Council for Electronic Revenue Communication Advancement (CERCA)
Bernard McKay, Chair

House Committee on Ways and Means
Subcommittee on Tax Policy

How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families

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Mr. Chairman and Members of the Committee. I am honored today to have the opportunity to testify on behalf of the Council for Electronic Revenue Communication Advancement (CERCA) – the electronic tax filing and innovation association -- about the critical importance that simplification of the tax code should play within tax reform.

CERCA was launched in 1994 at the request of the Internal Revenue Service to provide a means of collective communication and cooperation within the tax ecosystem for advancing electronic tax filing and electronic tax administration. CERCA members represent a wide diversity of industry participants and innovators, from tax software and technology firms, to the largest national chains offering tax preparation services, to the largest systems integrators and payroll houses, to financial services companies offering banks product and credit card services.

CERCA is proud to have been a part of leading the national adoption of electronic tax filing for more than two decades and an array of innovative technology advances within the tax ecosystem. In the 1998 IRS Restructuring and Reform Act, the US Government adopted a public policy objective of achieving 80% e-file adoption by American taxpayers because e-filing is more efficient, improves return submission processing, reducing government operating costs and improves accuracy. That national objective has in fact been exceeded, as e-filing now represents the tax return submission methodology for almost 90% of all individual tax returns. That accomplishment is the outcome of a fusion of public-private partnership and technology innovation.

But innovation in the tax compliance process is not the only thing that has changed over the last several decades. Over the past 30 years, since the tax code was last comprehensively changed, the make-up of the American family and characteristics of small businesses has changed and evolved in many ways. The time has come when truly modernizing and simplifying the tax code would be in everyone's interest. It would empower individuals and small businesses to more easily understand their taxes. It would also allow them to make better financial decisions, since tax compliance is the one time each year that the average family takes stock of their financial situation. And importantly, simplification reform could ultimately help grow our economy and make our system of tax Voluntary Compliance more successful, efficient and effective.

The private sector's development of tax preparation software has reduced much of the pain and complexity of tax compliance for average Americans, while bringing accurate preparation and speedy filing of returns within economical reach for all, whether taxpayers prepare their own returns or are assisted by professional practitioners. But private sector innovation is not enough. Tax simplification reform would benefit everyone and would be the right policy direction.

Tax Simplification

We believe a tax simplification reform strategy could begin with a thoughtful application of common sense solutions. Some of the most common difficulty and confusion today comes from the use of what may seem to be basic concepts in the current tax code, but which in the real world represent great confusion for taxpayers. One example is the tax code's use of the term

''Adjusted Gross Income (AGI)''. Most taxpayers simply don't know what the term means, or what it applies to. Historically, this disconnect has contributed directly to e-file rejects since entering prior year AGI was a key authentication step for e-file acceptance.

Another example is that today there are a half dozen different and conflicting definitions of the term "dependent", which apply to various tax provisions. Just as a practical matter, the average taxpayer and American family find it difficult to navigate the various differences and distinctions in the code for the identical term. And yet, understanding and applying that tax language is a very important part of American tax compliance and return accuracy.

Similarly, the range of specialized savings vehicles can create confusion on a practical level as to the tax status, treatment, rules and differences of the various alternatives. The multiplicity of current tax provisions for retirement and education leave many taxpayers uncertain over which may really apply to them or what the rules may be, which may result in under-utilization of provisions for which the taxpayer may be eligible. For example, the current code requires taxpayers to decipher 11 different kinds of IRAs, three distinct ways to help with childcare, and 14 varying education incentives. Each carries its own complex rules and multiple definitions of terms. The natural behavioral response to a multiplicity of options and choices can too often be inaction.

Beyond the need for streamlining the choices of tax options, and needed adoption of simplified tax terms, the tax code also needs to catch up with the realities of today's American society. Modern family circumstances and dynamics have become very different than they were 25 or 50 years ago. Today, more than half of all children will spend some time growing up in a non-traditional family structure such as one with a single parent, a grandparent or other relative, or a co-habitating couple. Moreover, significant growth in the on-demand or "gig economy" has changed the structure of small businesses and sole-entrepreneurships. Yet, the tax code has not kept pace with the changes in our family or economic structures, and needs to modernize to catch up. There are also multiple definitions of income under the code, which also contributes to confusion. For simplification reform to be meaningful, the social and economic changes that have taken place in the individual, family and small business tax base have to be taken into account for the future.

