



*Requiring Personal Identification Numbers
for Electronically Filed Returns Could
Improve Tax Administration and
Reduce Costs*

September 20, 2006

Reference Number: 2006-30-160

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

1 = Tax Return/Return Information

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TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

September 20, 2006

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

FROM: 
Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Requiring Personal Identification Numbers for Electronically Filed Returns Could Improve Tax Administration and Reduce Costs (Audit # 200630001)

This report presents the results of our review of the Internal Revenue Service's (IRS) actions regarding missing U.S. Individual Income Tax Declarations for an IRS *e-file* Return (Form 8453) and our determination whether the missing Forms have a negative effect on tax administration.

Impact on the Taxpayer

The IRS requires individual taxpayers who file online and electronic return originators (ERO) to file Forms 8453 when taxpayers do not sign their tax returns with a Personal Identification Number (PIN).¹ If Forms 8453 were eliminated for electronic tax returns and PINs were substituted, all electronic returns would have signatures and taxpayers would have less contact with the IRS. In addition, the IRS could save over \$1.8 million in processing costs as well as the cost of issuing reminder letters.

¹ Individual taxpayers file a U.S. Individual Income Tax Return (Form 1040). EROs file tax returns electronically for their clients, generally more than one taxpayer. Individual taxpayers filing online actually file a U.S. Individual Income Tax Declaration for an IRS *e-file* Online Return (Form 8453-OL).



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Synopsis

Form 8453 contains the taxpayer's physical signature, which attests to the return's validity. The Internal Revenue Code² and IRS tax publications clearly state that a return is not considered authentic or complete until a signature is received.

According to IRS records, over 2.26 million Tax Year (TY) 2004 individual income tax returns filed electronically were missing signatures, an increase of 563,000 (33 percent) over TY 2003.³

We believe several factors contributed to this problem.

- Electronic tax returns are processed and refunds are issued regardless of whether Forms 8453 are received.
- Follow-up (reminder) letters requesting missing Forms 8453 were issued erratically over the past 2 years.
- Signature documents for many taxpayers were missing for more than 1 year, indicating the IRS' actions did not cause a change in the taxpayers' behavior.
- When EROs consistently do not provide required Forms 8453, they can be suspended from participating in the electronic filing program with the IRS. However, the IRS has issued suspension letters to only two EROs since 2003.
- In some cases, taxpayers or their EROs may never have filed Forms 8453; in others, the IRS may have received the Forms but subsequently lost them.

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- According to the IRS, a Form 8453 is needed as a transmittal document for 11 paper tax Forms associated with electronically filed returns.⁴ However, IRS management has not addressed the possibility of creating a simple transmittal document for some of these paper Forms while still requiring a PIN for the associated Form 1040. In addition, because the IRS did not receive 17 percent of the required Forms 8453 for Tax Year 2004, its effectiveness as a transmittal document is questionable.
- The IRS' goal, as mandated by Congress, is to have 80 percent of all tax returns filed electronically. Despite its success in increasing the use of PINs, the IRS is hesitant to

² Internal Revenue Code Section 6061 (1954 Amended 1998).

³ TY 2004 was the latest year for which statistics were available for missing Forms 8453. The final figures for TY 2005 were not available at the time of our review.

⁴ See Appendix V.



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eliminate the option of filing Form 8453 with an electronic tax return and requiring use of a PIN, for fear this may discourage electronic filing.

Because of these issues, the IRS is not following the tax law and its own regulations that require a signature for each tax return and is spending more to process tax returns. Also, taxpayers are not treated equitably. The IRS routinely issues refunds to taxpayers who do not file their required Forms 8453. However, because of its own regulations, the IRS suspends processing of paper tax returns with missing signatures. No refunds are issued on these returns until the missing signatures are provided.

Recommendation

We recommended that the Commissioner, Wage and Investment Division, eliminate the use of Form 8453 as a signature document and mandate the use of a PIN, wherever possible, as the only acceptable signature for electronic returns for individual taxpayers filing through EROs and online.

Response

The Commissioner, Wage and Investment Division, disagreed with our recommendation because, in his opinion, mandating PINs could result in a larger volume of paper returns and because the Modernized e-File program⁵ should eventually cause Forms 8453 to become obsolete. Accordingly, management also disagreed with our outcome measure.

However, the Commissioner stated the IRS will improve the current Form 8453 process. For example, the IRS is exploring earlier processing of Forms 8453, more efficient letter sequencing to request missing Forms 8453, and using the Tax Return Data Base for timelier letter mail-outs. The IRS will also send taxpayers and EROs multiple signature compliance letters. Management's complete response to the draft report is included as Appendix VIII.

Office of Audit Comment

The IRS provided no empirical data to support its contention that mandating PINs could result in larger volumes of paper returns. With the advent of automated teller machines, debit cards, and online banking, the use of PINs has become commonplace. It seems unlikely that taxpayers that have experienced the advantages of filing electronically would return to filing paper returns because they were required to use a PIN.

⁵ The modernized program will allow for new methods of electronic signatures and the attachment of PDF files for third-party signatures.



