of burden necessary for taxpayers to meet their tax law responsibilities.

IRS and Treasury have recently developed a new model for measuring the burden on taxpayers of complying with the individual income tax. The new model will replace the two decades old A.D. Little model that is currently used. The new model will be superior to the A. D. Little model in several respects.

- It is based on updated surveys of taxpayer behavior conducted in 2000 and 2001.
- It is more comprehensive in that it measures not just form completion but record keeping and other necessary tasks of tax compliance more explicitly.
- It is conceptually better because it attempts to measure the compliance burden for each taxpayer as a whole rather than by each separate, paper tax form. This approach reflects the underlying changes to more electronic recordkeeping and tax form preparation in which the burden from each separate piece of paper is not meaningful.
- It is more flexible in that it calculates both out-of-pocket and time burdens; calculates burden by type of taxpayer (such as for W&I and SB/SE taxpayers or by income); and it permits differential burden estimates for taxpayers according to their preparation method: self-prepare by hand, with software, or with paid preparers;
- Importantly, the new model permits IRS to perform "what-if" simulations to determine the effect of tax administration proposals and legislative changes.

Although we are still in the process of refining and validating the "what-if" functions of the new model, we are excited about the capabilities that this model will offer.

Estimates from this model indicate the total burden of individual taxpayers (those filing Forms 1040, 1040A, 1040EZ) in Tax Year 2002 was almost 26 hours per return filed, or a total of 3.3 billion hours. Similarly, the out-of-pocket taxpayer cost was estimated at \$157 per return filed, or a total of \$20.3 billion. We are working to reduce this burden even though our continuing implementation of complex legislative changes, many of which provide benefits to taxpayers, has complicated our task.

I would point out that these estimates are somewhat higher than what the A.D. Little model shows, with just about all of the aggregate burden difference associated with self-employed (i.e., SB/SE) individuals. In 2002, about one-fourth of all returns were filed by self-employed taxpayers. Our model found that these taxpayers accounted for about 60% of both time and out-of-pocket costs (58% of time burden and 61% of costs). The reliance on paid professionals and technology continued with 56% of all returns prepared by paid professionals and 16% by taxpayers using software.

Aggregate taxpayer burden is expected to continue to grow in the future. Part of this increase is systemic, that is, it results simply when more people file tax returns each year. For example, in both 2001 and 2002, the number of returns filed increased by about one million and total individual taxpayer burden increased almost one percent each of those years.

IRS is committed to reducing taxpayer burden and established the Office of Taxpayer Burden Reduction (OTBR) in January 2002 to lead its efforts. Since its inception, OTBR has aggressively pursued burden reduction initiatives and enabled the IRS to reduce taxpayer burden by over 100 million hours. We must be doing something right, because OMB referred the Federal Energy Regulatory Commission (FERC) to OTBR as an example of a burden reduction best practice in Government.

Since last year's hearing, we have made progress in a number of areas:

- We expanded the use of the standard mileage rate for taxpayers with multiple vehicles used for business purposes, dramatically reducing record keeping burden by an estimated 8-10 million hours.
- We continued to expand the options available to taxpayers and their representatives to file returns, pay taxes, and to communicate with us electronically. The American Customer Satisfaction Index (ACSI) shows customer satisfaction scores for IRS e-file exceed those for both the Government and retail sectors.
- Our Modernized e-file project encompasses the design, development, and implementation of a new information technology architecture and infrastructure improving the timeliness, consistency, and reliability of information associated with the rapid processing of returns. This system makes it easier to file, and provides the IRS with the information necessary to facilitate the resolution of

taxpayer problems. Also for the first time, corporations and tax-exempt organizations have the ability to file annual tax returns electronically over the Internet

- Our public-private partnership agreement with the tax software industry continues to bear fruit with the growing Free File program. Over 3.2 million taxpayers have taken advantage of free, on-line tax preparation and e-filing through April 14, 2004. This represents an increase of 19% from last year.

We have more projects to reduce burden in store for next year. For example:

- We have simplified the 2004 Schedule D, Form 1040, and
- For Tax Year 2004, we are deleting 7 lines from each of 19 general business credit forms.

I will describe each of these in further detail below.

Clearly, we have made progress in addressing unnecessary taxpayer burden, but it remains a formidable challenge, especially when viewed within the context of an extremely complex and ever-changing Internal Revenue Code. The growing complexity of the tax law is illustrated by the oft-cited fact that the number of pages in the CCH Standard Federal Tax Reporter, which includes the Code, Treasury Regulations, and IRS rulings, was 19,500 in 1974 but has more than tripled, to 60,044 in 2004.

Since last year, when Acting Commissioner Wenzel testified before the Subcommittee, several legislative changes have been enacted that affect taxpayers' reporting burden. Although some provisions provide a tax benefit, taxpayer burden will increase due to the need to add more lines to the individual tax return.

