

Testimony for The IRS Oversight Board
On the Future of Electronic Tax Administration
The Contributions of Payroll Reporting Agents to Electronic Filing
National Payroll Reporting Consortium
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Executive Summary

Payroll Reporting Agents, who transmit more than one quarter of all Federal employment taxes received by the U.S. Treasury, 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. Far too often, however, the IRS has not considered the filing and reporting needs of Reporting Agents in IRS' policy decisions and implementation of new systems. As a consequence, to maintain their efficiency and compliance standards, Reporting Agents have often had to seek modifications to IRS policies and systems after they have already been designed and implemented. While such post-implementation modifications have ultimately been made in some instances, significant cost and uncertainty could have been avoided if IRS had considered the needs of Reporting Agents at the outset of consideration of policy or procedural changes.

The National Payroll Reporting Consortium (NPRC)¹ represents businesses providing payroll processing and employment tax services directly to employers. NPRC members serve over one 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.

This paper provides background on the role of Reporting Agents and their positive contributions to IRS tax collection, and addresses the need to bring about an improved understanding and awareness within the IRS with regard to Reporting Agent issues, to ensure that the interests of Reporting Agents are considered in connection with relevant IRS decisions. Business cases are set forth for three issues that should be addressed in the near term:

1. Making appropriate IRS e-services available to Reporting Agents;
2. Empowering an IRS official with authority sufficient to represent the interests of Reporting Agents in the making of any relevant decisions related to IRS policies or procedures; and
3. Ensuring that the new IRS' "Reasonable Cause Assistant." which handles penalty abatement requests, treats all taxpayers equitably.

¹ The following companies are members of NPRC: Automatic Data Processing, Inc.; Ceridian Corporation; Compupay, Inc.; Federal Liaison Services, Inc.; Fidelity Employer Services Company LLC; Interpay, Inc.; Intuit, Inc.; Paychex, Inc.; Payroll People, Inc.; Primepay, Inc.; and ProBusiness Services, Inc.

The Role of Reporting Agents and Their Contributions to Improving IRS Tax Collection

Reporting Agents -- Background

- Reporting Agents assist employers in making required tax deposits and tax information filings to the Federal Government and to state and local governments. Reporting Agents also often assist business owners with many other administrative aspects of running the business.
- With respect to Federal tax requirements, Reporting Agents perform one or more of the following services:
 - Preparation and electronic filing of Form 941, Employer's Quarterly Federal Tax Return;
 - Preparation of Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, and Form 945, Annual Return of Withheld Federal Income Tax; and
 - Electronic submission of Federal Tax Deposit (FTD) payments and related information.

Reporting Agents Transmit More Than One-Fourth of Total Employment Tax Revenue Received by the United States Treasury

- Reporting Agents have long served an important role in our nation's tax collection system as a conduit between employers and the IRS. Of the roughly \$1.5 trillion paid in 2001 to the US Treasury in employment taxes (federal income withholding, FICA, FUTA, and Medicare tax) approximately 25 percent was deposited by Reporting Agents.

Tax Compliance Is Significantly Enhanced for Businesses That Utilize Reporting Agents

- The ever-increasing complexity of the Internal Revenue Code has caused a significant non-compliance problem among many businesses that do not use Reporting Agents. The use of Reporting Agents by businesses eliminates problems associated with especially complicated issues. For example, the wide and poorly understood array of taxable fringe benefits and related types of monetary and non-monetary compensation often can cause considerable confusion. Reporting Agents offer the expertise to ensure that such types of income are automatically taxed and reported correctly.
- Reporting Agents better ensure that business clients are compliant with the Internal Revenue Code, and electronically file the necessary payments and information returns on a timely basis.

IRS Resources Are Spared Because of Payroll Reporting Agents

- Reporting Agents shoulder much of the burden of IRS tax administration by working with business owners to ensure compliance, filing tax deposits and returns electronically, and working with the IRS to resolve any resulting issues in an efficient manner.
- Reporting Agents help ensure that business owners are kept up-to-date on tax law, tax regulation, and IRS procedural changes.