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In our opinion, the steps discussed by the IRS to improve the current Form 8453 process may help but will not eliminate the problems associated with requiring Forms 8453, including burden to taxpayers, particularly when the IRS loses the forms, and the inequitable treatment of taxpayers. Nor will the steps reduce the increased costs associated with processing Forms 8453. However, because the IRS has identified steps for increasing the use of PINs and because the Modernized e-File program should begin phasing out the need for Forms 8453 in 2009, the IRS' interim corrective action is acceptable.

Copies of the report are also being sent to IRS managers affected by the report's recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Small Business and Corporate Programs), at 202-622-8500.



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Abbreviations

AGI	Adjusted Gross Income
<i>e-file</i>	Electronic File
ERO	Electronic Return Originator
I.R.C.	Internal Revenue Code
IRS	Internal Revenue Service
PIN	Personal Identification Number
SSN	Social Security Number
TY	Tax Year
U.S.	United States



Requiring Personal Identification Numbers for Electronically Filed Returns Could Improve Tax Administration and Reduce Costs

Background

The Internal Revenue Service (IRS) introduced electronic filing in 1986 and accepted 25,000 refund-only returns in that year. This enabled individual taxpayers to file their tax returns electronically, but it did not eliminate the need for a signature on the return.¹ The IRS needed to devise a way for individual taxpayers to supply their signatures for electronically filed tax returns. As a result, it created the U.S. Individual Income Tax Declaration for an IRS *e-file* Return (Form 8453).² Besides containing the taxpayer's physical signature attesting to the return's validity, the Form 8453 also served as a transmittal for the taxpayer's Wage and Tax Statement(s) (Form W-2). Unfortunately, this also meant the process was not entirely electronic.

In 1999, the IRS eliminated the requirement that taxpayers file Forms W-2 with their Forms 8453. A Personal Identification Number (PIN) was tested in 1999 and introduced for use in the 2001 Filing Season.³ Today, the Self-Select PIN method can be used by individual taxpayers who file electronically using tax preparation software or through an electronic return originator (ERO).⁴ A taxpayer using a Self-Select PIN to sign his or her income tax return uses the original adjusted gross income (AGI)⁵ from the prior year tax return and his or her date of birth to verify their identity. The PIN is created by the taxpayer at the time of filing.

A taxpayer is not required to provide the AGI and date of birth if he or she uses the Practitioner PIN method. This method can be used if the taxpayer files through an ERO, who verifies the taxpayer's identity. The taxpayer signs an IRS *e-file* Signature Authorization (Form 8879)⁶ authorizing the ERO to input the taxpayer's PIN as the signature on the electronic return. The Form 8879 is maintained by the ERO and is not filed with the IRS.

A taxpayer who files online without signing the tax return with a PIN must complete and sign a U.S. Individual Income Tax Declaration for an IRS *e-file* Online Return (Form 8453-OL) and mail it to the IRS. A taxpayer who files electronically using an ERO, but does not sign the tax return with a PIN, must sign the Form 8453 and the ERO must mail it to the IRS. Figure 1 illustrates the history of Form 8453.

¹ Individual taxpayers file a U.S. Individual Income Tax Return (Form 1040).

² See Appendix VI.

³ The filing season is the period from January through mid-April when most individual income tax returns are filed.

⁴ EROs file tax returns electronically for their clients, generally more than one taxpayer.

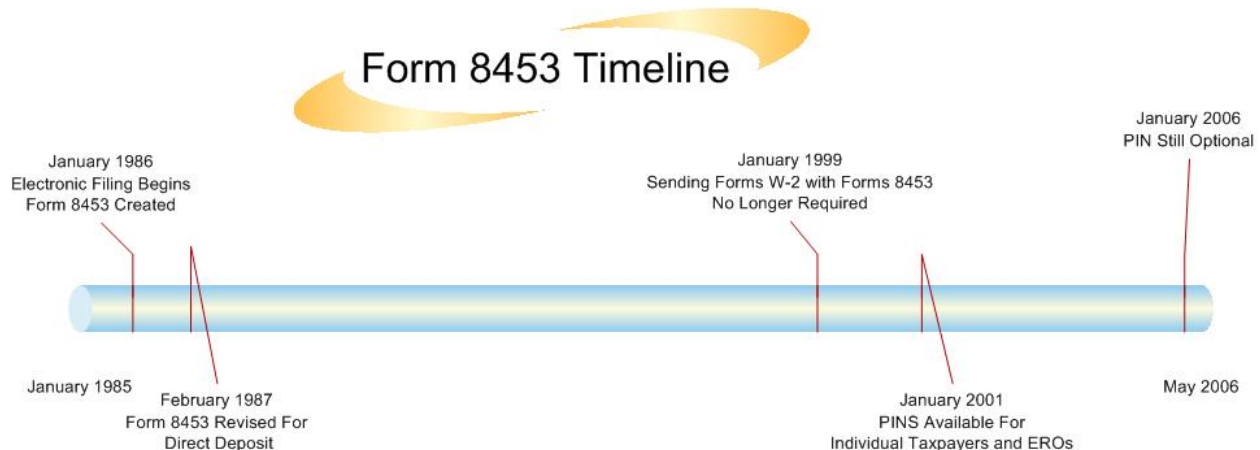
⁵ AGI is a line on a taxpayer's tax return that represents total income reduced by certain deductions known as "adjustments" but before itemized deductions or standard deductions and personal exemptions are taken.