In a study published last year by Elaine Maag, H. Elizabeth Peters, and Sara Edelstein of the Tax Policy Center, the authors found that over 90 percent of all families with children could benefit in some way from the range of provisions like the earned income tax credit (EITC), the child tax credit (CTC), or other personal and dependent exemptions, but many families simply do not understand what they qualify for because they do not know who in their family qualifies as a dependent, or who the custodial parent might be under the code. There are often multiple definitions of a term in the code, and many times they are not only confusing but conflicting. Simplifying terms and streamlining qualification criteria so taxpayers can better understand their eligibility can spell the difference between owing money or receiving a deserved refund. Moreover, excessive complexity can make credits susceptible to inaccuracy and error.

The labryinth of existing tax rules does not mesh easily with how people actually live their lives today, leaving opportunities for error and omission. Inaccuracy of claims by lower income working families can often be traced back to confusion and lack of understanding about basic eligibility. But the same can be said for savings vehicles for retirement and education. Excessive complexity is a barrier to achievement of the very economic policy objectives – such as savings or a better economic quality of life -- that Congress set about to achieve through tax incentives in the first place. The tax code needs to be sufficiently simplified that taxpayers can understand what financial decisions they may make going forward that could minimize their tax bills, oprtimize their refunds, or, more generally, improve the financial lives of themselves and their families.

The tax preparation industry is poised to work with Congress to continue to simplify the tax compliance and e-file experience. We will continue our collaboration to eliminate and reduce e-file rejects and remove barriers to facilitate small business e-filing. E-payment and other transactions are also enabled via technology. Through tax simplification, Congress should also ensure that IRS begin accepting electronic records as a satisfactory, or even preferred, form of record keeping. It not only comports with Congressional intent to reduce paperwork on small business, but it also directly correlates to the increased use of technology in which today's modern family businesses operate.

Public-Private-Partnership

The history of constructive collaboration between the public and private sectors in service to the taxpayer is significant, and needs to applied now again in the drive to ensure tax simplification reform.

Electronic Filing

The first major public-private-partnership was the collaboration between the IRS and the tax and technology industries to achieve public adoption of electronic filing as the preferred method of tax compliance in the United States. The dramatic growth over a little more than a decade from a national e-filing rate from a little over 10% to the current 88% of all individual tax returns is a transformative change in the American tax system and quantum improvement in its efficiency, cost-effectiveness and accuracy.

The American e-filing partnership represented a division of labors between the public and private sectors, where the Government was able to focus on modernizing its systems and its tax administration technologies, while industry invested in electronic filing infrastructure and platforms, applying its expertise not only through its continually evolving technology innovation but through its marketing and customer service expertise. The result is that e-filing today has become the return submission methodology for nearly 90% of all individual income tax returns.

IRS Free File Program

At the beginning of his Administration, President George W. Bush wanted to ensure that American taxpayers of modest means had a free way of electronically preparing and filing their tax returns. The then-IRS Commissioner proposed an innovative public-private-partnership to seek a non-monetary agreement with the private sector technology and tax products and services industry, whereby the industry would make private sector tax compliance innovations available to eligible taxpayers through the IRS website at no cost to either the Government or the end user. That Negotiated Public Rulemaking of October 2002 created the IRS Free File Program, which provided first service 90 days later, in time for the start of the 2003 tax season.

Over the last 15 tax seasons, the private sector Free File Alliance has donated more than 50 Million tax returns and e-filings to American taxpayers through the Free File Program, operating under a set of standards, requirements and consumer protections governed by the IRS. This public-private-partnership has been a singular, award-winning achievement in the *electronic government* space, while preserving the American system of Voluntary Compliance.

And beyond the 50 million free tax returns that have been donated by the private sector through Free File, you can also measure the results of this public-private-partnership through the estimate that the Government has saved Hundreds of Millions of dollars through operating cost reductions, the taxpayer has saved in excess of $1.5 Billion in individual and family tax compliance costs, and the public Treasury has saved estimated additional Billions of dollars over the last fifteen years by foregoing using public funds to attempt to duplicate the range of private sector innovations and services in tax compliance by trying to create the government's own tax preparation and e-filing products and services. All of these savings were made possible due to the innovative public-private-partnership known as Free File.

