ELECTRONIC FEDERAL TAX PAYMENT SYSTEM

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

APRIL 16, 1997

Serial 105–37

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

50–852 CC WASHINGTON : 1998

COMMITTEE ON WAYS AND MEANS

BILL ARCHER, Texas, *Chairman*

PHILIP M. CRANE, Illinois
BILL THOMAS, California
E. CLAY SHAW, JR., Florida
NANCY L. JOHNSON, Connecticut
JIM BUNNING, Kentucky
AMO HOUGHTON, New York
WALLY HERGER, California
JIM MCCRERY, Louisiana
DAVE CAMP, Michigan
JIM RAMSTAD, Minnesota
JIM NUSSLE, Iowa
SAM JOHNSON, Texas
JENNIFER DUNN, Washington
MAC COLLINS, Georgia
ROB PORTMAN, Ohio
PHILIP S. ENGLISH, Pennsylvania
JOHN ENSIGN, Nevada
JON CHRISTENSEN, Nebraska
WES WATKINS, Oklahoma
J.D. HAYWORTH, Arizona
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri

CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
ROBERT T. MATSUI, California
BARBARA B. KENNELLY, Connecticut
WILLIAM J. COYNE, Pennsylvania
SANDER M. LEVIN, Michigan
BENJAMIN L. CARDIN, Maryland
JIM MCDERMOTT, Washington
GERALD D. KLECZKA, Wisconsin
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
MICHAEL R. MCNULTY, New York
WILLIAM J. JEFFERSON, Louisiana
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
KAREN L. THURMAN, Florida

A.L. SINGLETON, *Chief of Staff*
JANICE MAYS, *Minority Chief Counsel*

SUBCOMMITTEE ON OVERSIGHT

NANCY L. JOHNSON, Connecticut, *Chairman*

ROB PORTMAN, Ohio
JIM RAMSTAD, Minnesota
JENNIFER DUNN, Washington
PHILIP S. ENGLISH, Pennsylvania
WES WATKINS, Oklahoma
JERRY WELLER, Illinois
KENNY HULSHOF, Missouri

WILLIAM J. COYNE, Pennsylvania
GERALD D. KLECZKA, Wisconsin
MICHAEL R. MCNULTY, New York
JOHN S. TANNER, Tennessee
KAREN L. THURMAN, Florida

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also published in electronic form. **The printed hearing record remains the official version.** Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

CONTENTS

	Page
Advisories announcing the hearing	2

WITNESSES

Internal Revenue Service, James E. Donelson, Chief, Taxpayer Service; accompanied by Robert Albicker, Deputy Chief Information Officer, Systems Development	43
U.S. Department of the Treasury, Russell D. Morris, Commissioner, Financial Management Service	49

Agrimanagement, T. Gene Cole	94
American Payroll Association, Carolyn Kelley	116
Automatic Data Processing, Inc., Regina R. Lee	110
First National Bank of Chicago, Lawrence F. Buettner	28
Hastings, Hon. Richard "Doc," a Representative in Congress from the State of Washington	10
Housing Authority Insurance, John M. Foehl, Jr	123
Mason Mechanical Laboratories, Inc., Randy Mason	85
National Association for the Self-Employed, Bennie L. Thayer	81
National Association of Enrolled Agents, Judy Akin	95
National Federation of Independent Business, Randy Mason	85
NationsBank, Larry Dreyer	26
Padgett Business Services, Roger N. Harris	89
Smith, Hon. Linda, a Representative in Congress from the State of Washington	7
Treasury Management Association, John M. Foehl, Jr., and Arlene S. Chapman	123

SUBMISSIONS FOR THE RECORD

Ceridian Corp., Minneapolis, MN, James R. Burkle, statement	135
Klug, Hon. Scott, a Representative in Congress from the State of Wisconsin, statement	137
LaHood, Hon. Ray, a Representative in Congress from the State of Illinois, statement	138
LoBiondo, Hon. Frank A., a Representative in Congress from the State of New Jersey, statement	139
National Automated Clearing House Association, Herndon, VA, Elliott C. McEntee, statement and attachment	139
National Business Owners Association, Alexandria, VA, J. Drew Hiatt, statement	143
U.S. Chamber of Commerce, William T. Sinclaire, statement	145

ELECTRONIC FEDERAL TAX PAYMENT SYSTEM

WEDNESDAY, APRIL 16, 1997

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:40 a.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

[The advisories announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
April 9, 1997
No. OV–4

CONTACT: (202) 225–7601

Johnson Announces Hearing on the Electronic Federal Tax Payment System

Congresswoman Nancy L. Johnson (R–CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to examine the Electronic Federal Tax Payment System. The hearing will take place on April 16, 1997, in room B–318 Rayburn House Office Building, beginning at 9:30 a.m.

In view of the limited time available to hear witnesses, oral testimony will be from invited witnesses only. Witnesses will include officials from the Department of the Treasury and the Internal Revenue Service (IRS), small businesses, payroll service providers, the banking industry, and others. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

Businesses must withhold or pay a variety of Federal taxes, e.g., Federal Insurance Contribution Act (FICA), income, excise, and corporate estimated taxes. Historically, businesses have been required to deposit these taxes in a government depository (i.e., banks and savings institutions designated by the Treasury Department as Treasury tax and loan depositories), with each deposit accompanied by a Federal tax deposit coupon supplying the taxpayer's name, identification number, tax period, and the type of tax being paid. The bank then processes the payment and coupon information and forwards it to the Federal Government.

Legislation enacted in 1993 (section 6302(h) of the Internal Revenue Code) required the IRS to implement a nationwide system for receiving Federal depository taxes electronically. This system, the Electronic Federal Tax Payment System (EFTPS), is intended to replace the existing paper coupon system to provide a simple, paperless way for taxpayers to make Federal tax deposits.

Under section 6302(h), IRS was required to phase in EFTPS from 1994–1999 and to collect a statutorily specified percentage of business taxes through electronic payment in each year. The IRS issued regulations in July 1994 which, among other things, set forth a schedule for implementing the program. Under the regulations, businesses would be required to begin using EFTPS if their annual employment tax deposits exceed certain thresholds. Under the phase-in schedule, if a taxpayer:

Deposited more than:	In calendar year:	The taxpayer must begin using EFTPS as of:
$47 million	1993/1994	1/1/96
$50 thousand	1995	1/1/97
$50 thousand	1996	1/1/98
$20 thousand	1997	1/1/99

A March 21, 1996, temporary regulation expanded the EFTPS requirement to cover businesses which do not make employment tax deposits, but whose other Federal tax payments exceed certain thresholds. If their other Federal tax deposits were:

More than:	In calendar year:	The taxpayer must begin using EFTPS as of:
$50 thousand	1995/1996	1/1/98
$20 thousand	1997	1/1/99

Between June 23 and July 1, 1996, IRS sent letters to approximately 1.2 million taxpayers to inform them of the requirement to enroll in EFTPS and begin paying their Federal depository taxes electronically by January 1, 1997. Among other things, the letters indicated that taxpayers who failed to enroll in EFTPS and began making their Federal tax deposits electronically as of January 1, 1997, would be assessed a penalty equal to 10 percent of the amount required to be deposited.

For many small businesses, particularly those that do not use payroll service providers to handle their payroll accounts, receipt of the IRS package was the first time they had heard of EFTPS. In response, many small business owners expressed concerns to Congress about being mandated to pay their taxes electronically and about the possibility that they would be subjected to significant penalties for failure to comply with the mandate. At the same time, concerns were also being raised that there was insufficient time remaining in the year to fully inform the affected businesses about the mandate to enroll in EFTPS, to actually enroll all mandated taxpayers on a timely basis, and to test the system before it became operational on January 1, 1997.

To address these concerns, Congress included a provision in the Small Business Jobs Protection Act (P.L. 104–188) to delay until July 1, 1997, the requirement for affected taxpayers to begin paying their depository taxes electronically through EFTPS.

In announcing the hearing, Chairman Johnson stated: "Not only do we need to evaluate whether the Electronic Federal Tax Payment System is actually ready to serve the 1.2 million taxpayers who are mandated to enroll and begin paying their taxes electronically by July 1, 1997, but the Subcommittee also needs to consider the full range of costs and benefits associated with this system for small business taxpayers."

FOCUS OF THE HEARING:

Effective July 1, 1997, approximately 1.2 million taxpayers will be required to begin making their Federal tax deposits electronically through EFTPS. The Subcommittee will examine: (1) the current status of IRS's efforts to implement EFTPS; (2) concerns which have been identified by small businesses, payroll service providers, the banking industry, and others about specific features of EFTPS (e.g., whether taxpayers will have the ability to quickly correct erroneous payments, whether the procedures that have been established to deal with emergencies which prevent taxpayers from making timely payments, such as natural disasters, are adequate); and (3) whether an additional delay in the July 1, 1997, effective date or other changes to the program are necessary.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement and a 3.5-inch diskette in WordPerfect or ASCII format, with their address and date of hearing noted, by the close of business, Wednesday, April 30, 1997, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments. At the same time written statements are submitted to the Committee, witnesses are now requested to submit their statements on a 3.5-inch diskette in WordPerfect or ASCII format.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS__MEANS/'.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–225–1904 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

NOTICE—CHANGE IN ROOM

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE CONTACT: (202) 225–7601
April 10, 1997
No. OV–4-Revised

Room Change for Subcommittee Hearing on Wednesday, April 16, 1997, on the Electronic Federal Tax Payment System

Congresswoman Nancy L. Johnson (R–CT), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, today announced that the Subcommittee hearing on the Electronic Federal Tax Payment System previously scheduled for Wednesday, April 16, 1997, at 9:30 a.m., in B-318 Rayburn House Office Building, will now be held in the main Committee hearing room, 1100 Longworth House Office Building.

All other details for the hearing remain the same. (See Subcommittee press release No. OV–4, dated April 9, 1997.)

Chairman JOHNSON. Good morning, and welcome to this important hearing at which we will examine the Electronic Federal Tax Payment System, the EFTPS System, and whether this new system for receiving Federal tax deposits electronically is ready for prime time.

In 1993, the Internal Revenue Service was mandated by Congress to implement a nationwide system for receiving Federal tax deposits electronically. This mandate was intended to accomplish several goals: First, to largely replace the existing FTD paper coupon system with a simple, paperless way for taxpayers to make their Federal tax deposits by telephone; second, to speed up by 1 day the time it takes banks to transmit tax payments to the Treasury; and third, to foster the growth of electronic commerce.

The EFTPS is the result. Today, approximately 1,500 of the Nation's largest companies are already mandatorily participating in this system, although another 200,000 companies have enrolled and are voluntarily using the system. On July 1, 1.2 million businesses will be required to start paying their taxes electronically, but despite good intentions, the IRS' mishandling of their first critical communication with these 1.2 million mandated taxpayers about this filing system last June, and its failure since to address legitimate technical concerns about the system's design have caused significant concern and controversy which is threatening the smooth implementation of the system.

As a result, the Nation's small businesses have no confidence that this system will provide them with true benefits. Today, small businesses make their Federal tax deposits by taking their tax payments and an accompanying paper coupon to their local banks. Under the FTD paper coupon system, they receive a receipt showing they have paid their taxes on time, and they don't incur additional fees in the process. Many resent one more mandate from the Federal Government, particularly when new fees may be involved. They want the system made voluntary for small business taxpayers.

The Nation's payroll service industry recognizes the benefits offered by this new system, but they, too, are concerned about the implementation of the system on July 1. They are worried about a number of technical aspects of its design, such as whether the system will allow a quick means of correcting erroneous payments and whether the IRS has established adequate procedures to deal with emergencies.

They are even more worried that if the tax system flaws they fear actually come to pass, thousands of customers will be hit with erroneous penalty notices causing chaos and creating a terribly unfair situation for our small businessmen.

Instead of being enthusiastic partners with the government in implementing EFTPS, as they have been with other automation initiatives such as the TaxLink pilot and the Electronic W–2 pilot, the payroll service industry today is standing on the sidelines with their fingers crossed because the IRS has been unresponsive to what they believe are legitimate concerns about the system.

Our job today is to sort through these concerns and work together to assure that this system will be ready to serve the 1.2 million taxpayers who are mandated to enroll in the system and begin paying their taxes electronically on July 1.

EFTPS has been designed to piggyback on the ACH network, an electronic payment mechanism developed by the private sector to support direct deposits, direct payments, and many other consumer and commercial electronic payment applications.

Has the IRS incorporated design features into the EFTPS which conform to the rules in place in the private sector for using the ACH network? If not, why not?

Will the benefits offered by the system, the simplicity of making tax deposits by telephone, be worth the potential costs to the small business community? What will those costs be?

What must be done to alleviate the legitimate concerns of stakeholders that EFTPS will be able to handle the expected workload without mishap?

These are the questions we must answer to protect taxpayers' interests.

Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman.

As you know, in less than 3 months, approximately 1.2 million business taxpayers will need to be prepared to pay their Federal taxes electronically through the Electronic Federal Tax Payment System called EFTPS. Importantly, this system of paying taxes eliminates the need for paper coupons and will facilitate the correct and timely payment of business taxes to the Federal Government.

During today's hearing, we will have the opportunity to discuss with the IRS its efforts to enroll businesses in the EFTPS System and to ensure that all will go well come this July when the law requires businesses to pay their taxes electronically.

I understand that our mutual goal in holding this hearing is to see that the EFTPS Program is implemented, as scheduled this summer, and to assist in resolution of any outstanding problem areas that exist.

I commend the Chairwoman for scheduling this Oversight hearing and look forward to the testimony of our private-sector witnesses concerning this very important program.

Thank you.

Chairman JOHNSON. Thank you.

My warmest welcome to my colleagues who both have been champions of small business concerns in this Congress, and we look forward to your testimony.

Congresswoman Smith.

STATEMENT OF HON. LINDA SMITH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Ms. SMITH. Good morning, Madam Chair and Members of the Subcommittee.

First, I want to thank you for taking up this issue. It has been an issue in our Small Business Committee.

Chairman JOHNSON. Congresswoman Smith, I should add that you are Vicechair of the House Small Business Committee, Subcommittee on Tax, Finance, and Exports.

Ms. SMITH. Thank you.

Chairman JOHNSON. It is a special pleasure to have you. Thanks.

Ms. SMITH. This is a big issue in the small business community, and Chairman Talent of the Small Business Committee and myself and other Subchairs have been getting contacted for months, and the concern has been uneasiness, lack of understanding, and surprise. As last year, we worked together with this Committee to get an extension of penalties, we would like to come before you again and express our concerns.

I am going to summarize this statement, though, and give you written testimony combined from Representative Talent and myself so that we can expedite the work of this Subcommittee and get to your other witnesses.

First of all, I watched the new training video that was given to us and prepared for the banks by the IRS. The video opens with a statement that the new EFTPS is, "one of the most aggressive government initiatives taken in centuries," and I agree, it is.

Through IRS regulations, the EFTPS mandates businesses to report and pay, this is what I don't think most people realize, all their Federal taxes electronically, not just their payroll taxes.

This new requirement is based on certain thresholds of deposit. On July 1, IRS will mandate that we go from 800 businesses reporting under the system to 1.2 million. Now, the threshold change is going from 50,000 payroll taxes to 47 million payroll taxes. I said that in reverse. It is from 47 million to 50,000—50,000 in employee taxes is not very many employees. It is a very small business. This change is staggering.

Most of the people getting ahold of us do not understand the new obligation. They are not clear that they even have to file many, many more taxes than just the payroll taxes.

What we find in the Small Business Committee is small businesses are remarkable. They are flexible. They are generating most of our job creation, and they can do a lot of things, but we also have found that they come to us not so much with taxes, but with regulation as the biggest obstacle to them making a living for their families.

You are going to hear about this later. What we want to ask you to do, though, is to consider phasing this in or making it optional. We believe that IRS is not ready, given our discussions with IRS, to go to 1.2 million filings. We feel that, also, it should be voluntary compliance instead of mandatory, but at least, if you could allow the small business community to phase in, we could show them that it works.

The concerns we have with IRS is not that we believe that we shouldn't do this or that it won't eventually be successful, but we believe that if they take in too many too quick, they could actually sour the result, and that is to have less paper, as more people get into it and file erroneous tax forms because if they only, say, file what they think are just the payroll taxes and leave off others, they will be subject to this 10-percent fine.

We believe, then, if we sour it, you will have a bigger mess starting it. So a request of this Committee would be to go slow. We like the idea of electronic filing. We do not oppose it. We would like the smaller businesses to be voluntary, if you could make this happen, and we understand IRS has quite a bit of latitude in this. There is nearly $3 billion already collected from this system, the ones that have already gone in, and then we would like to work with the small business community to show them the successes of the larger businesses that are already in it and make it voluntary at least for the temporary time until they can get used to the idea.

With that, we want to thank you for this opportunity and really do appreciate what you are doing. The small business community is important to all of Congress. We know that, but we focus on it and appreciate the opportunity to share that concern.

Thank you.

[The prepared statement follows:]

Statement of Hon. Linda Smith, a Representative in Congress from the State of Washington

Good Morning Chairwoman Johnson and Members of the Subcommittee. I thank you on behalf of Representative Jim Talent, Chairman of the Small Business Committee, and myself for your kind invitation to testify this morning concerning the development and implementation by the Internal Revenue Service (IRS) of its new "Electronic Federal Tax Payment System" (EFTPS). I commend your strong leadership as Chair of this important subcommittee, and in holding this timely hearing.

I recently watched a training video on EFTPS prepared by the IRS for financial institutions. The video opens with the statement that EFTPS is: "One of the most aggressive government initiatives taken in centuries." And it is. EFTPS is an electronic system for reporting and paying Federal tax deposits. EFTPS mandates businesses to report and pay all their Federal taxes electronically. IRS regulations dictate which businesses are required to begin using EFTPS based on certain employment tax deposit thresholds. As scheduled to proceed on July 1 of this year, the EFTPS will go from mandating 800 businesses with Federal tax deposits over $47 million to mandating 1.2 million businesses with Federal tax deposits over $50 thousand This drop in the EFTPS mandate threshold is staggering. It will impact mil-

lions of small employers who simply are not ready for it, and who do not know or fully understand the extent of their compliance obligations under EFTPS even though they are required to enroll by May 1.

Small businesses play a remarkable role in providing personal opportunity, security, flexibility and independence for millions of Americans. Since the early 1970's, small firms have created two of every three net new jobs in this country. There are approximately five and one-half million employers in the United States, and about 99 percent of them are small employers with under 500 employees. At the same time, about 90% of small employers—many of them family businesses—have fewer than 20 employees. Consequently, tax changes and regulatory mandates affect them most.

In fact, most Americans are a lot like the small business witnesses that you will hear from later today: honest, hardworking individuals who want to provide for their families, build their communities, and pay their fair share of taxes. But they face a tax code and tax regulations that stand in the way of their success. The tax code's complexity hurts America's small working families by killing economic stability and jobs in their neighborhoods and communities.

Yet, the explosion in technology is facilitating their entrepreneurial spirit and the growth of new entities and jobs. That is why I fully support the development and implementation of a successful electronic tax payment system as we enter the 21st century. But I caution you against supporting IRS efforts to force all taxpayers to use EFTPS. In contrast, for example, under the existing electronic TAXLINK system, thousands of businesses have chosen to use TAXLINK voluntarily.

The same thing could occur under the EFTPS if it is done right. But there is troubling evidence that the EFTPS and the IRS may not be fully prepared to handle 1.2 million business taxpayers this year, and 1.2 million next year, without imposing increased compliance costs and large potential penalties on America's small employers. Certainly, while EFTPS should be bold, it should also be reasonable and pliant. No government initiative, in particular one involving the voluntary payment of Federal taxes, should be so aggressive and rigid that it penalizes small business families and employers.

During the last year, I have heard a lot about EFTPS from my own constituents back home and from small businesses and their representatives here in Washington. Simply put, many small employers are unable or reticent to use EFTPS on a mandatory basis as proposed by the IRS. Several important factors are driving small businesses to oppose EFTPS, including:

- Fear of the enormous penalty of up to 10% of Federal tax deposits due per transaction;
- Increased compliance costs on small businesses (i.e., bank fees, penalties, etc.);
- Perception of IRS access to private bank accounts or bank information;
- Loss of paper trail;
- IRS push toward use of one of the two large banks serving as financial agents for the IRS, Nation's Bank and First Chicago, under the EFTPS' ACH debit system;
- Lack of readiness and meaningful participation under EFTPS by taxpayers' own local and community banks, as designed and implemented by the IRS;
- Lack of system readiness or procedures for taxpayers to correct simple mistakes, erroneous payments, and/or unauthorized transfers;
- Lack of system readiness or procedures to protect taxpayers from a controversy situation in the event of a disaster, emergency, or simple power outage which precludes the taxpayer from making an electronic payment;
- New paperwork burden from enrollment forms, etc.
- No clear understanding of the rights and responsibilities of taxpayers who want to stop payments, recover unauthorized or erroneous transfers, and maintain the privacy of their transactions; and
- Strong opposition to "one more government mandate."

In addition, many large and small employers do not know or understand that they need to enroll separately and pay all their other taxes, such as corporate estimated taxes, through EFTPS. This alone could cripple EFTPS as millions of employers, including small and closely-held concerns, learn that they are required to pay all their taxes electronically or face EFTPS' stiff penalties.

Consequently, I believe there are two fundamental questions before you today: First, is the EFTPS on a mandatory basis too aggressive and potentially punitive on small business taxpayers? And, second, will we hinder the potential success of EFTPS and, thereby, sour future recommendations and efforts to modernize our Federal tax payments systems electronically if EFTPS is not done right?

Because Chairman Talent and I are concerned that the answer to these two questions is a resounding "YES," we urge you to consider legislation to ease small business taxpayers into EFTPS along the lines proposed by my friend and colleague, Doc

Hastings, and by Senators Nickles and Breaux in the Senate. Consistent with Congress' legislative intent in 1993, these bills would encourage the voluntary participation in EFTPS by small employers and individual taxpayers.

Let's not sour what should be a bold first step to encourage American taxpayers to report and pay Federal taxes electronically. If we do it right, we can achieve Congress' goals of accelerating and improving the flow of information and revenue to the Federal government, while benefiting small entrepreneurs and invigorating the American taxpayer's enthusiasm for change and new technologies.

Chairman JOHNSON. Thank you very much, Congresswoman Smith.

Congressman Hastings.

STATEMENT OF HON. RICHARD "DOC" HASTINGS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. HASTINGS. Thank you, Madam Chairwoman. I would like to commend you for holding this hearing today on the electronic tax payment system.

This is just as an aside. When we start with these acronyms, this seems to be typical of the Federal Government, and this is another one of those, EFTPS.

Anyway, with the July 1 deadline coming up and 1.2 million businesses that are going to be impacted by that, I appreciate your holding this hearing today.

I am honored to have this opportunity to testify before the Subcommittee because as a businessowner for over 25 years, the issue of government mandates placed on small businesses are of particular concern to me. I hope that today's hearing will help to resolve some of the outstanding concerns with EFTPS and at the same time, identify how important it is to allow business the option of using this system.

I began working on this legislation during the last Congress to make the EFTPS voluntary in response to concerns voiced by small business owners in my district, such as Gene Cole who will be testifying later on today.

However, it was too late in the Congress last year for any action to be taken. As you are aware, the provision requiring a business to file their payroll taxes electronically, was included in the NAFTA implementation legislation.

In February, I reintroduced the legislation from the last Congress to make the electronic system voluntary for business. In just 2 months, H.R. 722 has been cosponsored by over 65 Members of Congress and has been endorsed by a number of national organizations including the NFIB, the U.S. Chamber of Commerce, and the National Restaurant Association.

As we begin today, let's put the whole issue of collecting payroll taxes into perspective. The Federal Government has used American businesses as their tax collector for the Treasury since 1935 when tax withholding was promulgated under the Social Security Act. Congress has never seen fit to compensate businesses for these efforts. Now, today, we are forcing businesses to file these taxes electronically and making them cover any cost that may be associated with that electronic filing.

The NAFTA implementation legislative history indicates that there were two reasons for mandating businesses to change from the traditional Federal tax deposit coupon system to an electronic system.

The first—and I think it is important to emphasize these two reasons that were in the bill report—the first was to reduce paperwork for small business. The second was to accelerate collection of revenue by $3.3 billion. Now, which do you really think was more important from the government's perspective, to help small business or to accelerate revenue? At any rate, those are the two issues I want to talk about.

In an effort to ensure that the first goal could be achieved, the Secretary of Treasury was granted considerable flexibility to take into account the specific needs of small employers including possible exemptions for small business.

As of today, to the best of my knowledge, no exemptions have been granted to any businesses in this country. Many Members have stated that they were unaware that this provision was included in NAFTA. I think that is probably true. For the first few years of the implementation, it was not a controversial issue because most businesses in question were already filing electronically through TaxLink. That is the 1,500 that you alluded to.

Now, however, that mandate has reached down to another 1.2 million businesses which includes the small businesses that are the backbone of our economy, and we find that they forgot to take into consideration one very important factor, what will be the impact on these small businesses.

Under current law today, the Treasury Department is threatening to impose a 10-percent penalty on any small business that fails to enroll in EFTPS. That is why it is essential that Congress take action now to consider the impact and take action to correct this situation.

My family has owned Columbia Basin Paper Supply in Pasco, Washington, since 1947. We are celebrating our fiftieth year in business this year. I was the firm's president before I was elected to Congress in 1994. Our business was constantly subjected to regulations by local, State, and Federal Governments.

When I received notifications of a new regulation, I have to admit that I would view it rather suspiciously. As a matter of fact, one of the first things I used to do is find someplace in the corner that indicated if it was voluntary or involuntary. Frankly, if it was voluntary, it would go in the round file because I didn't have time to deal with all of those sorts of things. That is what all small businesses do. You are in the business of whatever enterprises is important to what you are doing.

The reason is, because if there were any decisions made with my business, I felt I was much better qualified to make that decision than the Federal Government.

In most cases, regulations imposed on small businesses end up costing the businessowner and the consumer more and seldom simplify their operations. I think the EFTPS mandate is a good example of this.

Businesses are given two options on how to make their payroll tax obligation payments through the automated clearinghouse, or

ACH, the ACH debit method or the ACH credit method, but no option of whether they want to use either one. It is just those two options.

With the debit method, there is no direct cost to the businessowner. However, if employees do not want to give the Treasury, financial agents, NationsBank or First Bank of Chicago access to their bank account, they would have to maintain an alternative account, just for their payroll transactions. That is obviously a cost.

If businesses want to avoid opening an alternative account, they may choose to make their payments through the ACH credit system. This credit option opens a whole new obstacle course for business and potentially high costs.

The first problem that a businessowner will run into with the credit option is to try to find a bank to do this. My understanding is that only 25 percent of the financial institutions across the country would be willing to offer this credit option.

Second, if the business does find a financial institution to process the payroll transactions, using a credit system could cost as much as $130 a month for this option. Once again, another cost to the small business.

Maintaining a hard-copy paper trail is one of the key reasons why businessowners do not want to file electronically.

I can tell you as a small business owner, when you have a letter from the IRS asking something and you have no paper trail on this, it is a little disconcerting.

My company has always kept paper records for all aspects of their operations, even in our current technological age. There are many businesses that are run just like this. Why should we be forced by the government to start filing our taxes electronically when sometimes we don't even keep our inventories electronically?

Thousands of small business owners believe that because of the ever-present threat of an IRS audit, they must have accurate records available immediately. This is the coupon that small businesses use right here when they file quarterly. It is nice to have a receipt of your transaction.

I realize, of course, that that transaction could show up on your monthly bank statement, but I think that businesses should have the peace of mind that they currently enjoy when they walk out of the bank with the actual copy of a receipt in hand.

Because of these concerns and others that I know that you will hear later today from businessowners themselves, it is clear that the goal of reducing paperwork burden on businesses has not been met. Compliance with the EFTPS has created an administrative nightmare for businessowners, and that is why it is imperative that we allow small business owners the option to choose for themselves if they feel comfortable with paying taxes electronically.

Again, I want to emphasize, EFTPS may be a very good option, but that is a decision that should be made by the small business owner. I think that is especially true with the news that the IRS has investigated over 1,500 cases of electronic snooping by its employees. We passed a bill to take care of that yesterday, and the fact that the IRS has spent over $4 billion on a computer system to expedite the Tax Code.

I just think that simply asking business to mandatorily plug into a system like that doesn't make good sense.

So that was the first goal that was stated, was to simplify the paperwork, and I certainly don't think the facts support that that has happened.

The second reason was to accelerate revenue collections by $3.3 billion over a 5-year period. I am pleased to report that we are on track to achieve at least the two goals.

As I stated earlier, the second goal of implementing EFTPS was to accelerate revenue collections by $3.3 billion over 5 years, as estimated by the Joint Taxation Committee.

The Department of Treasury has recently verified in a letter that I would like to submit for the record. I think this is it here. I would like to submit for the record that the accelerated revenues to date have been $2.89 billion already, even though we have not fully implemented the system. So this amount does not even include the 1.2 million businesses that we are talking about that would be coming into the system by July 1. To me, this clearly demonstrates that we will far exceed the goal of accelerating revenue collections by $3.3 billion during the 5-year phase-in.

Thus, passage of my bill would not reduce the earlier revenue estimates. As a matter of fact, I think those revenue estimates may, indeed, work out the other way.

Because of the success in raising the revenue necessary to offset the cost of NAFTA, the Secretary of Treasury should have even greater flexibility to address the concerns of small business owners. That is why I have introduced my Small Business Tax Payment Relief Act. My legislation would ensure that tax payment decisions are left in the hands of businessowners and not the Federal Government.

So, in conclusion, I would just like to offer this. Senators Nickles and Breaux have introduced a similar piece of legislation in the Senate, and we have been in discussions, with the IRS, Treasury, small business owners, payroll services, and other Members of Congress since I have introduced H.R. 722.

On Monday, as I mentioned, legislation was introduced in the Senate on this to give flexibility for small business. This legislation in the Senate already has been cosponsored by 10 Senators, 5 of whom are Members of the Senate Finance Committee.

The Senate legislation will slow down the mandated enrollment fees of EFTPS, and that will allow the IRS time to adequately inform those who need to be informed regarding this, but more importantly, it would allow the system to be voluntary for small businesses.

During this tax-filing season, the IRS gave individuals the option of filing their returns electronically. Over 25 percent of the Americans took advantage of this program. I realize that electronic transactions are the wave of the future, but in every other aspect, using this technology has been the choice of the consumer and not a mandate from the Federal Government, and I think that is a very important distinction.

Rather than allowing a top-down, one-size-fits-all government mandate that would have a negative impact on business, I would

urge the Members of this Subcommittee to take swift action on the Small Business Tax Payment Relief Act.

If it is true that this program would be beneficial to business, then, the businessowner should be able to decide for themselves under a voluntary program. That, I think, is the least that we can do for small business men and women in our districts.

I thank you very much for this opportunity.

[The prepared statement follows:]

Statement of Hon. Richard "Doc" Hastings, a Representative in Congress from the State of Washington

INTRODUCTION:

Madam Chairwoman:

I would like to commend you for holding this hearing today to discuss the implementation of the Electronic Federal Tax Payment System (EFTPS). With a July 1, 1997 deadline looming over 1.2 million businesses, I appreciate the expediency with which this hearing was scheduled.

I am honored to have the opportunity to testify before the Subcommittee. As a business owner for 25 years, the issue of government mandates placed on small businesses is of particular concern to me. I hope that today's hearing will help to resolve some of the outstanding concerns about EFTPS, and at the same time identify how important it is to allow businesses the option of using the system.

BACKGROUND:

I began working on legislation during the last Congress to make the Electronic Federal Tax Payment System *voluntary* in response to concerns voiced by small business owners from my district, such as Mr. Gene Cole who will be testifying later today. However, it was too late in the session for action to be taken. As you are aware, the provision requiring businesses to file their payroll taxes electronically was included in the NAFTA Implementation legislation.

In February, I reintroduced legislation to make the electronic system voluntary for businesses. In just two months H.R. 722 has been co-sponsored by over 65 members of Congress and has been endorsed by numerous national organizations including the National Federation of Independent Businesses, the U.S. Chamber of Commerce, and the National Restaurant Association.

As we begin today, let's put the whole issue of collecting payroll taxes into perspective. The federal government has used American businesses as their tax collector for the Treasury since 1935 when tax withholding was promulgated under the Social Security Act. Congress has never seen fit to compensate them for their efforts. *Now we are forcing businesses to file these taxes electronically and making them cover any costs associated with filing electronically.*

The NAFTA Implementation legislative history indicates that there were two reasons for mandating that businesses change from the traditional Federal Tax Deposit Coupon system to an electronic system. The first was to reduce the paperwork burden on businesses. The second was to accelerate the collection of revenue by $3.3 billion to offset the costs of NAFTA. In an effort to ensure that the first goal could be achieved, the Secretary of the Treasury was granted considerable flexibility to take into account the specific needs of small employers, including possible exemptions for small businesses from the new electronic system. As of today, to the best of my knowledge, *no* exemptions have been granted.

Many members have stated that they were unaware that this provision was included in the NAFTA Implementation Act. And, for the first few years of implementation it was not a controversial issue because most of the businesses in question were already filing electronically through TAXLINK. Now that the mandate has reached the 1.2 million businesses that are the backbone of our economy—small businesses—we find that we forgot to consider one very important factor: the impact on these businesses.

Under current law the Treasury Department is threatening to impose a *10% penalty* on any small business that fails to enroll in EFTPS. That is why it is essential that Congress take action now to consider the impact and take action to correct this situation.

SMALL BUSINESS CONCERNS:

My family has owned the Columbia Basin Paper and Supply Company since 1947. I was the firm's president before I was elected to Congress in 1994. Our business was constantly subjected to regulations by the local, state, and federal government. When I received notifications of a new regulation, I have to admit that I would often view it suspiciously, because I firmly believed that I was more qualified to make decisions concerning the daily operations of my businesses than the federal government. In most cases, regulations imposed on small businesses end up costing the business owner—and thus, consumers—more, and seldom simplify their operations. The EFTPS mandate is a perfect example.

Businesses are given two options on *how* to make their payroll tax obligation payments through the Automated Clearing House (ACH): the ACH Debit method or the ACH Credit method, but no option of *whether* to use the electronic method. With the debit method, there is no direct cost to the business owner. However, if employers do not want to give the Treasury Financial Agents, NationsBank and First Bank of Chicago, access to their bank account, they will have to maintain an alternative account just for their payroll transactions. This is an unnecessary cost that business owners will now have to incur, solely for the purpose of maintaining the privacy they currently enjoy.