Reporting Agents Have Been Key Partners With the IRS in Helping to Achieve Electronic Filing Goals

- Reporting Agents transmit all tax deposits together with all corresponding data (detailing amounts remitted as federal income tax [FIT] withholding, Federal Insurance Contributions Act [FICA], Federal Unemployment Tax Act [FUTA], and Medicare payment amounts).
- Reporting Agents transmit all tax deposits and tax deposit information electronically through the Electronic Federal Tax Payment System (EFTPS) Bulk or Batch Filer programs. The inclusion of all Reporting Agent tax deposit activity is critical to the IRS' ability to reach EFTPS goals. The EFTPS Bulk and Batch Filer programs were developed and implemented through an exemplary cooperative effort to enhance EFTPS.
- Reporting Agents transmit more than 30 percent of total EFTPS tax funds deposited annually, and initiate nearly 40 percent of total EFTPS transactions each year, much of which is comprised of deposits for non-mandated taxpayers.
- Reporting Agents electronically file nearly all client Forms 941 and 940. In fact, over 95% of electronically filed IRS payroll tax returns are filed by Reporting Agents.
- Many Reporting Agents have helped to facilitate electronic filing of individual income tax returns, by enabling all employees of client companies to electronically "import" the more than 34 fields of W-2 data — including salary and withholding information — into electronically prepared individual income tax returns. Direct electronic importing of such data facilitates computer-assisted tax preparation, thereby increasing the chances that such returns will be filed electronically, and helping to eliminate income tax return transcription errors.
- Many Reporting Agents promote electronic filing of individual tax returns by printing the IRS e-file logo on employee copies of Form W-2. As a result, roughly 40 million taxpayers are reminded of the benefits of electronic filing (e.g., "*Safe, Accurate, FAST*") and provided with a reference to the IRS website, at the very moment they are preparing their tax return.

NPRC BUSINESS CASES

I. Making relevant IRS e-services available to Reporting Agents -- a Business Case.

- The IRS is currently working on Phase-1 of "e-services," which will offer to certain third parties (e.g., tax practitioners, financial institutions, and 1040 electronic return originators) the ability to transmit and receive information electronically. This phase is scheduled to be operational by the summer of 2003. Once implemented, it will allow users to electronically transmit client registrations, requests for client transcripts (which are used to determine actions necessary to resolve account discrepancies); and information to resolve client account issues (e.g., misapplied payments, penalties).
- Expanding IRS electronic services is a prime example of the E-Government mandate expressed in the President's Management Agenda. E-Services will cut government operating costs by allowing authorized self-service, reduce the expense and difficulty of doing business with the government, and provide customers with readier access to high quality government services.
- Until recently, Reporting Agents were able to transmit client-service communications with the IRS electronically through the Electronic Communication System (ECS) established by the IRS Philadelphia Service Center. As part of IRS consolidation, this service was shut down effective December 11, 2002. Ideally, Reporting Agents would have been offered similar e-services at the same time ECS -- the only existing electronic interface -- was eliminated, to ensure a smooth transition.
- For the interim (before implementation of e-services for Reporting Agents) the IRS has suggested that the Practitioner Priority Services (PPS) telephone sites be used as an alternative. The use of this telephone service often requires several minutes of unproductive waiting time, including the faxing of documents and letters, per client item. Reporting Agents need some means of transmitting this information electronically to maintain current levels of efficiency.
- Reporting Agents are not currently included in the first phase of e-services and there is currently no concrete plan to include Reporting Agents in future phases. Further, the IRS has provided no assurances that Reporting Agents will be included in any phase of the e-services enhancements. Given the importance of Reporting Agents to the process of tax collection, it is essential that Reporting Agents be included as part of e-services as soon as possible.
- Part of the IRS' e-file strategy is to provide certain services as a reward or inducement to increase participation in IRS electronic initiatives. From the magnetic tape programs of the early 1980's to the current e-file and EFTPS programs, Reporting Agents have demonstrated strong support of IRS electronic filing and payment programs. The omission of Reporting Agents from the e-services project means in essence that the IRS has penalized -- not rewarded -- the sector that has

contributed the most in terms of helping IRS to reach their goals for electronic filing of business tax deposits and returns.

➤ Specifically, NPRC supports adding appropriate e-services functionality for Reporting Agents, with the recognition that the existing and planned IRS electronic services were designed for individual income tax practitioners, and that many such services may not be relevant or appropriate for Reporting Agents. E-Services for Reporting Agents should include the following:

- Online access to client IRS accounts by Reporting Agent associates
- Secure environment to submit/receive information
- Individual and bulk access/transaction capability
 - Any registered employee of the Reporting Agent should be able to work on any client account
 - Ability to submit requests and information related to multiple accounts
- Ability to verify that the Reporting Agent has an authorization on the Reporting Agent File (RAF)
- Pre- and post-filing research capability
 - Online viewing of client account activity, modules, transcripts, etc.
 - Entity verification, e.g., confirmation of taxpayer EIN, name, assigned tax deposit schedule, etc.
- Account resolution
 - Online submission of correspondence and adjustments
 - Requests for holds on accounts pending research to avoid unnecessary notices
 - Online case tracking (e.g., received, in process, closed)
 - Ability to submit requests for penalty waivers on a pre-assessment basis
- Electronic Notices
 - Online access to view and download notices

II. Empower an IRS official with authority sufficient to represent the interests of Payroll Reporting Agents in the making of any relevant decisions related to IRS policies or procedures.