⁶ See Appendix VII.



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Figure 1: Form 8453 History



Source: Treasury Inspector General for Tax Administration analysis of IRS tax forms and instructions.

The IRS has had significant success at increasing electronic filing. As of June 2006, the IRS had received over 71 million electronically filed individual income tax returns for Tax Year (TY) 2005, and over 57 million (80 percent) of these were filed with a PIN. However, that meant almost 14 million taxpayers still needed to file paper Forms 8453 with the IRS. Some of those 14 million taxpayers are required to file Form 8453 rather than use a PIN. Among them are:

- Primary taxpayers under age 16 who have never filed, if they file online using tax preparation software without an ERO.
- Secondary taxpayers (spouse) under age 16 who did not file in the immediate prior year, if they file online using tax preparation software without an ERO.
- Taxpayers who are required to file any of the (paper) tax Forms listed in Appendix V. These paper Forms must be filed with a Form 8453.

This review was performed at the IRS Andover Campus⁷ in Andover, Massachusetts, and the National Headquarters in Washington, D.C., in the Offices of the Chief Counsel and Electronic Tax Administration during the period December 2005 through April 2006. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁷ The campuses are the data processing arms of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



Results of Review

Mandating the Use of Personal Identification Numbers Would Improve Tax Administration

The Internal Revenue Code (I.R.C.)⁸ and IRS tax publications clearly state that a tax return is not considered authentic or complete until a signature is received. When signing a Form 8453, a taxpayer attests “Under penalties of perjury, I declare that I have examined a copy of my electronic individual income tax return and accompanying schedules and statements for the tax year ending . . . and to the best of my knowledge and belief, it is true, correct, and complete.” The signature holds the taxpayer accountable for what is reported on the tax return.

As discussed earlier, taxpayers filing electronically must either use a PIN or file Form 8453 to satisfy this requirement for signature. Although processing tax returns signed by PINs is much less expensive than processing Forms 8453, the IRS continues to use Form 8453. However, the IRS is not receiving the required Form 8453 for many electronic returns.

According to IRS records, over 2.26 million TY 2004 electronic individual income tax returns were missing signatures, an increase of 563,000 (33 percent) over TY 2003. These missing Forms included more than 1.5 million missing Forms 8453-OL and 700,000 missing Forms 8453. We evaluated the tax accounts of a statistically valid sample of 271 individual taxpayers who filed electronic returns in TY 2004 for which a Form 8453 was required, but the IRS had no record of the Form, and found missing signature documents were not isolated to 1 year for many of these taxpayers. We determined 205 (76 percent) of these taxpayers had filed electronically for TY 2005 as of the date of our review. Of these, 112 (55 percent) again did not use a PIN and were therefore required to submit a Form 8453. IRS records indicated Forms 8453 were not filed by 89 (79 percent) of these taxpayers.

We believe several factors contributed to this problem.

- Electronic tax returns are processed and refunds are issued regardless of whether Forms 8453 are received.

In our sample of 271 taxpayers with missing Forms 8453, 244 taxpayers received refunds.⁹ Forms 8453 mailed by taxpayers or EROs are generally processed by the IRS well after the associated tax returns and any applicable refunds have been processed.

⁸ I.R.C Section (§) 6061 (1954 Amended 1998).

⁹ For our purposes, taxpayers with overpayments applied to other liabilities were considered to have received refunds.



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Further, the Form 8453 information is processed to a different computer system from that of the electronic tax return.

The IRS is also paying interest on refunds resulting from amendments to electronic tax returns that were filed with no record of a Form 8453. Sometimes after a taxpayer files a Form 1040, he or she files an Amended U.S. Individual Income Tax Return (Form 1040X) to make changes to the tax originally reported. When those changes result in a refund, the IRS may have to pay interest to the taxpayer, which is generally paid from the April 15 due date of the original Form 1040 to the date on which the Form 1040X is received.¹⁰ Interest should be paid only if the original return is complete, including a signature. When there is no record of the required Form 8453 having been received, interest should not be paid from the April 15 due date. However, we identified approximately 16,000 instances in which this occurred for TY 2004. The IRS paid interest totaling approximately \$179,000 on these returns.

- Appropriate follow-up letters may not have been sent to taxpayers or their EROs requesting the missing Forms 8453.

The IRS has developed a series of reminder letters to help obtain missing Forms 8453. However, these letters have been sent out erratically over the past 2 years. In fact, no letters were sent to individual taxpayers for TY 2004. When EROs consistently do not provide required Forms 8453, they can be suspended from participating in the electronic filing program with the IRS. However, we were informed by the IRS that only two EROs have received suspension letters since 2003.

- The IRS may not have adequate controls over Forms 8453.