If businesses want to avoid opening an alternative account, they may choose to make their payments through the ACH credit option. The credit option presents a whole new obstacle course for businesses and potentially high costs. The first problem a business owner will run into with the credit option is finding a bank that is offering this service. I understand that only 25 percent of financial institutions in the country will be offering this credit option. Secondly, if a business does find a financial institution to process their payroll transactions using the credit system, it can cost them as much as $130 a month to use the credit option.

Maintaining a hard copy paper trail is one of the key reasons why business owners do not want to file electronically. My company always kept paper records for all aspects of our operations. Even in our current technological age, there are many businesses that are run just like mine. Why should we be forced by the government to start filing our taxes electronically when we don't even keep our own records electronically? And thousands of small businesses believe that because of the ever present threat of an IRS audit, they must have accurate records available *immediately*. I realize that the transaction will be printed on the monthly bank statement, but businesses should have the peace of mind that they currently enjoy when they walk out of the bank with the actual copy of their Federal Tax Deposit Coupon.

Because of these concerns and others that you will hear later today from business owners themselves, it is clear that the goal of reducing the paperwork burden on businesses has not been met. Complying with the EFTPS has created an administrative nightmare for business owners and that is why it is imperative that we allow small businesses to choose for themselves whether or not they feel comfortable processing their payroll obligation transactions electronically.

With the news that the IRS has already investigated 1,515 cases of electronic snooping by its employees in confidential taxpayer files and wasted $4.4 billion since 1987 on what they promised would be a state-of-the-art computer system for the 21st Century, Congress needs to seriously consider how can we justify *forcing* businesses to file their tax obligation with another IRS initiated electronic system.

THE SECOND GOAL—RAISING $3.3 BILLION:

I am pleased to report however, that we are on track to achieve at least one of the two goals of transferring to an electronic tax filing system. As I stated earlier, the second goal of implementing EFTPS was to accelerate revenue collections by $3.3 billion over a period of five years as estimated by the Joint Committee on Taxation. The Treasury Department has recently verified in a letter that I would like to submit for the record, that in just *three* years, they have accelerated revenue collections by $2.89 billion through the use of electronic funds transfers. *This amount does not even include the 1.2 million taxpayers that are scheduled to begin using the EFTPS for their payroll obligations on July 1, 1997.* This clearly demonstrates that we will far exceed the goal of accelerating revenue collections by $3.3 billion during the five year phase-in. Thus, passage of my legislation will not reduce earlier revenue estimates.

Because of the success in raising the revenue necessary to offset the costs of NAFTA, the Secretary of the Treasury should have even greater flexibility to address the concerns of the small business owner. That is why I introduced the "Small Business Tax Payment Relief Act." My legislation will ensure that tax payment decisions are left in the hands of business owners—not the federal government.

CONCLUSION:

Senator Nickels, Senator Breaux and I have been in discussions with the IRS, Treasury, small business owners, payroll services, and other Members of Congress since I introduced H.R. 722. And on Monday, legislation was introduced in the Senate in an attempt to resolve the concerns of all parties involved with the EFTPS and most importantly to meet the goal of allowing *flexibility for small businesses*. This legislation has already been co-sponsored by 10 Senators, five of whom are members of the Senate Finance Committee. The Senate legislation will slow down the mandated enrollment phase-in of the EFTPS that will allow the IRS time to adequately inform those who need to enroll in the EFTPS. Most importantly, it will allow the system to be *voluntary for small businesses*.

During this tax filing season, the IRS gave individuals the option of filing their returns electronically. Over 25 percent of Americans took advantage of this program. I realize that electronic transactions are the wave of the future, but in every other aspect, using new technology has been the *choice of the consumer, not a mandate from the government*.

Rather than allowing a top down, one-size-fits all government mandate that will have a negative impact on businesses, I would urge the members of the Subcommittee to take swift action on the "Small Business Tax Payment Relief Act." If it is true that this program will be beneficial to businesses, then the business owner should be able to decide that for themselves under a voluntary program. That is the least that we can do for the small businessmen and women of our districts.

Thank you Madam Chairwoman.

Chairman JOHNSON. Thank you very much for your testimony, and I think you very clearly separated the two problems that we face today.

One is to see what needs to be done to assure that a national electronic filing system is well structured, will work well, and is easily accessible to the business community, and the problems that have developed in the implementation of this system are problems that we need to examine and address.

The second issue is, for how many taxpayers should this be mandatory, and it is absolutely true that in the NAFTA law, there was no legal requirement to go down to businesses as small as 50,000? Whether or not that is necessary is really a debatable point at this time, but there are two issues, the quality of the system which I think is very important because I think this is an alternative that as more and more small businesses get familiar with the power of new technology and new information management capabilities, they will want and it will, in fact, save them time, effort, and money, but we do need to do it in such a way that the system is well organized for small businesses to understand their obligations and their opportunities under this system and the government is well organized to respond and to inform.

So we will be looking at all the problems that have developed with this system, and hoping to resolve them, we will look also at the problem that you raise, Mr. Hastings, in your legislation, and I know Ms. Smith has been a part of this, whether or not it is necessary for this to be mandatory for very small businesses.

Thank you for your testimony.

Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman.

In the absence of the program moving forward toward implementation on July 1, I wonder if you would have any recommendations

for the IRS about how they could get the remaining 200,000 businesses enrolled in this program.

I know your position on the program, but in the absence of it not going forward, I wonder if there are any recommendations that you might have to the IRS to make it a better implementation process.

Mr. HASTINGS. Well, I would say that the record speaks for itself that if it is a good business decision and an individual feels comfortable with what the IRS is proposing that it will flow very smoothly, and I think what supports that fact is the fact that the revenue estimates was an acceleration of revenue of $3.3 billion over 5 years, and in fact, in 2 years, already, because people have enrolled for a variety of reasons, there already has been an increase of $2.89 billion. I just think because we are moving into an electronic age that it will happen if it makes good business sense.

Now, some of the concerns, however, that we have heard is if there is a breakdown in the computer. I just got to tell you, just today, just as an aside to that, as we were preparing for this, the computers in our office broke down, and so my staff was struggling to try to get all of this put together for today.

I would just suggest, what would happen, unless there is some sort of a way that IRS will be very clear on how they are going to let a business off if there is a breakdown someplace? What happens if they are electronically filing and they are using a credit method and they have their home institution and a car crashes into a telephone pole and knocks down all the power and there is no backup system in that bank and it happens to be the 15th of the month? How do you let that business off because it wasn't his or her fault? Those are the things that have to be answered in my mind, and if they are adequately, then I think people will probably get into this system because it makes good business sense.

Again, pointing it out, I think that has already been proven, but I still want to go back to the point that I think irritates probably a lot of Americans, and certainly entrepreneurs, is they don't want to be forced into something. They want to make that decision on their own, and that is why it should be voluntary, but IRS can certainly answer those questions in a very forthright way if there is a deadline missed on when, or if there is an overpayment, when are they going to get refunded. Keep in mind, businesses are collecting these payroll taxes, and if there is an overpayment or some of that sort of stuff, when are they going to get refunded? Is it going to be in a timely manner? Do they have to wait 6 months for that? All of these things, I think, should be answered before somebody gets into the system.

Mr. COYNE. Do you think it would be helpful if the IRS was to waive the 10-percent penalty for first-time filers of the program?

Mr. HASTINGS. I think I would waive the 10 percent and not even have it. If it makes good business sense, somebody will do it. Why penalize somebody because they decided that they wanted to stay with the same system?

Thank you.

Ms. SMITH. Just a brief comment.

You know, in business, and I am sure a lot of you Members have been in business, the best way to get compliance is to advertise well. I think we are having this Subcommittee meeting today be-

cause of poor communications and public relations and I believe IRS just needs to step up their public relations in selling this. Because as a businessperson, I know that if you could have gotten rid of paper and I was confident that when I sent it electronically they really got it and they would not hassle me, I would do it in a heartbeat.

But my concern would be that they are not ready to receive it, they would lose it, they are getting a whole bunch and I am not sure I am giving them what they really wanted to begin with. Now, that is the feeling I have as a businessperson.

So, I think that if we said, you have already got $3 billion, you have got the biggest businesses—what is it 70,000 or so—coming in on TaxLink, market your successes and encourage that growth but stay with the big ones and just wait.

They have the opportunity. NAFTA does not tell them to go to the bottom. Just start with the biggest and show you are succeeding and then encourage the rest in. And then come back to us again and show us your success of how you have marketed. That is probably the best thing they could do to get compliance.

Mr. COYNE. Thank you.

Chairman JOHNSON. Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair, and both of you for your good testimony. I really appreciate it as a former Member of the Small Business Committee. Linda, I appreciated your perspective and Doc, your talking about the fact that withholding provides most of our taxes. I think about 80 percent of our taxes are collected in this country through withholding. And often, we, as policymakers, forget that. Certainly, I think, Americans would be surprised to learn that.

Other countries who are putting together an income tax system call that privatization. But it is an important part of our system and people talk about voluntary compliance and it is a voluntary system. It is also a system where we rely heavily on the employer and I think that is a very efficient way to collect taxes, undoubtedly, and it is something that we should be encouraging. But we also have to keep that in mind as we look at these sorts of mandates, we want to make it easier not harder for employers to do the job they do of collecting these taxes and getting them into the Federal Treasury.

So, I am very sympathetic to your point of view, both of you, and would like to think that there is some way to move to electronic filing without undue hardship, particularly for smaller businesses.

I also agree with Linda's statement, which I thought was very good, with regard to the promise that electronic filing holds and Doc, you also said it is the wave of the future. The fact is that most small businesses over time will find great benefits to this but initially there are going to be some costs and there is a lot of skepticism.

Doc, you talked about the need for keeping hard copies of the records and so on for audits and that sort of thing. So, I think there has got to be a way for us to work through this and I guess what I would hope, Doc, is that the Senate bill offers some hope.

You talked about the fact that it slows down the process. Is there a time lag, is there another 6 months after July 1, or how does it go about phasing in the program, do you know?

Mr. HASTINGS. I have not seen the legislation but they lower the threshold. Right now we are at—if we were to pass my bill right now and freeze things in time, the threshold would be $47 million obligation, the tax obligation that business has.

I think the Senate's version would lower that down to $10 million. Anybody that has an obligation of $10 million or more would be obligated to file their taxes electronically. Anybody under that would have the option of doing it as I pointed out in my testimony or as in my bill.

Mr. PORTMAN. So, that is the voluntary amount. The new threshold will be established not at $50,000——

Mr. HASTINGS. That is correct.

Mr. PORTMAN [continuing]. But at $10 million or $5 million or something in that area.

Mr. HASTINGS. Yes. And I would suspect that probably most businesses that fall into that category, frankly, are probably filing electronically already.

Mr. PORTMAN. I would think at $10 million that would be true from the information we have had before the Subcommittee.

Well, I think, again, we want to continue to work with you all to come up with something that makes sense that moves us to that eventually. I agree with Linda in that if we have time to explain the benefits of this, I think, people will go to it. And one final comment, Doc, I appreciate your raising the emergency situation and also the underpayment/overpayment situation.

I think there are ways to do this which give flexibility to businesses that we do not currently have in the program and that would include permitting businesses in cases of electricity going down, as you mentioned, or a flood or an earthquake or something like that, to have a break which they do not have in the current regulations. And also to work in something with regard to the ability to go ahead and pay the taxes, then do the calculation, which often you cannot do immediately to add that lag time flexibility that many small businesses want. So, there are ways to do this, I think, that makes more sense, too, over time.

I thank you all for your testimony.

Mr. HASTINGS. I would just add, if I could, Rob, the Senate bill does phase it down to $10 million in 1998 and then the final threshold is $5 million in 1999 and thereafter and that is their limit.

Mr. PORTMAN. Thank you.

Chairman JOHNSON. Congresswoman Dunn.

Ms. DUNN. Thank you, Madam Chair.

I want to join my colleagues on this Subcommittee in welcoming the members of the panel today and especially the Members of Congress from Washington State for their great work in focusing on this issue. We have been known to focus on issues of this sort. Congressman George Nethercutt recently was able to convince the IRS that they ought to wait a while on collecting AMT taxes from farmers and we believe that is the right way to go and he has legislation that will plug that loophole as well.

Madam Chair, I want to thank you for having these hearings. I think it is terribly important for us to be listening to the small business people in our districts now. I first heard of the problem, the glitch in this reporting, from a close friend at home who called me last June and mentioned that they had been notified that they were mandated to report in the way this legislation required. And she was very concerned because she wanted to do the right thing, being an honest taxpayer, but she was not prepared to go to the expense and through the amount of time required to report electronically. Certainly, I believe both the Members of Congress testifying have focused on the choice that ought to be allowed to the small business people or, in broader terms, to the consumers of the United States.

I am very uncomfortable with the mandate that this ruling puts on our small businesses and it seems to me that one of the reasons this hearing is important is to determine whether the goals of the legislation are, indeed, being met and that is to reduce the paperwork and to accelerate the collection of revenue by $3.3 billion. It appears to me that neither of those goals is being met.

Exemptions are not being taken advantage of by the Secretary of Treasury. I am astounded to learn that those have been available to him and he could have made that move to provide flexibility to the folks who are trying to do the right thing by fulfilling their commitment to the Internal Revenue Service.

There are some constituents in my district who are very nervous about this. A small business woman from Bellevue, Washington: The new law is costly to small business, it is another intrusion by the Federal Government. The costs to implement this tax collection system are wasteful to all taxpayers.

Another small business man in Redmond, Washington: It is already nearly impossible to run a small business and follow all the regulations and the rules that the government imposes. I certainly hope this hastily thrown together proposal will not be jammed down our throats while you are still trying to work out the bugs in it.

And, last, a small business woman in Maple Valley, Washington: We have always done what has been asked of us when it comes to our businesses but this is the straw that breaks the camel's back. This is like a slap in the face, a punishment for something we did not do wrong.

I believe, through what you have said this morning and through my knowledge, that the IRS has been very lax in notifying people and in the way that they notified small business people about this change. That concerns me greatly and while I commend you, Congressman Hastings, for providing this legislation—which I signed on very early and Congresswoman Smith has signed on and 65 others as I understand in the Congress have signed on—do you think that the public outcry on this issue would have been less if the IRS had phased it in and given proper notification to the small business people who, I believe, would have been happy to comply had they been given warning?

Mr. HASTINGS. Well, my observation in reading that letter that came out from the IRS regarding this—a couple of things stuck out in my mind when I saw a copy of that letter. They said that you

have to do this and right up front it says, or be subjected to a 10-percent penalty. And then they said in that letter to do it as soon as possible because it is going to take 10 weeks to process, which I thought was rather interesting. Here we are trying to make a system simple, and they said, File because it is going to take 10 weeks for us to process you before we even get into the system.

And had I been on the receiving end as a businessman, I would have thought, wow, what do they think is going on? I mean this is really kind of silly. So, in that regard, I would say that first letter that came out did not have enough facts and figures in there. In fact, I think there is only one or two paragraphs that even associated itself with how you are going to pay these things.

So, a combination, but I do not think it was done well. And I spoke to a small business group earlier this week and the observation came up from one of the individuals in that organization that the IRS has done a poor job in marketing this, so to speak.

Ms. DUNN. Thank you, Congressman, and Madam Chairman, thanks again for holding these hearings. I believe that this optional participation, at least for the time being, is the proper way to go and I would encourage both of our members of our panel this morning to cooperate with Senator Nickles, because I think it could make a strong partnership and get what we need to do for small business.

Thank you, Madam Chair.

Chairman JOHNSON. Thank you.

Mr. Kleczka.

Mr. KLECZKA. Thank you, Madam Chair.

Congresswoman Smith, in your testimony you indicated that businesses are not aware that many other taxes are also covered under the electronic filing system, outside of the payroll tax. Outside of the payroll tax and FICA tax, what other taxes are covered?

Ms. SMITH. I could get you a list. All of your corporate taxes and your business taxes that you would pay quarterly.

Mr. KLECZKA. OK, what, could you give me a feel for what those are?

Ms. SMITH. Well, as a businessperson, you pay your tax, some of us pay them monthly, some of us pay them quarterly depending on your size and the flow of the taxes.

Mr. KLECZKA. Are the estimated taxes also covered?

Ms. SMITH. Yes, all taxes would be covered, yes.

Mr. KLECZKA. OK, thanks.

Mr. HASTINGS. I might add, if I may, your employment tax is one. If you have an excise tax, if you are in a business that pays excise taxes that comes into it. All Federal tax obligations fall into that category. The big ones, of course, are FICA and Federal withholding, but everything else falls in that category also.

Ms. SMITH. Most people that are talking understand the FICA, they understand if it says, payroll. They do not understand that their quarterlies, their monthlies now have to be paid electronically, and that is our understanding that they are not filing those in all cases or understanding they have to.

Chairman JOHNSON. Mr. Hulshof.

Mr. HULSHOF. Thank you, Madam Chair.

Congressman Hastings, I assume back in the good old days of 1947 and beyond, when the Columbia Basin Paper and Supply Co. would make your tax deposit at the local bank—and I think you showed us a copy of a coupon—and would have that hard record that you would take back to your business; and on the other side of it the bank would process that information, forward the tax payment to Treasury and under that old system banks had that 1-day float.

As you know, under the present Treasury regulations banks are now prohibited from charging fees for processing these FTD paper coupons because the processing costs were offset by the interest on the float and now that float has been eliminated.

If we took your approach to make electronic filing voluntary, should there be a corresponding lifting of the regulatory ban and allow banks to perhaps go back to charging fees to deal with small businesses or what suggestions might you have?

Mr. HASTINGS. Well, if we get into an electronic filing system that would be a determination for the businessowner. Because I certainly would not want to mandate to financial institutions that if you are handling these transactions you have to do it for free, if it is a cost to you.

So, I would certainly say that the financial institutions should have the options of having a service charge on that and, of course, the businessowner then would make that determination which is in his best interest. If he wants, desires a paper trail and the cost is something that he can live with and he feels comfortable with it then go ahead and work through the financial institution. But at that point, the decision may be made to file electronically but it should be the businessowner's option and not something mandatory.

But I certainly would not mandatorily say the banks could not charge any fee because of the costs that they incur in this.

Mr. HULSHOF. One question to each of you. Ms. Smith, you mentioned that had this been marketed better—and I think, Doc, you also mentioned we have a copy of the initial letter from the IRS with the bold headlines, you must enroll and deposit electronically—are there any other—and, you mentioned marketing, are there any other ways to provide incentives for small business other than just doing a better job of marketing?

Ms. SMITH. Well, I guess the best incentive for me is making my life easier and if I can see that it works, I am glad to do it. And, so, I do not know that there is. Except one thing they could have done better, and they might differ with this, is that they could have gone, back when NAFTA passed, and started working more closely with the small business community, the associations, and had them start training the people in this wonderful opportunity coming up to make your life easier. Instead, it came in as a club instead of a carrot.

And, so, now we have got a communication and a public relations problem that the government is doing something to us again, instead of the government is making our life easier. So, I do not think it is simple from here on out. We can make it simpler by making it voluntary, taking the pressure off and marketing it, and probably we will get better compliance.

I would imagine the costs of implementing are going to be higher because of the problems of people sending in inaccurate—can you imagine IRS getting 1.2 million filings that are probably either not complete or misunderstood and the mess they are going to have with that? I would imagine that is going to slow down collections and cause some real problems.

Mr. HULSHOF. Anything else, Doc?

Mr. HASTINGS. Well, I would go back to the basic premise that I mentioned. In 1935, when the Congress, in its wisdom under the Social Security Act, essentially made businesses the tax collector and they have not compensated them for being the tax collector. In fact, there are penalties, as you know, if you do not send your payment in on time.

I would entertain the thought that maybe you ought to find some way of allowing a businessowner to deduct a fraction of a percent for the privilege of collecting taxes for the government and keeping it. That may be an incentive.

Obviously, you have to look at the fiscal impact of that but it is something to consider because businesses are the tax collector for the Federal Government.

Mr. HULSHOF. Thank you both.

Madam Chair, I yield back.

Mr. HASTINGS. Madam Chair, I wanted to insert this into the record.

Chairman JOHNSON. Yes, your testimony will be included in its entirety in the record and we will insert that into the record and we will also give it our attention.

Mr. HASTINGS. Yes. This letter also is the one that I mentioned from the Treasury regarding the collections from the Department of Revenue. It used to be the Department of Revenue, what is it now anyway?

Chairman JOHNSON. We will certainly tend to that.

Ms. Thurman.

Ms. THURMAN. Thank you, Madam Chair.

Thank you for holding this hearing and I thank our two colleagues for coming here today. I need some clarification in the numbers that I am hearing here.

In both of your testimonies, I believe you talk about 1.2 million businesses that would be involved in this. It is my understanding that already there are 960,000 that are going to be participating one way or the other in this program to date. Is that your understanding?

Mr. HASTINGS. My understanding the way the phase-in was, it was a formula by which you were supposed to raise so many dollars over a period of time and that would dictate how many people were involved. And so, as this was projected out, this year it was supposed to hit 1.2 million businesses that are otherwise not enrolled.

Ms. THURMAN. But of those?

Mr. HASTINGS. Yes, that is what the figure is. Clearly some, within that 1.2 million, have already enrolled into the system because they thought it made good sense for them.

Ms. THURMAN. Do you know what those numbers are? I mean the numbers that voluntarily enrolled.

Mr. HASTINGS. No, I have not heard but I think that is what that figure is.

Ms. THURMAN. OK. Because what I have been told is, it is about 960,000 that have either enrolled, are using the system or are using the system already voluntarily. Is that correct?

Ms. SMITH. I think that you are right but not complete. Because I did not understand that either. I think there are around 70,000 already participating through the other system.

Ms. THURMAN. Right.

Ms. SMITH. And 960,000 have filed the paperwork but are not participating and will not until it kicks in, until the mandatory time. So, they have not started filing. And 1.2 million are who they sent the request to. So, out of that they have 75 percent of those who have sent their paperwork back in to enroll.

The rub comes in the fact that these are people that are pretty small. They have sent it because they knew they had to send something back in for fear of a penalty, but they have not started paying yet. They have not found the vendor, they have not connected. When they connect and do their first filing the anticipation is there is going to be 1.2 million of which really only 70,000-plus—and I am sure these can be corrected by IRS when they come—who have actually participated in the system.

And, so, we believe that that—given Internal Revenue Service's record with the problem and I am not talking about individual agents or their determination—that this is a flood. That even the best business setup with the best system it would hit pretty hard. So, that is the reason we would like them to back up a little bit.

Ms. THURMAN. When they do that—meaning the 960,000 or whatever the number that have volunteered to sign up—do we know of any information they receive back to make that transition easier for them? If they file something saying they have gotten some kind of a notice requiring them to file electronically, do they then receive from the IRS or from maybe an area business or bank any information that would show them how to do this?

Ms. SMITH. What I have so far are the training videos for the banks. Just a moment. Do we have anything that they send back? Yes, there is a confirmation slip and a 30-page guide that they send back. But, obviously, the 30-page guide is clarification but it is confusion also.

Ms. THURMAN. IRS sends that?

Ms. SMITH. Yes.

Ms. THURMAN. So, they do give them some feedback?

Ms. SMITH. Yes, training to prepare for this, if, in fact——

Ms. THURMAN. I was wondering if they have a personal contact or just the 30-page guide and a confirmation.

I think there is so much confusion even in the written material that it points to the problem that we have.

Ms. SMITH. But, yes, I think they are trying, it is just that they are trying to bring too many people in with too much of a change at one time.

Ms. THURMAN. Out of that number that you talked about with the Senate thresholds, of the $10 and the $5 million, what is the breakdown of the businesses that then have that, if we use the 1.2

million, what would then be the number left over of those coming in?

Mr. HASTINGS. I would have to research that because I do not know. That is the Senate version and I do not know what it would be. But I cannot answer that.

Ms. THURMAN. If I may, I have one more comment and question. I have not heard anything from our small businesses on this matter. Is the 10-percent penalty the issue for a lot of them? Is that what has gotten them scared?

Mr. HASTINGS. I think the biggest issue that I heard from my constituents—and maybe this is just my district, I do not know—is the fact that they do not want the IRS to have access to their account, whether electronically or any way. They want to have this coupon here because they are used to that coupon, it works for them and they want the option, frankly, and I probably have some businesses that would never want to file electronically, just the nature of them.

But I would say that is the biggest part is that danger. And the second part that comes with that is having to be told to do that. When you are talking about businesses generally entrepreneurs, you are talking about pretty independent people and they want to make that decision on their own and not be told.

If it were offered as a voluntary situation, which is what my bill does, then it makes it much easier. Then they can look at this and say, Hey, this makes sense, why not do it? I think the combination should be both of those; I do not think there is one overpowering reason that I have heard from my constituents.

Ms. THURMAN. Thank you.

Chairman JOHNSON. Thank you very much for your comments, both of you, they have been very helpful and we appreciate them. I think it is important to remember that Congress has pressured IRS to modernize its management and its business systems. And to be a strong economy in the decades ahead, we need businesses to modernize their management systems as well.

So, the thinking behind the government developing a good electronic payment system, I think is absolutely right, and the fact that this system is working very well in those sectors where it is up and running is a good thing for us all.

The issues you raised about how small businesses are going to participate and under what circumstances are very legitimate issues and we need to address them. Having delayed the implementation of this system for 6 months which we did last session to avoid these problems, that we should be here holding this hearing is, in and of itself, a statement about how difficult it has been for IRS to make change.

We should not have to deal with a letter that went out to small businesses that stressed penalties, stressed compliance, a 30-page booklet with a few months' notice after a 6-month delay. We should have been sitting here looking at a letter that clearly laid out the options, that helped small businesses to see that this does not give the IRS access to their accounts.

This is not very different from the way that individuals choose to let mortgageholders debit their accounts so that they pay their mortgage payments automatically and do not have to write checks.

No effort was made to educate, to communicate in a way that was user-friendly, and that is really just terribly unfortunate.

It is something that this Subcommittee has worked very hard on and made some progress. But we are here today both because we want to make sure that we do provide the leadership and work with the bureaucracy to modernize its systems, and to better serve the public through that modernization, but that we do it in a way that is user-friendly, that is intelligent, that educates, that leads, that guides and that at the appropriate level is voluntary.

So, I thank you very much for your testimony and we will examine all the problems that have developed with this system and we will make sure, in the end, that we work together to address both the interests of the government and the taxpayers and the interests of the small business taxpayers. I think it is important to remember that this is money due and these are taxes that people are obliged to pay. And the big difference here is that instead of the banks getting the earnings on 1 day's interest, the government is getting the earnings. And that is really an efficient tax system that uses our resources wisely to support the services that the public needs. We just have to do it well and we have to implement it well and that is what we are looking at today. And thank you for your testimony and input.

Ms. SMITH. Thank you, Madam Chair.

Chairman JOHNSON. The next panel will please come forward.

Mr. Donelson, who is the Chief, Taxpayer Service Division, Internal Revenue Service; Russell Morris, Commissioner, Financial Management Services, Treasury Department; Lawrence Buettner, senior vice president, First National Bank of Chicago; Larry Dreyer, senior vice president of NationsBank, Atlanta, Georgia.

And I am going to start in reverse order, calling on Larry Dreyer first, because through our banking officials we will, I think, get a better understanding of how this system is actually going to function and whether or not some of the processes are in place that the small business community is concerned about.

Mr. Dreyer.

STATEMENT OF LARRY DREYER, SENIOR VICE PRESIDENT, NATIONSBANK, ATLANTA, GEORGIA

Mr. DREYER. Thank you, Madam Chair.

Good morning, Madam Chair and Members of the Subcommittee. This morning the representatives from FMS, IRS, my colleague from First Chicago, and I would like to provide you with an update on the initial operation of EFTPS, the current status of the system and the role and the responsibilities of the Treasury financial agents.

NationsBank and First Chicago were selected during a competitive bid process to assist FMS and IRS in the design, development, implementation and operation of EFTPS. Both financial institutions are nationally recognized as being among the leading providers of the Electronic Treasury Management Services for the commercial market.

In 1996, we completed the design and development of the system. Even though required participation in EFTPS is currently deferred until July 1, 1997, we began operation of EFTPS last November.

On November 7, we processed our first payments for those taxpayers that had enrolled in the system as a result of the initial IRS notifications. Since that date, we have collected over $73 billion through this system. Just yesterday, we collected approximately $5.3 billion through EFTPS.

The responsibilities of the Treasury financial agents include enrollment of the taxpayer in EFTPS, processing the payment, and providing customer service. Please note that I stated processing the payment. This system has sometimes been referred to as an electronic filing program, however, EFTPS does not change or impact the filing requirements that are currently in place. It is just a payment mechanism.

As of last week, approximately 982,000 or 85 percent of the required taxpayers had enrolled in EFTPS. Only 177,000 remain to be enrolled and we are receiving approximately 15,000 new enrollments per week and estimate that over 87 percent of the required taxpayers will have responded by May 1. This will enable them to participate in the EFTPS by July 1.

Upon completions or successful completion of the enrollment process, the taxpayer receives a confirmation form, a payment instruction booklet, and by separate cover, separate envelope, a PIN, or personal identification number.

Unenrolled taxpayers have received three notices starting last summer, again in October, and in February. In addition to that, within the next couple of weeks, we will be sending out notices to those taxpayers that are enrolled but not yet using the system.

As part of the enrollment process, taxpayers can elect to make their payment via an automated clearinghouse debit, ACH credit or same day payment. If the taxpayer should elect to use ACH credits, they would instruct their bank to initiate the payment to EFTPS. If the taxpayer chooses to use the ACH data process, they would provide the financial agents with their bank account information. This information is necessary so that the taxpayer can initiate the transfer of their payments from their account to a special receipt account at the Federal Reserve. It does not move through either of the financial agents.

Even though the transfer of funds has to be reported at least 1 day prior to tax-due date, the money does not leave their account until tax-due date. All taxpayers are automatically enrolled for same-day payment and taxpayers that elect the debit payment method are also able to use the credit payment method.

In the testimony provided, the chart Payment Methods shows that 61 percent of enrolled taxpayers have selected the debit payment method and 38 percent the credit payment method. The next chart shows the actual payment methods currently being used by the taxpayers. Over 94 percent are using the debit payment method, slightly less than 5 percent the credit payment method, and less than 1 percent the same-day payment method. The next chart gives the breakdown of the dollars received by payment method.

During the enrollment process, the taxpayer who elected to pay via ACH debit also selects the method that they will use to report into EFTPS. The options available to the taxpayer include touch-tone telephone, voice operator or personal computer. If they select the personal computer method the financial agent provides the tax-

payer with the software that will enable the taxpayer to report their payment directly into EFTPS.

In the design of the system, financial agents determine the amount of capacity that would be necessary to accommodate expected volume in July and we currently have a capacity that exceeds that expected amount. During the first 6 months of operations we made the following observations. Eleven percent of the payments are made during nonbusiness hours and on weekends, 55 percent are made on days other than due date, 83 percent of the taxpayers are using the touch-tone system and only 7 percent of the touch-tone callers choose to request assistance from an operator. We had projected 15 to 20 percent.

In customer service, we provide information to the taxpayers on their enrollment status, payments process, PINs, request for additional forms, and general information and education. During March the financial agents received 128,000 customer service calls. The average speed of answer for each call was 16 seconds. This compares favorably to other commercial applications that range from 9 to 30 seconds.

We anticipate the number of calls in late June and into July will increase dramatically due to the July 1 date and are preparing to expand our capacity to handle a substantial increase in call volume.

That concludes my oral comments and I will ask my colleague, Larry Buettner, to make his statement next.

Chairman JOHNSON. I thank you.

Mr. Buettner.

STATEMENT OF LAWRENCE F. BUETTNER, SENIOR VICE PRESIDENT, FIRST NATIONAL BANK OF CHICAGO

Mr. BUETTNER. Good morning.

I will not reiterate the comments of my colleague from NationsBank concerning the enrollment and payment process of EFTPS. I will stress, however, First Chicago also believes it has taken all the necessary steps to prepare for the processing of electronic tax payments and the answering of taxpayer questions. In addition, we have gained considerable confidence in the ability of EFTPS since it has been operational for the last 6 months. We feel we are fully prepared and ready for July 1.

Both banks were designated as financial agents in October 1994. Although this is only 3 years ago, we need to step back a minute and recall the events of the time. TaxLink, the predecessor of EFTPS, was a pilot. Electronic bill payment systems were in their infancy. Fax machines and voice mail were only becoming universally available as a means to conduct business. Something called the Internet was still very much a toy of computer geeks. Yet, States were already requiring business taxpayers to make their tax payments electronically.

When we began our development of EFTPS it was grounded in the realities of the time. Technology, especially personal computers were not used by everyone. EFTPS today allows the taxpayer to utilize many different means to pay their taxes electronically. The set of features was developed as a result of market research data gathered from taxpayers. The EFTPS represents the broadest pos-

sible set of reporting options which are reasonable to introduce with a project of this size and, yet, allow taxpayers the greatest number of choices to select from to make their payments. At a minimum, EFTPS does not require taxpayers to purchase or utilize technology beyond their telephone.

There are a number of specific concerns which have been raised about EFTPS. First, both financial agents have gone to extensive ends to provide sufficient capacity to process tax payments. During the last 6 months we have been in production, we have gained significant understanding of taxpayer usage of EFTPS. We have learned the length of the time a taxpayer takes to make a payment, the pattern of when payments are made, the extent of the use of the warehouse capability and other features. All of these factors have been evaluated to ensure we have adequate system capacity.

We do have capacity which will ensure that the taxpayer can initiate a payment and make it successfully. We have gone to extensive efforts to ensure taxpayers will not encounter a service issue when they utilize EFTPS. Our overall system capacity well exceeds the total number of payments expected on a peak day with a significant safety cushion.

Just a few examples. We are able to process almost 1 million transactions an hour received from ACH credits. We have more than three times the capacity of telephone call capacity than the number of calls we are forecasting on a peak day. Second, both NationsBank and First Chicago are among the top 10 providers of ACH services. We handle thousands of ACH files and tens of thousands of transactions daily as banks. We have considerable experience in ACH processing and it is extremely uncommon for a customer or a bank to duplicate an ACH file or transaction, but it can happen.