The IRS has implemented the new provisions contained in the Jobs and Growth Tax Relief Reconciliation Act, which provided benefits to American taxpayers by setting lower tax rates for investment income. These benefits are substantial, but generated an estimated 113.9 million additional hours of burden, based on the A.D. Little burden methodology. (We have not completed validation of estimated changes from recent legislation based on the new burden model.) We anticipate, however, that burden will decrease significantly next year, when taxpayers will not need to apply different tax rates to their investment income based on the date the income was received. The increased burden this year was due to necessary revisions to several tax forms, including Form 1099-DIV, Dividends and Distributions; Form 1099-B, Proceeds from Broker and Barter Exchange Transactions; Form 1041, U.S. Income Tax Return for Estates and Trusts; Form 1065, U.S. Return of Partnership Income; Form 1120S, U.S. Income Tax Return for an S Corporation; Form 2220, Underpayment of Estimated Tax by Corporations; and Form 4797, Sale of Business Property.

We are also in the process of implementing provisions from other legislation enacted in 2003, including the Military Family Tax Relief Act; the Service members Civil Relief Act; and the Medicare Prescription Drug, Improvement, and Modernization Act. We must add two new lines to the individual income tax return to allow taxpayers to claim the above-the-line deduction for armed forces reservists and the new deduction for Health Savings Accounts. To implement these and other provisions enacted in 2003, we will make 154 changes to tax forms, instructions, and publications. There are further changes due to legislative provisions enacted prior to 2003 that affect returns filed in 2004 and beyond. Taxpayers will need to be aware of the changes, determine if they apply to them, and understand what they must do to comply with the changes.

In addition to the burden hours for completing new lines added to tax returns to accommodate new legislative provisions, taxpayer burden is increased by the complexity of the tax law. Frequent changes to the Code and complexity of the tax law are perhaps the greatest obstacles to overcome as we work to reduce unnecessary taxpayer burden. Our tax system relies on voluntary self-assessment of tax liability by taxpayers. Increasing complexity hinders the ability of the average American citizen to assess his or her own tax liability, and may serve as a disincentive for taxpayers to comply with their tax obligations. As I have noted many times before, our working equation at the IRS is “Service *plus* Enforcement *equals* Compliance.” The increasingly complex tax laws hinder our ability to provide American taxpayers with the service they deserve.

At last year’s hearing, the General Accounting Office (GAO) noted that legislation simplifying the Internal Revenue Code could probably do more to simplify IRS’s paperwork burden requirement than any other action. GAO also noted that redesigning processes to promote electronic filing would be an improvement.

### **THRESHOLD REVIEW INITIATIVE**

In the Subcommittee’s invitation letter, you asked us to provide you with an update of our comprehensive review of the law and regulations in an effort to identify thresholds that are within the Commissioner’s discretion to change in order to reduce paperwork burden.

The results from this review, however, revealed that the vast majority of thresholds are statutory in nature and, thus, not within our discretion to change.

Based on these findings, we have shifted to a bottom up approach to identifying actionable thresholds -- those in which the Commissioner has delegated authority to change, *e.g.*, changes to forms and instructions, publications, revenue procedures, and regulations.

In using this approach, we continue to identify thresholds, some of which appear to have the potential for significant taxpayer burden reduction. As thresholds or the opportunities to establish new thresholds are identified, we perform preliminary research and analyses to determine the effect on compliance, if any, and whether the potential for revenue slippage is within tolerable limits, before moving forward with an initiative. The determination to proceed is based, largely, on how much slippage the Service is willing to

accept as a trade off for reducing taxpayer burden, and frequently, at the same time, reducing internal processing costs. Some thresholds are inherently revenue associated, not merely for slippage but because they affect the tax, per se.

Following are some examples, currently under review by OTBR, of thresholds we have identified that could be changed, or newly established, through exercise of discretionary authority:

- In its report dated May 20, 2003, *“PROJECT ASPIRE” EO DETERMINATIONS PROCESS REVIEW PROJECT GROUP*, pages 31-32, the Advisory Committee on Tax Exempt and Government Entities (ACT) discusses the possibility of an increase in the filing threshold for Form 1023, Application for Exemption, established in Section 508 (c)(1)(B). Conforming the Form 1023 filing threshold to the Form 990, Return of Organization Exempt From Income Tax, filing threshold (currently \$25,000 in gross receipts) could eliminate confusion, enhance consistency in Exempt Organization (EO) filing requirements, and free up determination specialists for more consequential application review. However, any such increase in the threshold would have to be considered very carefully in light of the importance of ensuring that the requirements of section 501(c)(3) are met.
- Form 1040EZ and 1040A – Income Thresholds: Preliminary research provided by Tax Forms and Publications suggests that increasing the threshold for filing Form 1040EZ and 1040A from \$50,000 to \$100,000 of taxable income has the potential to reduce burden for newly-eligible users who self-prepare their returns without software. However, the six additional pages of tax tables that would be required to accommodate the newly-eligible taxpayers would increase the apparent complexity for millions of current users. To date, the decision has been to retain the current taxable income limits, but that is re-evaluated annually based on a balancing of the benefits for the estimated number of additional users against the increased burdens for current users.
- Cost of Materials – Install New Threshold for allowable Expensing vs. Capitalization: Reg. 1.162-3 provides that taxpayers carrying materials on hand should expense only materials actually consumed. If no record of consumption is kept, taxpayers may expense these amounts, but only if taxable income is clearly reflected by this method. A threshold here would remove much of the doubt.
- Repairs – Install New Threshold for Allowable Repairs Expense vs. Capitalization: Reg. 1.162-4 provides that the cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition may be deducted as an expense, provided the cost of acquisition or production or the gain or loss basis of the taxpayer’s plant, equipment, or other property, as the case may be, is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong

the life of the property, shall either be capitalized and depreciated in accordance with Section 167 or charged against the depreciation reserve if such an account is kept. A threshold here would provide a much needed bright line test.