In some cases, taxpayers or their ERO may never have filed the required Form 8453. In other cases, the IRS may have lost the Forms 8453 after receiving them.

- The IRS does not want to discourage electronic filing.

The IRS' goal, as mandated by Congress, is to have 80 percent of all tax returns filed electronically. Despite its success in increasing the use of PINs, the IRS is hesitant to eliminate the option of filing Form 8453 and requiring use of a PIN because it may discourage electronic filing. For TY 2004, 82 percent of returns filed electronically were signed using a PIN. As mentioned earlier, to obtain a PIN, taxpayers identify themselves using their prior year AGI and date of birth, or they get the PIN through an ERO.

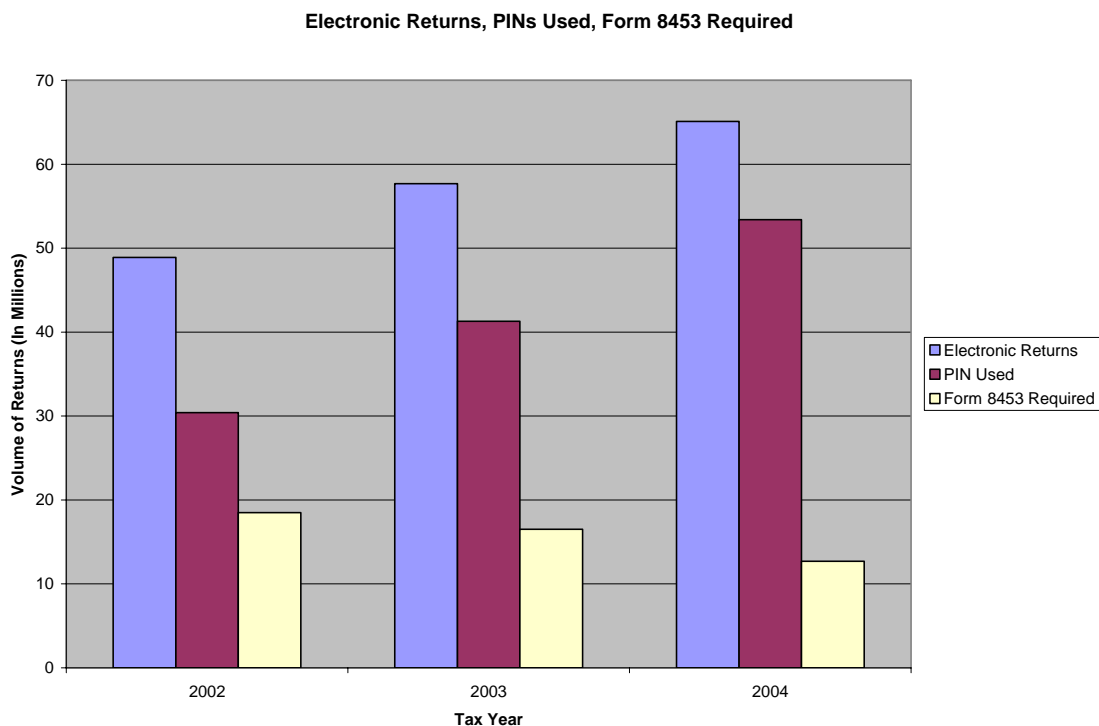
¹⁰ I.R.C § 6611 (Amended 2004).



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Taxpayers that do not have their AGI readily available can obtain it by calling the IRS toll-free telephone number. Our auditors tested this process by telephoning the number and were able to obtain the necessary information without difficulty. Figure 2 illustrates the increase in electronic filing and use of PINs.

Figure 2: Electronic Filing and PIN Use, FYs 2002 – 2004



Source: Statistics provided by the IRS.

- The IRS claims that Form 8453 is needed as a transmittal document for 11 paper tax Forms associated with electronic returns.

Appendix V contains a list of the 11 Forms the IRS states must be submitted on paper, even though a return is filed electronically, and must be accompanied by Form 8453. The Form 8453 serves as a transmittal document. However, we determined 3 of these 11 Forms contain taxpayer identifying information, tax year, and a signature line. Therefore, the Form 8453 appears to be an unnecessary redundancy for these Forms.

Seven of the other eight forms contain taxpayer identifying information and tax year but no signature line. IRS management has not addressed the possibility of creating a simple transmittal document for these paper Forms and still requiring a PIN for the associated



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electronic Form 1040. In addition, because the IRS did not receive 17 percent of required Forms 8453 for all tax forms, its effectiveness as a transmittal document is questionable.

Because of these issues, the IRS is not following the tax law and its own regulations requiring a signature for each tax return and is spending more to process tax returns. Also, taxpayers are not treated equitably. The IRS routinely issues refunds to taxpayers who do not file their required Forms 8453 or Forms 8453-OL. However, because of its own regulations, the IRS suspends processing of paper tax returns with missing signatures. No refunds are issued on these returns until the missing signatures are provided. In addition, as illustrated by Figure 3, processing a return with Form 8453 costs nearly twice what processing the same return with a PIN costs.