EFTPS offers more solutions to this problem than the normal commercial practice. In the case of service bureaus or payroll processors our systems are designed to detect duplicate files. If a file were truly duplicated we would be able to detect it. For some reason a service bureau or payroll processor should feel a duplicate file were processed, they only need to call their bank to place a stop payment.

In the case of a business making the payment through EFTPS our software checks for duplicate tax payments are initiated through the telephone or the PC. In the event the taxpayer inadvertently duplicated a payment they could cancel the payment through EFTPS or place a stop payment through their bank for the duplicate transaction. Mr. Donelson will shortly address the concerns about duplicative ACH transactions.

Third, security and access to computer systems and data are headline news. EFTPS utilizes proven security features to prevent the unauthorized access to taxpayer information or accounts. In order for us to process an ACH debit to a taxpayer account the taxpayer must initiate the payment utilizing their employer identification number, the EIN, and their PIN. Without the combination of the EIN and PIN the taxpayer would not be granted access to the system.

The IRS does not have access to the PIN and, therefore, is unable to execute a debit to a taxpayer's account through EFTPS. The IRS currently has greater access to more taxpayer bank information from checks provided by taxpayers. Both financial agents have a fiduciary and a legal responsibility to keep taxpayer account information confidential.

Finally, the pace of change is accelerating tremendously. The Internet and related technology is redefining the way we conduct our everyday lives, whether that is our children completing research on the Internet for their homework, a business conducting electronic commerce, or paying taxes electronically through EFTPS, the fact is the pace will only quicken in the next few years.

EFTPS is part of this change process. Given the explosive growth in technology with the Internet population estimated to be more than 35 million, it is clear that the desire of the general public is for more services similar to EFTPS. The Federal Government, given the large scale and the number of participants and transactions each program involves, can be a tremendous force behind the redefinition of how business is conducted in the United States. We believe EFTPS positively contributes to the future ease of doing business with the Federal Government, the system has worked well for the last 6 months, there are only a small percentage of taxpayers yet to enroll and the program should continue as it currently is designed.

Thank you.

[The joint statement and attachments follow:]

Joint statement of Lawrence F. Buettner, Senior Vice President, First National Bank of Chicago; and Larry Dreyer, Senior Vice President, NationsBank, Atlanta, Georgia

As EFTPS Financial Agents, for presentation to the House Committee on Ways and Means, Subcommittee on Oversight, thank you for the opportunity to appear today to discuss the Electronic Federal Tax Payment System.

BACKGROUND

In March 1994, the Financial Management Service (FMS) issued an Invitation to Express Interest (IEI) for the development and operation of the Electronic Federal Tax Payment System (EFTPS) for the Internal Revenue Service (IRS) and the Department of Treasury. At the conclusion of this process, The First National Bank of Chicago and NationsBank were designated as financial agents for EFTPS in October, 1994. First Chicago was designated to serve the northern tier of the country and NationsBank the southern tier.

First Chicago and NationsBank are among the top tier of cash management banks in the United States. Both banks have earned reputations for their broad array and leadership in the development of innovative cash management products. The development and operation of EFTPS is consistent with our experience and performance in the service of corporate and government customers.

First Chicago and NationsBank have developed an extensive relationship with the FMS and IRS through the cash management services provided by both banks. We currently provide lockbox products and comprehensive ACH services to the IRS and more than 120 other federal agencies or departments. We are very familiar with the service requirements of federal government customers.

Immediately upon designation, both banks began development of their respective systems. We share a common architectural design and have implemented a similar look and feel for taxpayers between each system. After thorough testing and validation, both systems were placed into production in June, 1996. The first payment was processed on November 7, 1996.

EFTPS represents a significant accomplishment for both banks in the development of what some consider the world's largest electronic collection system. We are confident the system we have built is well prepared to provide uninterrupted proc-

essing of taxpayer payments. We recognize the sensitivity of taxpayers in their interaction with the federal government in one of their most critical transactions, their tax payment. We believe we are well prepared for the task.

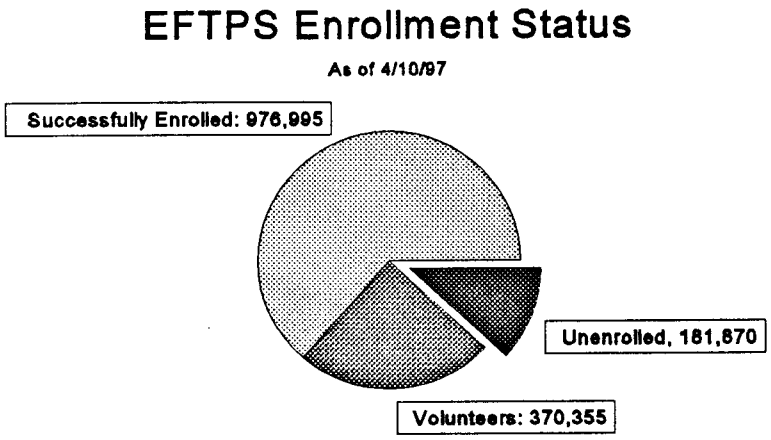
EFTPS represents a positive example of the joint collaboration of government and the private sector in the development of a key government system. Although we are utilizing well proven technology, the task to integrate all of the components into a working EFTPS solution was a huge undertaking for each bank. It was accomplished in a remarkably short period of time. Our experience in the operation of the system for the last six months reinforces our belief that the system is capable of successfully handling the migration of taxpayers from paper to electronics.

The remainder of this document details our experience since EFTPS has gone live and addresses some of the most frequently mentioned concerns about the use of EFTPS. We believe EFTPS is ready and fully prepared for the taxpayers required to utilize the system in July. It is a service which can readily be utilized by all taxpayers as they are required to make their tax payments electronically.

EFTPS Operation

Taxpayer interaction with EFTPS centers around three primary functions: enrollment, payments and customer service.

Taxpayers required to enroll into EFTPS received their initial notice and enrollment forms in July, 1996. The current number of taxpayers enrolled in EFTPS is as follows:



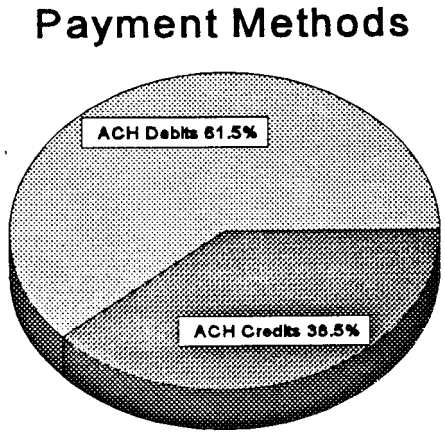
As of April 7, more than 84.2% of the 1,158,865 required taxpayers have successfully completed the EFTPS enrollment process. We are receiving approximately 15,000 new enrollments per week. We estimate that 87.4% of the taxpayers will have responded by May 1st which would allow for their enrollment to be successfully processed prior to July 1 for the first electronic payment of taxes. Enrollments received after May 1 will be expedited by us. Unenrolled taxpayers have received three notices (July, 1996, October, 1996, February, 1997) which included instructions regarding the enrollment process and an enrollment form. In addition to the taxpayers required to utilize EFTPS for electronic tax payment, we have received 370,355 voluntary enrollments.

Given the large number of taxpayers required to enroll into EFTPS, the percentage of successfully enrolled taxpayers is remarkably high. In comparable private sector initiatives, there are early adapters of new products who respond to new ideas and initiatives. On the opposite extreme, there are the laggards, who will be the last to adopt until faced with overwhelming need or external market pressures. The introduction of EFTPS in some respects is no different than any other new product or service either offered by the government or the private sector.

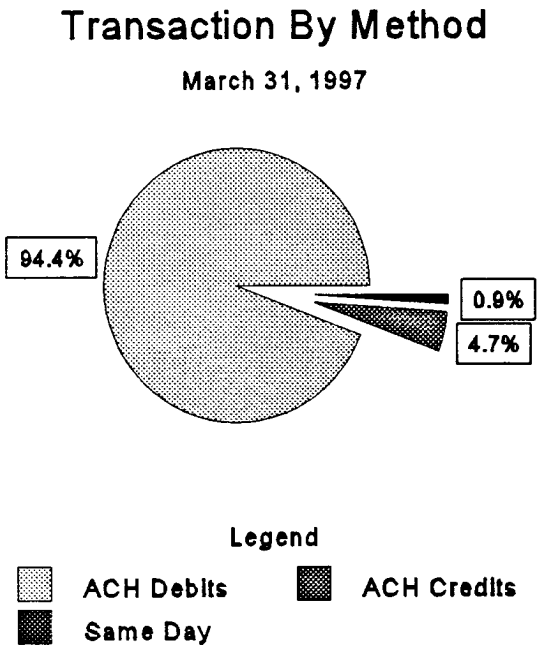
There is an analogy between EFTPS and another government service which encountered initial public scrutiny. The direct deposit of Social Security payments encountered initial public skepticism. SSA deposits have become an accepted means for deposit of social security payments and dramatically moved a large portion of paper payments into electronics utilizing the "same" Automated Clearinghouse House (ACH) process used by EFTPS. The leadership role played by the government

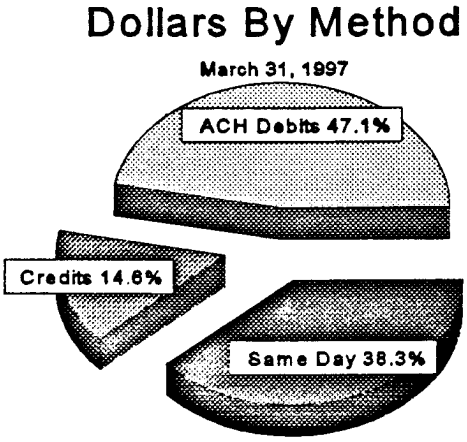
in SSA direct deposit reshaped and legitimatized retail electronic payments. EFTPS offers the federal government the opportunity to demonstrate the same leadership as the country moves to embrace electronic commerce (e.g. electronic bill payment, home banking, Internet payments, etc). The number of EFTPS payments expected to be processed over the next few years will provide the jump start and impetus for the general public to migrate to the use of other electronic payments products.

As part of the EFTPS enrollment process, the taxpayer can elect to make their tax payment via an ACH debit, ACH credit, or a Same Day payment. If the taxpayer chooses to utilize ACH credits, they would instruct their bank to initiate a payment to EFTPS. No bank account information is required from the taxpayer on the EFTPS enrollment form if they choose the ACH credit method. If the taxpayer chooses ACH debit, they would provide their bank account information on the EFTPS enrollment form to the Financial Agent. This information is necessary when the taxpayer initiates a transaction through EFTPS to debit their account. Although taxpayers initiate an ACH debit transaction the day before their tax is due, the funds are not debited from their account until the tax due date. All taxpayers are automatically enrolled for the Same Day payment option. Taxpayers electing to use ACH debits are automatically enrolled for ACH credits. The following chart depicts the choice of payment methods chosen by taxpayers:



The following charts represent the percentage of EFTPS payments processed by the Financial Agents between ACH debit, ACH credit, and Same Day payments and the percentage of dollars processed by each method.





We believe the above charts provide us with the following insights:

• The vast majority of taxpayers are utilizing the ACH debit method. We believe there is a comfort level on the part of the taxpayer and their ability to chose the time when they are able to initiate a tax payment by telephone or PC.

• ACH credits are not being used as frequently as originally anticipated in EFTPS. The experience in TAXLINK, which is the predecessor system to EFTPS and is being utilized by the largest taxpayers, indicates 54% of the dollars and 58% of the transactions are from ACH credits. We believe smaller companies will utilize the ACH debit method since they do not subscribe to the banking services which execute ACH credit transactions. This is consistent with the broader bank cash

management market where middle market and smaller companies utilize less sophisticated and more cost effective electronic banking products.

• Same Day transactions will remain a very small subset of the total transactions processed through EFTPS. Among the largest taxpayers in TAXLINK, Same Day payments represent 1.5% of the dollars collected and .28% of the transactions. Although available to all EFTPS users, Same Day payments will probably be a backup alternative for emergency situations with a few number of transactions once EFTPS is fully utilized by all required taxpayers.

CUSTOMER SERVICE

If taxpayers are to successfully transition to EFTPS, both Financial Agents must be prepared to provide customer service to taxpayers to assist them with their questions and concerns. Both financial agents are providing two forms of customer assistance:

• Taxpayer assistance—for answers to enrollment and payment related questions. The Financial Agents do not provide answers to tax related matters.

• Financial Institution assistance—to resolve bank's questions concerning EFTPS, ACH credit format requirements, and enrollment.

Customer service assistance is available Monday thru Friday from 8:30 a.m. to 8:00 p.m. E.S.T.

Customers who call the service centers for assistance have the option to speak to a customer service representative or utilize a self-service audio response service which provides answers to the most frequently asked questions. Approximately 30% of taxpayers have opted for the self-service option.

On a typical day, the customer service centers receive questions which fall into the following categories:

Customer Service Questions	Percentage
Enrollment	20
Payment	15
PIN	4
Fulfillment (add'l forms, etc)	23
General Education	38
Total	100

In the month of March, the financial agents received 128,807 customer service calls. The average speed of answer for a call was 16 seconds. This compares favorably to external benchmark data:

Company	Speed of Answer* (in seconds)
Federal Express	30
Charles Schwab	18
Commonwealth Edison	15
Ameritech**	9–12
Average	18
EFTPS Financial Agents	16

* One ring on the telephone = six seconds
** Chicago office

We anticipate the number of calls in late June and into July will increase dramatically due to the July 1 date. We are preparing to expand our capacity to handle a substantial increase in call volume. The logistical preparation for the expansion in capacity is currently underway. Additional staff will be hired and trained in advance of the expected call volume growth.

With the increase in customer service capacity, our goal is to handle 80% of the calls with 30 second speed of answer. This does not indicate in any one hour or in any one day we would not experience a longer speed of answer. With the availability of our self-service call center features and a moderate wait, we should be able to service all taxpayers requiring assistance. We recognize the potential concern on the part of taxpayers who are trying to initiate their first electronic payment if they are unable to resolve a service issue. We believe we are taking all of the necessary steps (i.e. staffing, equipment, training, etc) to be prepared for July 1.

SECURITY

As part of the implementation of the EFTPS systems developed by each Financial Agent, both systems went through extensive testing. The certification process was conducted by an independent audit company hired by the Internal Revenue Service. Testing consisted of two major categories:

- functionality testing to insure the solutions developed by the Financial Agents met all of the required specifications
- security testing to insure the system access was secure from third party access and taxpayer initiated payments were appropriately controlled to insure data integrity.

The systems of both Financial Agents successfully completed this process. In addition, since the initial certification of the systems, the Financial Agents have delivered subsequent system enhancements. Each of these system enhancements has successfully completed and passed a subsequent audit review performed by the independent auditors selected by the IRS.

Access to the EFTPS system is controlled through use of the taxpayer's Employer Identification Number (EIN) for corporations or the Social Security number (SSN) for individuals and a personal identification number (PIN) which is assigned to the taxpayer during the enrollment process. The system will not allow the taxpayer access to the system for initiation of a payment without providing both the EIN and PIN. The successful entry of the EIN and PIN allows the taxpayer to enter the data required for each specific tax payment. Once the data has been entered, the EFTPS system generates an ACH debit transaction which will result in the funds being debited from the taxpayers account at their bank and forwarded on to the U.S. Treasury. The taxpayer will immediately receive an EFT acknowledgment number as evidence they completed the first step in the payment of their taxes. Obviously, the tax is considered paid if the taxpayer has sufficient funds in their bank account to cover the ACH debit for the tax.

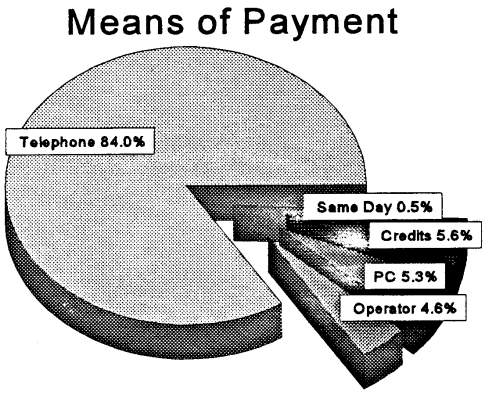
EFTPS is utilizing standard banking industry security procedures for the initiation of EFTPS tax payments. Without the combination of the EIN and PIN, access to the system will be denied. The PIN is kept by the taxpayer.

The Financial Agents have access to the PIN through their systems and the access is protected from general use by unauthorized personnel. The PIN is not provided to the IRS. Without access to the PIN controlled by the system and the taxpayer, it is impossible for the IRS to initiate an ACH debit payment against a taxpayer's account through EFTPS.

EASE OF USE

EFTPS was designed with the intention to make the ease of use as simple and quick as possible for the taxpayer. EFTPS also was designed to accommodate varying degrees of technology acceptance by taxpayers. With this in mind, taxpayers have the choice of utilizing the most commonly available technology, the telephone, or more sophisticated devices such as a personal computer when interacting with EFTPS. The taxpayer also has the opportunity to complete the tax payment through their bank via ACH credit or Fedwire.

EFTPS allows taxpayers the ability to initiate tax payments through a number of different means: touch tone phone, operator, personal computer, service bureau (payroll processor) or through their bank by ACH credit. In all cases except ACH credit, the taxpayer has the ability to control when they initiate a tax payment transaction through EFTPS. Taxpayers must deliver their ACH credit requests to their bank within the bank's prescribed processing windows.



Based on the number of taxpayer payments processed since implementation, we are able to determine:

• the vast majority of taxpayers are utilizing the ACH debit option which is the result of the use of a touch tone phone, operator assistance, or personal computer.

• since EFTPS does not require a taxpayer to utilize or purchase any new technology beyond the use of their telephone, the 84% payment by audio response technology demonstrates the system poses no undue burden on taxpayers.

• as compared to other audio response applications, the need for human operator intervention at 4.6% is about half of other similar banking related products. Taxpayers are able to utilize the system with minimal difficulty.

• Both ACH credits and Same Day payments remain a small proportion of the total transactions initiated by taxpayers.

The average time for the completion of a tax payment through EFTPS is approximately 3 minutes. The system was engineered for minimal data entry and the current taxpayer experience indicates they are not requiring an excessive amount of time to complete a transaction. Exhibit A is the worksheet provided to taxpayers to complete prior to initiation of a payment and illustrates the limited amount of data required to make a payment. An EFTPS demonstration system is available for taxpayers to practice on prior to making their first payment. The system is available to members of the Committee, at their request, for them to experience the relative ease of making a tax payment.

Since the taxpayer maintains control of their PIN and the taxpayer has the ability to choose when he or she wishes to initiate a transaction, approximately 11% of the transactions the taxpayer initiated have been received outside normal business hours. Taxpayers have the flexibility to execute a transaction at a time when it is most convenient to them. The system provides the flexibility to initiate a tax payment from their home or office at a time most suitable to them. In addition, approximately 30% of payments are initiated by taxpayers two (2) days before the required tax payment date utilizing the warehouse feature of the system. Although entered into the system 2+ days before the tax is due, the funds are still debited from the taxpayers account on the tax due date. The combination of readily available technology (i.e telephone) and system features makes the use of EFTPS easy and convenient for taxpayers.

EFTPS TECHNOLOGY

Although the requirements from the IRS for EFTPS are quite extensive to insure both ease of use by the taxpayer and the gathering of data necessary for internal IRS systems, EFTPS is utilizing technology which is commonly employed by banks for electronic banking. EFTPS is very similar to electronic bill payment systems utilized by banks to allow their retail customers to pay routine household bills electronically. Except for the specific data reporting layouts required by internal IRS systems, EFTPS does not contain any unique or custom technology specifically built for the IRS.

The EFTPS system developed by First Chicago and NationsBank each utilize proven technology. The system developed by First Chicago has been nominated for national recognition and within the computer industry for its approach in building EFTPS. The First Chicago solution is a finalist for the 1997 Computerworld Smith-

sonian Award as an example of the positive impact of technology. It will be included in the time capsule created by the Smithsonian as an example of a notable technology advancement.

Bank customers have become discerning buyers of financial services. Customers evaluate banks beyond the old paradigm of the convenience of a local branch but by their access to ATM machines, customer service, and access to new innovative products (e.g. electronic bill payment, home banking, etc). Financial service providers (i.e. large money center, regional and community banks) are employing new technology to provide new services to their customers. This is both out of necessity, as they are overwhelmed with highly labor intensive paper products, and survival, as many non-banks try to enter into their markets and leave them with the low margin commodity services. EFTPS is illustrative of the many new products and services which are being developed for the general public as they migrate from paper to electronics. Financial service providers must reduce the high fixed costs associated with branch banking and replace it with more efficient and responsive services. The trend within the industry is to close and consolidate branches and replace them with more effective delivery means such as service centers located in supermarkets and electronic home banking services.

Concern has been raised about the service fees potentially imposed by banks for the initiation of ACH credits for tax payments. The above scenario highlights the industry trend to streamline the services provided through branch locations. Not all bank customers have access to a full-service branch location. Wire transfers and ACH processing are considered labor intensive and high risk transactions which all branches are not equipped to handle. Banks are inclined to steer their customers into other alternatives which do not require the exception processing associated with electronic wire transfers. It is not surprising that banks are encouraging their customers to utilize the ACH debit method offered by EFTPS since it is less costly for them to service and results in a service charge essentially equal to that of processing a check for the taxpayer. This is a service which is easily provided by both large and small community banks. If required, banks will initiate electronic payments only after a thorough credit evaluation and the completion of a service contract by the customer. If demand for the execution of ACH credit transfers for EFTPS were to become a competitive requirement, the pricing for these services would reflect the costs of the service, the liability incurred, and market competition. We do not foresee this occurring given the current trends in the industry.

General customer acceptance of the use of self-service electronic products is verified by current market research data:

- 600,000 establishments use the Internet for business purposes (Computer Intelligence 1997)
- 50% of office-based employees have personal computers and 86% of small and mid-sized businesses have computers (Survey of Small and Mid-sized Businesses, Arthur Andersen, 1996)
- In 1996, almost 5 million US households used phone bill payment and about 2 million used PC bill payment; usage is expected to grow to over 7 million and 6 million respectively by 2000, with 3 million using Internet banking.(Electronic Bill Payment and Remote Banking Final Report, Mentis Corp. Published in Bank Systems & Technology 4/97)
- Estimates of the on-line population in mid-96 ranged from under 9 million to more than 35 million, with several studies in the 15 million range (Internet World, 12/96)

In a soon to be released comprehensive study of change in the US payments system, "several key trends and conclusions have already been documented:

- Government initiatives, which are riding on the existing infrastructure, will result in universal access to electronic payments systems for consumers and businesses.
- Cost and competitive marketing demands are putting pressure on both POS and bill payment environments, promising growing use of card transactions and electronic payment alternatives.
- Historical rates of adoption of electronic payment alternatives by consumers and businesses have been slow, but there is an indication that the pace of change is accelerating.
- Revolutionary system changes will occur at the back end, with new processing alternatives that lower transaction processing costs and broaden transaction information exchange.
- Consumer and business use of the Internet for commerce and transaction could fuel revolutionary change.

This market research is encouraging banks to develop products which will accommodate their customer's desire to use services which are: electronic, self-service, and

low cost. EFTPS is consistent with this customer preference. EFTPS is a key ingredient in the change occurring in the payments system. If actively encouraged by the requirement of taxpayers at lower tax thresholds to participate, it will potentially further accelerate these trends.

SUMMARY

As Financial Agents, we believe we have developed a solution which is prepared to begin the transition of taxpayers from the current paper process to electronics.

There a number of points which must be stressed:

- EFTPS has been live for six months. We have had the opportunity to correct any deficiencies. The system is performing well.
- EFTPS is a new service or product. Like any new product it will take time for it to be accepted and embraced by all customers.
- EFTPS represents a tremendous opportunity for the government to achieve efficiency in the tax collection process utilizing technology commonly used by everyone in their daily lives.
- EFTPS represents the future of electronic commerce. The federal government can accelerate the acceptance through EFTPS.

Finally, EFTPS represents change. Change is a disruptive process. The introduction of change on a wide scale is bound to be uncomfortable for some. Introduce change in the tax process, added by the fear of the IRS, and change turns to fear. We believe the fear is disproportionate to the actual benefit being achieved. The IRS and the Treasury Department are sensitive to the concerns of taxpayers. They have required the Financial Agents to take steps to insure taxpayer bank accounts cannot be accessed by the government.

EFTPS will not only serve the taxpayers currently required by the July 1 mandate but is well positioned to make the tax process easier for the vast majority of taxpayers. We encourage the Committee to maintain the July 1 mandate and the original plan for the years beyond.

EXHIBIT A

Appendix D

Tax Payment Report Worksheet

EFTPS Voice Response System (Photocopy this worksheet for future use.)

❶ **You dial:** **1-800-2PAYUSA (1-800-272-9872)**
EFTPS responds: "Welcome to EFTPS, the Electronic Federal Tax Payment System"

❷ EFTPS prompts: "Please enter your 9-digit Taxpayer Identification Number or TIN"
You enter: ☐☐☐☐☐☐☐☐☐ **(9-digit Employer Identification Number)**

❸ EFTPS prompts: "Enter your 4-digit PIN"
You enter: ☐☐☐☐ **(4-digit Personal Identification Number)**

❹ EFTPS prompts: Lists the Main Menu Selections
You enter: **Press 1 (To initiate a tax payment)**

❺ EFTPS prompts: "Enter the 3-to 6- digit Tax Form number"
You enter: ☐☐☐☐☐☐ **(3-to 6-digit tax form number from IRS Tax Form Table in Appendix A)**

EFTPS responds: Tax Form/Tax Description (Based on the selection in step #5)

❻ EFTPS prompts: "Enter Tax Payment Type"
You enter: **1 digit number Tax Payment Type (Select Tax Payment Type from VRS Prompt)**

❼ EFTPS prompts: "Enter the 4-digit Tax Period starting with the year followed by month for this payment"
OR "Enter the 2-digit Tax Period for this annual payment"
You enter: ☐☐☐☐ **(Valid 4-or 2-digit Tax Period based on IRS Tax Form Table in Appendix A)**

❽ EFTPS responds: "The next business date that the payment can be made is (Next Business Date)." (and gives you the option to accept the business date or enter a different date)
(Note, the next business date you enter must be at least one business day in the future).
You enter: **The Menu option to accept the business date or select a different date.**
☐ **(1-To accept the business date OR 2-To enter a different date)**

❾ If you enter "2"
EFTPS prompts: "Enter the 6-digit business date that the payment will be made"
You enter: ☐☐☐☐☐☐ **(6 digit business date in MMDDYY format)**

❿ EFTPS prompts: "Enter the Tax Payment Amount. You must enter cents even if you are reporting a whole dollar amount."
You enter: $ ☐☐,☐☐☐,☐☐☐.☐☐
(Your payment amount cannot exceed $99,999,999.99)

⓫ EFTPS responds: "You have entered:"
"Tax Form (Tax Form Number)"
"Tax Period (4-digit Tax Period)"
"Tax Payment Amount (Tax Payment Amount)"
"Withdraw Date (Tax Settlement Date)"
(Lists VRS Menu Selections to Accept, Change, or Void Transaction)
You enter: **The Menu Option from the VRS prompt (1-Accept; 2-Change; 3-Void)**

(continue)

VRS Tax Payment Report Worksheet (continued)

Further breakdown for the following tax forms:

For Tax Form 720, you are requested to report IRS numbers and amounts, and the IRS number amounts must balance to the Tax Form 720 payment amount. For Tax Form 941 and CT-1, you are requested to report the subcategories and amounts and the subcategory amounts must balance to the Tax Form 941or CT-1 payment amount.

For Tax Form 720 FTD Payment:

For Tax Form 720, you are requested to report IRS Number and amounts and the IRS Number amounts must balance to the Tax Form 720 payment amount.

EFTPS prompts: "Enter an IRS Number (Excise Tax IRS Numbers in Appendix B)."

You enter: ☐☐☐ **(2-or 3-digit IRS Number from 720 Tax Form)**
(You must enter at least one IRS number when making a 720 tax payment.)

EFTPS prompts: "Enter the IRS Number Amount." (The individual IRS number amounts must balance with the 720 tax payment amount entered in step #10.)

You enter: $☐☐,☐☐☐,☐☐☐.☐☐ **(IRS Number amount)**
AND "Press 2 To return to the Enter an IRS Number prompt"
OR "Press the pound key (#) if there are no more IRS Numbers to report."

For Tax Form 941 FTD Payment:

For Tax Form 941, you are requested to report the subcategories and amounts and the subcategory amounts must balance to the Tax Form 941 payment amount.

EFTPS prompts: "Enter the 941 Social Security Amount."

You enter: $☐☐,☐☐☐,☐☐☐.☐☐ **(941 Social Security Amount)**
(You must enter at least one 941 subcategory amount when making a 941 tax payment. The individual 941 subcategory amounts must balance with the 941 tax payment amount.)

EFTPS prompts: "Enter the 941 Medicare Amount."
$☐☐,☐☐☐,☐☐☐.☐☐ **(941 Medicare Amount)**

EFTPS prompts: "Enter the 941 Withholding Amount."

You enter: $☐☐,☐☐☐,☐☐☐.☐☐ **(941 Withholding Amount)**

For Tax Form CT-1 FTD Payment:

For Tax Form CT-1, you are requested to report the subcategories and amounts and the subcategory amounts must balance to the Tax Form CT-1 payment amount.

EFTPS prompts: "Enter the CT-1 Tier I (FICA Equivalent) Amount."

You enter: $☐☐,☐☐☐,☐☐☐.☐☐ **(Tier I FICA Equivalent Amount)**
(You must enter at least one CT-1 subcategory amount when making a CT-1 tax payment. The individual CT-1 subcategory amounts must balance with the CT-1 tax payment amount entered in step #10.)

EFTPS prompts: "Enter the CT-1 Tier II (Industry Portion) Amount."
$☐☐,☐☐☐,☐☐☐.☐☐ **(Tier II Industry Portion Amount)**

EFTPS prompts: "Enter the CT-1 Supplemental Annuity Amount."

You enter: $☐☐,☐☐☐,☐☐☐.☐☐
(CT-1 Supplemental Annuity Amount)

If this is correct,
EFTPS responds: "Your EFT Number is (EFT Number). Record your EFT Number for future reference.
Again, your EFT Number is (EFT Number). Press the star (*) key to repeat this message."

⑫ **You record:** **EFT Number** _____

EFTPS prompts: VRS lists the Main Menu Selections

⑬ **You enter:** **Main Menu Selection Number from the VRS prompt**

EFTPS responds: "Thank you for using EFTPS–the Electronic Federal Tax Payment System."

Appendix D

EXHIBIT B

Myths and Facts About the Electronic Federal Tax Payment System

Myth: Taxpayers need to acquire equipment.
Fact: Taxpayers **do not need** to acquire equipment.

By choosing the ACH Debit option, taxpayers can use either a telephone or a personal computer (PC) to make a payment. Electronic Federal Tax Payment System (EFTPS) sends free ACH Debit tax payment PC software to those taxpayers who request it.

If a taxpayer does not have a touch-tone telephone the taxpayer will be transferred to a voice operator who will take the payment information.

Myth: EFTPS has not been tested.
Fact: EFTPS **has been** tested.

EFTPS has undergone extensive testing, including security testing, by the government and an independent contractor. Each time a major enhancement is made to the system, it is subject to recertification.

The primary payment methods for EFTPS uses the Automated Clearing House (ACH), a financial network operated by the Federal Reserve Banking system. The ACH network has been operated successfully since the 1970's. More than 150,000 companies and all 50 states use the ACH.

Myth: The IRS has access to taxpayer's bank accounts.
Fact: The IRS **does not** have access to taxpayer's bank accounts.

Similar to a paper check, EFTPS can only withdraw the amount specified by the taxpayer from the taxpayer's account. Only the taxpayer can initiate payments from their bank account. IRS cannot initiate transfers from the taxpayer's account.

Myth: Taxpayers must change banks.
Fact: Taxpayers **do not have to** change banks.

All banks can accept ACH debit transactions; however, banks may choose not to offer ACH credit to their customers or may charge fees for using ACH Credit.

Myth: Taxpayers will incur additional fees as a result of EFTPS.
Fact: EFTPS **does not** charge banks or taxpayers any processing fee.

A taxpayer's financial institution may charge a fee for originating an ACH credit or same day payment or receiving an ACH debit item from EFTPS. Often fees depend on the account relationship or account type.

Myths and Facts About the Electronic Federal Tax Payment System (continued)

Myth: EFTPS requires taxpayers to pay earlier.
Fact: EFTPS **does not** require taxpayers to pay earlier.

EFTPS accelerates the flow of funds to the government enabling these funds to be invested sooner and begin earning interest sooner. EFTPS does not take the funds from the taxpayer sooner.

Taxpayers report the tax payment information by 8:00 P.M. EST at least one business day before the tax due date; however, funds do not move until the date specified by the taxpayer.

Myth: Taxpayers and tax practitioners confuse EFTPS with an electronic filing program.
Fact: EFTPS is **only** used to automate the payment.

There is no change in the process of calculating the taxes due. EFTPS simply replaces the 8109 paper coupon and check. With EFTPS, taxpayers will no longer bring a paper coupon and check to their bank on the tax due date. Now they can report their payment from their home office.

Myth: Taxpayers must use a third party processor.
Fact: It **is not necessary** to use a third party processor.

Taxpayers may use a third party processor in the electronic environment just as they did in the paper environment.

Myth: EFTPS is not prepared to handle the volumes of calls from taxpayers to report their tax payment information.
Fact: The EFTPS voice response system is "state-of-the-art". The systems and voice response capacity developed by the Financial Agents has been sized to handle the expected volume, even on peak reporting dates.

Myth: Electronic tax payments are new.
Fact: Although EFTPS is new, electronic tax payments **are not.**

Forty-five states operated electronic tax payment programs similar to EFTPS where payment options include ACH Debit, ACH Credit, and Fedwire as a back-up payment mechanism. EFTPS uses existing, proven technology.

Myth: Some taxpayers feel that if they provide subcategory information with their electronic payment, IRS will use that information to balance to the totals reported for the year.
Fact: IRS **does not receive** the sub-category information; it is used by the Office of the Fiscal Assistance Secretary (OFAS) for making investment decisions.

When making a payment through EFTPS, taxpayers can skip the subcategory fields and only input a total amount.