## **REDUCING BURDEN BY SIMPLIFYING FORMS, INSTRUCTIONS, PUBLICATIONS, AND NOTICES**

### Reduced and Increased Burden on Individual Income Tax Returns

We made changes to the 2003 Forms 1040 and 1040A and their instructions and schedules that reduced estimated burden by almost 12 million hours, based on the A.D. Little burden methodology. This included changing the Schedule SE, Self-Employment Tax, to allow taxpayers to skip lines on the form if they are only liable for the Medicare portion of the self-employment tax. However, the burden on Forms 1040 and 1040A was estimated to increase by over 28 million hours to implement tax legislation, the Jobs and Growth Tax Relief Reconciliation Act of 2003. This Act provided significant benefits to individuals and businesses, despite the net increase of 16 million burden hours. (Estimates based on A.D. Little methodology.)

### Consolidation of Publications Relating to Tax Benefits for Education

Last year, we reported that we were planning to consolidate the tax information publications about tax benefits for education into one product. We have made obsolete Publication 508, *Tax Benefits for Work-Related Expenses*, and Publication 520, *Scholarships and Fellowships*. The information in these publications has been added to Publication 970, *Tax Benefits for Education*. Taxpayers and tax practitioners now have one primary source for information in this area of tax benefits. About 500,000 copies of these publications were distributed in 2002.

### Publication 17 Redesign

We also reported last year that we would use feedback from focus groups to identify ways to improve Publication 17, *Your Federal Income Tax*. This publication is a comprehensive tax guide for individuals. Focus group results showed that taxpayers wanted a better way to find the information they need in the publication. Working with a consultant, we redesigned and expanded the index to the publication to make it easier for taxpayers to find the information on the topics they wanted. Based on other feedback, we also redesigned the introduction to the publication to help taxpayers understand how to use it. Other improvements include:

- New bubble art of Form 1040 and Schedule A, Itemized Deductions, guiding taxpayers to page references where various topics are explained;
- New chapter explaining education-related adjustments to income;
- A table listing items in the introduction of Part Four, Adjustments to Income, to make them easier to read and to find;
- A list of addresses to which taxpayers need to mail various IRS forms;

- A table listing and explaining the icons used throughout the publication to highlight important information; and
- An expanded section identifying important changes and reminders.

### Form 8855

We have also developed a new Form 8855, *Election to Treat a Qualified Revocable Trust as Part of an Estate*, for executors and trustees. With this form, taxpayers have a format to follow and can be sure to include all the necessary election information prescribed by the regulations. An official IRS form is easier for taxpayers to use than a self-prepared statement and enhances compliance. It will also allow the IRS to more accurately process elections, thus minimizing the need for IRS employees to contact taxpayers in order to resolve questions arising from such elections.

### Notice Redesign Activities

Ten redesigned notices advising taxpayers of adjustments to their accounts were implemented between July 2003 and January 2004. During Calendar Year 2003, over ten million of these types of notices were issued. The redesigned notices are:

- CP-21A – Data Processing Adjustment Notice, Balance Due of \$5 or More;
- CP-21B – Data Processing Adjustment Notice, Overpayment of \$5 or More;
- CP-21C – Data Processing Adjustment Notice Less Than \$5, Overpayment Less Than \$1;
- CP-21E – Examination Adjustment Notice;
- CP-22A – Data Processing Adjustment Notice, Balance Due of \$5 or More;
- CP-22E – Examination Adjustment Notice;
- CP-101 – Math error on Form 940 or 940EZ resulting in a net balance due;
- CP-102 – Math error on Form 941, 942, 943 or 945 resulting in a net balance due;
- CP-112 – Math error on Form 941, 942 or 943 resulting in a net overpayment; and
- CP-128 – Notification of the remaining balance due on a tax period after an offset.

Additional redesign projects are underway to rewrite notices to taxpayers in “plain English” and to reduce taxpayer burden relating to contacts from the IRS. Scheduled for implementation between now and January 2005 are redesigned:

- Letters 105C and 106C, with a volume of almost 500,000;
- CP71 series (reminder notices), with a volume of almost 5 million; and

- CP2000 (underreported income), with a volume of almost 2.1 million.

