

Real Time Tax System Initiative Public Meeting

December 8, 2011





Agenda

- Goals of the Real Time Tax System Initiative
- Benefits for Taxpayers
- Overview of key compliance practices today
- Key observations / fact base
- Discuss emerging ideas



The Real-Time Tax System initiative is focused on improving the taxpayer experience and improving overall tax compliance

Real-Time Tax System Goals

- The vision is to migrate away from the “after-the-fact” business model that has defined the IRS (and most major tax agencies globally) approach to compliance for decades.
- For individual tax returns (1040s), a Real-Time Tax System could:
 - Verify many elements when the tax return is filed
 - Allow taxpayers to correct potential discrepancies before the IRS processes the return
 - Enhance tax processing systems to embed information return data in pre-screening filters, to compare information returns and tax returns earlier and alert taxpayers to mismatches
- Elements would be phased in over time – for instance, we could concentrate on a small number of information returns, where compliance issues are largest today
- IRS would need to develop a process – working with the tax practitioner and software community – to flag these issues, and allow the taxpayer to either correct the return or otherwise explain the discrepancy.
- The real-time tax system is a vision for the future of the tax system, and the IRS is soliciting broad feedback on how best to move forward.



The Real-Time Tax System could reduce taxpayer burden, save money and improve compliance

Long-term Benefits

- **Reduced Burden:**
 - Potentially eliminates the need for millions of IRS contacts with taxpayers, and the associated correspondence and follow-up, because problems are resolved up-front
- **Taxpayer and Government Savings:**
 - For taxpayer, eliminates millions of dollars in penalties and interest payments, which would otherwise potentially be assessed years after the fact, by arriving at the correct tax up-front
 - For government, billions in net revenue and cost savings resulting from up-front quality checks on tax returns being filed with the IRS
- **Improved Compliance:**
 - Substantially mitigates largest vulnerabilities to identity-theft related refund fraud
 - Allows IRS, over time, to direct more resources to more complex issues, and fewer resources to basic omission / understatement cases



Currently, information return matching is facilitated by our AUR program – a highly effective “look-back” tool

Current Compliance Practices

- Information returns inform multiple compliance programs within the IRS, with the Automated Underreporter (AUR) program serving as the primary identifier of mismatches between tax returns and corresponding information returns
- Three times a year, the AUR program matches the more than 140 million tax returns to a corresponding 1.8 billion information returns filed every tax year
- In 2010, the IRS closed 4.3 million cases in which a discrepancy was identified between the taxpayer return and third-party information, resulting in more than \$7.2 billion in additional assessments¹

¹ 2010 IRS Data Book.



Looking more closely at outcomes and trends today helps us determine what it would take to make this vision a reality