Myths and Facts About the Electronic Federal Tax Payment System (continued)

Myth:	Some taxpayers are concerned about the IRS giving intermediaries (Treasury Financial Agents) access to business owner's accounts.
Fact:	The Treasury Financial Agents (NationsBank and First Chicago) must adhere to the same stringent security requirements for handling sensitive but unclassified taxpayer data that any government agency, including the IRS, must comply with.

Mr. PORTMAN [presiding]. Thank you, Mr. Buettner. We are now going to hear from Jim Donelson who is Chief, Taxpayer Service, Internal Revenue Service. And, Mr. Donelson, you are accompanied today by Bob Albicker, Deputy Chief Information Officer, Systems Development of the Internal Revenue Service.

Mr. Donelson.

STATEMENT OF JAMES E. DONELSON, CHIEF, TAXPAYER SERVICE, INTERNAL REVENUE SERVICE; ACCOMPANIED BY ROBERT ALBICKER, DEPUTY CHIEF INFORMATION OFFICER, SYSTEMS DEVELOPMENT, INTERNAL REVENUE SERVICE

Mr. DONELSON. Mr. Portman, and distinguished Members of the Subcommittee, thank you and we are pleased to be here this morning.

I would like to submit my written testimony for the record and I would like to give you a summary testimony orally.

This morning I want to give a brief overview of our EFTPS System which we consider to be one of our major success stories. EFTPS is the new paperless system designed to meet the congressional requirements of section 6302(h) of the Internal Revenue Code. Its objective is to implement an electronic funds transfer system for the payment of Federal tax deposits. EFTPS largely replaces the current paper coupon system that taxpayers now use.

I am pleased to tell you that EFTPS is fully operational as we have already heard. Since November 1996, EFTPS has been successfully processing payments from over 200,000 volunteer businesses. To date, EFTPS has processed more than 1.5 million transactions, representing over $50 billion in Federal tax deposits. As of April 5, 1997, over 970,000 of the approximately 1.2 million taxpayers that will be using the EFTPS on July 1 have enrolled to use EFTPS. In addition, over 365,000 taxpayers that are not mandated have already enrolled voluntarily.

I would like to take this opportunity to extend my appreciation to all the parties that have participated in making EFTPS a success. The IRS members, Treasury's financial management team and the Treasury financial agents, NationsBank and First National Bank of Chicago, developed a safe, secure system with payment and reporting choices for all types of businesses.

To cancel or dramatically alter the provisions of EFTPS, which has been suggested by some, would be a disservice to those taxpayers who have already enrolled and are using the system now. In my opinion, it would cause significant disruption and confusion to the hundreds of thousands of taxpayers who are trying to comply with the law.

Here is a sampling of what a number of tax professionals from the National Association of Enrolled Agents recently said about EFTPS: "It works great. I was amazed the first time I used it in how easy it was. The IRS has really done a great job on this one." "EFTPS is working fine. I have signed up and plan to start this month." "Electronic payment is working great here in South Carolina." And finally, "So far I have had much success with this program for payroll tax deposits in the San Francisco Bay area." Those are the people who are using the system and that is the testimony, I think, as to its ease.

The IRS, FMS, and Treasury financial agents worked together to provide as many benefits to taxpayers as possible. We incorporated the successful features of TaxLink, the predecessor electronic payment system which, to date, has successfully collected nearly $800 billion. We also consulted with taxpayers to learn what other features they desired. These benefits include ease of use, flexible payment options, privacy and security, and increased accuracy and better taxpayer service.

I recognize that some businesses may be comfortable with the current FTD coupon system that Congressman Hastings demonstrated earlier today. I know the IRS is also comfortable with the current paper coupon system. We have been using it for years. I would like to digress for a second and explain.

In my career I was a revenue officer and one of my jobs was to help taxpayers who had problems with that coupon system. One of the types of cases that was the most difficult for us to untangle was when taxpayers used the wrong coupons, did not receive their coupons from the IRS in the mail or did not know where to get a coupon. I had to deal with taxpayers and help them untangle that mess.

This system is so much better than that I cannot overemphasize that. So, from a real on-the-ground, dealing with taxpayers, this is an improvement, and I really mean that sincerely.

However, even though we are comfortable with this system, the current paper system, we recognize that the world is changing. Electronic commerce is here and adjustments are necessary. Our experience to this point indicates that there is little to fear except some change. I believe that it is change for the better.

The IRS has aggressively faced its obligation to inform the 1.2 million taxpayers required to participate in the EFTPS by July 1 of their new electronic payment requirement. The IRS worked closely with FMS to ensure that the banking community was fully informed of the new system so that banks could answer their customers' questions about EFTPS. The IRS used every opportunity to get our message out to taxpayers through speeches, presentations at professional association seminars across the country, including small business, at special EFTPS forums and through work with other Federal agencies.

All these efforts were very useful in providing information to taxpayers and professional organizations. However, direct mailing is the most effective way to provide taxpayers with our information. Thus, the IRS sent a series of direct mailings to taxpayers and organizations starting in the summer of 1996. And, since that has raised a number of concerns both by witnesses that preceded me and also by members of this panel, I would like to address the issue of that first notice that went out last summer.

I am the Chief of Taxpayer Service at Internal Revenue Service. That letter went out under my auspices. I recognize that it has raised the ire of many Members of Congress and certainly the constituents, and I want to publicly and personally apologize for the tone and the timing of that letter. If it was a mistake, it was my mistake and I apologize and I want that to be on the record.

I never meant, nor did my organization ever mean to be disruptive or bother taxpayers and get them stirred up to a point where they were afraid of the system. On the other hand, we had to get a notice out and if we did a bad job in that regard in terms of how it was designed, I will take personal responsibility for that and apologize. But I digress.

When over 1 million taxpayers move into the electronic age for making tax deposits we understand that these taxpayers may need to make adjustments in the way they do business. Commissioner Richardson announced on April 7 that special penalty relief would be available to encourage early use of EFTPS for those people that are experimenting with us. The extra steps the IRS is taking should assist business taxpayers in making the switch to EFTPS go more smoothly. The IRS will not impose any penalties on taxpayers who enroll in the EFTPS and attempt to make payments through the system before July 1, 1997.

In effect, a penalty-free period for those using EFTPS is in place right now. This approach to penalties should give more businesses the confidence they need to begin using EFTPS. Those 970,000 people that have enrolled already, they should try using it. If businesses encounter any problems, they will have time to make adjustments, to get comfortable with the system without penalties.

Let me now turn to some emergency procedures. In the event taxpayers make a late tax deposit due to emergency situations the IRS has a number of procedures in place to prevent penalty notices from being issued to taxpayers. Taxpayers who have trouble accessing the financial agent systems to initiate a payment should notify the financial agent probably the next business day. The financial agent will verify the problem and forward the information to the IRS. The Service will then be able to prevent notices from being issued in error. Taxpayers in this instance should use the same-day method option that was mentioned earlier, or FedWire, to make the payment.

In addition, the financial agents have been required to establish redundant systems to overcome technological failures and unexpected events. I am sure they can provide extensive details on their preparations during questions and answers.

We have procedures currently in place to cover natural disasters or emergency situations in the paper world. These procedures should prevent the issuance of notices to EFTPS taxpayers in areas

affected by either disasters or emergency situations. I can cite numerous examples recently when we employed these procedures. Unfortunately, the storms, the snows in the Midwest and floods have given us plenty of recent experience in that regard. These procedures work and we are quite liberal in their application.

Payroll processing companies who experience an emergency situation at their sites will be able to provide a listing of customers to their local IRS service center describing the emergency problem and ask for consideration of penalty relief. This will normally be granted using expanded definitions of reasonable cause due to the widespread locations of their clientele.

For those occurrences where a penalty notice is issued we will, of course, consider a company's request for penalty relief based on the facts and the circumstances of the case. In recent meetings we heard from service providers and others that use of reversal procedures approved in NAFTA guidelines was desirable. We agree and have begun working on internal solutions.

In cases where reversal is needed to fix a duplicate payment we would not require preapproval, only documentation after the fact.

Before I summarize, one last concern that has come up over and over again involves emergencies that would prevent transmission of data and funds simultaneously. We have heard that concern loud and clear. Our struggle, though, is to balance that legitimate concern that has been raised to us and our desire to create an auditable set of books with which GAO and IRS can be satisfied. And this Committee certainly is familiar with our difficulties in dealing with GAO and getting a clean financial audit opinion.

Separating the data and the funds creates a challenge for us but we believe every problem has a solution and we are determined to unlock the formula to solve this one. We will continue our dialog over the coming weeks to reach a reasonable solution as we complete our trial period leading to July 1.

In summary, I would once again like to stress that EFTPS is up and running. We are servicing 200,000 businesses as I speak. It is an easy-to-use, secure system with flexible payment options. It promotes accuracy and efficiency in processing. We continue to receive recommendations from the private sector on how to improve the EFTPS and are looking at ways to implement some of those recommendations. My advice to those who have not yet enrolled, that 170,000 group of people that still has to enroll by July 1, is try it, it works, you will like it.

Thank you, Madam Chairman.

[The prepared statement follows:]

Statement of James E. Donelson, Chief, Taxpayer Service, Internal Revenue Service

Madame Chairman and Distinguished Members of the Subcommittee:

I am pleased to be here today to discuss the Electronic Federal Tax Payment System (EFTPS). The Internal Revenue Service (IRS), Treasury Department's Financial Management Service (FMS), and the Treasury Financial Agents worked together to design EFTPS to meet the Congressional requirement imposed in Section 6302 (h) of the Internal Revenue Code to implement an electronic funds transfer system for the payment of federal tax deposits. EFTPS largely replaces the paper coupon system that taxpayers currently use to make their federal tax deposits.

I am pleased to tell you today that EFTPS is fully operational and has been successfully processing payments since November 1996. To date, EFTPS has processed

more than 1.5 million transactions, representing over $50 billion in federal tax deposits.

In addition to directing the Treasury Department to develop an electronic tax payment system, Congress in section 6302 (h) also required the IRS to collect electronically an increasing percentage of total business tax deposits over a phase in period from 1994 to 1999. To implement the phase-in requirements of section 6302 (h), the Treasury Department issued temporary regulations requiring all taxpayers with a semi-weekly deposit tax obligation (which translates into a yearly employment tax obligation of over $50,000 in 1995) to begin making their federal tax deposits electronically by January 1, 1997, (later extended to July 1, 1997, by Congress in the Small Business Jobs Protection Act). IRS and the Treasury Department deliberately drafted the electronic payment regulations to parallel the federal tax deposit rules in order to simplify these related rules for taxpayers as much as possible. Approximately 1.2 million taxpayers must begin using EFTPS by July 1, 1997.

The IRS has made significant efforts to inform these 1.2 million taxpayers of their obligation to begin making their federal tax deposits through EFTPS. As a result, as of April 5, 1997, over 970,000 of the 1.2 million taxpayers have enrolled to use EFTPS. In addition, over 365,000 taxpayers have enrolled voluntarily. These volunteers, who are not required to begin using EFTPS on July 1, are all drawn from the small business community, since they have annual tax deposit obligations of less than $50,000 per year.

We are particularly pleased that these small businesses heard our message about the advantages of EFTPS to their businesses and enrolled voluntarily. The reaction of these small businesses to EFTPS is a good indication that EFTPS answers the concerns voiced by the Ways and Means Committee in its 1993 House Report 103–361, Part 1:

"The [Federal Tax Deposit] coupon system and use of Government depositories is paperwork intensive. Phasing in a new electronic fund transfer system will significantly reduce paperwork and will result in greater accuracy. Technological advances in the electronic fund transfer process will permit businesses to utilize the electronic fund transfer system without needing to purchase new computers or equipment . . . . Use of an electronic fund transfer system for the collection of tax will promote accuracy and efficiency in processing, and consequently, is expected to result in significant cost savings to the Government. Taxpayers will benefit from increased accuracy, reduction in paperwork burden, and availability of a user-friendly tax collection system." (p. 106)

We at the IRS are confident that EFTPS meets the goals set by Congress for an electronic payment system. As Commissioner Richardson testified during this year's House Appropriations Committee hearing on the IRS' budget, EFTPS combined with the IRS' earlier pilot program known as TaxLink, is a faster, easier and more accurate system for tax collectors and taxpayers alike.

HOW EFTPS BENEFITS TAXPAYERS

The IRS, FMS and the Treasury Financial Agents worked together to design EFTPS to provide as many benefits to taxpayers as possible. We incorporated the successful features of TaxLink, the predecessor electronic payment system to EFTPS, which to date has successfully collected nearly $800 billion. We also consulted with taxpayers to learn what other features they desired. The benefits that EFTPS provides to taxpayers include:

- Ease of use. EFTPS is easier to use than the paper FTD coupon system. A taxpayer can make a payment with a short phone call by either pushing the buttons on a touch tone phone or talking with an operator if they have a rotary phone. Taxpayers can also use personal computers to initiate a tax payment with free software supplied by the Financial Agents.
- Flexible payment options. EFTPS lets taxpayers choose among various payment options based on their business requirements. EFTPS has both Automated Clearing House (ACH) debit and credit payment options. It also offers a same day payment option through Fedwire.
- Privacy and security. EFTPS is a fully secure electronic payment system. Payments can only be initiated with both a proper taxpayer identification number and personal identification number. Neither the IRS nor the Treasury Department have access to the taxpayers' personal identification numbers.
- Increased accuracy and better taxpayer service. Taxpayers' tax payment account information can be updated almost immediately. With the paper coupon system, it takes 5 to 7 days. Safeguards and prompts built into EFTPS help minimize errors and lessen the need for contact between the IRS and taxpayers to correct tax accounts.

HOW THE IRS NOTIFIED TAXPAYERS ABOUT EFTPS

The IRS has worked very hard to inform the taxpayers required to participate in EFTPS by July 1, 1997, of their new electronic payment requirement. The IRS has used a number of different ways to reach these taxpayers. As a result, over 970,000 taxpayers of the 1.2 million taxpayers required to enroll in EFTPS by July 1, 1997, have already enrolled. Another 365,000 small businesses heard our message and voluntarily enrolled.

Since many taxpayers were likely to ask their banks about EFTPS, the IRS worked closely with FMS to ensure that the banking community was fully informed of the new system. FMS conducted extensive educational activities for the banks and mailed them information about the system. The Treasury Financial Agents routinely provide taxpayers information about EFTPS through their EFTPS customer service lines which are prominently displayed in all materials directed to taxpayers.

For its part, the IRS used every opportunity to get the message out to taxpayers about EFTPS. IRS officials at all levels of the organization, including the Commissioner and Deputy Commissioner, addressed EFTPS in speeches and presentations at hundreds of professional association seminars across the country including, the American Institute of CPAs, the American Bar Association, the American Payroll Association, the American Society for Payroll Management, the National Association of Enrolled Agents, the National Association of Tax Practitioners, the Tax Executives Institute, the Independent Bankers of America Association, National Small Business United, and many others. The IRS mailed EFTPS informational packages to more than 200 associations across the country.

We held several special EFTPS forums in Washington, D.C. to share information about EFTPS with small business organizations, payroll processors, the banking community, practitioner associations and all other interested parties. Because of the favorable reaction from these groups, we are planning another forum this month. These events have resulted in many articles in trade journals, newsletters, newspapers, and magazines.

We have also worked with the Small Business Administration (SBA) to educate businesses about EFTPS through their Small Business Development Centers, Business Information Centers, and the Women's Business Centers. Both the IRS and the SBA have information about EFTPS on their websites. We also include information about EFTPS each quarter in the IRS/SSA Reporter, a newsletter mailed to more than 6 million businesses.

We have shared information internally on EFTPS with all of our Regional, District and Service Center offices and have trained IRS representatives from field offices to answer questions and inform taxpayers about the new system.

We have made a commitment to work with the private sector and other government agencies to bring the EFTPS message to businesses across this country and will continue to do so.

We sent letters and information to all Members of Congress. On July 31, 1996, every Member of Congress received a letter from Commissioner Richardson and a packet of information describing EFTPS as well as a press release and answers to commonly asked questions. On February 10, 1997, the IRS National Director for Legislative Affairs sent another letter to the Chairman and Ranking Members of key congressional oversight committees, which included a fact sheet and described the upcoming mailing to business taxpayers.

While all of these efforts were very useful to provide information to taxpayers and organizations representing them, direct mailings are the most effective way to provide taxpayers with information. The IRS accordingly sent:

- A letter in the summer of 1996 to advise taxpayers of the requirement to make federal tax deposits electronically by January 1, 1997;
- A second letter in late October/early November 1996 to inform the same taxpayers that Congress had enacted legislation to postpone the January deadline to July 1, 1997, and to encourage them to enroll or use the system early. Materials included were an additional enrollment form and our Publication 966, entitled, "EFTPS: Answers to the Most Commonly Asked Questions."
- A third letter, mailed the week of February 17, 1997, was sent to taxpayers required to begin using EFTPS by July 1, 1997, who had not then enrolled. This letter informed taxpayers of their requirements to enroll and advised them to send in their enrollment forms by May 1, 1997, to allow time for processing and confirmation of enrollment. Educational materials and instructions were also included in this mailing.
- A fourth letter will be mailed to taxpayers in April to encourage taxpayers who have enrolled in EFTPS, but who have not yet begun using it, to try the system before the July 1 deadline. The letter describes the special penalty relief period that

the Commissioner recently announced to encourage early use of EFTPS, as I discuss in greater detail below.

• In mid May, we intend to send a final letter to taxpayers who have not yet enrolled to encourage them to act immediately to meet the July 1 deadline.

PENALTY RELIEF FOR TAXPAYERS

Commissioner Richardson announced on April 7, 1997, the extra steps the IRS is taking to help business taxpayers make the switch to EFTPS go more smoothly. The IRS will not impose any penalties on taxpayers who enroll in EFTPS and attempt to make payments through the system before July 1, 1997.

This approach to penalties will give more taxpayers the confidence they need to begin using EFTPS. If businesses encounter any problems, they will have time to make adjustments, rather than face penalties.

As Commissioner Richardson said, "There is no reason to impose a penalty before July 1 on businesses that are simply trying to get comfortable with EFTPS but make a mistake in doing so."

CONCLUSION

In summary, I want to assure you that the IRS has taken its charge seriously to help develop this system. We have developed an easy-to-use, secure system with flexible payment options. We continue to receive excellent recommendations from taxpayers and professional associations on how to improve EFTPS, and we are looking at ways of implementing some of those recommendations. The EFTPS system is up and running. It promotes accuracy and efficiency in processing. It is already proving its worth to both taxpayers and the government, as Congress had intended it to do when it enacted section 6302(h).

I will be happy to answer any questions.

Chairman JOHNSON. Thank you.

Mr. Morris.

STATEMENT OF RUSSELL D. MORRIS, COMMISSIONER, FINANCIAL MANAGEMENT SERVICE, U.S. DEPARTMENT OF THE TREASURY

Mr. MORRIS. Thank you, Madam Chair and Members of the Subcommittee. Thank you for inviting me to participate in this important hearing. I have prepared a formal statement and with your permission, I would like to submit that for the record and just take a couple of minutes and emphasize certain highlights.

Chairman JOHNSON. Thank you, Mr. Morris, that will be done.

Mr. MORRIS. The Financial Management Service is the Bureau of Treasury that manages the government's financial infrastructure. We issue most of the government's payments, manage the processes through which government receipts become available for government purposes and account for all government cash flows.

Our strategic plan challenges us to create a world class financial infrastructure for the government, largely, through the development of user-friendly methods of replacing paper transactions with electronic flows of value and related information.

I would like to call to your attention the diagram which is attached to my formal statement. This diagram is actually a simplification of the processes through which Federal tax deposit coupons and Advices of Credit travel. These processes and, indeed, the paper that flows through them, have outlived their usefulness.

For the most part, this diagram represents a 45-year-old method of collecting payroll taxes. It is costly and more susceptible to error than electronics because it relies on multiple handlings of over 100

million pieces of paper. FMS and the IRS have been working in the electronic arena for more than a decade seeking to define an appropriate replacement for this old but vital process.

During that time, 42 States have developed electronic methods for tax collection and 39 States now require EFTPS for some tax payments. Over the past several years, we have tested and refined and tested and refined and sought input from financial institutions and taxpayers. The Electronic Federal Tax Payment System, EFTPS, process is a result of that learning, testing and inclusive process.

Although we were confident that we could have met the January 1997 implementation date included in the original law, FMS and the IRS have used the extra time that Congress has given us for the current phase of the EFTPS implementation to good advantage. As you have heard, the systems are ready for the volume. Taxpayers are well informed both as to their responsibilities and as to how to fulfill them, including their options, and financial institutions are well informed as to their role and their options.

Madam Chair, it is our opinion that altering the course at this juncture would not be a good idea for two reasons. It would be costly and would cause a great deal of uncertainty among both financial institutions and taxpayers.

Again, I thank you for this opportunity to appear before the Subcommittee and I am prepared to respond to any questions that you might have.

[The prepared statement follows:]

Statement of Russell D. Morris, Commissioner, Financial Management Service, U.S. Department of the Treasury

Madam Chair Johnson and members of the subcommittee, thank you for the opportunity to appear here today to discuss the Electronic Federal Tax Payment System.

OVERVIEW

The Financial Management Service (FMS) serves as the Federal Government's Financial Manager. As such, FMS provides payments, accounting information, debt collection and collection services for all Federal Agencies and nearly every individual who receives money from the government or pays a bill owed to the government. We operate from six locations in the United States, but we support government operations worldwide. Our central location within the government benefits the taxpayers as it creates efficiencies based on enormous volumes and allows Treasury to administer prudent financial management policies.

FMS disburses payments to a wide array of federal recipients including those who receive Social Security, Veterans benefits, Civil Service Retirement and Internal Revenue Service (IRS) tax refunds. FMS disbursed more than 840 million payments during FY 1996 on time. Our payment operations touched the lives of well over 100 million citizens last year.

FMS manages the central accounting and reporting systems that track the government's monetary assets and liabilities. FMS tracks and reports on enacted Congressional appropriations, some 7,500 separate accounts. FMS publishes the government's major financial and budgetary reports that are used by the public and private sectors to make policy and economic decisions.

The Debt Collection Improvement Act of 1996, Public Law 104–134, significantly increased FMS' responsibility to facilitate the collection of delinquent federal nontax debt. We believe that the fair, prompt, and efficient collection of delinquent federal debt is sound financial policy, so we view full implementation of the bill as critical to performing our basic mission. We are working with numerous federal agencies to help implement the provisions of this bill through the Treasury Offset Program, the Tax Refund Offset Program and the referral of delinquent debt to FMS for collection.

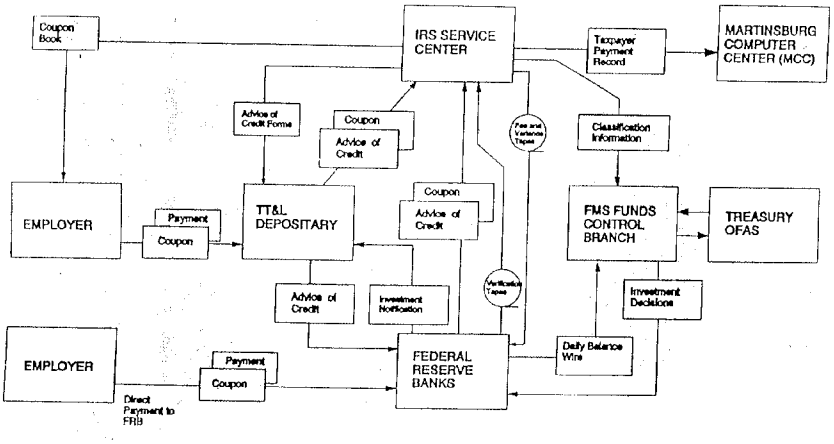
FMS manages the processing of all receipts, including corporate and individual income taxes, custom duties, federal fines and other levies. We manage the world's largest collection network of more than 11,000 financial institutions. As part of FMS' strategy to move toward an Electronic Treasury, we support moving more and more of the government's collections from paper checks to electronic transactions. We are working, in partnership with the IRS, to continue making the nation's tax collection system more efficient for taxpayers as well as the government. To this end, we are shifting from paper-based to electronic systems to collect taxes.

FEDERAL TAX DEPOSIT SYSTEM

The Federal Tax Deposit (FTD) System is a paper-based system operated jointly by the Financial Management Service, the Federal Reserve System, the Internal Revenue Service and over 11,000 financial institutions across the nation. In FY 1996, the FTD System collected over $814 billion. Financial institutions, the Federal Reserve and the IRS processed over 100 million paper coupons and over six million paper advices of credit last year. The basic FTD System has been operating for over 45 years. Several improvements have been made over the years, including the creation of the Treasury Tax and Loan Investment Program in the late 1970's; however, the use of the paper coupons by the taxpayers has remained essentially the same. The entire FTD paper process takes approximately 5–7 days before the taxpayer's account is credited.

Financial institutions accept and process FTD coupons in order to be "full service banks" to their business customers. Financial institutions receive the FTD coupons over the counter at branch offices. The branch bank consolidates the FTD coupons, creates a deposit ticket (Advice of Credit) and forwards the Advice of Credit to the Federal Reserve, with another copy (along with the FTD coupons) to the IRS. (See attached chart.) Financial institutions often provide receipts to the taxpayers as proof of payment. The Federal Reserve processes the Advices of Credit, crediting Treasury the day after deposit by the taxpayer.

FEDERAL TAX DEPOSIT SYSTEM
(Paper Based)



Flow-chart does not include:

Depositary's internal process for accepting, dating & forwarding deposits and data retention; flow of reports from FRBs to FMS; flow of fee payments to eligible depositaries; FRB's collateral monitoring system for deposits in transit; flow of penalty assessment against depositary for improper processing; flow for resolving lost coupons; adjustment process for depositary errors and flow of interest earned on investment program.

During this process, the coupons touch many hands, leaving them prone to loss and other processing errors. It is a very manual, labor-intensive process making it expensive for financial institutions to process the coupons. Also, because of the paper processing in the FTD system, the government doesn't receive the use of the

funds until the day after the taxes are paid, resulting in a loss of interest to the government.

FTD processing is unique and banks cannot utilize the systems and processes for FTD coupons that they use for "mainstream" banking activities such as processing checks and deposits. Consequently, it is expensive. Current Treasury regulations prohibit financial institutions from charging taxpayers for FTD processing. In the early 1970's, we determined that it cost approximately $.50 for a financial institution to process an FTD coupon. We estimate that it costs approximately $2.50 to process an FTD coupon today. Treasury began paying financial institutions $.50 per coupon in 1978. During the period, 1989 through 1990, fee payments were phased out for the medium and large financial institutions (except minority-owned). This decision was based on two reasons: 1) limited budget resources to pay the fees; and 2) medium and large financial institutions acquired considerable earnings from the one-day float between the taxpayer deposit date and the date which the Federal Reserve debits the financial institution's account. Currently, we pay only small and minority-owned financial institutions $.50 per coupon. This direct payment amounts to about $3 per business day for each of the 7,833 eligible financial institutions.

As the Financial Management Service began to focus on electronic collections in the 1980's, we began working with IRS to introduce electronic transactions for tax collections. In the mid-1980's, FMS and IRS implemented a program to collect delinquent taxes electronically. With the success of this program, we began to focus our efforts on improving other tax collection processes, including the paper-based Federal Tax Deposit System.

Historical Efforts to Replace Paper Federal Tax Deposit Coupons

Since the early 1980's, the Department of the Treasury has been working to introduce electronic applications to the collection of federal taxes. We sought input from the financial industry, taxpayers and professional associations and conducted tests of various electronic funds transfer mechanisms. Treasury first tested electronic payment of Federal taxes in a project called, Automated Deposit of Electronic Payments for Taxes (ADEPT). Treasury operated ADEPT from April of 1990 to June of 1991 to test the feasibility of using electronic payment mechanisms to collect Federal taxes and eliminate Federal Tax Deposit coupons. Treasury selected an existing electronic payment system used to make Direct Deposit disbursements. The Automated Clearing House (ACH) system is an established electronic payment network developed by the financial industry in the 1970's as an alternative to paper checks. The ACH System is operated primarily by the Federal Reserve with private processors entering the market over the last decade. The National Automated Clearing House Association (NACHA) is the organization that establishes the rules, standards, and procedures for financial institutions to exchange ACH payments on a national basis. Depositors can authorize a second party to originate a transaction through the ACH that will take funds from their account and deposit them to the second party's account (ACH debit). The ACH system also allows depositors to instruct their financial institution to send funds from their account to a payee's account located in another financial institution (ACH credit). Taxpayers used ACH Credits to make payments in the ADEPT system.

The State of Indiana had earlier implemented Electronic Funds Transfer (EFT) tax payments in November of 1987. Indiana led the way in EFT tax collections. Today, 46 states provide taxpayers with an EFT mechanism to pay state taxes. Tax rules in 39 states include provisions requiring certain taxpayers to use EFT for paying taxes. Like the federal EFTPS, tax collection systems in 42 states allow both ACH Credit and ACH Debit for the payment of taxes.

In 1992, FMS and IRS began a second project following in the footsteps of ADEPT. The goal of TAX-LINK was to advance the understanding of the requirements for building a national electronic federal tax deposit system. TAX-LINK employed three financial agents to test different concepts for use in a future, nationwide electronic federal tax collection system. The TAX-LINK project included marketing research with over 500 financial institutions and 1,800 business taxpayers to learn financial institution and taxpayer capabilities and preferences. Lessons learned from TAX-LINK were the building blocks for the current EFTPS. Among other things, Treasury learned: that taxpayers have differing needs and need multiple payment options; that the simple approach of allowing taxpayers to enter payment data directly into the government system is most efficient; and, that taxpayers and the financial institutions are most comfortable using existing payment systems, such as the Automated Clearing House System.

The TAX-LINK Evaluation Final Report, prepared by Decisions Systems Technology Inc., states: "Both the participating business taxpayers and banks surveyed

in the three TAX-LINK test are generally positive about the experience. Banks appreciate the reduction in paperwork. Business taxpayers mention the convenience of the electronic systems." In 1993, Public Law 103–182, Title V, Section 523(a), was passed, requiring the use of electronic methods to make tax payments. This law called for an increase in the amount of taxes collected each year using electronic methods. In order to achieve these levels, the IRS issued regulations identifying the taxpayers that must pay using electronic means. The IRS first required the largest taxpayers to pay electronically in 1995. In addition to the 1500 required taxpayers of 1995, another 80,000 taxpayers voluntarily enrolled in TAX-LINK to take advantage of the efficiencies of the electronic system. The system collected a total of $395 billion from 1.2 million transactions in fiscal year 1996. After deducting the system costs, net savings to the government totaled $46.7 million.

EFTPS Design and Implementation

Treasury drew on knowledge gained from TAX-LINK market research when designing EFTPS. The preferences of taxpayers, financial institutions, FMS, and the IRS were all considered. For example: taxpayers were offered several payment options; taxpayers were also provided the option of warehousing payments for future settlement dates; note option TT&L banks were provided an interface with the Treasury Investment Program to allow tax payments to remain invested with the financial institution's note balance; and large payroll processors were provided Electronic Data Interchange access for making payment reports and quick turnaround for the enrollment of clients.

The EFTPS improves service to a variety of government and taxpayer interests. For tax administration, EFTPS will eliminate the need for IRS to process over 100 million FTD coupons in 1999 and will speed the posting of taxpayer payments. Moving from a manual paper process to an electronic process will also improve the accuracy of posting payments. EFTPS will expedite the reporting of data on collections so that the Department will have advanced knowledge of expected tax receipts and allow improved accuracy in managing the government's cash position. Taxpayers also benefit from this easy-to-use system. Taxpayers no longer need to travel to their financial institution to deliver FTD coupons. They can access EFTPS in various ways, including the telephone or personal computer. Taxpayers can use PC software to interface with their existing accounting systems. Reduced manual intervention also reduces the opportunity for human error.

FMS, IRS, the Federal Reserve and the two EFTPS financial agents have participated in hundreds of seminars and forums nationwide to promote the EFTPS and educate taxpayers and financial institutions to the benefits for them and the government. The forums for our presentations included national ACH association meetings, regional ACH association forums, and financial industry and accounting organization educational forums across the country. We conducted Train-the-Trainer sessions for ACH associations in June 1995 and for the Independent Bankers Association of America in April 1996. As early as May 1995, FMS distributed a comprehensive education manual (55 pages) on the EFTPS to every financial institution in the country. In October 1996, we distributed an EFTPS Fact Sheet to every bank, savings association, and credit union head office and to every financial institution branch in the country to better educate workers in the branches; we distributed an updated Fact Sheet to all branches in February 1997. We established a Financial Institution Helpline at each financial agent dedicated to answering questions from financial institutions. FMS established an EFTPS Home Page on Treasury's Web Site. We produced two videos about EFTPS; one video focuses on educating customers and the other is designed to educate financial institution sales representatives. We are conducting over 30 EFTPS presentations for the American Bankers Association (ABA) state association workshops from April to June 1997.

During the first half of FY1997, Treasury collected 2.5 million tax payments electronically, totaling over $256 billion (these totals include EFTPS, as well as TAX-LINK, which will be converted to EFTPS by August 1997). As of April 10, 1997, enrollments of taxpayers required to pay taxes through EFTPS by July 1 had reached 976,995, or 84% of the total required to enroll. Only 181,870 required taxpayers remained to enroll. The consulting firm hired to assist IRS in reaching taxpayers with the message about EFTPS, has indicated that between 5–10% (58,000–116,000) of these required taxpayers will refuse to enroll until they receive penalty notices. Therefore, between 65,000 and 125,000 taxpayers actually may be expected to enroll before July. With enrollments being posted at the rate of 15,000 each week, EFTPS will be close to full enrollment for required taxpayers by July. During the TAX-LINK project, taxpayers learned of the benefits of paying electronically and the numbers of volunteer enrollments swelled. Only 1500 of the 80,000 TAX-LINK en-

rollments were from those required to use the system last year. The rest were volunteers. This is also happening in EFTPS. Of the 1.3 million TINs now enrolled in EFTPS, only 73% are required to use the system, 27% are volunteers.

Treasury's two EFTPS financial agents have staffed their respective Customer Service telephone lines to meet the expected need. January saw a very large surge in enrollments and customer service calls, due partly to taxpayers being unaware of the postponement until July of their requirement to pay electronically. Customer service calls for the month totaled 250,000. Even so, the EFTPS financial agents quickly adjusted to the call volume and callers to the customer service lines in January experienced an average wait of only 2 minutes and 46 seconds. The EFTPS financial agents expanded capacity in February and March, and the average wait time decreased accordingly. During February and March, the average speed of answering was less than one minute, once the caller answers two voice response questions to direct the call to the appropriate customer service representative.

