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ETAAC Recommends Mandatory e-Filing of Forms 941

The IRS's Electronic Tax Administration Advisory Committee (ETAAC) recommends that employers that are required to electronically file Forms W-2 should be required to electronically file Forms 941 as well. Further, ETAAC suggests that the threshold for mandatory electronic filing of W-2s (more than 250 forms) should be lowered, as it has not changed in 19 years. The committee also proposes that reporting agents that file employment and unemployment tax returns for other organizations should be required to deposit all their clients' taxes using the Electronic Federal Tax Payment System (EFTPS).

These items were included among 21 recommendations given to the IRS at ETAAC's annual public meeting and to the U.S. Congress in its 2008 Annual Report. The recommendations, which cover a wide range of issues pertaining to business filers, individual taxpayers, and return preparers, include creating free online filing options for Form 941, giving taxpayers online access to their tax data via *MyIRSAccount*, and requiring tax return preparers that prepare more than 50 individual returns per year to file all returns electronically.

Background

ETAAC provides an organized public forum for discussion of electronic tax administration issues and the overriding goal that paperless filing should be the preferred and most-convenient method of filing tax and information returns. Its 14 members represent various industries that are customers of the IRS. The payroll community is represented by APA member Tony Tullo, Director, Federal Compliance, ADP, Inc.

When Congress chartered ETAAC in 1998, it set a goal for the IRS – that 80% of all tax returns should be filed electronically by 2007. That goal has not been reached. ETAAC's 2008 Annual Report says, "The IRS has several key form types that have not reached the 80% e-file penetration goal and will not anytime in the near future without creating a catalyst for change."

ETAAC is required by law to submit to Congress each June a report that (1) reviews IRS progress in increasing e-filing and (2) makes recommendations to accelerate that increase. Some recommendations may be implemented by the IRS on its own, but other recommendations may require Congressional action.

The 2008 report is available at www.irs.gov/pub/irs-pdf/p3415.pdf, and public comment is being solicited. If you have any comments you would like APA to make on your behalf,

please write to Scott Mezistrano, CPP, APA Senior Manager of Government Relations, at smezistrano@americanpayroll.org.

Mandatory 941 e-filing

"ETAAC recommends that employers who are required to e-file their W-2s also be mandated to e-file their Forms 941" (2008 Recommendation #5). Forms 941 account for the highest number of tax returns (23.9 million annually) after Forms 1040 (143.1 million to date for the 2008 filing season), but 78% of them are still filed on paper. However, 82% of employer information returns (Forms W-2) are electronically filed with the Social Security Administration (SSA).

Tullo explained that there is a low e-file penetration rate for Form 941 because there is no incentive to e-file, other than the online acknowledgment of filing. Forms 941 are generally zero-balance returns, so there's no incentive to speed up the processing in order to get a refund more quickly. "Form 941 is almost an information return, like a W-2," and the IRS needs to offer free online filing solutions, he said.

"ETAAC recommends that the IRS develop a free online filing solution for employers to input and e-file their *Employer's Quarterly Federal Tax Return*, Form 941. ETAAC has identified three possible approaches: IRS develops, implements, and maintains a 941 e-file solution; IRS contracts out the development of a 941 e-file solution; or IRS negotiates a solution similar to the Free File Alliance program with third-party vendors" (2008 Recommendation #4).

Tullo favors the approach of a Free File Alliance for Form 941, which is how IRS has facilitated free filing of Form 1040. David Williams, IRS Director of Electronic Tax Administration, on the other hand, said he's not sure that he agrees with this recommendation, but he didn't elaborate.

Increasing W-2 e-filing

While Form W-2 has exceeded the 80% e-file goal, it's interesting to note that, according to the report, from tax year 2000 through 2007, the percentage of e-filed forms increased due to the conversion of magnetic media filers to e-filers. During the same period, however, the percentage of W-2s filed on paper barely decreased; SSA still gets 45 million paper forms per year.

"The e-file threshold for information returns (such as Form W-2) has been the same for 19 years," Tullo remarked, adding that it's time for a change. He reported that the SSA says a lower threshold would yield a big increase in e-filing, and he pointed to 2008 Recommendation #7: "ETAAC recommends that the mandate threshold for filing W-2s

electronically be decreased. The appropriate level should be based upon input from SSA on the effect of mandates on their W-2 website utilization and the threshold level needed to eliminate the majority of the 45 million paper W-2 filings. It is our understanding that Congress must authorize the change in this mandate.”

ETAAC feels the burden on employers will be minimal, because SSA offers Business Services Online, where employers can upload W-2s to SSA, free of charge.

