

Testimony for the IRS Oversight Board
The Importance and Impact of Measures
National Payroll Reporting Consortium
February 8, 2006

Chairman Wagner and distinguished members of the Board: My name is Pete Isberg and I am here today as President of the National Payroll Reporting Consortium (NPRC)¹. The NPRC is committed to working with the IRS to improve tax administration through electronic filing and related systems, and we appreciate the Board's role in helping to make this happen.

The NPRC represents businesses – “Reporting Agents” in IRS terminology – that provide human resource-related administrative services to employers, including payroll processing and employment tax payment and filing services. NPRC members serve more than 1.2 million employers with a combined total of more than 35 million employees, and process payroll for more than one-third of the private sector workforce. Reporting Agents transmit about 30 percent of all Federal depository taxes received by the U.S. Treasury, and have long served an important role in our nation's tax collection system as a conduit between employers and the IRS. Reporting Agents improve the efficiency of IRS tax collection and improve tax compliance.

We appreciate the ongoing efforts by the IRS to work with NPRC to resolve issues and problems, including the issues addressed in this testimony.

The E-File Goal and Measurement of Progress Should Be Expanded

NPRC believes that the goal of having 80 percent of all federal tax returns filed electronically remains appropriate and that extending the deadline for achieving this goal will result in continued focus and gains in this important area. We note, however, that the narrow focus of this goal has caused the IRS to neglect areas of tax administration that do not directly contribute to the volume of electronically filed returns, to the detriment of the IRS' overall success in improving the experience of taxpayers with whom they interact.

The area of employment taxes, for example, is critical considering that more than 70 percent of U.S. tax revenues flow into the Treasury through employers. Yet, because the volume of such returns is dwarfed by the number of individual income tax returns (there are about seven million employers compared to over 133 million

¹ The following companies are members of NPRC: Automatic Data Processing, Inc.; Ceridian Corporation; Compupay, Inc.; Fidelity Employer Services Company LLC; Intuit, Inc.; Paychex, Inc.; PayMaxx, Inc.; Payroll People, Inc.; PayCycle, Inc.; Primepay, Inc., and Sage Software, Inc.

individual taxpayers), virtually all IRS resources are dedicated to enhancing electronic filing of individual income tax returns.

We suggest that the electronic filing goal should be expanded, and the IRS's electronic services focus should encompass all transactions with the IRS, to avoid the inappropriate exclusive focus on inbound individual tax returns. Doing business with the IRS electronically is not just about inbound tax return filing. Our primary example of an area that has been neglected remains access to electronic services.

Reporting Agents should be the model for all electronic tax filing programs, as they have been paying and filing employment taxes electronically for many years. But in many important respects, Reporting Agents remain in the proverbial Stone Age. Reporting Agents are not able to use e-services because there is no link to the appropriate authorization file ("Reporting Agent File"). Without such access, the efficiency with which Reporting Agents can represent their clients -- not to mention the efficiency of tax collection as a whole -- is severely limited.

The IRS generates hundreds of thousands of notices annually that are handled using 1940's technology: written correspondence and telephone. Written correspondence means weeks or months of waiting for simple issues to be resolved. Telephone exchanges mean hours upon hours of hold time. These methods unnecessarily sap IRS and Reporting Agent resources -- a drain that is especially unfortunate because the vast majority of these inquiries relate to matters that could be resolved easily and quickly without any need for burdening IRS personnel if Reporting Agents simply had electronic access to client information through e-services.

E-services include the ability to transmit client registrations, requests for client transcripts, and information to resolve client account issues (e.g., misapplied payments or penalties). As an example of the types of inquiries that could be handled via e-services, a significant proportion of the calls made to the IRS are to obtain details on what caused a notice; or to determine the disposition of credits, deposits, or other returns posted. The availability of transcripts to Reporting Agents would make it unnecessary for an IRS staff member to field and respond to such calls.

Providing e-services to payroll firms would cut IRS operating costs by enabling authorized self-service, and reduce the expense and difficulty of doing business with the IRS. Doing so would effectively extend e-services to over 1.2 million employers who collectively employ more than one-third of the private sector work force. On this subject, we agree with several of the points made in the Internal Revenue Service Advisory Committee Report dated November 17, 2005 (E-services for Reporting Agents):

- Transcript Delivery Services (alone) would eliminate 90,000 telephone calls annually... a savings of over 11 FTE (Full Time Employees) or nearly \$800,000 per year;

- ...electronic notice delivery (eliminating mailing costs ...early receipt, faster resolution, and reduction in subsequent notices) has the potential to save the IRS over \$1.2 million annually...;
- pre- and post-filing applications will drive further IRS cost reductions... pre-filing applications would allow verification of taxpayer information before making payments and filing returns, thus reducing mistakes and *preventing notices before they occur*. (emphasis added); and
- e-services for Reporting Agents would be easy to implement and quickly accepted. Analysis and prototyping have already been done, development cost is reasonable, and Reporting Agents are a highly computer-literate community that has been requesting e-services for years.

There have been a number of meetings with the IRS on this subject, but no date has been projected by which payroll services will gain access to the system. This status has remained unchanged since 2002.

The Impact of Goals and Measures

None of this should come as a surprise, however, when one considers the unambiguous direction that Congress has given the IRS, which is to focus on converting all inbound tax returns to electronic. All returns filed by Reporting Agents have been 100% electronic for many years. Why would the IRS devote any of its resources to improving upon 100%? We suggest that the measure by which the IRS should be judged should be changed to encompass all transactions, not just inbound tax returns. This would enable the IRS to develop appropriate, comprehensive electronic systems that would fulfill the true intent of Congress.