## Paperwork Burden Reduction Plans for Next Year

### *Schedule D*

We simplified the 2004 Schedule D, Form 1040 by eliminating Part IV, *Tax Computation Using Maximum Capital Gains Rates*. Instead, taxpayers will use the *Qualified Dividends and Capital Gain Tax Worksheet*. Previously, only taxpayers who were not required to file Schedule D used this worksheet. In focus group tests, taxpayers preferred the format of the worksheet to Part IV. Although this change does not result in quantifiable burden reduction under our current method of measuring burden, we are responding to customer preferences. The implementation of the 2003 tax law changes (eliminating the special treatment of 5-year gains and the pre-May 6, 2003, capital gain tax rates) will also result in burden reduction. In 2003, the reporting burden on Schedule D was 123.8 million hours. For 2004, the reporting burden is estimated at 109 million hours, or 14.8 million fewer hours, based on the A.D. Little burden methodology.

### *Business Credit Forms*

For Tax Year 2004, we are deleting 7 lines from each of 19 general business credit forms (for a total reduction of 133 lines) by replacing 8 separate lines for tax credits with a single line. According to the A.D. Little burden methodology, these changes will reduce taxpayer-reporting burden by almost 3 million hours in tax year 2004. The affected forms are:

- Form 3468, Investment Credit;
- Form 3800, General Business Credit;
- Form 5884, Work Opportunity Credit;
- Form 6478, Credit for Alcohol Used as Fuel;
- Form 6765, Credit for Increasing Research Activities;
- Form 8586, Low Income Housing Credit;
- Form 8820, Orphan Drug Credit;
- Form 8826, Disabled Access Credit;
- Form 8830, Enhanced Oil Recovery Credit;
- Form 8835, Renewable Electricity Production Credit;
- Form 8844, Empowerment Zone and Renewal Community Employment Credit;
- Form 8845, Indian Employment Credit;
- Form 8846, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips;

- Form 8847, Credit for Contributions to Selected Community Development Corporations;
- Form 8861, Welfare-to-Work Credit;
- Form 8874, New Markets Credit;
- Form 8881, Credit for Small Employer Pension Plan Startup Costs;
- Form 8882, Credit for Employer-Provided Childcare Facilities and Services; and
- Form 8884, New York Liberty Zone Business Employee Credit.

### *Form 941 Redesign*

Last year, we reported on the status of our redesign of Form 941, Employer's Quarterly Federal Tax Return, filed by approximately 6.6 million small business taxpayers. Since then, we have met with representatives from the payroll community, such as the American Payroll Association, to discuss the new form and have used their feedback to make additional modifications. Taxpayer cognitive testing is planned for this spring. The redesigned form and its plain-language instructions will first be used for the March 31, 2005, quarter. An extensive communications plan has been developed to ensure taxpayers and practitioners make a smooth transition to the new form.

In a separate, but related, project, we are designing a new form for employers to reconcile wage and tax information for employees involved in mergers and other acquisitions. We initiated this project upon a request from employers and tax practitioners through the Industry Issue Resolution program discussed below.

### *Schedule K-1 Redesign*

Plans are proceeding on schedule for implementation of the redesigned Schedules K-1, which are used to report income, deductions, and credits from pass-through entities. Beginning with Tax Year 2004, taxpayers will see a new, streamlined look to the Schedules K-1 for Form 1065, U.S. Return of Partnership Income; Form 1120S, U.S. Income Tax Return for an S Corporation; and Form 8865, Return of U.S. Persons with Respect to Certain Foreign Partnerships. This spring we are conducting focus group testing and this fall IRS will engage in outreach activities to familiarize investors and practitioners with the new format.

Over 23 million taxpayers receive Schedule K-1 (Forms 1065, 1120S, and 1041). The simplified Schedules K-1 will reduce taxpayer burden by improving taxpayer comprehension, resulting in fewer pre-filing preparation errors and fewer unnecessary post-filing notices, including those generated by the K-1 matching program.

## **REDUCING TAXPAYER BURDEN BY STREAMLINING POLICIES, PROCESSES, AND PROCEDURES**

### Extensions to File Process

We are currently working on an initiative to simplify applications for extensions of time to file a return. This process has become complicated over the years as new forms and new requirements have been added. The current procedure allows corporate taxpayers to use one standard form to request a one-time automatic six-month extension. All other entities and individuals must select from an array of ten different forms to request an initial, or an additional, extension.

The overall goal of the Extension Initiative is to lessen the burden associated with applying for an extension and to create efficiency in processing extension requests. We are considering regulatory changes to create a single six-month extension period for non-corporate taxpayers; designing simplified and consolidated extension forms; and proposing centralized submissions processing of the extension applications. Although there is significant work to be done on this initiative, we are hopeful that it will result in meaningful burden reduction for approximately 15 million taxpayers.

### S Corporation Election Process

We currently are evaluating the viability of amending portions of section 1362 of the Internal Revenue Code to allow a less burdensome process for a corporate taxpayer seeking to be taxed as an S corporation. Under section 1362(a) of the Code, a small business corporation may elect to be treated as an S Corporation for tax purposes, if all shareholders consent to the election on the day the election is made. The process for small business corporations to elect treatment as an S corporation was identified as one of the most difficult processes for taxpayers to comply with. It requires adherence to rigid rules including sequential submission of at least two other forms prior to the filing of the tax return. A statutory change to the election process could result in significant taxpayer burden reduction benefits.