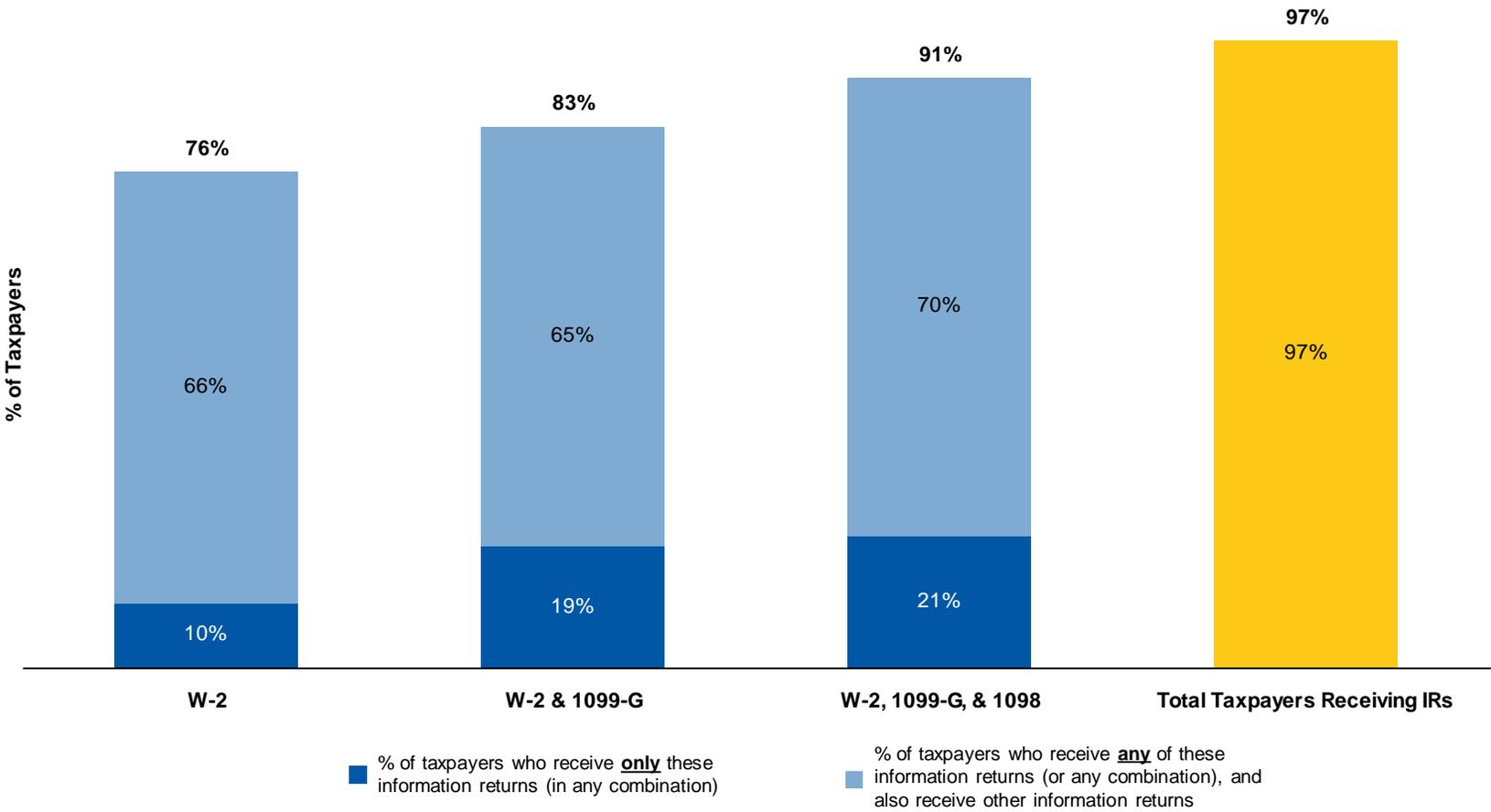
Current Observations

- In order to evaluate this concept, it is important to look at the concentration and distribution of information returns across the taxpayer base.
- Tax Year 2009 data shows that:
 - 97% of taxpayers receive at least one information return
 - Over 91% of taxpayers receive at least 1 of 3 information return types
 - Four information return types account for 70% of assessments from our matching program, AUR
 - 56 payors constitute 50% of overall information return volume, with the largest concentration in the government and financial sectors
 - Less than 1% of total information return volume is from amendments or corrections to the original return



Although there are dozens of information returns, 91% of taxpayers receive at least one of the W-2, 1099-G, and/or 1098; 21% of taxpayers *only* get W-2s, 1099-Gs, and/or 1098s.