Figure 3: Figure 8453 Processing Costs

Filing Method	Cost to Process
File on paper	\$2.65
File electronically with Form 8453	\$1.03
File electronically with PIN	\$.59

Source: Cost figures provided by the IRS representing cost per return processed.

By mandating the use of PINs, the IRS could save over \$1.8 million in Form 8453 processing costs.¹¹

Recently, IRS Electronic Tax Administration function management identified 11 areas in which the use of PINs could be increased. Their proposals included ideas to reduce the number of missing Forms 8453. Although we believe all the ideas have merit, we specifically endorse those with objectives to eliminate the use of Form 8453. They include the following:

- Enable the taxpayer to create a PIN signature through the IRS web site (IRS.gov).
- Create a telephone line for the sole purpose of providing the information a taxpayer would need to create a PIN.
- Mandate the use of PINs on returns prepared on IRS computers.
- Mandate the use of PINs by consortiums.¹²
- Mandate the use of PINs by EROs.

¹¹ See Appendix IV for details.

¹² Consortiums are members of the Free Filing Alliance that provides free *e-file* services to taxpayers that meet a certain criteria.



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Recommendation

Recommendation 1: The Commissioner, Wage and Investment Division, should eliminate the use of Form 8453 as a signature document and mandate the use of a PIN, whenever possible, as the only acceptable signature for individual taxpayers filing through EROs and online. To accomplish this, the Commissioner will need to create a revised transmittal form for some of the 11 paper tax Forms that currently must be filed with the IRS and explore alternate methods for the other taxpayers discussed in the background of this report that are now required to use Form 8453 to file electronically instead of using a PIN.

Management's Response: The Commissioner, Wage and Investment Division, disagreed with our recommendation (and associated outcome measure) to eliminate the use of Form 8453 as a signature document and mandate the use of PINs, whenever possible, for the following reasons:

- Mandating PINs could result in a larger volume of paper returns, costing more to process than the savings from not processing the Form 8453, and
- The 1040 Modernized e-File program will be implemented over a 3-year period starting in 2009. The modernized platform will allow for new methods of electronic signatures and the attachment of PDF files for third-party signatures. With full implementation, the Form 8453 should become obsolete.

However, the Commissioner, Wage and Investment Division, stated the IRS would continue to improve the current Form 8453 process. For example, the IRS is exploring earlier processing of Forms 8453, more efficient letter sequencing to request missing Forms 8453, and using the Tax Return Data Base for timelier letter mail-outs. The IRS will also send taxpayers and EROs multiple signature compliance letters.

Office of Audit Comment: The IRS provided no empirical data to support its contention that mandating PINs could result in larger volumes of paper returns. With the advent of automated teller machines, debit cards, online banking, etc., the use of PINs has become commonplace. It seems unlikely that taxpayers who have experienced the advantages of filing electronically would return to filing paper returns because they were required to use a PIN.

In our opinion, the steps discussed by the IRS to improve the current Form 8453 process may help but will not eliminate the problems associated with requiring Forms 8453, including burden to taxpayers, particularly when the IRS loses the forms, and the inequitable treatment of taxpayers. Nor will the steps reduce the increased costs associated with processing Forms 8453. However, because the IRS has identified steps for increasing the use of PINs and because the Modernized e-File program should begin phasing out the need for Forms 8453 in 2009, the IRS' interim corrective action is acceptable.



Appendix I

Detailed Objectives, Scope, and Methodology

The overall objectives of this review were to evaluate the IRS' actions regarding missing U.S. Individual Income Tax Declarations for an IRS *e-file* Return (Form 8453) and to determine whether the missing Forms have a negative effect on tax administration. To accomplish these objectives, we:

- I. Evaluated the effectiveness and legal rationale for requiring a paper signature document with certain electronically filed returns and determined the feasibility of implementing viable alternatives to filing a paper Form 8453.
 - A. Met with IRS management and determined under what conditions Form 8453 must accompany an electronically filed return, the legal requirements for paper and electronic signatures, and what other types of taxpayer authorization (e.g., electronic signatures) have been reviewed and investigated by the IRS as alternative forms of taxpayer identification.
 - B. Obtained documentation that authorizes the IRS to send a refund to a taxpayer whose return is considered “incomplete” until a complete and signed Form 8453 is received, and obtained documentation that justifies the IRS' adherence to procedures that continue to require paper signature forms in lieu of other available alternative signature documentation.
- II. Evaluated the processing of Forms 8453 and actions the IRS is taking to retrieve missing Forms 8453.
 - A. Visited the IRS Andover Campus¹ in Andover, Massachusetts, which receives electronically filed returns, and determined how Forms 8453 are received, the functions that receive them, the functions responsible for processing the Forms, and whether the returns are coded and entered into IRS computers by IRS employees, and where and how the returns are transported after processing.
 - B. Met with local management to determine who is responsible for issuing a notice to the taxpayer and the tax practitioner to request Form 8453 and who is responsible for ensuring Forms 8453 are received.
 - C. Met with responsible officials to determine what actions are taken to secure Forms 8453.