### The Industry Issue Resolution Program

The IRS created the Industry Issue Resolution (IIR) program more than three years ago as an initiative under our Large and Mid-Size Business Operating Division's Issue Management Strategy, and it continues to produce burden reduction results for business taxpayers. Taxpayers, industry associations, and other interested parties are encouraged to submit business tax issues for possible resolution through published or administrative guidance through the IIR program. The goal is to resolve tax issues that are common to a significant number of business taxpayers by providing targeted guidance on specific tax issues. For each issue selected, an IIR team including IRS and Treasury personnel gathers relevant facts from taxpayers or other interested parties and recommends guidance to resolve the issue. Under the program, the IRS has issued guidance that has reduced costs, burden, and uncertainty for taxpayers. Since its inception, eleven IIR projects have been completed, and since the last hearing, Revenue Procedures have been issued concerning the following:

- Clarification of the depreciation of gasoline station pump canopies (published in Revenue Ruling 2003-54);
- A safe harbor method for depreciating certain fiber cable used in cable television distribution systems as a unit of property (published in Revenue Procedure 2003-63); and
- Guidance on the computation of total recoverable units for purposes of computing cost depletion under Section 611 of the Internal Revenue Code (published in Revenue Procedure (2004-19).

There are currently eight open IIR projects targeted for completion in Fiscal Year 2004:

- Tax treatment of pre-production costs of creative property;
- Definition of highway tractors subject to the heavy truck tax under Code section 4051;
- Deduction and capitalization of costs incurred by utilities for assets used for power generation;
- Application of Code section 382 to U.S. Branches of Acquired International Banks;
- Tax treatment of health care provider incentive payments;
- Tax treatment of vendor allowances involving build-outs and image upgrades
- Guidance under Code section 4051(a)(2) and (3) regarding “Suitable for Use”; and
- Reporting Employment Taxes in Context of Mergers, Consolidations, etc.

The next IIR project selections will be identified from issues submitted to the IRS by March 31, 2004.

#### Electronic Tax Administration (ETA)

The IRS Restructuring and Reform Act of 1998 mandated that the IRS have as a goal that at least 80 percent of all Federal tax and information returns be filed electronically by 2007. Electronic filing’s benefits are clear and compelling. Taxpayers find it more convenient and economical and less time-consuming to do business electronically than sending paper through the mail. Other benefits of electronic filing include reduced preparation time, faster refunds, increased accuracy of returns, and acknowledgement of receipt of the e-filed return.

Currently, taxpayers who transmit their 1040 tax returns electronically give high marks to the IRS’s electronic filing programs. The American Customer Satisfaction Index (ACSI) shows customer satisfaction scores for IRS e-file exceed the averages for both the Government and retail sectors and rival those of the financial services sector. For electronic tax return filers, the overall ACSI rating is 74%. This surpasses the rating among paper return filers and the Government-wide satisfaction rating of 68.6%. Customer satisfaction and burden reduction initiatives are fundamental to the IRS’s continued efforts to maintain taxpayer trust and compliance. The present e-filing system has demonstrated measurable success with regard to individual taxpayer satisfaction.

From its modest beginning as a pilot program in 1986, when 25,000 returns were filed electronically, the number of e-filed returns has dramatically increased, with more than 53 million returns filed electronically last year. In 2004, IRS expects about 60 million taxpayers to take advantage of the many benefits of electronic filing. These include:

- **Faster refunds:** Direct deposit can speed refunds to e-filers in about two weeks or less. During 2003, 44,422,000 refunds were direct deposited, up from 39,744,000 during 2002, an increase of almost 12 percent. The average direct deposit refund in 2003 was \$2,362, totaling \$104.9 billion, up 12.2 percent over the prior year. We expect this year's direct deposit numbers to be about 10% higher than last year's.
- **More accurate returns:** E-filed returns are automatically checked for errors or missing information. Processing is more accurate and the likelihood that a taxpayer might receive an error letter from the IRS is reduced.
- **Quick electronic confirmation:** E-filers receive an acknowledgement that we have received their returns.
- **Electronic signatures:** Taxpayers and their tax preparers can create a Personal Identification Number (PIN) and file a completely paperless return. Those who take advantage of this option do not mail anything to the IRS. Last year taxpayers filed 11 million returns that were signed using a PIN, up 12% from the previous year. Also, 24.2 million taxpayers e-filed through a paid preparer and used self-select PIN or a practitioner PIN, up 41%.
- **Free Internet Filing:** Now in its second year, Free File allows millions of taxpayers to prepare and file their Federal tax returns on-line for free. The program is a partnership between the IRS and an alliance of tax software companies that offers free on-line tax return preparation and e-filing services to at least 60% of the nation's 130 million taxpayers. Free File, which was used by 2.8 million taxpayers last year, was principally designed to advance and increase e-filing receipts and assist taxpayers, particularly in underserved and disadvantaged communities. (At this point our volume of Free File returns is more than 20% higher than last year.) While each of the 16 companies participating in the program sets its own qualifying criteria for its free services, the majority of the offerings are designed to serve lower-income individuals or families who claim the earned income tax credit. Others are based on the taxpayer's age, military service, or state residency.
- **Easy payment options:** E-filers with a balance due can file early and schedule a safe and convenient electronic funds withdrawal from their bank account, or pay with a credit card by April 15<sup>th</sup>. More than 1.2 million people paid their Federal taxes by electronic funds withdrawal or credit card during 2003, up from 750,000 in the prior year, a 60 percent increase.