Forms 1099

Only the 1099-MISC has significant paper submissions, according to the report – 32 million out of 82 million. All other 1099s are at or nearing 100% e-file penetration. The threshold for mandatory e-filing – more than 250 forms – is the same as for Form W-2. “There are commercially available products that allow for filing Form 1099-MISC electronically, but there is no current free method available ... As such, before the mandate is lowered for Form 1099-MISC, the barriers to e-filing should be reduced.

“ETAAC recommends that the IRS develop an online process to upload data electronically for inputting and e-filing Forms 1099-MISC, similar to the functionality provided by the SSA that allows W-2s to be electronically submitted” (2008 Recommendation #8).

Reporting agents and EFTPS

“Revenue Procedure 2007-38 currently requires Reporting Agents to e-file all employment and unemployment tax returns where there is an e-file option. Reporting Agents are only required to use EFTPS to deposit taxes for their clients who the IRS has mandated to deposit by Electronic Funds Transfer (EFT).”

The IRS receives over 50 million deposits each year via paper check. If reporting agents made deposits electronically, it would help to reduce this volume, according to the report. “ETAAC recommends that Reporting Agents, who file employment and unemployment returns for others, be required to submit payments electronically via EFTPS” (2008 Recommendation #6).

The National Payroll Reporting Consortium and the

Independent Payroll Providers Association, the largest trade associations for payroll service providers, support this proposal, said Tullo.

Personal income tax returns

According to ETAAC chair Robert Meighan, Vice President for TurboTax, Intuit, e-filing of personal income tax returns was at 58% of all returns last year, and might reach 60% this year. There has been an 11% increase in total income tax returns, due to economic stimulus payments – many people who ordinarily do not have to file a return did so this year in order to get their payment – and it’s not clear whether they have slowed the increase in e-filing.

“ETAAC believes that all reasonable voluntary means have been exhausted with respect to encouraging preparers to e-file individual tax returns, and it is time to take a stance by announcing an e-file mandate for tax return preparers,” states the report. “ETAAC recommends that Congress empower the IRS to require paid preparers who, using tax software, prepare more than 50 individual returns per year to file all returns electronically” (2008 Recommendation #1).

Tullo pointed out that 18-20 states require tax return preparers to electronically file state personal income tax returns, and there has been “no substantial pushback” on the part of the return preparer community. He thinks the federal government should take a similar approach, with some sort of phase-in period.

The transition should not be difficult for many preparers, Meighan said, as “according to the IRS over 36 million returns were prepared on computers but were filed on paper in calendar year 2007,” and most of those were filed by preparers.

As for returns prepared by individuals using tax software, “ETAAC recommends that the IRS strongly encourage transmitters, software providers, on-line providers, and preparers to eliminate fees for electronic filing, so as to not discourage the selection of the e-file option” (2008 Recommendation #3). These fees might instead be built into the price of the software package. ■

Pennsylvania Acts to Simplify Local Tax Collections

Pennsylvania local income tax collection reform will soon be under way now that Governor Ed Rendell has signed S.B. 1063 into law. When the law is completely phased in in 2012, the number of tax collectors will have been reduced to 69, or roughly one per county.

The law is the culmination of years of work by legislators and lobbyists to craft a fair process that will save money for the state and reduce burden for employers. In 2004, the Department of Community and Economic Development (DCED) issued a study showing that the state was losing \$100 million each year due to inefficiencies in its system. The Pennsylvania Economy League estimated losses at more than double that amount, saying, “Pennsylvania’s fractured and inefficient system left some \$237 million uncollected each year.”

“Today marks the culmination of a tremendous grassroots effort by the business community, local government and professional associations and, ultimately, the legislature,” said Governor Rendell in signing S.B. 1063. “This fixes what is

now, probably, the most complex and confusing local taxing environment in the nation, with more local earned income tax collectors – 560 – and more local taxing jurisdictions – nearly 2,900 – than all other states combined.”

In addition to reducing the number of tax collectors, the state will implement uniform withholding, remittance, and distribution requirements, thereby eliminating the burden employers suffer when complying with myriad rules imposed by hundreds of collectors under the current system. Employers will be required to withhold all local taxes imposed on their employees, but they will remit all the withheld amounts to a single tax collector.

The DCED is charged with developing standardized forms, notices, reports, returns, schedules, and codes for each tax collection district, school district, and municipality.

The state will use a standardized definition of taxable income across all local tax jurisdictions, and will implement a system of appeals for taxpayers to resolve disputes. ■