Payroll Reporting Agents' Interests Are Not Well Understood Within the IRS

- Despite the significant role played by Payroll Reporting Agents in collecting revenue for the Federal Government and contributing to IRS' electronic tax administration goals, Reporting Agent issues do not receive adequate attention within the IRS.
- IRS policy decisions that most directly impact Payroll Reporting Agents are made by the Small Business/Self Employed Division (SB/SE). SBSE is comprised of three organizations: Customer Account Services (CAS); Taxpayer Education and Communication (TEC); and Compliance.
- CAS is responsible for processing operations and programs in the SBSE campus sites. They oversee all business returns processing, telephone assistance programs, and third party authorization programs such as the Centralized Authorization File (CAF) and the Reporting Agent File (RAF).
- CAS has largely ignored the needs of Reporting Agents when making key decisions. For example, Reporting Agents were not considered in the design of e-services, and were excluded from e-services. In addition, the implementation of the Practitioner Priority Services was seriously flawed by lack of training and staff knowledge about Reporting Agents.
- TEC is responsible for interfacing with internal and external stakeholders. They perform an important educational and liaison function, and have been instrumental in bringing Reporting Agent issues and concerns to the appropriate IRS business owners. TEC established very effective, ongoing Reporting Agent Forum meetings, and the joint IRS/RA working group to redesign the Reporting Agent File.
- However, although virtually all policy and operations decisions regarding the processing of payroll taxes resides in SBSE, the National Account Manager ("NAM"), who is responsible for interfacing with Reporting Agents, serves under the Electronic Tax Administration, in the Wage and Investment Division.
- The IRS first implemented the National Account Management Program three years ago, as a program aimed at developing partnerships between the IRS and key industries. Under this program, NAMs were assigned to various industry segments (software providers, return preparers, financial institutions, Payroll Reporting Agents) to work through IRS issues. Although there have been recent successes, the program has not yet met the expectations of Reporting Agents. At the same time, the SB/SE Division has become more active in addressing Reporting Agent issues.
- Although the NAM position has been very helpful and responsive to Reporting Agents, the placement of the NAM position outside of the key policymaking division -- SB/SE -- and the lack of recognition and authority of the NAM, has meant that the interests of Payroll Reporting Agents have been under-represented in key IRS policy decisions.

- The NAM's lack of influence has been exacerbated by the recent IRS reorganization that moved all responsibility for current business e-file and EFTPS programs from ETA to SB/SE. The National Account Manager should be granted additional authority and moved into the appropriate operating division; i.e., SB/SE.

III. The IRS' Reasonable Cause Assistant (RCA) system should be evaluated to ensure that standards for reasonable cause abatement of penalties apply equitably to all taxpayers, including those who employ reporting agents.

- The RCA system is an artificial intelligence system that determines whether "reasonable cause" exists to abate certain penalties assessed against a taxpayer.
- The RCA system as currently programmed does not adequately recognize reasonable cause in situations involving Reporting Agents. All penalty abatement determinations are required to specify the reasons for any denial; but the RCA system does not appear to accept normal reasonable cause explanations once IRS personnel identify the case as involving a Reporting Agent. This is because the resulting explanations generated by the RCA are unsuitably vague or irrelevant, and, therefore, appear to lack any acknowledgement of the issues raised.
- Several examples of instances where the IRS has in the past found reasonable cause to exist for situations involving Reporting Agents were recently provided to the IRS. These examples demonstrate that the new RCA system as currently programmed does not appear to accommodate the same rationale for abatement.
- The inappropriate or erroneous RCA denial reasons have put an unnecessary burden on employers, their Reporting Agents, and IRS Penalty Appeals Officers, as the taxpayers and/or their Reporting Agents are increasingly being forced to appeal these decisions in order to have their situations fairly and adequately reviewed. In more cases than not, the Appeals Function abates the penalties, just as they would have been abated pre-RCA.