Taxpayer Coverage by Information Return Combinations
Tax year 2009

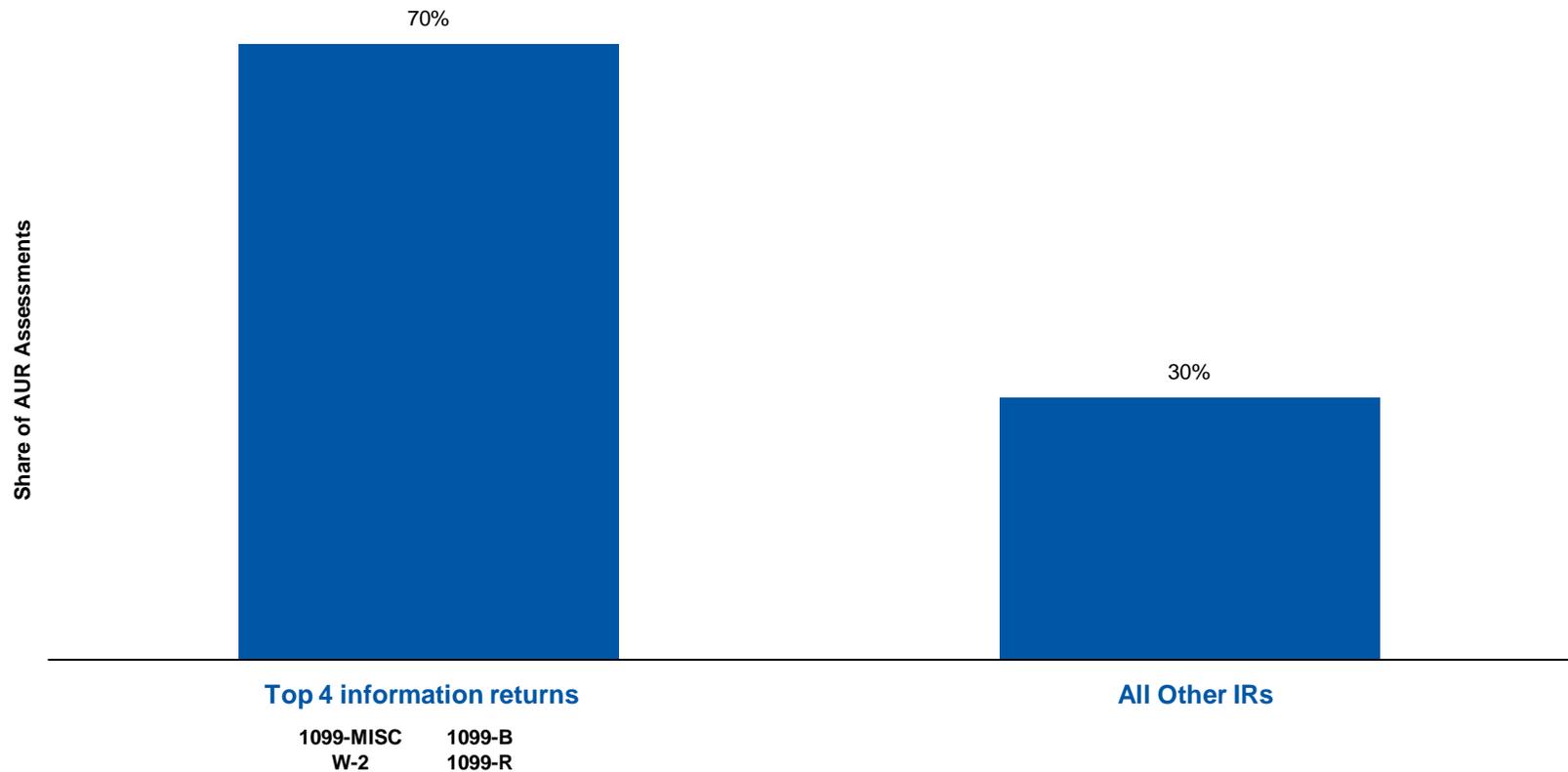


Note: 1% sample size of 1040 taxpayers (~1.5MM)



More than 70% of our current AUR assessments, which create burden for the taxpayer to follow up with the IRS, could potentially be addressed more effectively with upfront matching of just 4 information return types