¹ The campuses are the data processing arms of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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- III. Evaluated the database obtained from the IRS of approximately 2.2 million SSNs that represented missing Forms 8453 for TY 2004 to determine the characteristics of those taxpayers who do not file the Forms 8453 to determine what effect the missing Forms are having on tax administration.
- A. To test the validity of the data, we used a judgmental sample of 50 SSNs of the approximately 2.2 million SSNs that represented missing Forms 8453 for TY 2004 and checked the IRS computer database to determine whether the Forms 8453 were actually filed.
 - B. Developed a computer program using the missing Forms 8453 SSNs for TY 2004 to determine whether any accounts were being worked by the IRS Criminal Investigation, Examination, or Collection functions and whether any liens or levies were on the accounts. We determined the percentage of missing Forms 8453 that have IRS actions on their accounts. We took a statistically valid sample of 271 SSNs using a precision rate of ± 5 percent, an estimated error rate of 50 percent, and a confidence level of 90 percent. The population was 2,259,736 SSNs.
 - C. Compared the SSNs for TYs 2003 and 2004 to determine whether the taxpayers were not filing Forms 8453 for multiple years.
 - D. Determined the difficulties taxpayers faced in obtaining their prior year's AGI for use in creating a PIN to sign their tax returns. Two auditors personally telephoned the IRS toll-free telephone number in May 2006 to determine whether the AGI can be obtained by telephone or must be mailed to the taxpayer's address of record.²

² AGI is a line on a taxpayer's tax return that represents total income reduced by certain deductions known as "adjustments" but before itemized deductions or standard deductions and personal exemptions are taken.



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Appendix II

Major Contributors to This Report

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Margaret Filippelli, Senior Auditor
Carol Gerkens, Senior Auditor
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Commissioner, Small Business/Self-Employed Division SE:S
Chief Information Officer OS:CIO
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
Director, Electronic Tax Administration S:W:ETA
Director, Office of Strategy and Finance OS:A:F
Director, Submission Processing, Wage and Investment Division SE:W:CAS:SP
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Appendix IV

Outcome Measure

This appendix presents detailed information on the measurable impact that our recommended corrective action will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure

- Funds Put to Better Use – Potential: \$1.83 million (see page 3)

Methodology Used to Measure the Reported Benefit:

We took the following steps to estimate this outcome:

- 1) We estimated the volume of U.S. Individual Income Tax Declarations for an IRS *e-file* Return (Form 8453) that would be filed in Calendar Year 2007. We began with the actual number of Forms 8453 filed during 2003 – 2006.¹ We then calculated the average change in the number of Forms 8453 filed for that period, which was a reduction of 895,678 Forms. (The number of Forms 8453 actually increased by 72,272 from 2005 to 2006. However, to ensure our estimate was conservative, we assumed the number of required Forms would again decrease from 2006 to 2007). We applied that average reduction to the number of Forms 8453 filed in 2006, which gave us a projected number of Forms 8453 for 2007 of 12,507,720.

$$13,403,398 - 895,678 = 12,507,720.$$

- 2) We estimated the number of Forms 8453 that would still have to be processed if PINs were mandated. The IRS advised us that 11 different tax Forms² cannot be eliminated from paper filing; therefore, these Forms would still have to be processed, as would the Form 8453 that serves as a transmittal document. Volumes were available for only 5 of the 11 Forms. However, as illustrated by the table below, the volumes associated with these five Forms seemed reasonably representative of what they would be for the other Forms (some high volumes, some low volumes).

¹ Although Calendar Year 2006 was not over at the time of our review, most electronic returns would have already been filed at the time of our review.

² See Appendix V.



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Form	Volume	Source
3468	11,754	IRS.gov figures for TY 2002
4136	349,860	IRS line usage study for TY 2003
5713	3,421	IRS line usage study for TY 2003
8283	5,933,934	IRS line usage study for TY 2003
8885	17,834	IRS line usage study for TY 2003
Total	6,316,803	

Therefore, we projected these volumes over the unknown volumes of the other six Forms that require Form 8453 as a transmittal (if filed with an electronic Form 1040).

$$6,316,803 \text{ divided by } 5/11 = 13,896,967.$$

No break out was available for the Forms filed with paper Forms 1040 and those filed with electronic Forms 1040. Therefore, we used the percentage of Forms 1040 filed electronically in Filing Year 2006 to estimate the volumes of these Forms that would be associated with electronic returns and would require a Form 8453.

$$13,896,967 \times .54 = 7,504,362.$$

- 3) We calculated the potential volume of Forms 8453 that could be eliminated by mandating the use of PINs for all but those taxpayers filing 1 of the 11 required paper Forms.

$$12,507,720 - 7,504,362 = 5,003,358.$$

- 4) We reduced this number by the 17 percent of all required Forms 8453 for all tax forms that never get filed.

$$5,003,358 \times .83 = 4,152,787.$$

- 5) We calculated the potential savings in processing costs. The cost of processing an electronic tax return with a Form 8453 is \$1.03, while the cost of processing an electronic tax return with a PIN is \$.59 – a savings of \$.44 per return. We multiplied this figure by the potential volume of Forms 8453 that could be eliminated by mandating the use of PINs to arrive at the potential savings.