- **Federal/State e-filing:** Taxpayers in 37 states and the District of Columbia can e-file their Federal and state tax returns in one transmission to the IRS. The IRS forwards the state data to the appropriate state agency. In 2003, more than 22.7 million taxpayers filed Federal-state electronic returns.
- **Extension of Time to File by Phone:** Anyone who filed a return last year can use the telephone to request an automatic extension of time, to August 16, 2004, to file his or her tax return. Telephone filers get a confirmation number at the end of their call, telling them that their extension request has been accepted.
- **Federal/State TeleFile:** In 2003, 345,422 taxpayers filed their Federal and state tax returns with a single phone call, up 16 percent over the prior year. Taxpayers in seven states can e-file their return by phone.

### Taking the Paper Out of Business Taxpayer Burden in 2004

The IRS has taken steps to decrease the burden of business taxpayers by introducing a variety of electronic services that will ease both information reporting and payment of taxes. Businesses file annual income tax returns but are also required to file various employment tax returns and information returns. They must also make periodic payments to the Federal Government, such as income tax withheld from employees' earnings and unemployment taxes. In fact, payments are a business's most frequent transaction with the IRS. We plan to convert all of these transactions to fast, accurate, paper-free electronic methods, and we are making progress on a number of fronts.

During FY 2003, over 4.4 million taxpayers made \$1.55 trillion in electronic tax payments through the Electronic Federal Tax Payment System (EFTPS), which now includes an online option. For 2004, IRS expects more than 4.5 million taxpayers to pay their taxes using the EFTPS System.

In FY 2003, IRS received more than 2.7 million Form 941 (Employer's Quarterly Federal Tax Return) e-file program returns and 840,000 returns for Form 941 TeleFile and On-Line Filing Programs. In FY 2003, 350,767 businesses used the Form 940 (Employer's Annual Federal Unemployment Tax Return) e-file program, and more than 49,115 partnerships chose to e-file Form 1065 (U.S. Return of Partnership Income) in FY 2003.

IRS is also delivering several applications that provide tangible benefits to taxpayers and improve the efficiency and effectiveness of our tax administration system. They include:

#### Employment Tax E-File System

The Employment Tax E-File System offers an improved way for current Form 940 and 941 e-file and On-Line Filing Partners to file returns with the IRS, and for the first time, Electronic Return Originators (EROs) have the ability to offer electronic employment tax

filing for their clients. The Employment Tax E-file System will provide more filing options, flexible filing, faster acknowledgements, an integrated payment option, a completely electronic signature process, and a Federal-state filing component, all of which will result in reduced burden for the tax preparation community and the taxpayers they represent.

### E-Services

E-Services is a suite of Internet based products that allows tax professionals and payers to do business with the IRS electronically. These services include preparer tax identification number (PTIN) applications with instant delivery, individual TIN matching for third party payers, on-line registration for electronic E-Services, and on-line initiation of the electronic return originator application. In addition, IRS will be offering incentives to those tax professionals and payers that e-file 100 individual returns or more, such as on-line disclosure authorization, electronic account resolution, and transcript delivery system.

### Modernized E-File System (MeF)

On February 20, 2004, IRS launched the modernized e-file program. This new electronic filing program, developed and delivered through the IRS Business Systems Modernization program, gives corporations and tax-exempt organizations the ability to file annual tax returns electronically over the Internet. For the first time, electronic filing is available to corporations filing their corporate income tax returns, Form 1120 & 1120S, and charitable organizations filing their annual Form 990, along with related forms and schedules. These forms are the first to be filed through a modernized e-file program that uses a secure Internet connection instead of a modem to transmit tax return data. Corporations filed more than 5.7 million Forms 1120 and charitable organizations filed 748,000 Forms 990 last year. Through the week of April 11, 2004, IRS has accepted 25,822 returns under this new system.

### *Corporations*

The IRS is implementing MeF for business returns in two phases. The first phase was released in February 2004, with 53 forms and schedules made available for electronic filing. The second phase will roll out in July 2004, adding another 43 forms. We estimate that 95% of corporations will be able to file electronically.

Tax and information filers, and the IRS, will spend less time completing transactions. MeF proposes to decrease the burden on taxpayers by reducing preparation time, including time associated with copying, assembling, sending filings to the IRS, and storing filings, and by eliminating postage costs and delivery time. These burdens are compounded for businesses where tax returns are more complex and can require numerous attachments and schedules. Customers with multi-state filings must complete this process for each state in which they do business. The system will provide a single standard for filing electronic tax returns and allow transmitters to submit multiple return

types within the same transmission. MeF will decrease third party transaction costs, improve the maintenance of taxpayer accounts, and facilitate more cost-effective resolution of compliance issues. It will also expedite income verification for purposes of disaster loans, grants, mortgage, and educational loans.