The IRS Security Summit and ISAC

Over the last several years, a growing threat to Government and the Private Sector has been the emergence of global cybersecurity attacks and resulting cyberfraud. The theft of massive amounts of personal identity information from both Public and Private databases of various kinds obtained through breaches on the Web over the last several years has made targets of both the Government and Private Sector for outside electronic attacks. These external malicious actors weaponize the identities they stole or purchased off the Web to attempt to perpetrate Account Takeover Attacks (ATOs) or Stolen Identity Refund Fraud (SIRF), using the data to try to create new tax accounts, masquerading as legititmate taxpayers.

In March 2015, the IRS Commissioner convened a new public-private-partnership between the Federal Government, State Governments and the Private Sector – including the tax, technology, payroll, and financial services industries -- to fight cyberfraud. Known as the IRS Security Summit, this collaborative process has created a code of requirements and standards to defend the American tax system against cyber theft, and to date has slashed IRS cases of reported Identify Theft Refund Fraud by more than 50%. And the IRS has focused the Electronic Tax Administration Federal Advisory Committee to carry on the work of the Security Summit long term, because the fight against cyberfraud will be a long, twilight struggle, which will require commitment and persistence on the part of the collective tax ecosystem. And to take that fight to the next level, the Security Summit has also created an Information Sharing and Analysis Center – a tax ISAC – as the next phase of the public-private-partnership to ensure a proactive, long-term strategic defense of the American tax system.

These three examples of public-private-partnership within the US tax system represent a proven and economically efficient strategy of success, while defining a division of labors between public sector tax administration and enforcement, and the inventions and innovations of the private sector tax, financial and technology industries. Together, this tax ecosystem also defines the strength of the quintessentially American system of Voluntary Compliance.

As policymakers now contemplate tax simplification reform, it will be important that these divisions of labor and productive collaborations be preserved and strengthened. The alternative emergence of duplicative taxpayer services, data systems, individual accounts and other related initiatives by Government would unnecessarily create more complexity, not less. For simplification to be meaningful for the American taxpayer, the Public and Private Sectors each need to do what they do best.

The Taxpayer Advocate has offered cautionary counsel as policymakers consider the *Future State* of the U.S. tax administration. It is important that the *IRS Future State* focus on those core, essential capabilities that it uniquely contributes to the American tax system. Government should continue to rely on the private innovation sector for those taxpayer service capabilities that are most efficiently and effectively created and provided from the private sector's wheelhouse, such as e-filing amendments, transcript delivery, handling notices, just to name a few. These principles make simple economic sense in terms of prudent application of limited Public resources. Government investment in overlapping or duplicative systems and service offerings would create added complexity and increased confusion for taxpayers. And so, in seeking to achieve simplification reform in the American tax system, a key principle for policymakers must be to ensure that the *Future State* of the American tax system continue a clear division of labors in the differentiated roles and contributions of the Public and Private Sectors respectively, each doing what it does best. The taxpayer already trusts their tax service relationships and can understand the different roles played by each party in the ecosystem. That clarity about the division of labors and resources in the tax system is important to public confidence in, and understanding of, the fairness and objectivity of that tax system.

Future Public-Private-Partnership

There has been much talk in the public square about creation of simplified Post Card Tax Return. Obviously, in the modern environment of electronic filing and electronic tax administration, we are really talking about an Electronic Post Card. And of course, electronic filing of a future Post Card return will mean that it will fully benefit from the many modern safeguards already adopted by the IRS Security Summit process, which protect both the taxpayer and the tax system.

But the key message that the tax, technology and financial product and service industries wish to convey with clarity today is that continued innovation to simplify and reduce the burdens of tax compliance is already a future that the Private Sector is deeply committed to. The innovative capabilities of the technology and tax services sector will be applied in a continued environment of intense competition and rich consumer choice.

Creating a simplified Electronic Post Card Return is an innovation opportunity this industry welcomes and will embrace if that is the direction policymakers take.

And in this regard, we ask policymakers to keep in mind that the Government and Industry each will require some time to fully implement the reforms and changes you may make in the tax code. We would urge that policymakers not wait to the end of the year to make its final decisions. A smooth, effective, and innovative new Tax Season will require some time to deliver, particularly if a substantial amount of change is adopted. So the bottom line of our message in this regard is that policymakers need to begin with the end in mind, and allow sufficient time for rigorous and well-tested implementation to be put in place, all of which is in service to a high quality taxpayer experience.

The industry is poised to collaborate with Congress and the IRS and help facilitate and enable tax simplification reform.

Thank you for the opportunity to contribute our thoughts, and we will be happy to respond to any questions you may have.