TAXPAYER BURDEN AND COSTS

One of the driving forces in developing EFTPS was easing taxpayer burden. Taxpayer burden was a major issue in the decision making process for every aspect of the EFTPS design. For that reason, it was our intent to build a system around the use of ACH debits. ACH debits are the most economical and efficient electronic payment system available. We provided a toll-free number for taxpayers to report their tax liabilities, free software to PC users, an acknowledgment number to demonstrate proof of payment, a warehousing capability to allow taxpayers to report their tax payments early (but actually pay them on tax due date), and a toll-free number to provide customer service 24 hours per day.

In listening to taxpayer desires, we learned that they wanted other options to the ACH debit method. We included the ability to accept ACH credits from the taxpayer's financial institution. Additionally, we worked with the Federal Reserve to develop a special wire transfer procedure just for tax payments. Each of these options is offered at no charge by the Federal government.

Trends indicate that more than 85 percent of EFTPS enrollees will choose the ACH debit method by July 1997. Using their personal identification number and their TIN, only the taxpayer can access EFTPS to make their payment. Within the paper FTD process, taxpayers present the payments to one of 11,000 designated depositaries. According to the National Automated Clearing House Association, virtually all financial institutions in the country (approximately 20,000) can receive ACH debit transactions. Although the government does not charge a fee for the use of EFTPS, the taxpayer's financial institution may charge a nominal fee to accept an ACH debit, usually lower than a check charge.

Currently, only 5% of tax payments are made by the ACH credit method. Taxpayers choosing to pay using ACH credit, will need to establish a relationship with one of the 4000–5000 financial institutions that originate ACH credits. This includes some financial institutions that originate ACH credits through a larger correspondent bank. Taxpayers will normally select one of the 10,000 commercial banks that process most corporate transactions and are most likely to be capable of originating ACH credits. Many small to medium-sized financial institutions do not originate credits because their customers have not expressed this need. The low number of originators reflects the financial institutions' concerns involving higher risks associated with originating ACH credits. When the financial institution originates a credit, it must guarantee good funds to the receiving financial institution. Accordingly, financial institutions may limit access to the ACH credit service to their most creditworthy customers, require prepayment, and charge higher fees to mitigate their risk. Charges for ACH credit services vary widely among financial institutions, among customers, and among the methods used to originate the transaction to the bank. These prices are set according to market forces and are not dictated by the government.

According to the Federal Reserve, approximately 8500 financial institutions are Fedwire participants (Fedwire is a same-day electronic funds transfer system operated by the Federal Reserve. Approximately 43% of the 20,000 financial institutions in the country use Fedwire). Financial institutions must guarantee good funds with the same-day settlement of a Fedwire. Due to this risk, banks may limit their access to Fedwire service and may charge high fees to mitigate their risk. Prices for Fedwire vary widely among financial institutions and among customers. These prices are set according to market forces and are not dictated by the government.

TRENDS IN THE USE OF ELECTRONIC BANKING

We are witnessing today a technology revolution in banking. Financial Institutions work harder than ever to streamline costs and improve efficiency to remain competitive in the marketplace. EFT payment of taxes through the EFTPS is clearly in keeping with these objectives.

EFTPS represents the culmination of an ongoing search to introduce electronic technology to the collection of Federal taxes. It was patterned after the way most states collect their taxes. We are confident that EFTPS, as it is currently designed, offers taxpayers a secure and easy system to pay their taxes. Thank you for the opportunity to discuss this exciting new venture. I would be happy to answer any questions you have on EFTPS.

Chairman JOHNSON. Thank you, Mr. Morris.

Mr. Albicker, did you have a separate statement from Mr. Donelson?

Mr. ALBICKER. No.

Chairman JOHNSON. That was my understanding, but I did want to give you the opportunity if you had prepared to do so.

I thank the panel for your comments. Mr. Morris, you say 42 States have electronic filing systems already?

Mr. MORRIS. Yes, Madam Chairman. Forty-two States utilize electronic funds transfer for some business tax collection.

Chairman JOHNSON. And 39 of those States require electronic payment for some portion of their taxes?

Mr. MORRIS. That is true.

Chairman JOHNSON. And what is the relationship between the new national system and these State systems?

Mr. MORRIS. I would have to explain that my knowledge is a little superficial and we could provide more detail on paper. But, by and large, it is my understanding that every one of these States does rely on the automated clearinghouse system for tax collection. That there has evolved a standard format for tax collection within the automated clearinghouse.

Chairman JOHNSON. In other words, the automated clearinghouse is the system that was developed that supports the State systems and is the system that the national system will use?

Mr. MORRIS. The automated clearinghouse system has evolved for the exchange of value among businesses and it is the basic EFTPS System in the United States. The States, as they have developed their processes, have utilized that infrastructure, as have we, with the IRS.

Chairman JOHNSON. Mr. Buettner and Mr. Dreyer, would you like to comment on that?

Mr. DREYER. Madam Chair, the ACH, automated clearinghouse system, has been in place since the early seventies and is a common mechanism of exchanging payment within the financial industry. It is commonly used for direct deposit, deposit of Social Security.

Chairman JOHNSON. So, it is fairly well developed?

Mr. DREYER. Exactly.

Chairman JOHNSON. Have you had any problems with the implementation of this new system with the larger payers?

Mr. DREYER. The larger payers are utilizing the ACH in the TaxLink pilot system as far as widespread application, widespread

use. The larger users commonly use the ACH system for a number of other applications including exchanging commercial payments, their own in-house direct deposit, payment of State taxes also.

Chairman JOHNSON. I was very interested that you pointed out that people are using this system to pay their taxes on weekends or at nights in a way that is far more flexible for them.

Mr. DREYER. That is correct.

Chairman JOHNSON. Are there other advantages that you see for taxpayers who are using the new electronic system?

Mr. DREYER. The primary advantage that we see is that it is low cost, it is efficient. There is an audit trail available. We also believe that it is more anonymous than the current paper-based system in that there is not a lot of paper associated with this, therefore, the taxpayer's checking account number or tax ID number are not associated in moving through the banking system, the Federal Reserve System or the IRS.

Mr. BUETTNER. I think some of the other things we have seen is that about 84 percent of all the transactions have been ACH debits which are initiated through a telephone, touch-tone phone. This has provided a lot of ease of use for taxpayers. The average amount of time for a taxpayer to complete a payment through the system is less than 3 minutes.

We were hoping to do a demonstration today of how the system worked if a corporation had to pay their 1120 corporate tax the other day, April 15. There were only five data elements that were necessary to be input into the touch-tone phone in order to complete the 1120 transaction.

So, not only are there many hours in the day, offhours, nonbusiness hours to do the transaction, but the ease of use and the different methods that are available make it a lot easier for taxpayers to make their payment.

Chairman JOHNSON. Mr. Donelson, in implementing this system, did you anticipate that any of the advantages that the gentlemen from the banks have spoken of would be available?

Mr. DONELSON. Yes, Madam Chairman.

One of the concerns we have with small business people as a matter of fact is that oftentimes they have to shut down their business and leave the business and go to a bank to buy a Federal tax deposit. That has been historically a concern that has been raised to us by small business people. And in this system they can either do it as we have heard, after hours, after the business closes, during a lull in the business. If there is somebody else to watch the front of the operation, somebody can go in the back and make a telephone call, and if the telephone call is less than a 5-minute telephone call, that seems to be an extremely convenient approach.

There was some mention in the discussion of the previous panel and the Committee over extraordinary costs that were incurred by businesses and we should have had exceptions. Well, one of the exceptions built into this was people using the telephone. And I do not think there were that many businesses that would have trouble finding access to the telephone, either on premises or very close by. So, the fact that we have made this a telephone-based system, if you choose that option, as well as a computer system, saves you an

awful lot of money. You do not have to go out and buy a PC or a system for your business that you were not in need of before.

Chairman JOHNSON. Was there anything about this system that changed tax laws, increased taxes for the people paying their taxes or in any way altered their obligations?

Mr. DONELSON. I think that has been seamless. I do not think we have made any changes.

Chairman JOHNSON. Right. In other words, all we were asking them to do was to pay the same taxes that they needed to pay anyway in a different manner?

Mr. DONELSON. Yes.

Chairman JOHNSON. The benefit was that the government got the money sooner, so we earned the interest for the 24 hour-period that we used to let the banks earn the interest on.

Mr. DONELSON. And we did, I think, a very good job in eliminating a lot of paper.

Chairman JOHNSON. Now, Mr. Dolan was before our Committee recently and he talked about the number of notices that the IRS has rewritten to make them more intelligible to customers and a number of other projects that the IRS has undertaken to be more consumer-friendly, to be more intelligible, to have a healthier dialog with taxpayers out there. This Committee worked very well with the IRS for 1 year in developing the last Taxpayers Bill of Rights and has made great efforts to listen to the IRS and to work with them and to get the kind of input we need to write better tax law and to develop a system that is more taxpayer-friendly.

I guess it is because this effort has been going on for almost 2 years now and there is some evidence of success that I was really so discouraged and outraged by your letter. It does seem to me that if you are going to tell a lot of small businesses that they are going to have to apply for something that takes 10 weeks to complete and you are giving them 6 months' notice; they look at 6 months' notice and they have got to go through a process that takes 2½ months to complete, and they are dealing with the government, they double that in their mind. What if it does not work?

And you are telling them that if it does not work, if they are not enrolled on time, they will not be able to pay their taxes; that we will prevent you from making your payment electronically but we will penalize you 10 percent. Do you not think that is pretty harsh? Do you not think that is a way of sort of saber rattling? If you were a small business, a single-operator person, would not that send chills down your spine?

Oh, my gosh, it is going to take 2½ months. And I have 6 months and if I do not succeed and the bureaucracy does not hear me, I will be prevented from paying my taxes and penalized 10 percent. Do you not think that is harsh?

Mr. DONELSON. Ms. Johnson, I took the opportunity during my oral testimony to step away and apologize for that notice already. But let me just add, my sense of schizophrenia. I am also, as Chief Taxpayer Service, the guy who eliminated 12 notices and has modified the collection notices and has eliminated almost 20 million notices from being sent out to taxpayers unnecessarily.

So——

Chairman JOHNSON. Well, I am glad you are able to recall those statistics because I thought they were impressive. And all I can say is you have got to be schizophrenic.

Mr. DONELSON. I think I had a bad day that day when I let that one go.

Chairman JOHNSON. Well, I would hope that in the future, first of all, instead of starting a letter by saying this was required, as a result of passage of the North American Free Trade Agreement—that has brought millions of jobs into this country and increased exports and so on and so forth, we could go into the economic benefits of the NAFTA Agreement—but instead of starting with that, that you might have talked about the advantages to the taxpayer that this system will net.

NAFTA did not require that the threshold go down to $50,000. We just heard testimony before from the Members, and we will check this with the IRS, that by keeping the threshold at a far higher level you were already going to meet the revenue requirements of NAFTA and you are going to meet it simply by people paying their taxes in a way that the taxpayers of America benefit the most from the collection of those taxes. That seems to me fair and reasonable.

So if you are going to talk about NAFTA, you should have talked about NAFTA not requiring you to go down to $50,000 because it certainly did not. And you certainly should have put this in the context of electronic filing, of telephone technology. "We think this is going to help you, we think this is going to let you file your taxes on weekends and nights. We hope to make it user-friendly."

If we do not begin to market ourselves on first contact so that people can see that not only are we serving, but we are trying to serve well. When you have 46 States that already have a system based on roughly a similar accounting system, the ACH system, that gives taxpayers assurance, and you can make that analogy to State systems and you can refer to some of the benefits and you can say, "Yes, the last time we were going to implement this we waived the penalties the first 6 months and we intend to waive the penalties the first few months because we know that when we take in 1.2 million taxpayers, there could be glitches, but we think in the long run this is going to be good for you and good for us." Why do we not talk to each other that way?

So, I appreciate your apologizing for this letter but, frankly, the kind of attitudinal change I am getting at goes way beyond the sort of technical details of this letter. It is true, it does not lay out the alternatives. It does not make the analogy of the debit alternative to the way you might choose to pay your mortgage, to make it more familiar and build confidence.

But beyond that, it does not market this as a positive product that Americans might actually like and that might help small businesses function far more efficiently and effectively, at the same time serve taxpayers better.

So, I hope that as one who has accomplished a good deal of simplification and is dealing with a lot of notices in a way that we hope will help taxpayers understand more clearly what the government is trying to say to them and reduce the amount of confusion and calls and so on associated with some of those communications,

I hope that not just you, but the whole IRS, will begin thinking about the person you are talking to and the information you need to translate. Because I consider this letter, which really started this problem, for this quality of communication to go out seems to me really a travesty. I am glad you have apologized for it. I will not dwell on it any more.

But I did want to bring out that not only does it not lay out the information in detail, but we have got to start to market the positive benefits of changes so that we are not just coming in and saying, "You are going to be mandated to do this. If you do not get it done, even if we are the problem, you are going to get a 10-percent penalty and, furthermore, we are going to prevent you from paying your taxes." So, I am going to yield to my colleagues now, but I certainly did want to get on the record that I consider this an outward visible sign of the failure of the efforts we have been making for the last 2 years. And, while we have made progress in other areas, we have to accelerate the pace at which we make progress together or the American taxpayers have every reason to fault us.

Mr. DONELSON. I agree.

Chairman JOHNSON. So, I will yield now to my colleague, Mr. Coyne.

Mr. COYNE. Thank you, Madam Chairwoman.

Mr. Donelson, in your testimony you pointed out that there were 365,000 taxpayers who opted to do this program voluntarily. Why do you think they chose to do that? What advantage is there to them to do it?

Mr. DONELSON. Well, I think we have heard a number of the advantages, Mr. Coyne. We have probably—and I would have to be guessing with some of these ideas—but we probably have a lot of businesses who are electronic based or run their businesses in this manner and this just fits perfectly with them.

They are generally the smaller businesses because they are not mandated so they have a payroll of under $50,000 a year. They are probably startups. And because of that, they are probably entrepreneurial or Internet-based businesses for which this is an attractive feature.

I would yield to some of the two members from the banks and they may have some ideas as well.

Mr. BUETTNER. I think if you take a look at the general cash management business in the United States that banks provide to businesses, the middle market and small business, this is an area that points to the most rapid growth and change in the types and uses of technology that corporations are using to conduct their banking business.

The Internet, itself, is a great example of how the small business market is looking for this type of service, similar to EFTPS, to conduct their business at their location rather than having to do the physical movement of paper or going to a bank to conduct business.

So, this is really just another example of how small businesses really are looking for these types of cash management services.

Mr. COYNE. Our two colleagues, Mr. Hastings and Ms. Smith, earlier gave pertinent testimony about this subject and you all were in the room at the time. Is there anything you would like to

say relative to that testimony that might be able to clarify anything or help out with our deliberations?

Mr. DREYER. Yes, Mr. Coyne. One of the comments made was IRS access to the taxpayer's account. As we have stated in previous testimony the IRS does not have access to the taxpayer's account. The only way the funds can move, the tax deposit can move from the taxpayer's is by initiation by the taxpayer, himself, through the use of their TIN and the personal identification number, reporting into the EFTPS System. That is the only way that the funds can move from the taxpayer's account. So, the taxpayer controls the timing and the total amount and the tax types that are moved out of their account.

The funds do not move any sooner. In fact, the taxpayer can warehouse or report up to 30 days ahead of time for payment of their taxes. And we have noticed a high use of that feature of the system. Again, it is another convenience to the taxpayer.

Mr. DONELSON. Mr. Coyne, I would like to add, there was an observation that was made, I think, by Mr. Hastings that people like to have a paper trail. Well, they receive a confirmation and they have this in their bank statement that they get from the bank each month. There is a paper trail that indicates, that would be sufficient for our auditors, to show that there was a transaction made appropriately, if we have some doubt as to whether that occurred.

So, there is a paper trail and I am sure that was just an oversight on his part. But that issue is rather compelling. And when I was sitting back there listening to him, when he said there was no paper trail it was like it was in thin air and was out in the stratosphere, but there is a paper trail.

Mr. COYNE. Is that only in the monthly statement?

Mr. DREYER. No, the paper trail that Mr. Donelson is referring to is represented on a bank statement which is typically released monthly. In addition to that, during the report process or upon completion of the report session, the taxpayer receives an acknowledgment number. If they are using the PC-based system that acknowledgment number is displayed on their screen and they can do a print screen of that and that, in combination with their bank statement showing deposit of good funds on tax-due date, has been deemed sufficient to provide an audit trail for that taxpayer.

Mr. COYNE. And you feel that this is all sufficient to replace the coupons and the documents?

Mr. DONELSON. Absolutely.

Mr. DREYER. Yes, sir.

Mr. COYNE. Thank you.

Chairman JOHNSON. May I just follow up on that for 1 minute. I understand your point about the bank statement. So, monthly you have confirmation that the transfer of this money occurred. The acknowledgment number you receive if you make your payments by computer, could you go through that again? Just give me a little more understanding of that, please

Mr. BUETTNER. The acknowledgment number is provided when the taxpayer initiates the payment, itself. So, as an example, if they should use a touch-tone telephone and put in the appropriate data and the system determines that the edit checks are appro-

priate, when that payment is complete they get an EFTPS reference number.

That number can be used——

Chairman JOHNSON. On the telephone, they are told that number?

Mr. BUETTNER. Right in the session. If they use a personal computer, again, the system will preedit the data to make sure it is correct. It will initiate a transmission to the EFTPS System of both financial agents and they receive back an acknowledgment number for each individual payment which is, as Mr. Dreyer pointed out, can be printed out or can be stored on the computer, itself.

Both of those are used as audit trail points.

Chairman JOHNSON. Thank you.

Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair.

I have so many questions for this well informed panel. But I guess I will start by associating myself with your comments, Mr. Donelson. You have seen through Mrs. Johnson's reaction to the program how a lot of Members feel and that is because we are hearing about it from our constituents. I guess my suggestion to the Service would be instead of calling this one of Internal Revenue Service's great success stories which is what you mentioned at the outset of your comments, you might qualify that and raise your concerns a little more openly. Because I think this is an example of a larger problem of the Service not successfully marketing what, in this case, could have been a very beneficial program in the views of small business owners had they had it properly described to them.

But Mrs. Johnson has done a nice job of talking about the letter. I would just give you one quote that we have. You mentioned the quotes that you have from small business people saying it is working well for them. Here is one from an enrolled agent from Oklahoma in a survey of enrolled agents about the real world experiences with this. And her quote was, "I am doing damage control because of the first letter."

And that is what we are hearing from the intermediaries as well, as I said earlier, from the small business constituents regarding the way we have gone about explaining this and really marketing this program. So, I think this is a symptom of a larger problem that we need to focus on. The 58.3-percent requirement in NAFTA did not require the $50,000 threshold. I do not know what that magic number is. I do not know if you can give us one today but I would just say that that is something that all of us are very concerned about.

Let me ask a couple of questions, if I could, regarding the way this system is being designed. Because, to the extent that we are going to move forward with something, I think that we must be sure it works as well as possible, particularly for smaller businesses.

I appreciate your comment, Mr. Dreyer, in response to Mr. Coyne's good question on the access to accounts. I think that is a very important point to make, particularly to small business taxpayers. Another question I would have for you or Mr. Buettner, would be with regard to systems failures. We have heard a lot

about this and I guess the specific question I would have for the banks is, in the 6 months that EFTPS has been in operation, have either of your banks experienced any systems failures which have prevented taxpayers from getting through or making their payments?

Mr. DREYER. Mr. Portman, let me address that. On one occasion in the last 3 weeks, the NationsBank system has had to switch to their backup system. There were a number of hours in which we stabilized the system and the data between the systems. However, by midafternoon, 3 p.m. eastern time on March 24, we had stabilized the system and all taxpayers were able to successfully report into the system.

However——

Mr. PORTMAN. Were these your customer service lines?

Mr. DREYER. These were the deposit report lines. However, during that timeframe we were continuing to accept the deposit reports from the taxpayers and by close of business we had met all of our transmission deadlines to IRS and FMS. We had not lost any taxpayer data and we had maintained security in the system.

Mr. PORTMAN. That is a very important issue on the customer service side, too. Have you had some breakdowns in your customer service lines?

Mr. BUETTNER. We have not experienced any problem with our customer service.

Mr. PORTMAN. Do you have emergency backups in place? You mentioned you have a backup system. Do you feel as though the system is properly backed up with an emergency system to handle situations like that

Mr. BUETTNER. Both banks have gone through extensive efforts to make sure that we have contingency plans. We have both primary and backup data centers in each case. We have tested our disaster recovery means to make sure that we can recover in a short period of time. I would probably say that the contingency plans for EFTPS are beyond what most banks would make for an ACH type of process. There has been a lot of work placed into making sure that we have more than adequate contingency capabilities.

Mr. PORTMAN. One other quick question and I will direct this more to the Service. That is in regard to bulk filers. As I said earlier, we rely on our employers to really collect these taxes and on bulk filers, as you know, in particular with regard to the system.

And I encourage the Service to work more closely with the private sector because to the extent we can do that we are going to facilitate all of this. The bulk filers have a number of concerns, as you know.

One is the ability to reverse erroneous or duplicate files that they send in. Do you have something in place to assist with that, Mr. Albicker or Mr. Donelson?

Mr. BUETTNER. Well, first of all, if a file was to be sent to either one of the financial agents from a payroll processor we have software edits to make sure that we can detect whether a file has been erroneously duplicated during the same processing day.

If we receive such a file we are not going to process it on, we are going to contact the payroll processor and determine whether there is a problem with it.

Mr. PORTMAN. You will contact the processor under the current system?

Mr. BUETTNER. Yes.

Mr. PORTMAN. Prior to submitting——

Mr. BUETTNER. In other words, they send us a file and we determine that there is a duplicate file received and we are not going to automatically process that second file. We are going to stop that file from being processed and we will want to determine whether this is, in fact, a file that needs to be processed or should it be rejected.

Mr. DONELSON. That is a major improvement over the current paper system that oftentimes——

Mr. PORTMAN. That should be one of the advantages of electronic filing.

Mr. DONELSON [continuing]. Oftentimes results in us having to work that issue back while we hold the money or the duplicate payment.

Mr. PORTMAN. We are going to hear from some of the bulk filers later and having seen their written statement, they still have some concerns in that area and we hope to work with you on it.

Thank you, Madam Chairwoman.

Chairman JOHNSON. Ms. Dunn.

Ms. DUNN. Thank you, Madam Chairman.

Mr. Donelson, I appreciated your presentation of the goals and objectives of the program. I think it was an excellent presentation. And I believe that we agree that what you are trying to do is the right thing to do. And yet, I believe Mrs. Johnson made an important point that had to do with attitude and in the presentation of the taxpayer advocates to our Subcommittee a number of weeks ago, attitude came out of those 20 points that he presented again and again. And that is really a big, big concern of mine. With a group of small business people all over the Nation who are very sensitized to the IRS and to the problems they have in complying with the requirements that both Congress and the agency has set on the small business person, it is no wonder that they reacted in the way that they did which was a firestorm of complaining to us last June when the letter first came out.

Mr. Morris, I wanted to ask you a question. In Representative Hastings' testimony he said that the Secretary of the Treasury had been given broad ability to produce waivers or allow exemptions for folks who were having a hard time meeting the requirements of the legislation.

I am wondering why he did not take advantage of that or did he and we simply do not have that information?

Mr. MORRIS. Congresswoman, the final regulations, as well as the final revenue ruling by IRS have not been issued. We put out a notice of proposed rulemaking some months ago and gathered input from many sources. That input is being considered and the final rules have not been written. The issues around those final rules will be in front of the Secretary and we will have to see how that goes. But we are in review of the issues right now.

Ms. DUNN. And the initial goal of cutting down the amount of paperwork on taxpayers that was one of the two major goals of this program. When it caused trouble to the taxpayer the Secretary of

Treasury was allowed to exempt certain taxpayers and what Representative Hastings told us is that, to his knowledge, no exemption had been granted. And that is really my question, why Secretary Rubin did not take advantage of his ability to ease off on some of the taxpayers who wanted to do what was right but were having problems in organizing their presentation in a way that goes along with what we have asked them to do?

Mr. MORRIS. I have to admit some ignorance here, as well, because until Congressman Hastings made that comment I was not aware of any waiver authority. And, so, I just have to go back and look at that as we all do.

Ms. DUNN. OK. That would be helpful if I could just have some sort of a response on that one.

The other thing is I am still dealing with all the players in this whole situation. We have talked about ACH a lot and we talked about the fact that that was first operated in the late seventies, I think somebody said. I am just wondering is that a patented program and, if it is—and Mr. Morris you may have the answer to this—who holds that patent and who is paid the royalties on that patent?

Mr. MORRIS. I think it is public domain software. The automated clearinghouse system actually dates to the early seventies and was developed by the banking industry in cooperation with the Federal Reserve System. The Federal Reserve operates most, but not all, of the clearinghouses. They are operated by a government entity, although there are a couple of private-sector organizations who operate regional clearinghouses as well.

I do not think this question of patents has ever come up or copyrights. There is a national trade association or national association, automated clearinghouse association that essentially maintains the rules of engagement but it is an industry association with a broad input. And they maintain the operating rules and the standards for the system but it is not a patent. You do not pay a fee or a franchise fee to use it.

Mr. BUETTNER. It is essentially a service that is run by the Federal Reserve for all the member banks. So, any bank who is a member can utilize the service. There are a few other private ACH systems, but they have some very specific uses. The system is very commonly used for mortgages, insurance collection. I think the statistic I saw the other day is that over 300 million transactions went through the system last year. The system has been growing double digit for the last 10 years. I think it grew about 17 percent last year. So, it is a very commonly utilized system used primarily for the retail type transactions but a growing percentage of the use is for commerce, for business.

Ms. DUNN. Thank you very much.

Mr. MORRIS. For example, if you have direct deposit of your payroll, that direct deposit goes through the automated clearinghouse system. So, you are a user.

Ms. DUNN. Good. Thank you.

Chairman JOHNSON. Congresswoman Thurman.

Ms. THURMAN. Thank you, Madam Chairman.

Madam Chairman, I would like to request maybe to put into the record, personally I would like to see not just what happened in,

I guess, the June letter or the July letter, whatever it was, but also any other of the information that was distributed—the training tapes, whatever. I think that might be beneficial for this Subcommittee to have in the record, so that we know what has been out there.

Chairman JOHNSON. Thank you, Congresswoman, that is a good suggestion and also the 30-page booklet of instructions, and other materials and any other correspondence that you put out to help people.

Mr. DONELSON. We have already discussed the possibility of suggesting it would go into the record, so, we would be glad to comply.

Chairman JOHNSON. Thank you.

Ms. THURMAN. I think that would be very helpful for all of us. So, I would appreciate that.

[The materials are being retained in the Committee files.]

I have been trying to read ahead on some of the testimony that is going to be offered by the other panels. Sometimes in these hearings, we get some information and then never have the opportunity to ask people the questions that are going to come up in the next panels. So, I am going to try to do a little bit of that.

I would like to ask the banks a question. In the NFIB testimony, we are going to hear that one of the major concerns is the cost to small businesses. I think we need to have an answer to that because as they have pointed out today, this system basically is free to them.

How do you answer them regarding any costs they might accrue in their businesses for this transaction now?

Mr. DREYER. Ms. Thurman, the cost of the system to the taxpayer, there is no cost for the enrollment process. The enrollment process consists of returning a 2-page front-and-back form to the EFTPS, to the financial agents for processing. If they elect to utilize the ACH debit method, they can utilize their telephone. Again, I would assume that that would be normal. There is no additional cost or incremental cost for them to use their telephone to make their tax payment.

Ms. THURMAN. So, there is no cost with the debit method?

Mr. DREYER. That is correct.

And the telephone numbers that they use to call for customer or for reporting are 800 numbers provided by the financial agents.

The cost of an ACH debit posting to their account that would effect a payment probably costs no more and, quite often, costs less than the cost of a check clearing against their account.

Now, if, for business reasons, business practices, business reasons, they elect to use the ACH credit method, and quite often, you know, if they are using the ACH credit for other applications, it is probably a very easy incremental process. However, if they were to utilize this strictly for EFTPS they would incur some costs. Now, one of the problems is that their banks may not offer that service, however, that is a business decision that their banks make as to whether or not they will or will not offer those types of services to their customers. But if the taxpayer elects the tax payment for the ACH debit method, there is virtually no incremental cost and a very simple process to participate in the system.

Ms. THURMAN. So, the number that was used in previous testimony—anywhere between $120 to $130 to $600—is not necessarily the one that would be accrued. That would not be the case with the debit method?

Mr. DREYER. That is correct. And as I had stated previously, 95 percent of the participants currently using the system are using the debit method and less than 5 percent are using the ACH credit method.

Ms. THURMAN. Let me go to another issue that is an interesting one and, quite frankly, could create some ill will out there. Again, my question is to the banks.

The issue concerns our community bankers who, quite frankly, are very helpful to our businesses by advising them and doing a number of other things. The concern is that if they do not offer this service, the big banks or, in your case, who you represent, will gain all the depositors and take the money away from these community banks.

How do you answer that? I hate to put you on the spot but you happen to be here and I think it is important because sometimes that can be part of a problem.

Mr. BUETTNER. I think community banks have a number of opportunities to choose to decide to participate in the ACH process. They can do that by directly joining. They can work through a correspondent to do that. So, they do not have to always incur the direct cost of participation.

I do not believe that any bank will be gaining any undue market share by processing an individual's tax payment. There is not enough volume here to warrant a large bank thinking this is a market share opportunity. The other opportunity that community banks have is through service providers, third parties, that provide products that they can utilize so they can originate ACH credits as well.

So, there are other alternatives if they choose to get into that market. And it is very much a business decision by each of the banks to do that.

Ms. THURMAN. Let me ask another question. In your branches throughout the country, how much correspondence have you had between say, the chambers of commerce or the NFIBs in trying to get more information on how to do this? I am just curious to know if they are using educational tools that might be available to them? I mean what is going on out there?

I have heard that 960,000 have actually signed up, but have not started to use it. Are they starting to ask more questions?

Mr. BUETTNER. We have conducted a number of seminars, industry seminars both with banks, accounting firms, associations, small business associations——

Ms. THURMAN. At their request or——

Mr. BUETTNER. A combination of both. One association had us do almost 25 different seminars across the country. Very well attended. So, we were able to get the information out that way. In addition, information has been provided to every bank through the Federal Reserve as far as the programs, so, every bank has received a notification as to what the intent of the program was and how to comply and implement their software accordingly.

So, we have gone, I think, as best as we can to identify those groups that need information and when asked have provided speakers to come onsite and explain the system to them.

Ms. THURMAN. From those people that are kind of the naysayers right now, and from the experience that you have had from customers, what would be your response, to try to initiate them to get into the program?

If you had a message that you could give those that have enrolled but are not participating yet, what would you tell them?

Mr. DREYER. Ms. Thurman, in conversations with tax practitioners, tax professionals, small business groups, taxpayers, when that question comes up once we discuss and alleviate their initial concerns concerning the cost, concerning the misconception that they have to have additional equipment, concerning the IRS access to their accounts, once we address those main concerns, most of them are, quite frankly, say, well, there is no issue here, we will go ahead and try it, once they receive that basic reassurance.

Some of them, it is an issue of change, it is just something different. But, again, once we explain the basic system, the operation, the fact that this is an existing payment processing system that we simply adapted to the requirements of the IRS we alleviate most of the concerns and misconceptions that they were under and they go ahead and participate and say, Oh, it is not a big deal.

Ms. THURMAN. Mr. Donelson, in your testimony you talk about the fact that you probably receive or somebody receives about 100 letters a week that you answer to folks that participate. When you look at the information you send out to these taxpayers that you are trying to enroll in the system, how often do you change the information to reflect the commonly asked questions? Certainly there have got to be some that are repetitious, some that keep coming up which your booklets or videos are not explaining. Do you go through a process of trying to address those most common themes?

Mr. DONELSON. Ms. Thurman, we capture and accumulate the most frequently asked questions and come back in the next mailout with brochures and lists of those most frequently asked questions. As was just mentioned there are two or three toppers but there are a number of other questions that we know are bothering people and we use that data that we capture to formulate the next wave of mail. So, yes, we try to improve as we go along and learn from each succeeding mailout.

Ms. THURMAN. And those would also come from those telephone inquiries, as well?

Mr. DONELSON. Absolutely. We get a lot of information from the agents.

Mr. BUETTNER. Ms. Thurman, in the next set of mailouts that will go to anyone that has not started to utilize the system, we have included a brochure entitled, "Start Right, Start Now." It includes all the most commonly asked questions and concerns and helpful tips as to how to use the system to make sure that your first-time encounter with the system is an easy one.

So, we have heard a lot from the feedback from taxpayers, particularly through our customer service centers and have captured it. We have reformulated that back to the taxpayer and are hopefully providing them the piece of information that will alleviate

some of their concerns and make their first-time experience an easy one.

Mr. DONELSON. It was mentioned earlier that we were thinking this morning of showing an actual hands-on tutorial that we have on our telephone system. The taxpayer can get in without any money on the line or any of his business at stake and actually practice with a tutorial system that is built into the operation. And that is, in our view, a feature that can add comfort to the user so that they do not have any concern that their money will disappear into space. They can exercise and play with the system and get comfortable before they actually put money in the process.

Ms. THURMAN. OK. Thank you.

Mr. PORTMAN [presiding]. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chair.

Mr. Dreyer, and Mr. Buettner, I want to echo what Ms. Thurman mentioned. We have some community, family owned banks who have survived in our district, in my district in Missouri and I think there is, Mr. Dreyer, as you suggested, misperception. But there is a concern whether it is appropriately placed or not that in order to comply with the law that taxpayers will have to open an account with NationsBank or First Chicago. So, this is not just a concern in Florida and granted, perhaps it is misplaced. What can we do to help alleviate those concerns?

You mentioned some of the other options available, but what suggestions would you give to alleviate some of these misplaced ideas?

Mr. DREYER. In addition to the techniques or the procedures that we are following through on our AUR, automated response or touch-tone systems, the financial agents provide additional information as far as frequently asked questions that the taxpayers have expressed to us.

We also communicate through the banking industry. The FMS coordinates with the banking industry, the Federal Reserve communicates through the banking industry in terms of ensuring that everybody that we come in contact with and that raises those questions understands that that is not a requirement of the system. There is absolutely no change in the banking relationship by a taxpayer as a result of participating in EFTPS.