### *Charitable Organizations*

More than 748,000 nonprofit organizations will enjoy the benefits of burden reduction through the IRS's implementation of MeF for Forms 990. MeF will also effectively address the problem of rejected returns. Approximately 40% of exempt organizations' returns were rejected due to oversight, such as omission of required schedules, incorrect name or identification numbers, missing signatures, and mathematical errors. While IRS personnel were able to correct many of these errors, just as many result in the issuance of correspondence to the filer. This creates significant delays in the processing of these returns. E-filing will reduce many of the steps associated with IRS Service Center paper processing, including mail handling, editing, data entry, and error resolution. From the taxpayers' perspective, it will reduce taxpayer correspondence, mail handling, time spent trying to resolve errors and recordkeeping.

The Form 990 series of returns is unique because each is a multi-jurisdictional form used by both the IRS and state regulators. The current plans for Modernized e-File are to enable single point filing to meet both Federal and state filing requirements. This capability will save state tax resources and eliminate duplicative filings by the taxpayer.

### Express Enrollment for New Businesses

The IRS and the Treasury Department's Financial Management Service launched a new program in January 2004 called Express Enrollment for New Businesses. Express Enrollment was developed to encourage new businesses to use the Electronic Federal Tax Payment System (EFTPS), which is an efficient and cost-saving method for paying all Federal taxes. All businesses receiving a new Employer Identification Number (EIN) and that have a Federal tax obligation will be automatically enrolled in EFTPS to make all of their Federal Tax Deposits. When they receive their EIN, they will also receive a separate mailing containing an EFTPS PIN and instructions for activating their enrollment. They can choose the Government's free electronic payment program rather than using paper Federal Tax Deposit coupons. Plus, Express Enrollment expedites the enrollment process, allowing the business taxpayer an opportunity to make payments as soon as its enrollment is activated.

### Federal Tax Deposit/Electronic Federal Tax Payment System Penalty Abatement Program

Another new program launched in 2004 is the Federal Tax Deposit/Electronic Federal Tax Payment System Penalty Abatement Program. This is an incentive for taxpayers to enroll in EFTPS and make timely deposits, and involves a one-time refund of a Federal Tax Deposit Penalty for any business that has been assessed a late deposit penalty. To

claim the one-time refund of a late deposit penalty, the business must enroll in EFTPS and use it successfully for four consecutive quarters (one year). After successfully using EFTPS for one year to timely deposit all Form 941 taxes, IRS will automatically remove the assessed penalty and refund it if no other taxes are owed.

### Future Electronic Initiatives

In the next couple of years, IRS will be offering additional incentives to taxpayers to file their returns electronically. These initiatives will both reduce taxpayer burden and help the IRS to achieve its goal that 80% of returns be filed electronically. These incentives include:

- Internet Refund Fact of Filing (IRFOF) Expansion. This will provide the capability to initiate refund trace options for lost/stolen refunds, make address changes, and provide telephone numbers to update IDRS and receive explanations of the 40 most common math error situations.
- Internet Employer Identification Number (EIN), Phase 2. This initiative would fully automate the current internal EIN processing. Phase 2 functionality will include full validation against information housed in IRS databases and will result in a same session, valid EIN. The entity will be immediately established on IRS systems and the transaction will be accomplished without IRS employee intervention.
- Expanded E-Services for Reporting Agents. We will provide access to current E-Services (Transcript Delivery System, Disclosure Authorization, and Electronic Account Resolution) to Reporting Agents who meet required criteria we establish for the incentive program.
- Corporate Returns, Forms 1120/1120S MeF Release 2. This will expand the electronic filing and processing capabilities of Corporate Tax Returns.
- Exempt Organization Returns, Form 990. We will expand the electronic filing and processing capabilities of Forms 990, 990EZ, and 1120POL.

## **REDUCING BURDEN BY SUPPORTING LESS BURDENSOME RULINGS, REGULATIONS, AND LAWS**

### Standard Mileage Rate

To reduce recordkeeping burden, IRS expanded the use of the standard mileage rate for taxpayers with multiple vehicles. Starting in 2004, the standard mileage rate may be used for up to four vehicles in the taxpayer's business. Previously, those businesses owning more than one vehicle for use in their business could not use the standard rate at all,

leaving them to track the actual expenses for each vehicle. With this change, more than 800,000 businesses will become eligible to use the standard mileage rate, saving 8-10 million hours in recordkeeping burden.

You noted, yourself, Mr. Chairman, that “This reduction in tax recordkeeping is a step in the right direction.” Representative Manzullo and Senator Collins, Chairs of the House and Senate Small Business Committees, respectively, applauded this change.

Revenue Procedure 2003-76 contains additional information on the standard mileage rates.