Automated Underreporter (AUR) Assessment¹ Tax year 2007



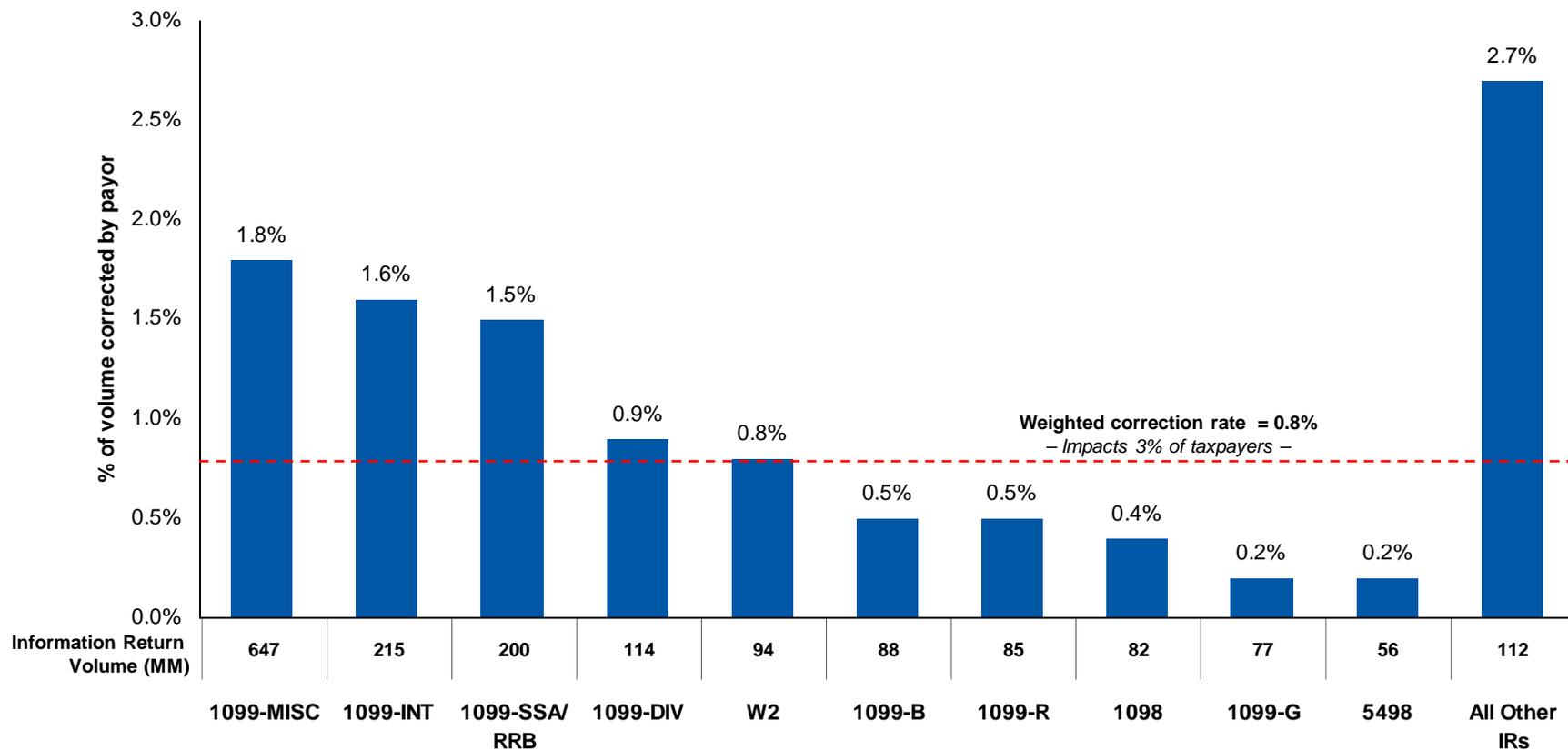
1. Tax year 2007 was used for analysis as it is the most recent tax year with complete AUR data