Mr. BUETTNER. I think in some respects the community banks can play a lot more valuable role than some of us larger banks. They know their customers very well, and if they have good knowledge about how EFTPS works, they should realize that the ability to provide their taxpayers direction on how to use the ACH debit method essentially insures that they are continuing to bank with them. Their account will be maintained with that bank. It is just that the service happens to be provided by the two financial agents but it ultimately comes back to their bank account where that customer is doing their banking.

So, we are not looking to pull the accounts. We do not open the accounts.

Mr. HULSHOF. I recognize that. And I agree there is probably not a large market share there for targeting promotion. Mr. Morris, earlier this morning Congressman Hastings, in his testimony, talked about some numbers, reacknowledged the goal that implementing EFTPS was to accelerate revenue collections by $3.3 bil-

lion over 5 years and he indicated in his testimony that we are up to $2.89 billion through just 3 years and had a letter that he was submitting in conjunction with his testimony as part of the record. Let me first ask you, do you have any quarrel with those numbers? Are you familiar with those numbers?

Mr. MORRIS. I have no quarrel with the number that he presented. In fact, it is true that in the letter we had provided data actually from my boss' office, from the Office of Fiscal Assistant Secretary that represents the measure of the movement of value from what would have been fiscal year 1997 into 1996 as a result of last year's activity.

Mr. HULSHOF. Mr. Morris, given the accuracy then of those numbers, does the Department of Treasury have a position on legislation that would provide voluntary compliance with EFTPS?

Mr. MORRIS. Mr. Congressman, I think we need to be real clear here that even though the stated intent of the NAFTA legislation was to move value forward in fiscal years, that the way the law was written, it was written in terms of a percentage of tax revenue to be collected by EFTPS.

So, what we are doing is implementing the law as it was written and our target is that percentage of tax revenue and the byproduct is the money that is moved from fiscal year to fiscal year.

I do not know if I am making any sense to you but our view is, as I said, the view of the Financial Management Service or the fiscal service and, quite frankly, I am not empowered to speak for the Secretary, is that given where we are in history, that we have notified, we have nearly 1 million organizations signed up. There have been no significant problems that any of us are aware of. We have over 200,000 users of the system right now. Our view is that it creates more turmoil than it solves if you terminate this project at this time.

Certainly, Treasury has an interest in the acceleration of the funds flow. It saves taxpayers money in a different pocket. It reduces interest costs. And, so, we would like to move on, move out and get this law implemented.

Mr. HULSHOF. I do not think there is the suggestion that we terminate it. I think, as Mr. Donelson said, that once people try it, they like it. But I guess what my thrust is and what I heard Congressman Hastings say was that we have moved very far toward our goal of raising the revenue that we need and should we now back up and say, Well, maybe voluntary compliance? But I see my time is running short.

Mr. Donelson, first of all, congratulations for surviving another tax day with the rough seas of April 15. Do you have a number of how many penalty notices have been issued to the 1,500 largest employers that have already been mandated to comply with the EFTPS, an approximate number?

Mr. DONELSON. I do not have the number with me and I think it is a very small number.

Mr. HULSHOF. OK.

Mr. DONELSON. But it is extremely reasonable on listening to their concerns and abating any penalties that have occurred.

Mr. HULSHOF. Could we and perhaps with followup find out how many notices and about what sort of revenue we are talking if collection were obtained?

Mr. DONELSON. Absolutely.

[The following was subsequently received:]

Total number of penalties assessed: 8,433 for $2,463,473,940.14.
Total number of penalties abated: 4,425 for $2,184,312,283.11.

Mr. HULSHOF. Thanks.

Thanks, Mr. Chairman.

Mr. DONELSON. And Congressman, thanks for the kind words about the filing season. We think we had a real good filing season and we have 100,000 people working very hard to make that happen every year.

Thank you.

Mr. PORTMAN. Thank you, Mr. Hulshof.

Before we adjourn, I have just one followup to Mr. Hulshof's good question on the numbers. Mr. Morris said the numbers were accurate and that they had, in fact, been provided by Treasury and then you indicated that the target under the NAFTA legislation was the percentage which was the 58.3 percent that we discussed earlier and not the impact on future fiscal years from a revenue basis, even though that may have been the intent. But just one clarification is necessary I think and correct me if I am wrong.

If 58.3 percent is, indeed, your target, then the $50,000 threshold which was selected, which was the tax-filing threshold, would have been inaccurate. In other words, you could have chosen a number that was higher than that to give some relief to the smallest businesses, is that correct?

Mr. MORRIS. I need to defer to IRS. The decision about or the calculation of which taxpayers needed to be included to meet those targets were based on Internal Revenue Service's review of their tax revenue stream.

Mr. PORTMAN. I am not sure that is true, but let me, Mr. Morris, I want the record to stand that there was, in fact, a percentage target and that was the only target used and, therefore, we came up with the policy of a $50,000 threshold.

Mr. MORRIS. Right.

Mr. DONELSON. Maybe I can help you out, Congressman.

In the *Federal Register* dated Monday, July 11, 1994, there was a discussion of the calculation and how we arrived at that. And I am sure this is available to you but we could make this available, as well, to you. There are a couple of factors. One is that it is not just an annual target. It is a target based on a 3- or 4-year growth in moving people into EFTPS. So at the end of that we will have an accumulation of *x* percentage of the EFT, the total deposits.

[The following was subsequently received:]

1ST DOCUMENT of Level 1 printed in FULL format.

FEDERAL REGISTER
VOL. 59, No. 131

Rules and Regulations

DEPARTMENT OF THE TREASURY
Internal Revenue Service (IRS)

26 CFR Parts 1, 31, and 40

[TD 8553]
RIN 1545-AS80

Federal Tax Deposits by Electronic Funds Transfer

Part II

59 FR 35414

DATE: Monday, July 11, 1994

ACTION: Temporary regulations.

To view the next page, type .np* TRANSMIT.
To view a specific page, transmit p* and the page number, e.g. p*1

SUMMARY: This document contains temporary regulations relating to the deposit of taxes by electronic funds transfer. The temporary regulations describe the taxpayers that must make deposits by means of electronic funds transfer, the types of taxes that must be so deposited, and when the deposits must commence. The temporary regulations reflect changes to the Internal Revenue Code made by section 523 of the North American Free Trade Agreement Implementation Act (NAFTA). The text of the temporary regulations also serves as the text of the cross-reference notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the Federal Register.

DATES: These temporary regulations are effective July 11, 1994.

For dates of applicability, see § 31.6302-1T(h) of these regulations.

FOR FURTHER INFORMATION CONTACT: Vincent G. Surabian, 202-622-6232 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 523 of NAFTA amended section 6302 of the Internal Revenue Code of 1986 (Code) by enacting a new subsection (h) authorizing the Secretary of the Treasury to prescribe such regulations as may be necessary for the development

and implementation of an electronic funds transfer (EFT) system to be used for the collection of depository taxes. The depository taxes are the taxes required to be deposited with an authorized financial institution or Federal Reserve bank pursuant to any regulations prescribed by the Secretary (generally FICA and railroad retirement taxes, income tax withheld, corporate income and estimated taxes, and various Federal excise taxes). The new system will be designed to ensure that the depository taxes are credited to the Treasury's general account by the due date of the deposit.

Explanation of Provisions

A. Current Tax Deposit System

At present, taxpayers are required to deposit taxes with an authorized government depository (generally, a commercial bank or savings institution or a Federal Reserve bank) by various dates specified in regulations. Each deposit must be accompanied by Form 8109, Federal Tax Deposit Coupon, which contains the taxpayer's name, identification number, the amount and type of tax being deposited, and the tax period for which the deposit is being made. The government depository forwards the coupon to the appropriate IRS Service Center. The Service Center compares the information entered on the coupon with the liabilities reported by the taxpayer on the return for the applicable tax period. The funds are transferred by the depository to the Treasury on the business date following the date of the deposit.

B. An Electronic Tax Deposit System

Section 6302(h) of the Code authorizes a new system which will allow for the transfer of tax deposit amounts electronically from taxpayer accounts to the Treasury's general account. The new system will be phased in over a period of several fiscal years, beginning with fiscal year 1994 (October 1, 1993, to September 30, 1994), by gradually increasing the percentage of the total depository taxes required to be collected by EFT. The temporary regulations implement this phase-in by gradually increasing the number of taxpayers that must deposit all of their depository taxes by EFT.

The requirement to deposit by EFT under these temporary regulations applies only to those taxpayers required to make deposits pursuant to regulations under section 6302 of the Code, and only for those taxes required to be deposited. At present, many small taxpayers are excluded from the various deposit requirements imposed by regulations under section 6302. For example, filers of Form 720, Quarterly Federal Excise Tax Return, are not required to make deposits for any calendar quarter in which the net tax liability reported on the Form 720 does not exceed $ 2,000. Similarly, filers of Form 941, Employer's Quarterly Federal Tax Return, are not required to make deposits for any calendar quarter in which the liability reported on the Form 941 is less than $ 500.

The temporary regulations, with one exception, do not apply to taxes with respect to wages for domestic service in the private home of an employer because these taxes are not required to be deposited but are remitted quarterly with Form 942, Employer's Quarterly Federal Tax Return for Household Employees. The sole exception is if the employer is a sole proprietor filing Form 941, Employer's Quarterly Federal Tax Return, who chooses to report wages to household employees on that form.

In order to achieve an expedited and orderly conversion to an EFT system, NAFTA prescribed a schedule of minimum percentages of taxes that must be deposited by EFT during a phase-in period. These percentages depend in part on whether the taxes are: (a) The taxes imposed by chapters 21 (Federal Insurance Contributions Act), 22 (Railroad Retirement Tax Act), and 24 (Collection of Income Tax at Source on Wages) of the Code, or (b) "other" depository taxes (generally corporate income taxes and various excise taxes). The statutorily prescribed minimum percentages for each year are as follows:

Fiscal year	Chapter 21, 22, & 24 taxes (percent)	Other taxes (percent)
1994	3	3
1995	16.9	20
1996	20.1	30
1997 & 1998	58.3	60
1999 and later	94	94

For the period prior to January 1, 1995, the first step of the phase-in of the EFT system will be carried out through binding agreements entered into between the Commissioner of Internal Revenue and certain third party bulk data processors (processors) under which the processors have committed to make deposits of Federal depository taxes of certain of their customers by EFT in such a manner as to ensure that the amounts are credited to the general account of the Treasury by the deposit due date. These agreements will take effect beginning in the latter part of fiscal year 1994 and will continue for a period of time into fiscal year 1995. A taxpayer who is a customer of a processor that is a party to one of these agreements may have its deposits that are subject to such an agreement made by the processor pursuant to the terms of the agreement until the expiration or termination of the agreement. However, the taxpayer continues to be responsible for the deposit of those depository taxes that are not subject to such agreement. If a taxpayer whose deposits are being made by a processor pursuant to such an agreement becomes required to deposit by electronic funds transfer pursuant to § 31.6302-1T(h)(1)(ii) of these temporary regulations, the taxpayer is responsible for making [*35415] deposits by electronic funds transfer of those depository taxes not subject to the agreement.

For periods after December 31, 1994, the temporary regulations require that deposits be made by EFT based on the taxpayer's total deposits of taxes imposed by chapters 21, 22, and 24 during certain "determination" periods. If a taxpayer's total deposits of the taxes imposed by chapters 21, 22, and 24 during the determination period exceed a prescribed dollar threshold, the taxpayer must begin depositing by EFT on and after the applicable effective date prescribed in the regulations, unless otherwise exempted. (A taxpayer will become subject to the EFT requirement for the applicable effective date "January 1, 1996" by exceeding the threshold amount during either calendar years 1993 or 1994). The phase-in schedule is as follows:

Threshold amount	Determination period	Applicable effective date

$ 78 million	1-1-93 to 12-31-93	January 1, 1995.
47 million	1-1-93 to 12-31-93	January 1, 1996.
47 million	1-1-94 to 12-31-94	January 1, 1996.
50 thousand	1-1-95 to 12-31-95	January 1, 1997.
50 thousand	1-1-96 to 12-31-96	January 1, 1998.
20 thousand	1-1-97 to 12-31-97	January 1, 1999.

The thresholds set forth in this phase-in schedule have been set by taking into account the minimum percentages prescribed by NAFTA, the need for administrative convenience and simplicity, and the potential need for exemptions from the EFT system for certain small businesses. Therefore, the thresholds for the January 1, 1995 and January 1, 1996 effective dates were specifically set to satisfy the statutory minimum percentages. The $ 50,000 threshold for the January 1, 1997 effective date will result in receipts of depository taxes somewhat in excess of the percentage prescribed by NAFTA. For purposes of administrative convenience and simplicity, this threshold was adopted to require the participation of an entire class of taxpayers, that is, those taxpayers that are classified as "semi-weekly" depositors of employment taxes (the taxes imposed by chapters 21, 22, and 24). Finally, the $ 20,000 threshold for the January 1, 1999 effective date was set to satisfy the statutory percentage while allowing for the possibility that the smallest of depositors will be exempted from the EFT system. As described in paragraph C of this preamble, the IRS solicits comments on the impact of these regulations on small businesses. Based on those comments, the IRS will determine those categories of small businesses, if any, that should be exempted from the EFT requirements, and may adjust the threshold for the January 1, 1999 effective date to bring in additional taxpayers while at the same time accommodating any appropriate exemptions.

Although only the taxes imposed by chapters 21, 22, and 24 are used to determine whether a taxpayer is subject to the EFT deposit requirement, the requirement, once triggered, applies to all federal taxes (not just the taxes imposed by chapters 21, 22, and 24) that the taxpayer is required to deposit pursuant to regulations prescribed under section 6302 of the Code. Once a taxpayer becomes subject to the EFT deposit requirement, the taxpayer must continue to deposit by EFT.

At present the IRS has in place a voluntary electronic funds transfer (EFT) system in which a taxpayer may by telephone or computer effectuate an electronic funds transfer through the use of one of two payment options: debit and credit. The debit option is effected by using a Financial Agent of the Department of Treasury. The taxpayer requests the Financial Agent to initiate the transfer of funds from the taxpayer's bank account(s) to Treasury's general account and transmit the related tax payment data, supplied by the taxpayer, to the IRS. The credit option is effected by using the taxpayer's financial institution. The taxpayer requests the financial institution to initiate the transfer of funds to the Treasury's general account and submit the related tax data, supplied by the taxpayer, to a Financial Agent for transmission to the IRS. The EFT system required to be used in connection with these regulations will employ similar options and procedures.

C. Exemptions

Section 6302(h)(1)(B) of the Code, as added by NAFTA, provides that the

regulations may contain such exemptions as the Secretary may deem appropriate. The Senate Report accompanying section 6302(h) strongly encourages the Secretary of the Treasury to consider the impact of the regulations on small businesses. S. Rep. No. 103-189, 103d Cong., 1st Sess., at 61 et. seq. (1993). The report recommends that the regulations should not create hardships for small businesses and that no small business should be required to purchase computers or gain access to any electronic equipment other than a touch-tone telephone. Further, the report urges the Secretary to take into account the specific needs of small employers, including possible exemption for the very smallest businesses from the new electronic funds transfer system. The phase-in schedule included in the temporary regulations defers use of the EFT system by the smallest businesses until at least calendar year 2000. The IRS welcomes comments about the impact of the temporary regulations on small businesses and will consider any suggestions regarding how small businesses should be treated under the regulations in order to implement Congressional intent. Based on the comments and suggestions received, the IRS will determine those categories of small businesses, if any, that should be exempted from the EFT requirements and publish such determinations in the Internal Revenue Bulletin. (See § 601.601(d)(2)(ii)(b)).

Special Analyses

It has been determined that these temporary regulations are not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, a copy of these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Vincent G. Surabian, Office of the Assistant Chief Counsel (Income Tax & Accounting), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social Security, Unemployment compensation. [*35416]

26 CFR Part 40

Excise taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR parts 1, 31, and 40 are amended as follows:

PART 1-INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805. * * *

Sections 1.6302-1T, 1.6302-2T and 1.6302-3T also issued under 26 U.S.C. 6302(h). * * *

Par. 2. Section 1.6302-1T is added to read as follows:

§ 1.6302-1T -- Use of Government depositaries in connection with corporation income and estimated income taxes and certain taxes of tax-exempt organizations-deposits required to be made by electronic funds transfer after December 31, 1994 (temporary).

(a) through (b)(1) [Reserved].

(b)(2) Deposits by electronic funds transfer. For the requirement to deposit corporation income and estimated income taxes and certain taxes of tax-exempt organizations by electronic funds transfer, see § 31.6302-1T(h) of this chapter. A taxpayer not required to deposit by electronic funds transfer pursuant to § 31.6302-1T(h) of this chapter remains subject to the rules of § 1.6302-1(b).

Par. 3. Section 1.6302-2T is added to read as follows:

§ 1.6302-2T -- Use of Government depositaries for payment of tax withheld on nonresident aliens and foreign corporations-deposits required to be made by electronic funds transfer after December 31, 1994 (temporary).

(a) through (b) [Reserved].

(c) Deposits by electronic funds transfer. For the requirement to deposit taxes withheld on nonresident aliens and foreign corporations by electronic funds transfer, see § 31.6302-1T(h) of this chapter. A taxpayer not required to deposit by electronic funds transfer pursuant to § 31.6302-1T(h) of this chapter remains subject to the rules of § 1.6302-2(b).

Par. 4. Section 1.6302-3T is added to read as follows:

§ 1.6302-3T -- Use of Government depositaries in connection with estimated taxes of certain trusts-deposits required to be made by electronic funds transfer after December 31, 1994 (temporary).

(a) through (b) [Reserved].

(c) Cross-references. For further guidance and instructions for certain banks and financial institutions acting as fiduciaries with respect to taxable trusts, see Revenue Procedure 89-49, 1989-2 C.B. 615 (see § 601.601(d)(2) of this

chapter) or any successor revenue procedure. For the requirement to deposit estimated tax payments of taxable trusts by electronic funds transfer, see § 31.6302-1T(h) of this chapter.

PART 31-EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

Par. 5. The authority citation for part 31 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805. * * *

Section 31.6302-1T also issued under 26 U.S.C. 6302(h). * * *

Section 31.6302(c)-3T also issued under 26 U.S.C. 6302(h). * * *

Par. 6. Section 31.6302-1T is added to read as follows:

§ 31.6302-1T -- Federal tax deposit rules for withheld income taxes and taxes under the Federal Insurance Contributions Act (FICA)-deposits required to be made by electronic funds transfer after December 31, 1994 (temporary).

(a) through (g) [Reserved].

(h) Time and manner of deposit-deposits required to be made by electronic funds transfer-(1) In general. Section 6302(h) of the Internal Revenue Code requires the Secretary to prescribe regulations as may be necessary for the development and implementation of an electronic funds transfer system to be used for the collection of depository taxes as described in paragraph (h)(2) of this section. Section 6302(h)(2) of the Code provides a phase-in schedule which sets forth escalating minimum percentages of those depository taxes to be deposited by electronic funds transfer, starting with the fiscal year beginning October 1, 1993, and ending September 30, 1994. This section prescribes the rules necessary for implementing an electronic funds transfer system for collection of depository taxes and for effecting an orderly and expeditious phase-in of that system.

(i) Period prior to January 1, 1995. The Commissioner of Internal Revenue has entered into binding agreements with third party bulk data processors. These agreements require that the third party bulk processors deposit certain depository taxes of certain of their customers by electronic funds transfer in a manner designed to ensure that those amounts are credited to the general account of the Treasury by the deposit due date. A taxpayer who is a customer of a third party bulk data processor that is a party to such an agreement may have its deposits that are subject to such agreement made by the processor until the expiration or termination of the agreement. However, the taxpayer continues to be responsible for the deposit of those depository taxes that are not subject to such agreement.

(ii) Periods after December 31, 1994. (A) Taxpayers whose aggregate deposits of the taxes imposed by Chapters 21 (Federal Insurance Contributions Act), 22 (Railroad Retirement Tax Act), and 24 (Collection of Income Tax at Source on Wages) of the Internal Revenue Code during a 12-month determination period exceed the applicable threshold amount are required to deposit all depository taxes (as described in paragraph (h)(2) of this section) due on and after the applicable effective date by electronic funds transfer (as defined in paragraph

(h)(3) of this section) unless exempted under paragraph (h)(4) of this section. In general, each applicable effective date has one 12-month determination period. However, for the applicable effective date January 1, 1996, there are two determination periods. If the applicable threshold amount is exceeded in either of those determination periods, the taxpayer becomes subject to the requirement to deposit by electronic funds transfer, effective January 1, 1996. The threshold amounts, determination periods, and applicable effective dates are as follows:

Threshold amount	Determination period	Applicable effective date
$ 78 million	1-1-93 to 12-31-93	January 1, 1995.
47 million	1-1-93 to 12-31-93	January 1, 1996.
47 million	1-1-94 to 12-31-94	January 1, 1996.
50 thousand	1-1-95 to 12-31-95	January 1, 1997.
50 thousand	1-1-96 to 12-31-96	January 1, 1998.
20 thousand	1-1-97 to 12-31-97	January 1, 1999.

(B) Once a taxpayer is required to deposit by electronic funds transfer pursuant to paragraph (h)(1)(ii) of this section, the taxpayer will continue to deposit by electronic funds transfer. Until such time as a taxpayer is required by this section to deposit by electronic funds transfer, the taxpayer may voluntarily make deposits by electronic funds transfer, or must make deposits following the rules of § 31.6302-1(h), pertaining to deposits by Federal tax deposit (FTD) coupon.

(C) Any taxpayer whose deposits are being made by a third party bulk data processor pursuant to an agreement described in paragraph (h)(1)(i) of this section, and who is required to deposit by electronic funds transfer pursuant to this paragraph (h)(1)(ii), may have its deposits that are subject to such agreement made by the third party bulk data processor until the expiration or termination of the agreement. The taxpayer, however, is responsible for making deposits by electronic funds transfer of those depository taxes not subject to such agreement.

(2) Taxes required to be deposited by electronic funds transfer. Any taxpayer who is required under paragraph (h)(1)(ii) of this section to deposit by electronic funds transfer the taxes imposed by chapters 21, 22, and 24 of the Internal Revenue Code must also deposit by electronic funds transfer, beginning with the same applicable effective date, the taxes required to be deposited under §§ 1.6302-1, 1.6302-2, 1.6302-3 of this chapter, 31.6302(c)-3, and 40.6302(c)-1 of this chapter.

(3) Electronic funds transfer defined. For purposes of this section, an electronic funds transfer is any transfer of depository taxes made in accordance with Revenue Procedure 94-48, 1994-29 I.R.B. (see § 601.601(d)(2) of this chapter), or in accordance with procedures subsequently published by the Commissioner.

(4) Exemptions. The Commissioner of Internal Revenue will identify by guidance published in the Internal Revenue Bulletin those categories of

taxpayers, if any, that are to be exempted from the requirement to deposit by electronic funds transfer. (See § 601.601(d)(2)(ii)(b) of this chapter.)

(5) Separation of deposits. A deposit for one return period must be made separately from a deposit for another return period.

(6) Payment of balance due. If the aggregate amount of taxes reportable on the applicable tax return for the return period exceeds the total amount deposited by the taxpayer with regard to the return period, then the balance due must be remitted in accordance with the applicable form and instructions.

(7) Time deemed deposited. A deposit by electronic funds transfer will be deemed made-

(i) At the time a debit is made (the amount is withdrawn from the taxpayer's account) if the Government's authorized financial agent debits the taxpayer's account; or

(ii) In all other cases, at the time the funds are credited to Treasury's general account.

(8) Time deemed paid. In general, amounts deposited under this paragraph (h) will be considered paid at the time deemed deposited under paragraph (h)(7) of this section, or on the last day prescribed for filing the return (determined without regard to any extension of time for filing the return), whichever is later. In the case of the taxes imposed by chapters 21 and 24 of the Internal Revenue Code, for purposes of section 6511 and the regulations thereunder (relating to the period of limitation on credit or refund), if an amount is deposited prior to April 15th of the calendar year immediately succeeding the calendar year that includes the period for which the amount was deposited, the amount will be considered paid on April 15th.

Par. 7. Section 31.6302(c)-3T is added to read as follows:

§ 31.6302(c)-3T -- Use of Government depositaries in connection with tax under the Federal Unemployment Tax Act-deposits required to be made by electronic funds transfer after December 31, 1994 (temporary).

(a) through (b) [Reserved].

(c) Manner of deposit-deposits required to be made by electronic funds transfer. For the requirement to deposit tax under the Federal Unemployment Tax Act by electronic funds transfer, see § 31.6302-1T(h). A taxpayer not required to deposit by electronic funds transfer pursuant to § 31.6302-1T(h) remains subject to the rules of § 31.6302(c)-3(b).

PART 40-EXCISE TAX PROCEDURAL REGULATIONS

Par. 8. The authority citation for part 40 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805. * * *

Section 40.6302(c)-1T also issued under 26 U.S.C. 6302 (a) and (h). * * *

Par. 9. Section 40.6302(c)-1T is added to read as follows:

§ 40.6302(c)-1T -- Use of Government depositaries-deposits required to be made by electronic funds transfer after December 31, 1994 (temporary).

(a) through (d)(1) [Reserved].

(d)(2) Deposits by electronic funds transfer. For the requirement to deposit excise taxes by electronic funds transfer, see § 31.6302-1T(h) of this chapter. A taxpayer not required to deposit by electronic funds transfer pursuant to § 31.6302-1T(h) of this chapter remains subject to the rules of § 40.6302(c)-1(d).

Michael P. Dolan,

Acting Commissioner of Internal Revenue.

Approved: June 27, 1994.

Leslie Samuels,

Assistant Secretary of the Treasury.

[FR Doc. 94-16477 Filed 7-6-94; 1:01 pm]

BILLING CODE 4830-01-U

Mr. PORTMAN. But the proposal was January 1, 1997, 100-percent compliance with a penalty attached on $50,000 or up.

Mr. DONELSON. I understand that.

Mr. PORTMAN. That is hardly a phase-in.

Mr. DONELSON. But the actuaries that we used to come up with this projection helped us in terms of you will have so much slippage. Everybody will not automatically be in. And people will come in and go out of business. So, you have to pick a number that is realistic in order to make the level that Congress mandated us to achieve. So, if you just target what you think the number should be if everything works perfectly, you would always undershoot the mark. So, you have to, obviously, give yourself some room for events not working out exactly correctly.

Second, the target is a target as of 1999, not just where we start in 1997. Plus, with the late start in 1997, Congress moved the date from January 1 to July 1, and we lose a little bit more. And so we had to adjust even from the date established in 1994.

There is one last part I would just like to add. And we also tried to get a whole grouping of taxpayers, taxpayers who file on a semiweekly basis for the main taxes which are the withholding taxes. So, the semiweekly group, if you split them in half by cutting the number off at 82,000, you would create a tremendous administrative burden, not only on us but on the taxpayers trying to figure out whether they were in or out of this. And if they had an increase in their payroll in one month they might have to be in it, and if they were below that level the next month they could opt out of it.

So, there is more than one factor in that calculation than simply $50,000 gets the money that you need or not. It is calculated over

time, it is calculated in terms of a group or class of taxpayers, the semiweekly depositors, as well as total dollar amount.

Mr. PORTMAN. I appreciate the semiweekly distinction and I think that is an important distinction on the administration of this. But my point stands which is let us not let the record state that the 58.3 percent was the target. Instead there was a number chosen which included a lot of factors. The actual number, I think, is in excess of 82,000 although we do not have that number and you may not have that number.

Mr. DONELSON. I made that number up, Congressman. That 82,000 is an illustration.

Mr. PORTMAN. My point is there may have been other ways to have done this and I think it is instructive for the future. It is also instructive though, and the reason I raise it for how we deal with this problem now, because there may be some flexibility here. It is my understanding that the Joint Tax Committee has been asked by this Subcommittee to give us a better revenue estimate so we can understand how the budget rules apply to what we come up with in terms of legislation to alleviate the concerns that have been expressed today. We do not have a number yet and until the Joint Tax Committee can give us something it will be difficult for us to draft legislation.

Thank you all very much for excellent testimony. We will now adjourn until 1 o'clock. I see other panelists are here already. We have a Members' meeting until 1, but we will reconvene with the next panel at 1 o'clock.

This hearing is adjourned until 1 o'clock.

[Whereupon, at 12:03 p.m, the Subcommittee recessed, to reconvene at 1 p.m., the same day.]

Chairman JOHNSON. Will the members of the second full panel please come forward? Bennie Thayer, president and chief executive officer of the National Association for the Self-Employed; Roger Harris, president, Padgett Business Services, Athens, Georgia; Randy Mason, general manager of Mason Mechanical Laboratories, Inc., on behalf of the National Federation of Independent Business; Gene Cole, Agrimanagement, Yakima, Washington, on behalf of the Small Business Survival Committee; and Judy Akin, enrolled agent, on behalf of the National Association of Enrolled Agents.

Welcome, and I am sorry that we had to adjourn for a period of time. I welcome you back.

Bennie Thayer.

STATEMENT OF BENNIE L. THAYER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED

Mr. THAYER. Madam Chairman and Members of the Subcommittee, may I say, good afternoon now. My name is Bennie L. Thayer and I am president of the National Association for the Self-Employed. I am here today representing approximately 325,000 of the smallest of small business. Madam Chair, at the outset, may I thank you also for your efforts on behalf of small business with the home office deduction last year.

I am pleased to testify here today on the impact of the Electronic Federal Tax Payment System, and especially the effect of that sys-

tem on the smallest of small business. We commend Committee Chairman Bill Archer and you, Mrs. Johnson, as well as the other Ways and Means Committee Members for delaying the EFTPS Program last year.

The NASE vigorously lobbied for this legislation. Without this delay many businesses with 10 or fewer employees would be forced to pay all of its payroll tax deposits electronically. The Committee rightly recognized, in 1996, that the IRS was ill equipped administratively to manage such a dramatic extension of the EFTPS Program from a few hundred businesses to more than 1 million.

A year later, small businesses and the IRS are still unprepared for this mandate. Why? First, because businesses still are not prepared for the change. The EFTPS replaces a previous electronic payment system program called TaxLink, as we very well know. While 63,000 employers used TaxLink through May 1996, they were mainly firms with payrolls larger than $1 million dollars. Therefore, the NASE recommends the program remain voluntary and backs legislation by Senator Nickles and Representative "Doc" Hastings, whom we heard from here this morning, to make the EFTPS Program voluntary for small businesses.

While nearly 1 million businesses have enrolled in the EFTPS Program, only a small fraction of those businesses are actually using it. We believe that the business community continues to be confused even today with all aspects, details and requirements of the EFTPS Program.

Second, the structure of the program could damage the relationship between banks and small businesses. Why do I say that? Businesses have two options in filing these taxes electronically. As we very well know, the ACH debit method is one of those options and the ACH credit method is the other option.

Many of our members are telling us that they would prefer to use their community banks rather than the two national banks that are presently being used which are NationsBank which we have heard from this morning and the First National Bank of Chicago, primarily put in place because of the debit method. Meanwhile, local community banks fear that they will lose depository accounts to NationsBank or First National Bank of Chicago, when small businesses switch their payroll tax payments to these banks.

In effect, the debit method has been set up as a free user service. Smaller banks may need to charge customers for use of the credit method in order to cover operating costs. That will bias the system toward the debit method and the big banks. Thus, many small banks have not yet developed a marketing strategy to address the EFTPS. The NASE urges Congress to monitor this closely. The local community bank has historically served as the lifeblood for many small businesses in terms of financing business growth and expansion. This relationship should not be damaged simply for the administrative convenience of the Internal Revenue Service.

Third, I would point out here today, if the program is as good as advertised, then a mandate is not necessary. The IRS has advertised the EFTPS Program as a fast, easy and convenient way to initiate Federal tax deposits electronically with a telephone call or through a personal computer.

These are good benefits, both certainly do not warrant a mandate. Tax payment methods should be left in the hands of the business community and not mandated in Washington.

Fourth, I would point out here today that many businesses simply want paper records of their tax payments. A voluntary system would permit a small business to decide for itself whether it wants to continue utilizing the traditional pay per coupon method for making payroll tax deposits with the government.

Finally, a mandatory program will inevitably involve tax penalties for noncompliance. We do not need more of these. We believe that the use of the EFTPS Program over the coming months is likely to be fraught with inadvertent acts and mistakes. The NASE strongly recommends that the House Ways and Means Committee take steps to alleviate the threat of tax penalties under the EFTPS Program, by making the program voluntary beyond July 1, 1997, the cutoff date.

In conclusion, Madam Chair, I would simply say this: In today's paper, ''Investment Business Daily,'' the headline reads, ''The Situation is Normal at the IRS: Computers Management, Books Are All Fouled Up.'' I would submit here today that while our members strongly want to see us go into the modern age in terms of utilizing electronic mechanisms to file our systems, certainly as we approach the millennium, these types of headlines certainly do not encourage our members to believe that the IRS will be any different after this than they have been before.

I thank you very much for appearing today.

[The prepared statement follows:]

Statement of Bennie L. Thayer, President and Chief Executive Officer, National Association for the Self-Employed

My name is Bennie L. Thayer, President of the National Association for the Self-Employed. I am pleased to testify before the House Ways and Means Subcommittee on Oversight today to address the impact of the Electronic Federal Tax Payment System (EFTPS) on small business.

The NASE commends Committee Chairman Bill Archer, Subcommittee Chairman Nancy Johnson and the other Ways and Means Committee members in spearheading legislation last year to delay further extension of EFTPS to any more businesses until July 1, 1997. The NASE vigorously lobbied for this legislation.

Without passage of this EFTPS delay measure, a business with yearly payroll tax deposits of $50,000 or more would generally now be obligated to transmit all of its payroll tax deposits electronically. The Committee rightly recognized in 1996 that the IRS was ill-equipped administratively to manage such a dramatic extension of the program to more than one million additional businesses.