NPRC notes, for example, the exemplary success that the IRS has achieved in EFTPS, which enables taxpayers to not only initiate electronic tax payments, but also to view their accounts via secure Internet connection. This is of particular importance to employers who outsource their employment tax responsibilities, and the IRS is wisely promoting EFTPS as a means to verify that tax payments are being correctly credited to the employer's account. EFTPS online access is similar to what taxpayers expect and receive from their financial institutions, and EFTPS would hardly be viewed as the success it is today if it only supported tax payment initiation. The IRS needs to focus on *comprehensive* systems, including pre- and post-filing electronic services, in order to gain broader acceptance and participation by taxpayers.

Burden Reduction Measures Should Actually Achieve Reduced Taxpayer Burden

The IRS has devoted significant resources and countless well-intentioned staff hours toward reducing taxpayer burden, resulting recently in the announcement of a new annual employment tax return, Form 944. Form 944 was intended to be a burden

reduction measure, and to observers, any reduction of return filing requirements would appear to be a step in the right direction. Upon closer analysis, however, it appears that the emergence of Form 944 may not result in actual burden reduction.

We applaud the hard work and good intentions of the IRS in formulating this new annual employment tax return, but frankly, the reaction of the employment tax community has been that of bewilderment. Form 944 appears to have added substantially to the complexity of employment tax administration for those who will be affected, and for those who provide services to them. We believe that the key decisions made in this case were driven by measures that failed to consider the real-world implications of the proposal. Indeed, even the IRS Taxpayer Advocate questioned “whether the benefits of the program outweigh the burdens imposed on taxpayers”; noting that the 944 program “...increases complexity. Affected taxpayers may not feel that the IRS has eased their employment tax paperwork burden.”² If the measurement of taxpayer burden has led the IRS to implement a supposed burden reduction program that actually increases such burden, we suggest that a thorough analysis of the Service’s measurement methodology is in order.

For those who handle their employment taxes through a payroll service (Reporting Agent), it is admittedly difficult to measure taxpayer burden when the calculation, payment, and reporting of employment taxes are all automatically handled within a seamless array of payroll-related services. There is typically no distinct fee per tax deposit or return filed by such service providers, so the cost of payroll services for taxpayers may not be directly affected by the frequency of filings or deposits. Thus, it may appear that an employer who utilizes a reporting agent and who now will be subject to the new Form 944 requirements will be unaffected by the change. The reality, however, is that the new requirements will likely result in decreased efficiency at the Reporting Agent level, and the cost of this decreased efficiency may be passed on in one form or another to the employer clients of payroll services.

One summary observation is that if Form 944 was truly intended as a taxpayer burden reduction measure, it would not have been implemented on an effectively mandatory basis, with employers needing to take affirmative steps to opt out. It is apparent that greater efficiency was a primary goal in the development of the new requirements -- small businesses could either file one employment tax form annually, rather than four, or if such businesses prefer to continue filing quarterly reports, they could do so only if such reports are filed electronically. Either way, the result should be a more efficient system -- at least for the IRS, if not for taxpayers -- and that admittedly would be a step in the direction of good government.

This same goal could have been achieved, however, if the IRS had allowed those employers who already file a quarterly Form 941 electronically to simply continue to do so without opting out of Form 944. Instead, those employers who prefer Form 941 and its deposit rules must communicate this preference to the IRS by April 1st to advise

² IRS Taxpayer Advocate, 2005 Annual Report, p. 201

them of their election to opt out of Form 944. They must justify their election and wait for written IRS approval. If they deposit their employment taxes under Form 941 or file Form 941 electronically without prior approval, they will receive a notice of rejection and will need to correspond with the IRS to 'correct' the deposits or returns.

Taxpayers who file Form 944 must monitor their return filing assignment from year to year since it may change. They must monitor their deposit schedule from year to year since it may change, and they must monitor their tax liabilities during the year since penalties may be assessed if their unpaid taxes exceed a threshold amount. Some burden is also added because of the 944 program's non-definitive nature. New taxpayers are asked to predict future results, which is contradictory to most IRS programs, where requirements are based on past results. So although on the surface filing and deposit requirements appear to have been simplified, taxpayers whose liability varies above and below the applicable thresholds may experience added burden and complexity.

Because Reporting Agents already must file their clients' Forms 941 electronically, this is not an area where efficiency gains will be realized. To the contrary, because Reporting Agents are not permitted to opt out of Form 944 on behalf of their clients, they will be required to either alter their processing systems to accommodate Form 944 filing, or communicate to, and follow up with, each of their clients about the need for them to personally contact the IRS to opt out of Form 944. On this issue, just as it would be more efficient for Reporting Agents to have access to their clients' accounts through e-services, it would be more efficient if Reporting Agents had the ability to opt out of Form 944 on their clients' behalf. Instead, as written, the new Form 944 requirements will undoubtedly result in increased burden for Reporting Agents.

In conclusion, the NPRC respectfully recommends that the measure by which the IRS is judged should be changed to encompass all transactions, not just inbound tax returns. The IRS should expand its e-file goal to include electronic services beyond the filing of tax returns -- most notably, expansion of e-services to Reporting Agents so that they may more efficiently serve their clients and the IRS. We also recommend that the IRS reevaluate its method of measuring taxpayer burden, to ensure that measures put in place to reduce such burden actually do so rather than increase it. Lastly, we recommend that the IRS start addressing this issue of taxpayer burden by reevaluating the manner in which the Form 944 annual filing requirements will be implemented.

The NPRC is proud of the relationship that Reporting Agents have maintained with the IRS over the years, and we believe that a more thorough assessment of efficiency goals and burden reduction measures would help to strengthen this valuable partnership. We appreciate the opportunity to provide input to the IRS Oversight Board and would be happy to answer any questions you may have.