# E-File Systems Design for Payroll-related Tax Reporting

## *FTA Technology Conference*

Janice Krueger—National Association of Computerized Tax Processors (NACTP)

Pete Isberg—National Payroll Reporting Consortium (NPRC)

Jenine Hallings – Paychex/NPRC

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# NACTP

- Non-profit organization founded in 1969
- Includes in its membership over 50 payroll and tax preparation software companies, electronic filing processors, tax form publishers, and tax processing and payroll service providers
- Represents over 1 million employers in addition to individual taxpayers
- Worked extensively with IRS, SSA, and State Revenue Agencies to develop and design e-file systems and automated paper processing systems

# NACTP Payroll Goals

- Serve as an advisor to taxing authorities to address payroll and information reporting issues
- Provide employers with a less costly, less time-consuming, more accurate method of form preparation than manually prepared forms
- Help agencies benefit from maximized compliance and minimized costs due to more limited manual processing through providing compliant products and services to employers
- Promote the standardization/simplification of electronic and alternative filing systems

# Why We're Here

- State Revenue agencies are rapidly adopting new systems for electronic transmission of employment tax reports
  - Replacing magnetic media wage reporting programs
    - Worth a comprehensive planning effort
  - Separate systems are necessary
    - Individual employer filings (or small batch)
    - High volume filers (over one-third of wage records)
    - Focus first on high volume filers to gain higher numbers of e-filed returns
  - Early designs have been problematic
    - Resulting systems dramatically increase agency and private sector workload
    - Include industry in design phase

# Electronic Filing Roles

○ Some entities can serve multiple roles

- Taxpayer/Employer
- Preparer or Electronic Return Originator
- Reporting Agent
- Transmitter
- Software Developer
- Taxing Authority

○ Recommend electronic filing systems address the needs of all participants

# Agency Sponsored Data Entry Systems

○ Requires time-consuming step of re-keying information from accounting software into data entry system increasing the probability of errors

○ Problematic to maintain and market; counterproductive for the computerized return processing industry

○ Only focuses on the taxpayer rather than the other participants

○ Recommend building electronic filing systems for bulk filers

# File Format Standards

○ Recommend use of established data formats with no "tweaking"

- FSET (Fed-State Employment Tax)
- MMREF/EFW2 (Specifications for Filing Forms W-2 Electronically)
- Publication 1220 (Specifications for Filing Forms 1098, 1099, 5498 and W-2G Electronically or Magnetically)
- ICESA (Interstate Conference of Employment Security Agencies)

# Specifications

- Even when standards are used, specifications need to outline elements such as:
  - Transmission and security protocols
  - XML schemas and versions; format
  - Business rules and edits
  - Applicable data elements; name tag protocol
- Recommend high level specifications be released for industry review one year prior to planned implementation

# E-Services

- Recommend providing access to additional information via e-services based on the role of the participant
  - View returns, amendments, and notices for authorized periods
  - Permit taxpayers to view payments, returns, and any error conditions
  - Secure e-mail for account resolution

# National Payroll Reporting Consortium (NPRC)

○ NPRC is a non-profit trade association whose members provide payroll tax reporting and payment services to over 1.3 million employers nationwide - - *more than one-third of the private sector workforce.*

- NPRC actively supports appropriate electronic filing and tax payment programs.
- For over 30 years, NPRC members have supported electronic tax administration in every state

# Intelligent design can minimize agency and private sector workload

- Design recommendations address industry characteristics and best practices; e.g.,
  - "Enrollment" in electronic filing systems
  - New edit capabilities – how far should you go?
  - How to manage authorizations
    - SSA vs. IRS models
- Recommendations include software developer and transmitter perspectives
  - E.g., Intuit Quickbooks – used by >1 million employers

# Examples of Issues Addressed:
## *Lessons Learned, Best Practices, and Recommendations*

Avoid Mandatory Enrollment in *e-file* Systems

- Employers are already registered with a valid EIN
  - Why register again for e-filing?
  - Don't reject otherwise-valid electronic filings for lack of enrollment
  - Why not automatically enroll all employers?
- *If enrollments are necessary, use existing reporting systems to populate enrollment files*

# Examples of Issues Addressed:
*Lessons Learned, Best Practices, and Recommendations*

How to manage authorizations

○ How many service providers does it take to change a light bulb? Early assumptions.

○ Paper world: Copies of signed authorization forms are sent to SWAs for slow, costly, painstaking recording and file maintenance

- Future: Rely on a trading partner agreement ('memorandum of understanding') and electronic submissions of client information

# Examples of Issues Addressed:
*Lessons Learned, Best Practices, and Recommendations*

Pre-filing data exchanges improve data quality

- Needed to achieve efficiencies and accuracy inherent in electronic filing
  - Conceptually a 'pre-filing' submission through existing filing systems to identify any problems
  - States have been conducting these data exchanges via magnetic media for many years
    - Those with effective systems eliminate 97% of the notices that would otherwise result.

# Examples of Issues Addressed:
*Lessons Learned, Best Practices, and Recommendations*

Application of new edit capabilities is important

- Early systems rejected entire transmissions (thousands of employers) for a few errors
  - *At what level should reports be rejected?*
- New edits – What is appropriate?
  - Consistency with SSA, IRS, other agencies, other states, and prior practice?
  - E.g., punctuation, special characters in name fields:
    - *John Smith Jr., John O'Malley, St. Regis; N. Hollywood*

# Examples of Issues Addressed:
*Lessons Learned, Best Practices, and Recommendations*

*Transmission protocols are different for large files*

- eFiling through Web Services:
  - Basic Authentication thru User ID/password over SSL
  - Leverage WS Security for additional authentication, encryption, signing
  - Leverage SwA (SOAP with Attachments) to support large binary attachments (e.g., ICESA layout)
    - Avoids complex file management requirements
- Acceptable Alternatives:
  - FTP with PGP encryption
  - FTP over SSL
  - SFTP using SSH
  - Third party software for TCP/IP (costly)
  - Least favored - - HTTP over SSL
    - (browser based & file size limitations)

# ACH Debit and Credit Options Are Needed

○ Embedding ACH tax payment instructions within electronic returns is not appropriate for high volume submissions

- When there are file submission or processing problems, it's not clear whether banking instructions were released and for which returns.
- When corrected files are submitted, duplicate transactions may result.

○ Large companies are also prohibited from permitting external organizations to access their bank accounts directly for risk management purposes.

○ Some software developers/transmitters do use ACH Debit.

○ *Recommendation: Permit separate submission of tax payments and tax reports via ACH Credit, and support ACH Debit and Credit options*

# Careful Design of e-file Systems Would Save Countless Resources

- NPRC and NACTP recommendations are available now
  - www.nprc-inc.org
  - www.nactp.org
- Early collaboration is helpful
- NPRC and NACTP members would like to work with interested state agencies who are working on or planning new electronic filing systems

# Contact Information

Jenine Hallings – Paychex/NPRC

jhallings@paychex.com

(585) 336-7463

Pete Isberg – ADP/NPRC

Pete_Isberg@adp.com

 (610) 827-1591

www.nprc-inc.org

Janice Krueger – Nelco/NACTP

jkrueger@nelcosolutions.com

(920) 337-2848

www.nactp.org