#### Annualization of Form 941

The IRS, working with the Social Security Administration, the Treasury Department, and the Commerce Department’s Bureau of the Census, is studying a proposal that would allow taxpayers to file an annual Employer’s Federal Income Tax return filing option. By extending this option to taxpayers who have demonstrated compliant behavior in filing returns and payment of taxes for at least eight quarters, and who owe less than \$2,500 per quarter in tax liability, the initiative could affect approximately 691,000 small business taxpayers. Under this proposal, this group of taxpayers will be allowed to file an annual return each year, saving approximately 2 million hours in return preparation time. This group will still be required to make quarterly deposits via the EFTPS. Form 941, “Employer’s Quarterly Federal Income Tax Return” would continue to be required for all other employers. We have just begun study of this proposal. If the IRS develops the capacity to implement this plan, there is potential for decreasing the burden imposed on compliant, small employers.

#### Support of Government-Wide Paperwork Burden Reduction

IRS has been supportive of all Government-wide efforts to reduce the regulatory and paperwork burden imposed on our customers, including aggressively addressing the requirements of the Small Business Paperwork Relief Act (SBPRA) of 2002. IRS is well represented on the SBPRA task groups addressing Government-wide burden, making it easier for small businesses to understand their regulatory requirements, identifying ways to integrate and consolidate data, and making recommendations to improve the electronic collection and dissemination of data collected under Federal requirements. As the 2002 SBPRA Task Force recommended, the IRS is working with the Business Gateway E-Government Initiative to make it easier for businesses to interact with the Federal government and help to reduce burden through data harmonization and forms consolidation. In addition, periodic meetings are held with SBA and OMB to discuss burden reduction efforts and to identify partnering opportunities.

The SBPRA required publication of a Government-wide inventory of resources available to help taxpayers comply with Government regulations, known as compliance assistance resources. Taxpayers, particularly small business taxpayers, have indicated that

determining what regulations apply to them is the initial hurdle to their ability to comply with those regulations.

To inform and educate taxpayers about their tax law responsibilities, IRS offers a wide array of compliance assistance resources that are available through a variety of channels. Such resources include face-to-face tax help at Taxpayer Assistance Centers; Toll-Free Telephone Assistance and Tax Information; Websites/Internet; Workshops, Training Sessions and Seminars; and products developed for specific taxpayer segments, such as small businesses. For individual taxpayers, the Understanding Taxes program, available on IRS.gov, makes learning about taxes interactive, relevant and educational. It is a great tool for high schools, colleges, and the general public.

Specialty products for small businesses include:

- Small Business Tax Workshops and Workbooks;
- Small Business On-Line Classroom – Video streaming of a Small Business Workshop and on-line courses;
- Small Business Resource Guide - A one-stop tax information/management tool;
- Introduction to Federal Taxes for Small Business/Self-Employed CD ROM – Comprehensive tool that teaches the basics of how to comply with IRS regulations; and,
- Tax Calendar for Small Business/Self-Employed – Wall calendar with helpful information and common tax filing dates.

The staffs of Taxpayer Education and Communication (TEC), within the Small Business/Self Employed Operating Division, and Stakeholder Partnerships, Education and Communication (SPEC), within the Wage & Investment Operating Division, leverage numerous partners in the private and public sectors to inform, educate, and assist taxpayers in understanding and complying with their tax law responsibilities.

## **MEASURING TAXPAYER BURDEN**

The Individual Taxpayer Burden Model is the product of IRS's collaborative efforts with IBM Consulting Services and representatives from Treasury, OMB, and GAO to develop new estimates of burden. This new tool is designed to improve our understanding of the impact on taxpayers of changes in tax policy and tax administration. The model provides separate estimates of the taxpayer time and out-of-pocket expense for filing and pre-filing activities. For the first time, IRS is able to evaluate the burden on specific types of taxpayers, for example, taxpayers who prepare their taxes using paper forms or software or who rely on paid professionals. We can also look at the burden from basic taxpayer activities, such as record-keeping and form completion.

We are currently working with IBM to develop a model of Small Business Taxpayer Burden. Two small business surveys, covering income taxes and employment taxes, are underway. The survey data will be the basis for developing a micro-simulation model

similar to the individual model. Tax law, filing regulations, and taxpayer attributes (behavior) will be incorporated with IRS administrative data and survey data in the model. We anticipate completion of the model in mid-2005.

We plan to develop burden models covering most taxpayers, including mid-size corporations and tax-exempt entities, in addition to individuals and small businesses. We also plan to model post-filing burden. A core technical and analytic group will maintain and update the models and work with contractors on development of new ones. In addition, new surveys will be required every five to seven years, depending on the changes in tax laws.

The Individual Taxpayer Model has great potential for IRS and tax policy makers because it can meet a variety of different needs. IRS management can prioritize initiatives by using it to estimate the impact of major initiatives on taxpayer burden. For example, the model could be used to estimate the impact of administratively changing various thresholds, such as for interest and dividends. Also, the model could assist with the evaluation of tax policy. "What-if" scenarios reflecting potential legislative changes could be specified by model users to estimate the impact on burden.

## **CONCLUSION**

Mr. Chairman, in conclusion, I believe that the IRS continues to demonstrate progress in balancing compliance and customer service with burden reduction. We will continue to seek administrative and other solutions to reduce taxpayer burden. However, at the same time, tax law complexity must be properly addressed if we are to reduce taxpayer burden in a meaningful way.