$$4,152,787 \times .44 = \$1.83 \text{ million.}$$



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Appendix V

Tax Forms Required to Be Filed With Form 8453 or Form 8453-OL

Form 1098-C	Contributions of Motor Vehicles, Boats, and Airplanes (or acceptable documentation/required donor documentation)
Form 3115	Application for Change in Accounting Method
Form 3468	Investment Credit (if Historic Structure Certificate is required)
Form 4136	Credit for Federal Tax Paid on Fuels (if certificate and/or reseller statement is required)
Form 5713	International Boycott Report
Form 8283	Noncash Charitable Contributions, Section A (if statement(s) required) Noncash Charitable Contributions, Section B
Form 8332	Release of Claim to Exemption for Child of Divorced or Separated Parents (or similar statement)
Form 8858	Information Return of U.S. Persons With Respect to Foreign Disregarded Entities
Form 8864	Biodiesel and Renewable Diesel Fuels Credit (if certification and/or reseller statement is required)
Form 8885	Health Coverage Tax Credit
Schedule D-1	Continuation Sheet for Schedule D (Form 1040) (or acceptable substitute) (if taxpayer elects not to include his or her transactions on the electronic Short Term Capital Gain or Loss Record or Long Term Capital Gain or Loss Record)



Requiring Personal Identification Numbers for Electronically Filed Returns Could Improve Tax Administration and Reduce Costs

Appendix VI

U.S. Individual Income Tax Declaration for an IRS e-file Return (Form 8453)

Declaration Control Number (DCN) 00- - - - - 6 IRS Use Only—Do not write or staple in this space.

Form 8453 U.S. Individual Income Tax Declaration for an IRS e-file Return For the year January 1–December 31, 2005 OMB No. 1545-0074 2005

Use the IRS label. Otherwise, please print or type. Your first name and initial, Last name, Your social security number, Spouse's social security number, Home address, Apt. no., City, town or post office, state, and ZIP code, Important! You must enter your SSN(s) above., Daytime phone number

Part I Tax Return Information (Whole dollars only) Table with 5 rows: 1 Adjusted gross income, 2 Total tax, 3 Federal income tax withheld, 4 Refund, 5 Amount you owe

Part II Declaration of Taxpayer (Sign only after Part I is completed.) Be sure to keep a copy of your tax return.

- 6a I consent that my refund be directly deposited as designated in the electronic portion of my 2005 Federal income tax return.
b I do not want direct deposit of my refund or I am not receiving a refund.
c I authorize the U.S. Treasury and its designated Financial Agent to initiate an ACH electronic funds withdrawal entry to the financial institution account indicated in the tax preparation software for payment of my Federal taxes owed on this return and/or a payment of estimated tax.

If I have filed a balance due return, I understand that if the IRS does not receive full and timely payment of my tax liability, I will remain liable for the tax liability and all applicable interest and penalties.

Under penalties of perjury, I declare that I have examined a copy of my electronic individual income tax return and accompanying schedules and statements for the tax year ending December 31, 2005, and to the best of my knowledge and belief, it is true, correct, and complete.

Sign Here Your signature, Date, Spouse's signature. If a joint return, both must sign., Date

Part III Declaration of Electronic Return Originator (ERO) and Paid Preparer (See instructions.)

I declare that I have reviewed the above taxpayer's return and that the entries on Form 8453 are complete and correct to the best of my knowledge. If I am only a collector, I am not responsible for reviewing the return and only declare that this form accurately reflects the data on the return.

ERO's Use Only ERO's signature, Date, Check if also paid preparer, Check if self-employed, ERO's SSN or PTIN, Firm's name (or yours if self-employed), address, and ZIP code, EIN, Phone no.

Under penalties of perjury, I declare that I have examined the above taxpayer's return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. This declaration is based on all information of which I have any knowledge.

Paid Preparer's Use Only Preparer's signature, Date, Check if self-employed, Preparer's SSN or PTIN, Firm's name (or yours if self-employed), address, and ZIP code, EIN, Phone no.



Requiring Personal Identification Numbers for Electronically Filed Returns Could Improve Tax Administration and Reduce Costs

Appendix VII

IRS e-file Signature Authorization (Form 8879)

Form 8879

IRS e-file Signature Authorization

OMB No. 1545-0074

Department of the Treasury Internal Revenue Service

Do not send to the IRS. This is not a tax return. Keep this form for your records. See instructions.

2005

Declaration Control Number (DCN)

Taxpayer's name

Social security number

Spouse's name

Spouse's social security number

Part I Tax Return Information—Tax Year Ending December 31, 2005 (Whole Dollars Only)

Table with 2 columns: Description (Adjusted gross income, Total tax, Federal income tax withheld, Refund, Amount you owe) and Amount (lines 1-5)

Part II Taxpayer Declaration and Signature Authorization (Be sure you get and keep a copy of your return)

Under penalties of perjury, I declare that I have examined a copy of my electronic individual income tax return and accompanying schedules and statements for the tax year ending December 31, 2005, and to the best of my knowledge and belief, it is true, correct, and complete.