Less than 1% of information returns are amended or corrected today

Volume of Information Returns

Tax year 2009; total number of records processed and correction rate¹



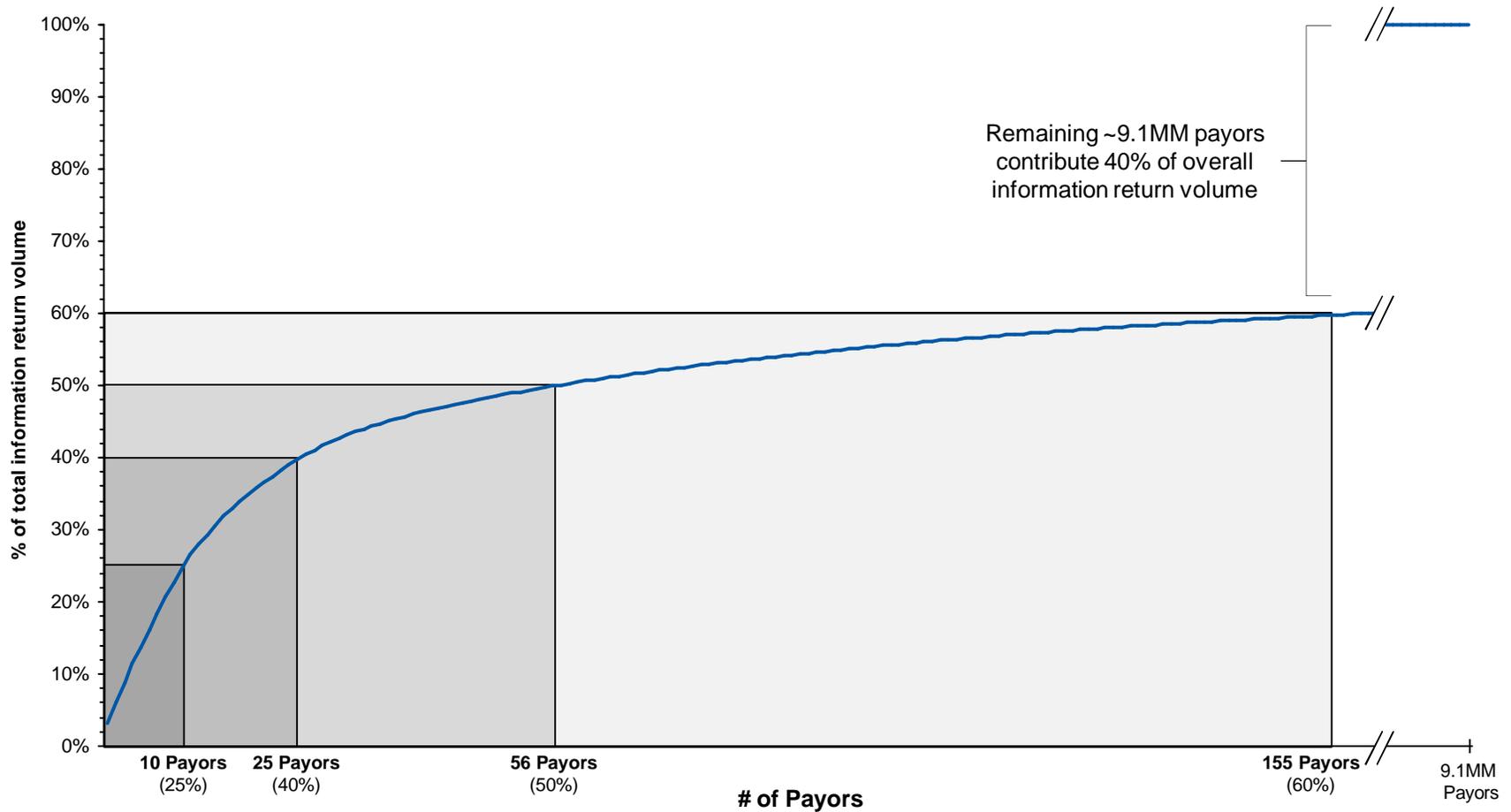
Source: IRS

1. Correction rate = percent of total volume attributed to amended, duplicate, and corrected returns – includes tax change, address change, incorrect SSN, etc.



56 payors account for 50% of information return volume

Payor Concentration of Information Return Volume Number of payors, all information returns





Key Considerations and Issues

When considering how to make a real time tax system work, several considerations arise, including:

- Timeline/deadlines for filing of information returns
- Schedule for processing of individual income tax returns
- Speed of processing information returns as they are filed (paper versus electronic)
- Accuracy of information returns

Environmental factors that must also be considered

- State and local information returns / deadlines
- Potential changes required of payors (e.g., employers, governments, etc.)

Specific Information Return Issues

- Non-wage data required for W-2
- Simple financial products versus complex



Key Questions for Discussion

General Questions

- What are the best opportunities to evolve the tax system to be more real time in the short, medium, and long-term? How can we most effectively structure our collective efforts to eliminate hassle for taxpayers, and reduce burden?
- What suggestions would participants offer on how to operate an up-front matching process? What should be the role of the taxpayer, the tax practitioner, and the software industry in resolving issues that arise? What tools could the IRS provide to support up-front issue resolution?

Specific Questions / Scenarios for Feedback and Recommendations

- In a scenario where the IRS moved substantially toward upfront matching, how would panelists envision the process working between the IRS, taxpayers, and practitioners to resolve issues up front, rather than months and years after the fact? What issues and concerns would panelists suggest that the IRS should consider?
- Several commenters have raised questions about the interaction of the timing of tax return filings, and information return filings. To the extent that there are gaps, how would panelists suggest that these gaps could be narrowed over time?



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