HOW THE EFTPS PROGRAM WORKS

Section 6302(h) of the Internal Revenue Code authorizes the IRS to institute an electronic funds transfer program for the payment of employment taxes by employers. This was a voluntary program before 1995. Beginning on January 1, 1995, the program was made mandatory for certain employers based on the firm's total payroll tax deposits for the year. The phase-in schedule was as follows:

Tax Deposits	Determination Period	Effective Date
$78 million	1/1/93 to 12/31/93	1/1/95
$47 million	1/1/93 to 12/31/93	1/1/96
$47 million	1/1/94 to 12/31/94	1/1/96
$50,000	1/1/95 to 12/31/95	1/1/97
$50,000	1/1/96 to 12/31/96	1/1/98
$20,000	1/1/97 to 12/31/97	1/1/99

EFTPS replaces a previous electronic payment system program called TaxLink. About 63,000 employers used TaxLink through May 1996, paying about $227.1 billion in payroll tax deposits electronically. However, it is commonly recognized that the companies currently using the EFTPS program are firms with payrolls that are larger than $1 million.[1]

The following hypothetical illustrates the type of small business impacted by a mandatory EFTPS program. Under this hypothetical, three assumptions are made. First, the small business is depositing $50,000 in payroll tax deposits with the government on a yearly basis. Second, the average tax bracket for all employees working for the business is 20 percent. Last, the average wage paid by the business to each employee is $25,000. Based on this hypothetical, a business with 10 workers and a total yearly payroll of $250,000 would be required to utilize EFTPS. Obviously, businesses that employ even fewer workers would be brought under EFTPS if they pay their workers—on average—significantly more than $25,000.

One of the principal reasons that NASE supported a delay in further implementation of the program was that small businesses were generally not aware of the program in the Spring of 1996. And more than 1.2 million businesses were affected in 1996, those with yearly tax deposits of $50,000 or more.

According to a survey released in June 1996 by Automatic Data Processing (ADP), 70 percent of U.S. businesses were not aware that EFTPS was scheduled to become a mandatory program. This level of unawareness among the small business community was extremely high last year despite IRS efforts through the media and public seminars to educate the business community. ADP's survey clearly illustrates why the NASE supported a delay in EFTPS implementation.

THE IRS' EFTPS OUTREACH IN 1997

According to the IRS, over 840,000 EFTPS enrollment applications were received by the IRS as of February 12, 1997. While it is conceivable that the number of EFTPS enrollment applications may be approaching 950,000 or more by the date of today's hearing, the NASE remains concerned about the ability of the IRS to successfully implement the program over the coming months.

The IRS has sent several mailings reminding businesses that they must enroll in the EFTPS program by May 1, 1997. According to the IRS, this May 1, 1997 deadline is necessary to ensure sufficient time for processing the enrollment applications, so that a business will be properly enrolled and ready to start transmitting payroll taxes electronically by July 1, 1997.

Unfortunately, it is the NASE's understanding that only a small percentage of all businesses enrolled in the EFTPS program are actually currently using the program to make electronic transmissions. We believe that the business community continues to be confused even today with all aspects, details, and requirements of the EFTPS program. An unfortunately, today's level of confusion appears to be very comparable to the high degree of confusion which existed last year among business owners. The various concerns existing today about the EFTPS program are as follows:

1. *ACH Debit Method.* It appears that the IRS prefers small businesses to utilize the ACH debit method for purposes of making electronic transmissions of payroll taxes. Under this method, the small business is told that it will not be charged for making the electronic transmission of taxes as long as the firm facilitates the transmission through one of Treasury's two Financial Agents for the EFTPS program, NationsBank or First National Bank of Chicago. But our members are telling us that they want to continue using their local community banks for paying payroll taxes.

2. *ACH Credit Method.* The ACH credit method is designed to enable the small business person to electronically transmit the payroll taxes by working with a local community bank. Unfortunately, when many small business persons have contacted their local bank about the EFTPS program in recent weeks or months, they have been informed by the local bank that the bank has not yet developed a process or pricing strategy for handling electronic tax transfers for business customers. Thus, to the extent smaller firms are considering the ACH credit method, many of these firms still don't know what it will cost and how it would work in detail.

3. *The Loss of Bank Customers to NationsBank or First National Bank of Chicago.* There is a fear among local community banks that they will lose depository accounts to NationsBank or First National Bank of Chicago because of the way the EFTPS program is structured. These banks believe that the program inherently favors the ACH debit method. While the ACH debit method has been setup as a "free" service

[1] Tax Analysts Internet Page, http://www.tax.org/notes/tadiscus/291e.htm, Employment Tax Update, Vol. 3, No. 8, May 21, 1996.

to users, smaller banks are concerned that they may need to charge customers for use of the ACH credit method in order to cover operating costs. These small banks are concerned that small businesses using the "free" debit method will decide to move their depository accounts to either NationsBank or First National Bank of Chicago. We have not seen studies on this problem but we would urge Congress to examine the issue in more detail. Historically the local community bank has served as the lifeblood for many small businesses in terms of financing business growth and expansion. This historical financing link for small business should not be deliberately—or inadvertently—severed.

MAKING THE EFTPS SYSTEM VOLUNTARY

The IRS has "advertised" the EFTPS program as "a fast, easy and convenient way to initiate federal tax deposits electronically with a telephone call or through a personal computer." The Service also claims that "EFTPS means no more paper Federal Tax Deposit coupons, checks or trips to the bank." Both of these claims on the part of the government are very positive and worthy as objectives.

But based on our observations about the EFTPS program, the NASE strongly supports making EFTPS a voluntary program for small business. We believe that tax payment decisions should be left in the hands of the business community, as opposed to being decisions made in Washington. A voluntary system would permit a small business to decide for itself whether it wants to continue utilizing the traditional paper coupon method for making payroll tax deposits with the government. Many business owners are telling us that they want the sense of security that they get with having their tax records on paper. Also, a voluntary system would provide the federal government with the opportunity to test the EFTPS program without resorting to tax penalties to mandate compliance by the small business community. For these reasons, the NASE commends Congressman Doc Hastings for introducing H.R. 4251, legislation to make EFTPS a voluntary program.

TAX PENALTIES

As noted above, it appears that the vast majority of businesses described as "enrolled" in EFTPS are not actually using the system. Therefore, the NASE fears that the IRS will use the traditional compliance weapon—tax penalties—to make the EFTPS program work beginning on July 1, 1997. But, tax penalties will not make a poorly designed system work. Small businesses are already weary of EFTPS. Forcing them into it, particularly if EFTPS fails to meet expectations, will only intensify public skepticism and opposition.

The NASE also believes that use of the EFTPS program over the coming months is likely to be fraught with inadvertent acts and mistakes. Therefore, the NASE strongly recommends that the House Ways and Means Committee take steps to alleviate the threat of tax penalties under the EFTPS program.

Chairman JOHNSON. Thank you, Mr. Thayer.

Mr. Mason.

STATEMENT OF RANDY MASON, GENERAL MANAGER, MASON MECHANICAL LABORATORIES, INC., SALEM, VIRGINIA; ON BEHALF OF THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. MASON. Thank you, Madam Chairwoman.

I would like to thank, Madam Chairwoman and the Subcommittee for allowing me the opportunity to represent myself and my small business, as well as the National Federation of Independent Business membership which is about 600,000 small businesses.

It is a rare opportunity for a small business man to get an opportunity to come and speak before the House and I have been very concerned about this issue ever since I first heard about it. I also was very troubled by the letter that I received informing us of it, by the wording of the letter and the fact that it was a mandate and

it was basically saying you have to do this, in addition to the fact that it is mandated.

As a small business, we see mandates every day from the State, Federal and local levels and we are constantly having to change things in order to meet these mandates. And, as small business men, we have a lot to do other than changing things to suit the government's needs and the government's requirements and, in some cases, the government's experiments in new ways to do things.

In addition to the fact that we are just against being mandated, we are looking to have a voluntary method. I have no problem with the EFTPS as a voluntary method but as a mandate it is a big problem to us.

Second, the cost to small business, I believe, is considerably more than was anticipated by Congress when this was passed by the IRS. In talking to my bank, there are two options that we could choose under the ACH credit method which is what I would prefer to go with because I do not want to deal with sending in our bank account numbers and everything and dealing directly with the IRS and that method.

So, I, looking at the other two options, the cost would be anywhere from $120 a year in fees up to $600 per year in fees. And even at the lowest option for our business that amounts to $144 million a year, for the 1.2 million businesses that will be forced, if they pay just the smallest amount involved here.

Another thing that really bothers me is the lack of written documentation, the receipts. As it stands right now, when we deposit our payroll taxes we take our check and our payroll coupon to the bank at the same time we take our normal deposits, so there is no additional time involved in going there. At the time we do that, we receive a receipt immediately as we have sent the check in. We also get the canceled check back as a receipt and the receipt we get from the bank gives us the date and time of deposit so we have proof immediately. We can file and not have to worry about it any more.

With the methods that we will be dealing with, with the ACH credit, when we do the telephone transaction we will, they say, give us a number, a code that we can put down as an authorization code. In some cases, as a businessman, I will admit that we make mistakes sometimes. What if I write that code down wrong somehow? What if I get a number wrong and then I try to go back and correct it if there is a problem?

Without us having written documentation, and having that number on a written piece of paper, I have no way of proving that I had the right number or getting the right number.

Also, in talking to my bank I found that when we do the cheaper method that is $120 a year in fees, we are not dealing directly with our bank, I am dealing with a third-party processor that is in Cape Coral, Florida. I am in Virginia, Salem, Virginia. So, that is quite a bit of distance between me and them. They, then, will take the entries off the telephone and process it, send it back across the phone lines later that day to my local bank to make the transactions. I do not like the idea of being so far separated from the

people that I am used to doing banking with. We've banked with the same bank for about 19 years.

Also, something that bothers me is the fact that this seems to go against an existing law in the fact that U.S. currency is legally able to be used to pay taxes. In a letter that my Congressman got from the IRS, it said that once you are mandated to do this, you can no longer use U.S. currency to pay this tax because there is no way to take it and deposit it at the bank. And that seems to go against the existing law. And a lot of people overlook that and say it is no big deal since we are all going electronic but that bothers me a lot.

Also, there was not enough review done before this was made into law or made a regulation. The IRS said in their statements that this was not a significant regulatory action and, yet, there are two definitions of that. One is anything over $100 million a year has an effect on the economy, which is just the cheapest fees to the banks by small business, makes it more than that.

And also, any novel legal issue or novel legal problem is another thing and the fact that you cannot use cash to pay your taxes or U.S. currency to pay your taxes seems to be that novel legal issue there.

In conclusion, I would like to ask that Congress would change this to make it totally voluntary at all levels, because in this country we are used to having the choice and the freedom to do things. I think it is ironic that this is part of a North American Free Trade Agreement and we are changing regulations and lowering fees in tariffs and all but yet, we are putting regulations and putting fees on small businesses in America which are the backbone of our country.

Thank you very much.

[The prepared statement follows:]

Statement of Randy Mason, General Manager, Mason Mechanical Laboratories, Inc., Salem, Virginia; on Behalf of the National Federation of Independent Business

Dear Committee Members,

Thank you for the opportunity to voice the concerns of myself and many other small business owners across America. My name is Randy Mason. I am part owner and general manager of Mason Mechanical Laboratories Inc.; a small, family owned business in Salem, Virginia. I first heard of Electronic Federal Tax Payment System (EFTPS) on June 10, 1996. My bookkeeper showed me a copy of IRS publication 1693 (rev. 5–96) with an article entitled "ELECTRONIC FEDERAL TAX PAYMENTS—IT'S THE LAW." My bookkeeper informed me that we would fall under this mandate beginning January 1, 1997.

As a small business owner, I have seen many regulations from both federal and state levels which affect our business. In the past I have done what most small business owners do, complain and comply. This time I decided to take a stand against what I feel is an unnecessary, unwise and burdensome mandate on small businesses in America. We are here today because many other small business owners feel this way and have spoken out against EFTPS. Following are the major concerns I have with EFTPS.

1. Small business owners are being constantly subjected to new regulations from federal, state, and local governments. Often these new regulations are accompanied by letters composed by bureaucrats, who may have never owned or run a business, informing us that these new regulations will make our jobs easier, make our businesses run smoother, and cost us less. In reality most regulations imposed on small businesses make our jobs harder, interfere with our ordinary course of business, and definitely cost us more. The IRS issued a legislative fact sheet #96–14 (July 29, 1996) stating that "TAXLINK customer surveys show that small businesses are strongly in favor of TAXLINK." If this were true, no mandate would be needed. The fact is, we are not in favor of EFTPS, nor any mandate imposing EFTPS on us.

Small businesses have been forced to act as tax collection agencies for the federal government since the Current Tax Payment Act of 1943. For 53 years we have done this with no compensation for the time required to calculate the withholding, FICA, etc. It is time for the federal government to concentrate on making itself more efficient, and stop forcing experiments on small business.

2. The cost to small businesses will be considerably more than the members of congress realized when they passed this bill (H.R. 3450). According to CRS report for congress 96–703 E (August 8, 1996); "The Joint Commission on Taxation estimated that the provision (Electronics Fund Transfer) would increase revenues by $3.3 billion over the 5 years, 1994–1998." As I understand it, these revenues would be the interest gained as a result of the funds being transferred earlier out of the business accounts and banks, and into the treasury accounts. If the federal government is gaining $3.3 billion, then it would be reasonable to assume that private business is losing $3.3 billion.

In addition to these losses, banks will be charging a transaction fee to make the electronic transfers. My bank has informed me of two options. The least expensive option would cost our business approximately $120.00 per year in fees. The more expensive option would cost our business approximately $600.00 per year in fees. If each of the 1.2 million small businesses being affected this year pay only the lesser fee, this would amount to an annual cost of $144 million.

3. With the EFTPS there is no immediate written proof of payment issued to the business. Under the current coupon system, we take our federal tax deposits to the bank at the same time we take our regular account deposits. When we make those deposits, we receive an immediate receipt with the date and time of deposit, which we keep as proof of timely payment. If the IRS has any question about our timely payments, they will require proof.

4. I am concerned with future changes that may occur if the EFTPS is fully implemented. Even though there is no direct access to business accounts in the ACH credit option under the current regulations; once the system is in place, what is to keep a future congress from deciding that they could raise an additional $3.3 billion in revenues by directly accessing business accounts and allowing the IRS to initiate the transfers. This may seem outrageous now, but in another 10 years or in a time of fiscal crisis, there will be a strong temptation to move in that direction. We have an historical model of taxation and collection of taxation in this country dating from the sixteenth amendment in 1913 which would certainly point in that direction.

5. There is a law (31 USC Sec. 5103) which states "United States coins and currency (including federal reserve notes and circulating notes of federal reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues." According to a letter sent to my congressman, Mr. Goodlatte, from the IRS (Feb. 21, 1997); the IRS states "once a taxpayer is required to pay electronically, cash will no longer be an acceptable form of payment for tax deposit payments." This raises a novel legal issue, and also raises a lot of questions.

A. Can the federal government choose for whom currency will be legal tender and for whom it will not?

B. Can the federal government make currency legal tender for all transactions except taxes?

C. Will the federal government in order to bring these two laws into agreement:

i. Repeal mandatory EFTPS?

ii. Remove legal tender status of U.S. currency?

6. The Department of the Treasury states: [federal register: September 30,1996 (volume 61, number 190, page 51180)] "the regulations are not a significant regulatory action as defined in Executive Order 12866. Accordingly a regulatory assessment is not required. It is hereby certified that this revision will not have a significant economic impact on a substantial number of small entities. Therefore a regulatory flexibility analysis is not required"

However, Executive Order 12866 states: "'significant regulatory action' means any regulatory action that is likely to result in a rule that may:

(1) Have an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities;

(2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;

(3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or

(4) Raise novel legal or policy issues arising out of legal mandates, the presidents priorities, or the principles set forth in this Executive Order."

This regulation (mandatory EFTPS) definitely falls under the definition of a "significant regulatory action" according to definitions (1) and (4). Yet the IRS chose to ignore the impact that this regulation would have. These regulations and many others should be much more carefully reviewed, not only by the agencies that write them, but also by the people who will be affected by them.

In conclusion: H.R. 3450 was introduced in the house November 4, 1993 and passed on November 17, 1993. Two weeks seems much too short a time for a massive bill with so many questionable provisions among which is mandatory EFTPS. Congress needs to correct this mistake by making EFTPS voluntary at every level of business. H.R. 722 is a step in that direction. In ten weeks over a million small business owners will be forced to comply with EFTPS if congress doesn't act quickly. If two weeks was long enough to get H.R. 3450 through, then ten weeks should be more than enough time to pass H.R. 722.

Chairman JOHNSON. Thank you very much, Mr. Mason.

Mr. Harris.

STATEMENT OF ROGER N. HARRIS, PRESIDENT, PADGETT BUSINESS SERVICES, ATHENS, GEORGIA

Mr. HARRIS. Thank you very much, Madam Chairman and the Subcommittee, it is a pleasure to be here today. I think to better understand my comments, I would like to give you a little background on Padgett Business Services, what we do, and our relationship with small business.

For the past 30 years, we have been providing accounting and tax services to small business. Our definition of a small business is one with fewer than 20 employees. So, I think we are talking about the people who are going to be affected by any change to EFTPS.

We are very much involved in administering with those clients the current paper system of paying taxes. Another part of our service is two monthly visits from one of our representatives to each of our small business clients.

Therefore, in addition to preparing reports and statements for small business, we also have the opportunity to talk to them, discuss with them issues and deal with their concerns. It is from that experience that I make my comments with regard to EFTPS.

I think what we have in EFTPS is a very good system that was miscommunicated and is misunderstood. When we have taken the time to inform our small business clients of the truth about the system, we have found EFTPS to be something that they are no longer concerned about and many of them have, in fact, chosen to enroll early.

Now, I would like to share with you how we went about explaining EFTPS to our small business clients because I think it brought out some of the questions that small business has about EFTPS. As soon as EFTPS was made public we began, through a monthly newsletter that we furnished our clients, giving them information about start dates and when they were going to be faced with this requirement. We were fortunate this past November to have Lilly McCracken from the IRS speak to our office owners, deal with their concerns about EFTPS to enable them to then go out and deal with our small business clients' concerns.

We then took it upon ourselves to listen to their questions and give them the answers that they needed. We found they had some very basic questions.

Number one, will I have to change banks? The answer, of course, is, no, but as long as they believe that they may be forced to change banks they will not be in favor of this system.

There was a tremendous amount of concern about whether or not the IRS would have access to their bank account. Again, the answer is, no, but that concern must be addressed and it must be addressed in plain english and it must be communicated in a way that alleviates any doubts that they are furnishing information to the Internal Revenue Service that those businesses do not want them to have.

And finally, is there any new equipment needed? In other words, is it going to cost me any money? Here, again, we were able to tell them that as long as they have a telephone they can comply with the EFTPS. That is all it is going to take.

Unfortunately, the information that was sent out by the IRS, and you have already discussed much of that, answered some of those questions but not in a language that I think small business is accustomed to reading and understanding.

ACH debit and ACH credit means nothing to small business owners. My bank or another bank means something. And we have to communicate to them that is really the choice between ACH debit and ACH credit. Do you wish to deal with your local bank if they subscribe or do you wish to deal with one of the Treasury agents?

And then, of course, the fees that are going to be charged. I think there is a concern. Most people prefer to deal with their local banks. There is no question about that. But if it is going to cost more I think that they are going to feel pressured to move to the two Treasury agents. But, again, when you ask them, Is it easier to take a coupon to the bank with a check than to pick up the phone and call a toll-free number, given the proper assurances that their checking account is secure, that they are not going to have to open accounts, they will say, Yes, that is better.

And I think all the people in small business understand that we get very busy at times and to remember to go to the bank on the 15th of the month or the 30th of the month can sometimes be difficult. To be able to pick up a telephone on any day of the month and warehouse a payment for a future payment date is an extremely important feature.

Finally, I would like to say that Padgett Business Services is a small business, itself. We employ 27 people. We enrolled in EFTPS January 1 of this year. We have not had one problem with the system. And we are very much encouraged by it and would continue to use it no matter what the Subcommittee decides.

I think you do have to make some changes to go forward with small business' blessings. You have to insist that the communications improve. I think at a minimum, you should assure small business that for no less than two quarters after they are required to start using EFTPS that they cannot be assessed any penalties for the time that they are attempting to learn this new system. As long as they have made an honest attempt and at the end of that

6-month period, have in fact, enrolled and are paying their taxes under EFTPS that they will never receive a bill for any penalties that they may have accrued prior to that time.

I think you have to give them time to get used to EFTPS, and you have to inform them better and when those things are done, I think that they will find it a better system than the paper system that we now have.

I thank the Subcommittee again for this opportunity to testify and look forward to any questions that you may have.

[The prepared statement follows:]

Statement of Roger N. Harris, President, Padgett Business Services, Athens, Georgia

Good afternoon Chairman Johnson and members of the committee. My name is Roger Harris, President of Padgett Business Services and I am pleased to have the opportunity to speak to you today. To help the committee better understand my comments, I should give you some background information about myself and Padgett Business Services.

Padgett Business Services has been in business for over thirty years providing accounting and tax services to small business owners. Currently, we have 292 franchised offices in the United States. We estimate that we represent over 20,000 small business owners. Our definition of a small business is one that employs less than 20 people. Businesses with less than 20 employees represent 85% of all businesses in the United States. Our service includes monthly preparation of financial statements, income tax preparation, state and local tax reports, and, finally, we prepare all federal payroll tax forms and reports for our clients. Our service also includes two visits each month by our accountant to each small business owner. These visits allow us to talk to business owners about their business and to know how they feel about issues that will effect them.

As I mentioned, I am President of Padgett Business Services. I became President in 1992 and, prior to that, I was a Padgett franchisee. From 1972 to 1992, I was one of those people who provided accounting and tax services to the small business owners we serve. Since becoming President I have assumed many other roles, but have continued to provide services to a limited number of small businesses. This keeps me in touch with small business and the rules and regulations they must comply with. I am an Enrolled Agent, Accredited Tax Advisor, Accredited Tax Preparer, and a member of the Federal Tax Committee of the National Society of Accountants.

I think the service we provide, the regular contacts we have with small business owners, and our years of experience gives us the ability to assist the committee as you look at the Electronic Federal Tax Payment System.

On July 1, 1997 more than one million business will be required to start paying their taxes through EFTPS. As the July 1 start date draws near we are hearing that this system may not be good for small business. There are suggestions to either make the program voluntary or to raise the threshold that requires participation in the program. We believe that most of the people who oppose this new payment system have not had it properly explained to them. We have all heard the myths that exist about EFTPS. We must not allow misinformation about the system to kill a system that will save the federal government a tremendous amount of money and make it easer on small businesses to pay their taxes.

Today I would like to share with you how our company is dealing with EFTPS and our clients' reaction to the system.

When we became aware of EFTPS, we began to inform our clients about the system in the tax newsletter we give them each month. In November of 1996, we had Lillie McCracken of the IRS make a presentation to our franchisees at our annual tax conference. Ms. McCracken did a wonderful job of explaining the program, and she answered all of the questions we had and the questions our clients would have about EFTPS. With this information, we were able to go out and explain to our clients as we met with them each month what EFTPS would mean to them and when they would be required to start paying their taxes electronically. We found that when our clients had all of the information they needed, they liked the program and, in fact, many elected to enroll before they were required to do so. Those clients who are now using EFTPS like the program and see it as an improvement over the current paper system. We have also changed our software to produce a report that gives every one of our clients all of the information they will need to transmit the

required payment. What all of this tells me is that when EFTPS is properly explained, small business will comply and see it as a change for the better. I believe that the problems with EFTPS are not with the program itself, but with the communication of the program.

Today, many small businesses still do not know that such a program exists or that they must comply in the near future. This is because many small business owners do not read or understand all of the mail they receive from the IRS. This problem is not unique to EFTPS. I think we can all Roger Harris Padgett Business Services agree that the Internal Revenue Service needs to continue to improve their communications with taxpayers, and I know they are working on this issue. The IRS should work with taxpayers, practitioners, and other outside stakeholders to quickly come up with a way to inform businesses that will be covered in 1998 and beyond about the new system and how to enroll in the system.

In this communication, I would ask that they look for terms that are more understandable than ACH Debit and ACH Credit. ACH Debit and ACH Credit are terms that have no meaning to small business owners. The real question that the business owners need answered is, do they use their bank or the financial institutions contracted by the Department of Treasury? Remember, you are trying to communicate a new service. What about this service helps the small business owner? Be sure to answer the question, "What's in it for me?" Small businesses do not like to be told by the Internal Revenue Service that they are required to make changes in their way of keeping records and paying their taxes without being shown why this change is good for them and the country.

Also, the booklet that was mailed to small business owners had too much information in it. How can a simple system require a thirty page book to explain? The booklet tried to answer all the questions, instead of the important questions. Additional information, such as software information, should have been made available to those who needed it rather than everyone.

I am sure it is no surprise to this committee that most small business owners do not consider the IRS their friend. Because of the way small business views the IRS, the IRS must use all of their public relations skills to properly communicate this new program. Effective communication of this program means answering some basic questions about EFTPS in a way everyone will understand.

Let's look at the basic questions small business has about EFTPS:

"Will the IRS have access to a small business owners checking account after they enroll in EFTPS?"

We all know that the answer is no, but that is always the first question we are asked by our clients when we discuss EFTPS with them. As long as this issue is in the minds of small business owners, they will oppose this system. All future correspondence with taxpayers must address this issue quickly and in a way that will leave no doubt in taxpayers' minds that the IRS cannot take money from their checking account without their awareness and without proper authority to do so. The assurances of this committee would be helpful in this area.

"Will I have to change banks?"

Again, we all know the answer to this question is no. It must be made clear that, as long as their local banks participate in this program, the program will not require a change in banks. Also, taxpayers should be made aware that Nationsbank or First National Bank of Chicago can be used, for this program, without an account at those banks. The Service must also address the issue of bank fees charged to participating businesses. This program cannot cost more to comply with if you want the support of the business community. It must not require unwanted changes such as opening new bank accounts. Again, we know this is not the case, but small business is not convinced.

"What new equipment will I need?"

Here again, we know the answer is none, beyond a touch tone telephone. This must be made very clear to the people who must use EFTPS. They do not want to pay more to pay their taxes electronically.

I know these questions have been addressed in the IRS mailings. I can tell you, however, that the questions still remain. They must be addressed again and they must be addressed in a way that leaves no doubt in business owners minds as to what the answers are. I can not stress enough that this must be done directly and in a way that is easy to understand.

I would also like to comment on EFTPS from a practitioners standpoint. For years we have computed the tax liability for our clients, properly filled out tax deposit coupon, taken that coupon to our client, and then had them write a check and take it to their bank before the due date. This was a very time consuming process and one that could cause mistakes. Now, with EFTPS, our software will not only compute the liability but, as I mentioned before, produce the form needed for our client.

The form can then either be taken to our client on our next scheduled visit or faxed immediately. The client only needs to pick up the telephone and follow the instructions and their tax will be paid. They will even be able to call at their convenience and instruct the bank to make the payment at a future date before the deadline. We too often hear stories of business owners rushing to the bank late in the afternoon to meet a deadline. This feature alone answers the question "What's in it for me?" Finally, the business owner will receive confirmation of payment for their records.

This system is not only much more efficient, but greatly reduces the chance of mistakes. Also, under EFTPS, practitioners can transmit payments on behalf of their clients. For liability reasons, we have decided not to transmit for our clients, but I know some practitioners will like that feature. I am aware, however, that some practitioners still oppose EFTPS. I can only speculate about the reasons. Some will oppose the program because it represents change, others because it is an IRS program, and still others because it is simpler and they feel it could cause their clients to question the need for an accountant. Padgett Business Services does not agree with any of these reasons to oppose EFTPS.

This committee is faced with making a decision on what to do with EFTPS quickly because millions of small businesses will be faced with the new system in a matter of weeks. Shortly after that, millions more will also need to enroll. I believe that too much has been invested in EFTPS to allow it to become a voluntary program. My experience tells me that any program offered on a voluntary basis by the Internal Revenue Service will not be successful. That would be an unfortunate result, because I feel this is a good program and, once put in place, will be well received by most small business owners. In addition, if this program is not successful, the Federal government will have wasted a great deal of time and money.

What then is a reasonable solution to the problem of a good program that, due to lack of information, has strong opposition in the small business community?

First, examine all information mailed to small businesses about EFTPS and make sure it answers all of their questions. Make sure all mailings explain why it is good for small business owners, not just that it is required. Do not mail information on EFTPS with any other IRS forms or notices. Inserts in routine mailings tend not to get noticed. Each of these mailings must address the three concerns we have discussed.

Second, stick to the stated start dates. Business owners who make an honest attempt to enroll and comply with EFTPS, however, should be excused from any penalties for the first two quarters of enrollment. This should give all taxpayers time to learn how the system works without fear of penalty.

Another suggestion would be for the IRS to make a concerted effort to update practitioners, as well as local banks, on how the program works. Every time a small business owner talks to an accountant or a banker who does not appear to understand the program, it gives the small business owner a reason to be concerned. We have heard from many clients that when they call their bank to ask about EFTPS, they cannot find anyone to help them or answer their questions. Staff members in your offices and other Congress members' offices are probably receiving many calls from small business owners as well. I would hope they have been furnished enough information to answer small business owners basic questions about EFTPS.

Padgett Business Services began using EFTPS in January of 1997. We have had no problems at all with the program, and it is now just as much a part of our routine as the old paper system once was. I am certain other businesses will feel the same way once they have used EFTPS.

As taxpayers, we are all quick to criticize the IRS when they do something we do not like or understand. In the case of EFTPS, the IRS has come up with a program that will work if allowed to do so. We should work to answer small business owners questions rather than effectively killing the program, which voluntary participation will do.

Electronic-based information is the future. To ignore this or to consider it too difficult, is not the way to achieve an efficient government, which everyone will agree is a primary concern for taxpayers. While this system may not be perfect, it is a step in the right direction. I hope this committee will agree that EFTPS must go forward. While we may make changes in the future, a delay in the start date or a rise in the threshold could signal the end of EFTPS.

I hope my comments have been helpful to the committee today. I thank you for your interest and hope you will feel free to contact me at any time if I may be of any further assistance to you.

Chairman JOHNSON. Thank you, Mr. Harris, for sharing your experience, both as a user and as a manager and educator of others.

Gene Cole from Yakima, Washington. I have been corrected.

STATEMENT OF T. GENE COLE, BOOKKEEPER, AGRIMANAGEMENT, YAKIMA, WASHINGTON

Mr. COLE. Thank you, Mrs. Chairman.

I appreciate the opportunity to testify before you today. Currently I am employed as a bookkeeper for Agrimanagement which is an agricultural consulting firm in central Washington. Our current payroll tax load is about $65,000.

I am here today to express the concerns and problems that I have had with the Electronic Federal Tax Payment System. When I first received the notice that Agrimanagement had to comply with the EFTPS I wondered what that had to do with NAFTA and why the new procedure was necessary?

The repeated use of words like mandated, you must, and you will be required, concerned me deeply. But because we were required to do this I started with the enrollment process.

I believe the fear of IRS involvement could be why there is some silence in terms of the response and the feelings toward this mandated procedure.

It has been a real headache trying to comply with this EFTPS mandated system. We began the implementation procedure in August 1996. About 1 month later EFTPS sent us a letter saying that the routing number that the bank, with which we deal in Yakima, had given me was incorrect.

I went over to the bank and showed them the letter and asked for the valid number. A different number was given and sent into EFTPS. In November we received another letter saying that this routing number was also incorrect.

I asked our bank what was going on? You would think that a mandated tax deposit procedure would be well planned and understood by the banks before putting this procedure into effect.

The bank people insisted that the number they had given me was correct. So, I then called the EFTPS phone number and asked them what number I should be using. They said they could not give me that information, that only our bank could.

After several calls I was told to contact the Federal Reserve bank that our bank dealt with. One of the tellers at our bank said it was in Seattle but that she could not give me the phone number. So, I got the information from the operator in Seattle.

I spoke with a representative of the Federal Reserve bank in Seattle who was very disturbed that I was requesting that information from her and that I even know where to call.

She kept me online and called EFTPS and spoke with someone in Illinois who called a representative of our bank in Pasco to find out why they did not have the right routing number.

The representative from Pasco then assured me that they would notify the Yakima branch of the correct routing number. I called our bank later that week and they still did not have the right number. The same bank representative I spoke with from Pasco, the

week before, said I did not need this number if I was using the credit method anyway.

However, she recommended using the debit method due to the liability placed upon the bank to get the tax payment deposited with the IRS Agency. If we chose the debit option, she recommended that we open a separate bank account for our payroll tax deposits and have the EFTPS pull the money from that account, this would keep them out of our normal business checking account.

Another point she made was that they believed that the credit method would only be temporary, eventually the debit method would be the only option available.

For all the effort to assure us that no one would be able to have access to our bank accounts, I thought it was interesting that the bank recommended opening a different account than our normal business account. It is also interesting that the bank does not want the hassle of being held liable if people choose the credit method and that they believe the IRS will eliminate the choice of a credit method anyway.

As it stands now, Agrimanagement has yet to be enrolled with the EFTPS. I am currently in the process of changing our bank and hope that I do not have to go through this procedure again. This detailed account of our expense, time, resource and mental well-being has surely been felt by thousands of businesses elsewhere. I guess we just dislike any further attempt by the government to put its hands into our pockets. I furnish this long detail to help you fortify your efforts for making the system voluntary for small businesses.

Thank you again for this opportunity to testify before the Subcommittee.

Chairman JOHNSON. Thank you, Mr. Cole.

Ms. Akin.

STATEMENT OF JUDY AKIN, ENROLLED AGENT; ON BEHALF OF NATIONAL ASSOCIATION OF ENROLLED AGENTS

Ms. AKIN. Thank you, Madam Chair, Members of the Subcommittee, distinguished guests, I am an enrolled agent engaged in private practice in Oklahoma City. I have been in private practice specializing in individual and small business clients for 23 years. I am very pleased to have this opportunity to present testimony about EFTPS on behalf of more than 9,000 members of the National Association of Enrolled Agents.

I, personally, have 14 clients using the EFTPS and my own business, as well. In December, NAEA conducted a survey of its online members which represents about 25 percent of our membership, requesting their experiences with the EFTPS. Again, in March, I requested an additional survey on the EFTPS with questions asking: How was it going in your area? Any particular problems or concerns? Are there any questions that you would like for me to share with my committee?

We received 167 responses from throughout the country. This is twice as many as those who responded to the first survey. Many of our respondents who did have clients mandated to come under EFTPS in July have referred their clients to payroll services. For other members, IRS outreach programs have provided the edu-

cation necessary. We are working with the IRS through State affiliates and local chapters to get the word out to the small business community.