Taxpayer's PIN: check one box only

- I authorize [ERO firm name] to enter my PIN [] as my signature on my tax year 2005 electronically filed income tax return.
I will enter my PIN as my signature on my tax year 2005 electronically filed income tax return.

Your signature Date

Spouse's PIN: check one box only

- I authorize [ERO firm name] to enter my PIN [] as my signature on my tax year 2005 electronically filed income tax return.
I will enter my PIN as my signature on my tax year 2005 electronically filed income tax return.

Spouse's signature Date

Practitioner PIN Method Returns Only—continue below

Part III Certification and Authentication—Practitioner PIN Method Only

ERO's EFIN/PIN. Enter your six-digit EFIN followed by your five-digit self-selected PIN. [] do not enter all zeros

I certify that the above numeric entry is my PIN, which is my signature for the tax year 2005 electronically filed income tax return for the taxpayer(s) indicated above.

ERO's signature Date

ERO Must Retain This Form — See Instructions Do Not Submit This Form to the IRS Unless Requested To Do So



Requiring Personal Identification Numbers for Electronically Filed Returns Could Improve Tax Administration and Reduce Costs

Appendix VIII

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

RECEIVED
SEP 13 2006

September 12, 2006

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Richard J. Morgante *Richard J. Morgante*
Commissioner, Wage and Investment Division

SUBJECT: Draft Audit Report – Requiring Personal Identification Numbers for Electronically Filed Returns Could Improve Tax Administration and Reduce Costs (Audit # 200630001)

I have reviewed the subject draft report and appreciate your acknowledgement that the IRS has had significant success in increasing electronic filing. Your report recognizes that we have identified 11 areas for increasing the use of Personal Identification Numbers (PIN). You agree that all the ideas have merit, specifically endorsing those with objectives leading to the elimination of the Form 8453 (U.S. Individual Income Tax Declaration for an IRS e-file Return), such as:

- Enabling the taxpayer to create a PIN signature through the IRS website (IRS.gov)
- Setting up a phone line for the sole purpose of providing the information a taxpayer would need to create a PIN
- Mandating the use of PINs on returns prepared on IRS computers
- Mandating the use of PINs by consortiums
- Mandating the use of PINs by Electronic Return Originators (EROs)

These possibilities notwithstanding, we do not agree with your recommendation to eliminate the use of Form 8453 as a signature document and mandate the use of PINs as the only acceptable signature for individual taxpayers filing through EROs and on-line. The 1040 Modernized e-File (MeF) program will be implemented over a three year period starting in 2009, and the modernized platform will allow for new methods of electronic signature, as well as the attachment of Portable Document Format (PDF) files for third party signatures. With full implementation of MeF, the Form 8453 should become obsolete. In the meantime, mandating the use of PINs could increase the volume of paper Forms 1040. We believe processing the increased volume of paper Forms 1040 would cost more than your suggested savings from not processing Forms 8453. Consequently, we question the outcome measure you report in Appendix IV.



Requiring Personal Identification Numbers for Electronically Filed Returns Could Improve Tax Administration and Reduce Costs

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As of September 3, 2006, over 58 million electronically filed returns used PINs. This represents more than 80 percent of the total number of electronically filed returns and is an increase of 13.8 percent over the number that used PINs in 2005. However, we will continue to improve the current Form 8453 process. For example, we are exploring earlier processing of Forms 8453, more efficient letter sequencing to request missing Forms 8453, and using the Tax Return Data Base for timelier letter mail-outs. We will also send taxpayers and EROs multiple signature compliance letters.

Our response to your recommendation is detailed in the attachment. If you have any questions, please contact me at (404) 338-7060, or members of your staff may contact Bert DuMars, Director, Electronic Tax Administration, at (202) 283-2610.

Attachment



Requiring Personal Identification Numbers for Electronically Filed Returns Could Improve Tax Administration and Reduce Costs

Attachment

RECOMMENDATION 1

The Commissioner, Wage and Investment Division, should eliminate the use of Form 8453 as a signature document and mandate the use of PIN, whenever possible, as the only acceptable signature for individual taxpayers filing through EROs and on-line. To accomplish this, the Commissioner will need to create a revised transmittal form for some of the 11 paper tax forms that currently must be filed with the IRS and explore alternate methods for the other discussed in the background of this report that are now required to use Form 8453 to file electronically instead of using a PIN.

CORRECTIVE ACTION

We do not agree with the recommendation for the following reasons:

1. Mandating PINs could result in a larger volume of paper returns, costing more to process than the savings from not processing the Form 8453.
2. The 1040 Modernized e-file (MeF) program will be implemented over a three year period starting in 2009. The modernized platform will allow for new methods of electronic signatures and the attachment of PDF files for third party signatures. With full implementation, the Form 8453 should become obsolete.

IMPLEMENTATION DATE

N/A

RESPONSIBLE OFFICIAL

N/A

CORRECTIVE ACTION MONITORING PLAN

N/A