Many of the December respondents indicated that there was confusion about the system which may be attributed to practitioners and clients just beginning to really focus on the EFTPS requirements. At that time, enrollment forms were not readily available. Also, the tone of the first letter was considered hostile and offputting.

However, other EFTPS documents, notably the question and answer booklet, were praised for clarity and general helpfulness. There were still requests for a plain English version for the taxpayers and NAEA members observed most taxpayers do a mental shutdown as soon as they hear a debit or credit method.

Many of our members indicated that clients fear the IRS reaching into their bank accounts and taking money, a fear which still must be overcome.

Earlier there were reports of major problems with phone lines used by the banks handling the EFTPS contracts. That problem seems to have been resolved by the time of the March survey.

Other problems concern liability of local banks to handle EFTPS. Typical was the comment, "When I went to the bank the tellers at the window did not know anything about the program. IRS should encourage the bank to fill their tellers in on what is going on."

One EA wrote, "The biggest problem is the bank's inability to tell us how they will do it and what costs there are, if any." Unfortunately, problems with the local banks were still evident in the March survey and they, perhaps, have contributed to the unwillingness of some taxpayers to enroll in EFTPS.

"EFTPS works OK, banks are not very cooperative. We have had our first catastrophe with EFTPS. Signed up all the clients as ACH debit depositors so they would get confirmation numbers when completed. It turned out that one of the banks in the area had communication errors with EFTPS and none of the clients' deposits were made.

"We do not know what position the Service will take about the deposits being made now with the coupon except that we do have acknowledgment numbers and penalties should be abated under reasonable cause."

From the surveys, we have learned that some States have already adopted a similar system to EFTPS and it is working very well.

There were also many concerns about the impact that EFTPS could have on the small business community. A central California EA wrote, "Will life continue to get more complex for our small business clients? The dollar amounts are way too low."

On the other hand, many practitioners are willing to utilize the system and have positive comments. A later March survey confirmed this.

However, there are suggestions for improvement. A number of our members offered many ways to improve the system, making the enrollment application easier, and so forth. From the comments from our members it is clear that there is a need for greater edu-

cational outreach to alleviate uncertainty and fear, particularly the fear that the IRS is going to invade the taxpayer's bank account.

In many areas of the country local banks may simply not be ready to deal with the situation. Penalties are one area that seems to be of concern to a broad consensus of NAEA members. IRS needs to be sensitive to the taxpayers. As the comments of our members indicate, there may be a way in which well-intentioned taxpayers who might have a problem with the system should not be penalized.

NAEA strongly believes that a taxpayer who retains a professional advisor, a competent payroll staff, or uses a reputable payroll service company has demonstrated an intent to comply with the law. This should be reasonable cause, in itself, for abatement of the penalties. We would envision that this would constitute a good taxpayer threshold.

Thank you.

[The prepared statement follows:]

Statement of Judy Akin, Enrolled Agent; on Behalf of National Association of Enrolled Agents

Madame Chair Johnson, Members of the Subcommittee, distinguished guests, my name is Judy Akin and I am an Enrolled Agent engaged in private practice in Oklahoma City, Oklahoma. I have been in private practice specializing in individual and small business clients for 23 years. I serve on the NAEA Board of Directors and chair the Affiliates-IRS Subcommittee for the Government Relations Committee. I am also a member of IRPAC, the Information Reporting Program Advisory Committee, at IRS.

I am very pleased to have this opportunity to present testimony about the Electronic Federal Tax Payment System or EFTPS on behalf of the more than 9,000 Members of the National Association of Enrolled Agents. Personally, I have 14 clients using EFTPS and have signed up my own business as well.

Under House rules, I am required to advise you that the National Association of Enrolled Agents receives no federal grants or contracts.

Enrolled Agents are licensed by Treasury to represent taxpayers before the Internal Revenue Service. Enrolled Agents were created by legislation signed into law by President Chester Arthur in 1884 to remedy problems arising from claims brought to the Treasury after the Civil War. We represent taxpayers at all administrative levels of the IRS. Since we collectively work with more than 4 million taxpayers and small businesses each year, Enrolled Agents can fairly be said to be at the frontlines of tax administration.

RESULTS OF DECEMBER 1996 AND MARCH 1997 SURVEYS

NAEA has conducted two surveys of its online Members—about one quarter of our membership—to gauge their experience with EFTPS. The first survey was conducted in early December 1996 and a second was done about a month ago. The responses came overwhelmingly from rank and file Members. They truly reflect the views of those tax practitioners out in the hinterlands, well beyond the Beltway.

In the first survey, we received 85 responses to the following questions: Have you reviewed the IRS information on EFTPS? Have you signed up a client for EFTPS? How did it go? Any problems you want the IRS to know about? Anything that would make the system more user-friendly? Any other comments? Any questions you would like NAEA to ask IRS?

We found in that survey that many of our Members have clients who are too small to fall under the July 1 mandate. Rather, their clients will come in next January.

I requested a second survey, along with other issues, in early March 1997. The sole EFTPS question was: "On EFTPS, how is it going in your area? Any particular problems or concerns you would like Judy Akin to share with her committee?" We received 167 responses. We thought it interesting that nearly twice as many replied during the height of filing season as in December. It may indicate greater focus by tax practitioners on EFTPS requirements.

PRACTITIONER EXPERIENCE WITH EFTPS

Many of our respondents who did have clients mandated to come under EFTPS in July have referred their clients to payroll services. As one Member put it, "I have directed all clients to contact a third party payroll tax service because these companies seemed to know what to do and how to do it. I try to get out of the payroll business whenever possible. I attended a seminar sponsored by Paychex and was impressed with their knowledge and procedures around EFTPS."

For other Members, IRS outreach—seminars in San Diego and at the Ogden Service Center, for instance—provided information they needed. From our Members' reports, we know there still needs to be educational outreach. We are working with the IRS through our State Affiliates and Local Chapters to get the word out to the small business community where we are hearing of problems. For example, the Ohio State Society of Enrolled Agents is working with the local IRS office on outreach programs.

Many of the December respondents indicated that there was confusion about the system, which may be attributed to practitioners and clients just beginning to really focus on the EFTPS requirements. At the time, enrollment forms were not readily available. Some complained that enrollment applications that were mailed in September were not acknowledged by early December. Those complaints did not appear in the March survey.

Also, the tone of some early letters—one from July 1996 in particular—was considered hostile and off-putting. As one Member noted, "It referred to more forms than most of my clients have ever heard of, much less made deposits for. It furthered the impression that the IRS is intruding into the lives of the owners of small business. It made the entire matter seem more complex than it needed to." Later letters—in October and November—were considered more friendly but the same practitioner noted, "I am still doing damage control because of the first letter."

However, other EFTPS documents, notably the Question and Answer booklet, were praised for clarity and general helpfulness. Still, there were requests for "Plain English" versions for taxpayers. As one EA observed, "Most taxpayers do a mental shutdown as soon as a debit or credit is mentioned."

OTHER CONCERNS

Many comments of our Members indicated that clients fear the IRS reaching into their bank accounts and taking money, a fear which still must be overcome. One Enrolled Agent noted that "Some of our clients who have had trouble with IRS in the past have serious problems with allowing a direct connection between their bank account and the IRS. This is especially true of people who have had liens wrongfully put on their accounts. We are still contemplating the possibility of opening an escrow account from which to transmit the funds."

Earlier, there were reports of major problems with the phone lines used by the banks handling the EFTPS contract. That problem seems to have been resolved by the time of the March survey.

Other problems concern the ability of local banks to handle EFTPS. Typical was the comment, "When I went to the bank, the tellers at the windows did not know anything about the program. IRS should encourage the bank to fill their tellers in on what is going on." In addition, there were lots of rumors about bank charges which many call unfair to small businesses. One EA wrote, "The biggest problem is the banks' inability to tell how they will do it, the cost or even when they will do it. The sense my clients have is that it will cost them $15 to $25 for each deposit by the ACH credit method. Some banks can't (or won't) do the credit method. There seems to be a lot of confusion on the banks' part."

And from another Member, "I asked my local commercial bank four months ago if they would facilitate this new requirement on their electronic banking programs. They still haven't identified a way I could work with them without using their payroll service. IRS should have worked with the Federal Reserve System banks to require that they participate and facilitate this program."

Unfortunately, problems with local banks were still evident in our March survey and they perhaps have contributed to the unwillingness of some taxpayers to enroll in EFTPS:

"Many problems with debit. Haven't found a bank that allows ACH credit method. Problems with validity of confirmation numbers."

"I've encountered three banks in Houston that don't have a clue about EFTPS."

"EFTPS works OK. Banks are not very cooperative. Some want to charge exorbitant fees by going through them. We are having most of our clients just call the IRS and have them transfer the funds."

"We've had our first catastrophe with the EFTPS system. Signed up all of our clients as ACH debit depositors so they would get the confirmation number when completed. Turns out one of the banks in our area has a communication error with the EFTPS system and NONE of this client's deposits have been drawn! The bank indicates they will probably be online around May. Let's hope. Don't know what position the Service will take about the deposits being made now by coupon to replace the ones that didn't get drawn (late by more than a month), except that we have the acknowledgement numbers."

"Because of the confusion and inability of the banks to answer questions regarding this program, my clients have been reluctant to enroll. Since most of those mandated to use the program just received their final notice last week, we'll be contacting their banks to confirm their ability to meet our clients' needs and subsequently filing the enrollment form. We can only hope that all the bugs will be worked out of the system prior to my clients having to make deposits in this manner."

"We hope the banks will begin to support the credit side of the system, since personally I have no faith in our debit bank. They can't seem to keep their records straight and mess up accounts on a regular basis. I also don't quite understand why it takes 6 plus weeks for processing when other "commercial" entities can do the same kind of processing in just a couple of weeks."

COMPARABLE STATE SYSTEMS

From the surveys, we learned that some states have already adopted systems similar to EFTPS for payment of state taxes. In those states, our Members seemed very comfortable with EFTPS.

From a Colorado EA: "We have enrolled about 15 clients and that has gone well. We have received confirmation and PIN numbers...We have been transferring Colorado withholding payments for a couple of years now and it actually works very well."

And from a Florida Member who reported no problems, "We utilize a Florida State Local Option Tax electronic program and it works efficiently."

From a New Jersey EA, "New Jersey is beginning a similar [electronic] system statewide."

From a Maryland practitioner, "I have signed up 3 clients using the ACH debit method and it is dependable. I like it for small businesses. . ."

THE SMALL BUSINESS PERSPECTIVE

There were, however, concerns about the impact EFTPS could have on the small business community:

From a central California EA, "Will life continue to get even more complex for our small business clients?"

And from another EA, "The dollar amounts are way too low. They are forcing small businessmen who are not sophisticated to apply a system that requires knowledge they don't want to acquire. I have a hard enough time getting people to not throw up their hands and go off the books now."

"This is going to be a tremendous penalty generator...dropping the threshold down to $20,000 per year causes all but very small employers to have to use this new system. Again, it is not that the little guy doesn't want to comply, it is that they may not have the savvy it takes to overcome their fear of electronics."

PENALTIES

Many of our Members in both surveys expressed concern about the transition to the new system and the penalties which could be applied.

From a Florida EA, "Two clients go on the program this year. Both are ready to run. Had no problems getting them set up although there were some delays. Telephone help was available and courteous. We like the idea and have promoted it in our publications. I think the big problem is still helping employers to understand the commitment, and giving them time to get into the system. I would anticipate many, due to unfamiliarity and disliking change, not being ready even when the procedures become mandatory. I would like to see IRS go easy on them re. penalties."

"We are advising clients to open a separate account to use for these transfers. Clients have concerns and fears of IRS having access to their regular checking accounts. A separate savings account should handle this without too much expense. Also, [we are] advising clients to go straight to IRS for transfer. With acknowledgment of transfer, potential penalty liability should be lessened. Concerned that banks might not get things right and client will be left with penalty problems."

SUCCESS STORIES

On the other hand, many practitioners who are utilizing the system have very positive comments. The later March survey confirmed earlier successes. Following are some typical reports. We would be pleased to share copies of all replies with the Subcommittee Members and staff.

"We had a 20-minute seminar from our payroll service representative [Paychex] who covered it fully. It is pretty much a no-brainer and no one should have a problem."

"I believe that this type of modernization will have a greater impact on taxpayers' daily routines than electronic filing."

"No problems so far. Everything went smooth. It is by far easier than the coupons...this is very user friendly for me. They did a super job on this on and I appreciate that they are furnishing the software."

"This is better than the TaxLink System! The best feature is the ability to warehouse the payment until the due date!"

"No problems thus far in Laguna Nigel. Let's keep our fingers crossed."

"Working fine. I have two fairly large clients who are using it and plan to start others July 1."

"Most of my clients don't plan to start until July. Like most business people, they are a little reluctant to start something new. I don't think they realize how convenient not having to go to the bank to pay taxes will be!"

"I have called the EFTPS 800 number several times and have always been treated courteously and gotten the answers I need. It was a big help to be able to tell my clients they need not supply the breakdown of the SS-Med-WH but only hit the pound sign when asked for an amount."

"I use EFTPS for one client that I prepare payroll checks. It works great! I was amazed the first time I used it how easy it was. The IRS has really done a great job with this one."

"EFTPS is working great here in South Carolina."

"So far I have had much success with this program for payroll tax deposits in the San Francisco Bay area."

"I have been using EFTPS since being available. Think it's great. The few problems I have had have been quickly resolved by their support. The support people seem to be well trained and most cooperative."

"Clients using EFTPS are having no problems and have advised me that they are getting good help from IRS."

"I haven't heard any complaints, but it sure helps those taxpayers that have a three day deposit rule and are busy."

"Clients still a bit reluctant but like it once they get used to it."

"We find EFTPS system working very well. The use of the software has made it very easy. The people at the helpline have been very helpful. Now if only California would join the bandwagon and use an easier method."

SUGGESTED IMPROVEMENTS

A number of our Members offered ways in which the system could be improved. They include

1) Making the enrollment application typewriter friendly by providing better spacing;

2) Permitting taxpayer or practitioner to go online to see what payments have been posted to the client's accounts for specific periods;

3) Providing a recordkeeping system in the instruction booklet for EFTPS to show date called, type of tax, date of payroll, amount, confirmation number, etc;

4) Lowering the batch number from 100 small businesses to as few as 10 in order to bring more tax practitioners and their clients into the program by allowing for faster processing;

5) Providing exceptions to the threshold dollar amount in the case of winding down businesses;

6) Permitting reclassification of companies with highly variable incomes because of contraction of business;

7) Standardization of software interface for use on EFTPS;

8) Permitting 24 hour a day transmittal;

9) Providing taxpayers and practitioners with a methods and procedures handbook to explain what to do in an emergency; and

10) Installing practitioner hotlines with PIN numbers so that client accounts can be monitored.

NAEA OVERVIEW AND RECOMMENDATIONS

From the comments of our Members, it is clear that there is need for greater educational outreach to alleviate uncertainty and fear, particularly the fear that IRS is going to invade taxpayer bank accounts. This is one issue which will require greater sensitivity by IRS.

In many areas of the country, local banks may simply not be ready to deal with the new system. It is also evident from the comments of EAs that many businesses, even if enrolled, do not plan to start using the EFTPS system until July 1. Penalty-free use of the EFTPS prior to July 1 may help, if that information is widely publicized.

Perhaps most significantly, a number of states have already put in place or are in the process of implementing electronic deposit of funds for state tax payments. The States of California, Maryland, New Jersey and Florida, to name a just a few, have already put in place comparable systems and practitioners report they are working well.

Penalties are one area where there seems to be broad consensus among NAEA Members that IRS needs to be sensitive to taxpayers. As the comments of our Members indicate, there are many ways in which well-intentioned taxpayers may have a problem with the system and should not be penalized.

NAEA strongly believes that a taxpayer who retains a professional adviser, hires a competent payroll/tax staff, or uses a reputable payroll service company has demonstrated intent to comply with the law. This should be reasonable cause in and of itself for abatement of penalties that occur. We would envision that this would constitute a "good taxpayer" threshold that allows periodic errors without penalty for overall long-term performance.

Thank you for allowing me this opportunity to testify today. I will answer any questions you may have.

Chairman JOHNSON. Thank you very much.

In view of your experience—there are a couple of you on the panel that could comment on this—do you think that the date at which very small businesses, that is, below $50,000, between $20,000 and $50,000, that the date of their entry into the system should be delayed?

Ms. AKIN. No, I do not believe it should be delayed. I do believe that delaying the program again would greatly hinder the integrity of the IRS. If on-again, off-again, people would take the attitude, "When are we supposed to believe the Internal Revenue Service?"

Chairman JOHNSON. I see. So, you think providing penalty relief for those who were in the system and trying is a preferable approach?

Ms. AKIN. Yes, I do.

Chairman JOHNSON. And is there more education that is needed?

Ms. AKIN. Yes. There is definitely more education needed at the small banks. NationsBank and Chicago Bank are doing a very good job. The outreach needs to go to the smaller banks, especially in the rural parts of the country and smaller towns where the banking industry is not up to date on what EFTPS is.

Chairman JOHNSON. Mr. Harris.

Mr. HARRIS. I would favor that we go ahead with the current dates as long as penalty relief is available. I am afraid if we continue to extend the start date, we are just going to be back at the same place, whenever that extension is, 30 days out, discussing whether to go ahead with the program or extend the date again.

I think what you have heard today is we have got to do a much better job educating everyone, including the banks. And a lot of the problems we are having is the misinformation that is not always

the fault of the Internal Revenue Service. It is that someone at the bank cannot properly explain the system. And, so, I think that education is a must and it must go to all levels of people who will be part of this program. But I think penalty relief is more important at this point than extension.

Mr. MASON. Can I comment on that?

Chairman JOHNSON. Yes, you certainly can, Mr. Mason.

Mr. MASON. Thank you.

I would like to say that as far as penalty relief, I do not think that is the answer to the problem. In January 1999 this is all going to happen again because nobody has brought up the point yet as to whether any of those people between the $50,000 and $20,000 level have been contacted yet. But you are just dealing with the 1.2 million today and we are going to have another 1 to 2 million that will probably come on in January 1999 and this is all going to happen again.

I think what we need is to make this voluntary and then we will not—if the system is good, businesses are going to make decisions based on what they see. And the people who are on it will talk among themselves, among business organizations and let them know if it is a good program or not. You know, we are out here in business and we make decisions every day and we make decisions that keep us in business or force us to go out of business based on the wisdom of those decisions.

I think this needs to be left to the businessowner to decide. If it is a good system it will become widespread. If it is not, then the only way the IRS is going to know that is if they make it voluntary, this will show them the weak points of the system. If it is mandated they cannot see whether this is something that people will voluntarily come to because it is good, they are forced to.

Chairman JOHNSON. Any other comments on that?

Mr. COLE. Yes, I would agree with what the gentleman, prior, just mentioned. I do not think we are against the concept of the EFTPS but it is just the initial presentation and original intent, the requirement of it being mandatory, that comes across as being very negative and which arouses the current fear people have of IRS involvement. Most of us know how long it takes to try and get ahold of someone from IRS on a phone. Many times you get just a prerecorded phone message. I would also agree with the area of this marketing concept that was mentioned earlier, of doing it in a better way so that it is a positive thing rather than a negative thing. And if it works, then great, people will join it. But I think it is best to keep EFTPS voluntary.

Chairman JOHNSON. You do understand that in keeping it voluntary there is one change that would go on and that is the past practices of banks not charging to process the coupons. Because, in the past, the banks paid for the cost of processing the coupons through the interest on the float.

They will not have the interest on the float. They do not have the interest on the float in the new system. So, even just keeping it voluntary will involve for small businesses a charge for those banks that prefer to do it the old way.

Mr. THAYER. Mrs. Johnson, if I might, as I alluded to in my remarks, we believe that whatever that nominal charge might be,

that small businesses would opt, if under a voluntary system, to pay that charge. And we believe that simply because most of our members fall in that very small category. We are fearful of 1999 because when it falls from $50,000 to $20,000, if it has not operated efficiently at the $50,000 level we are very fearful and know that it is absolutely not going to operate efficiently when it falls down to the preponderance of our membership.

So, keeping it voluntary and not mandated and, in addition to that, addressing the penalty issue if there is a nominal cost charged to the local banks because of the benefits that accrue to small business people in terms of having that relationship with their bank, we think that they would opt to do that.

Chairman JOHNSON. Thank you.

Mr. Mason.

Mr. MASON. Yes. I would just like to say regarding the charge that the banks may charge, personally speaking, I would have no problem with that. Being in business, I know that when you have expenses you have to have revenues to cover them. And to have the freedom to make that option to either use or not use the EFTPS, I would not mind paying the fee if they had to charge it for the normal transactions. There is going to be a fee with the new system and I would assume there would be a similar fee with the other.

Chairman JOHNSON. Mr. Harris and Ms. Akin, in your experience is there sort of a level of smallness at which you are making such small payments that it is not worth your while to get into the electronic system or it is too sophisticated? I mean is there a problem of smallness here that would make it either uneconomic for the small business or unreasonable?

Mr. HARRIS. I think you can probably look at the current system where, right now, if your total quarterly deposits are $500 or less you do not have to make monthly deposits, you can make payment with your quarterly report. I think it would be unreasonable to ask people, that right now do not have to pay more than once a quarter, and can mail the payment with their tax form, to go to a system any different than that.

But I think if you are going to be faced with a monthly payment obligation I just come down to this: Is it easier to pick up the telephone than to go to your bank with a piece of paper and a check and make sure you get there before 2 o'clock or whatever the cutoff time is for your bank?

So, I think that it probably has more to do with the timing of payments which has a relationship to size.

Chairman JOHNSON. Thank you very much.

Mr. Coyne.

Mr. COYNE. Thank you, Madam Chair.

Mr. Harris, what have you found in your experience to be some of the reasons why businesses hesitate to enroll in this program?

Mr. HARRIS. I think it maybe goes to the heart of the whole voluntary system. I think that it is not hard to understand that small business does not look at the Internal Revenue Service as their friend. And if you ask them to volunteer to do anything with the Internal Revenue Service, there is a certain amount of objection.

But it goes back to the three basic questions: First, will they have access to my bank account? Will I have to change banks? And will I have to buy any equipment?

When you alleviate those concerns and take it down to the level that I just referred to, either go to the bank with a coupon or pick up the phone and make a payment, most of their concerns go away, and then the fear is related to just fear of change in general.

Mr. COYNE. Well, have you found the efforts of the NFIB and NASE to be helpful or hurtful relative to the public's understanding and participation in the program?

Mr. HARRIS. I think there is just a general misunderstanding about the program, and I think we all contribute to that, again, the communication that originally came out from the Service, the media, the practitioners, everyone. I think that what we have to be able to do is go sit down, unfortunately at this point, on a one-on-one basis with each small business owner and say let me explain this program to you the way it will really work.

It is very easy to explain the program in a negative way as well. If I want to make it appear to be a very intrusive and negative program, I can do that, too. But I think when all the facts are really laid out in front of small business in a way that they can understand, most of their concerns will go away. And, again, I think they will be like us. Once you use EFTPS for a while, you will wonder why this was not available earlier.

Mr. COYNE. So that in a hearing like this today, when all sides are being heard, and particularly those who are charged with the administration of the program, when you hear from them and they are able to respond to some of the concerns of those who are charged with having to implement the program, then that ought to clear some of the misconceptions up. Would you think?

Mr. HARRIS. I would hope so. I think a big concern that we have at this point: Is the Service equipped to handle the program when fully implemented? That is something that, until we test it, I guess we will never know. So one of the reasons I see for going ahead with EFTPS is let's test the system. If it is not ready, then we have to stop it. But we have to trust them at that point that they are ready.

Mr. COYNE. Thank you.

Chairman JOHNSON. Congresswoman Dunn.

Ms. DUNN. Thank you, Madam Chairman.

Mr. Harris, I want to pursue that. It is my understanding, then, that you believe it should not be an optional system?

Mr. HARRIS. I think in essence, if you make it optional, you are going to end up killing it with most small businesses, and that is, unfortunately, just the perception of the Internal Revenue Service. It is not a judgment of the program.

Ms. DUNN. But why would you say you would end up killing the program if it is a good program and small business has proved over and over again, as Mr. Mason said, that if it is a good program, they will take advantage of it?

Mr. HARRIS. I am not sure they will give it a chance. I think when you—and this comes from many years of dealing with small businesses and their perception of the IRS, the IRS is judged solely on the fact that they collect money and audit, not other things that

they do. It is for that reason that they may never give EFTPS a chance. Change is not always easy to accept, even when it is for the better. And I think that small business may just object to an IRS program.

Ms. DUNN. Are you a small business man, Mr. Harris?

Mr. HARRIS. Yes.

Ms. DUNN. Is yours one of the 1.2 million mandated taxpayer——

Mr. HARRIS. Yes, but we went ahead and enrolled early.

Ms. DUNN. You did?

Mr. HARRIS. Yes.

Ms. DUNN. Would it ease you a little bit if you knew, as Representative Hastings testified this morning, that the Treasury Department has recently verified in a letter that in just 3 years they have accelerated revenue collections by $2.8 billion—and as you will recall, their goal for the total program was $3.3 billion through the use of these transfers. It does not include the 1.2 million taxpayers that are scheduled to begin using the EFTPS for their obligations on July 1. Would that ease your approach toward this whole thing? Because I think what we are debating here is whether this should be optional to the taxpayer. Apparently, it does not ease the burden of paperwork for the small business, and yet they are far ahead of their goals when it comes to raising the amount of money they wanted to bring in early.

Mr. HARRIS. Obviously, the benefit to the Federal Government is enormous in picking up the float on the early payments. And I think to the extent that those goals were being reached ahead of schedule, that is tremendous.

I guess my only hesitation about a voluntary program or extending the deadline is: What are we going to do during that period of time? I have no problem with extending the deadline if the purpose of that is to do a better job of informing the small business community of what this program is all about, with the intent that we go forward with it at some date. I think just to say it is voluntary and leave everything as is is going to effectively make the program—though it may be effective in the revenue collection, it will not be as effective as it could be because thousands of businesses will never participate.

Ms. DUNN. It seems to me that when you run into a program of this magnitude that in most management situations you do ease it in or phase it in over a period of time. I would suggest that you and Mr. Mason and Mr. Cole sit down and help the IRS write that marketing plan that they need to have so that the public relations will be out there and people will understand this program. And meanwhile we go ahead and make it an optional program. And I do believe that if it is sold properly, as many of you have said, some of the consternation with the program will be overcome. But it appears to me from the testimony we have heard today, not just from your panel but the add-up of the testimony from all the panels, makes it seem more and more obvious that this is a program that was poorly sold and has created its own obstacles and that it could be a very good program in the long run and accomplish at least the two major goals if it were phased in.

Thank you, Madam Chairman.

Chairman JOHNSON. Thank you.

Congresswoman Thurman.

Ms. THURMAN. Thank you, Madam Chairman.

You know, one of the things that strikes me in this conversation is we talk about this as being a mandate, but nothing has really changed here. I mean, you are still going to pay the tax. Correct? So really the only difference is in the form of how it might be paid. Would you all agree with that.

I do not know—maybe the Chairman can tell me; this is my first year—how many times this has changed before. I mean, we talk about a coupon. Have there been other ways that this has been submitted before? Maybe you can tell me. Is there this kind of confusion any time we change it. I mean the bottom line is we are still going to remit the money.

Beyond that, I need to ask Mr. Thayer a question. When we talk about education, we seem to put it on the IRS. I have looked at the exhibits from previous testimony regarding the amount of things that have been sent out, the videos, the questions that needed answers, and so forth. In your organization, have you invited either the IRS or any other groups of people—the banks—to come in and talk to your membership as to how this system should work?

Mr. THAYER. Yes, we have, Ms. Thurman. We actually had Ms. Richardson come in and address us at our annual meeting. Even prior to that, when this first came out and we discerned from our membership that very few people really knew what it was all about and certainly were not prepared for it, we were among the first to sound an alarm here on the Hill saying we need to hold off and do something. And in that process——

Ms. THURMAN. When was that?

Mr. THAYER. We disseminate more than 400,000 newsletters nationwide to our membership and others. In that process, we laid out an educational piece that covered more than one page on here is how it will work and here is what we must do to get ready for it. And we would be amenable to doing even more with the IRS in terms of educating the membership.

Ms. THURMAN. When did those classes take place, or when was that offered to your membership?

Mr. THAYER. When was the newspaper offered to our membership?

Ms. THURMAN. No, when did Ms. Richardson come?

Mr. THAYER. Ms. Richardson came to our group last year. I do not recall the exact date, but it was also in conjunction with the whole simplification process. At that same time, the IRS had come out with a simplified form of understanding the independent contractor bill, if you recall that.

Ms. THURMAN. Right.

Mr. THAYER. And that is when she came to our membership, and included her remarks in that as well.

Ms. THURMAN. Was there a question and answer period that took place after her remarks?

Mr. THAYER. Afterward, she did not have too much time, in all honesty, but she did speak with a couple of our people as she was departing.

Ms. THURMAN. Can you give this Subcommittee some examples of the kinds of questions that were asked regarding the IRS so that

we might know? I mean, I am sure she took that information back, but just for our clarification to know where some of those problems are?

Mr. THAYER. I was not privy to any specific conversations between her and the individual members. However, those questions that you have heard raised here, especially by Mr. Harris, are the questions that were so very much indicative of the questions that were raised at our meeting following her departure. And that is, you know, after dealing with the penalties, do I have to change banks? Which was one of the main things that was raised.

Ms. THURMAN. Sure.

Mr. THAYER. In addition to that, the other questions you know—what equipment do I have to use and really common questions that accrue to the smallest of small business people and what is the burden going to be on me.

Ms. THURMAN. These have been part of the conversation today—the myths and the reality. You just raised the questions that seem to be part of the myths. Hopefully, most of them will be cleared up today.

Mr. Mason, since you are part of the NFIB, I have a question for you. As a businessman—and, Mr. Cole, maybe you, too, from organizations that might be involved in your area—did you ever get notice from any of these organizations or did you get any help? Did they tell you that there might be IRS coming into town to go through an explanation, that there might be a video at the bank to help you through this? I am not so sure that helps you, Mr. Cole, under the circumstances that you were in with the bank. But I am just curious to know what the organizations have done themselves in helping businesses such as yourself comply with this.

Mr. MASON. I can say the NFIB has always been very helpful for any questions we had as far as questions about this issue. One thing I found since I became interested in this back on June 10 when I first got the notice was that it seems that very few people have a full realization of what is going on here, not just business organizations but the banks, the IRS. It is like everybody has a piece of it, but nobody can really give you all the information about what is going on, how the process works. And I think that is a lot of the fear that businesses have, and that is why they do not want to be forced to do something that they are not comfortable with. And I think that is an educational process.

As I said before, I do not have a problem with a voluntary system, but when you mandate something like this, it is going to be a battle with the people who it is being forced upon. And we have a lot of other things to do in business than that.

I know I have spent—on the subject of the cost of this, to me personally it has been very expensive because I cannot tell you the amount that I have lost already in the time that I have spent in just trying to stop something being forced on my business.

Now, I did not have to do that. I could have just said, OK, we will do it and not had that expense. But I feel that it is something that is important that we have that choice rather than being enforced upon.

Ms. THURMAN. And I can understand that. However, if one of the things that I hear correctly is that, you know, this is a telephone

call away instead of going to the bank, are those not some benefits. Yes, Mr. Cole, I know you have had an awful experience in what has happened to you with the PIN numbers. But once it was up and running everything was fine. It seems to me in the long run that there are some real benefits to this.

If I were trying to do my banking and doing some other things where I could just pick up the telephone, put my number in, and have it done, I would be a real happy person. What do you think, Mr. Cole?

Mr. COLE. We use the telephone for reporting for our State labor and industry, and we have had no problems with that. It works just fine.

Ms. THURMAN. How long has that been going on?

Mr. COLE. I am not exactly sure, but it has been about 1 year.

Ms. THURMAN. OK.

Mr. COLE. And as far as the education material, I did have a number of notices—I cannot remember exact publications—that this was coming out. But there was nothing educational that I ever received.

Ms. THURMAN. This is a real difficult issue, from a congressional side of it because we have to streamline programs.

Let me ask one other question, maybe this to Mr. Mason and to Mr. Cole. Are either one of your States one of the States that have been discussed as far as already going through electronic transfers?

Mr. COLE. Not ours.

Mr. MASON. Our State does not currently have mandated, but I think they are talking about it.

Ms. THURMAN. OK. So you may be faced with this at the State level?

Mr. MASON. Yes, we may be faced with this at the State level, also.

Ms. THURMAN. I bring that up because in Ms. Akin's statement she talks about different States that are going through this system, and there has been some positive feedback. Being from Florida, I obviously noted that Florida was one of those that does this, and the agents have said it has been a very positive system.

Ms. AKIN. Yes, we have heard no real complaints about the States that are doing it, and most of them are saying there is a Federal-State option, and it is working very well for them.

Ms. THURMAN. Mr. Thayer, you started to say something. Somebody else was speaking, but I will be glad to come back to it.

Mr. THAYER. I simply wanted to respond to your remark when we were talking about a simple change in the method of payment. And you are absolutely correct, and I would hope that you understand that the NASE and I do not think the NFIB is opposed to the system in terms of making it better, not only for the government but for the taxpayer.

What we have a problem with here is the process of making that change, and that is simply what we are addressing here today. Our members do not understand right now what it is all about, and they do not understand and they cannot get their questions answered when they pick up the phones. We must address this, whether it be through a mass marketing campaign that everyone is involved in, including the associations and the government, or

whether it be individually. We must educate the people before we complete the process, and that is what we are saying here today, is that we have problems with the process.

Then if we do that and we educate rightly, if we educate well, if the system is good, small business people will elect to participate in it because it will be simpler for them and they would elect to participate in it. I believe that very firmly.

But unless we allay those fears, they are going to do just like Mr. Harris. They are not going to participate in it, and rightly so, because they have to base it upon the track record that they have seen as far as IRS is concerned.

Ms. THURMAN. I guess where I might disagree a little bit is—and not on the education part of it, but I notice that in your testimony actually the survey was done in 1996. The testimony that we heard today is that now we have 960,000 people that have actually enrolled, maybe not totally signed up, but the education is starting to happen. I guess I think it is incumbent on us as legislators, you as somebody representing self-employed, or NFIB, the IRS, for us to start making this more available to people at home so that they can get these questions answered.

On the other side of this, we are looking at programs not only to small business, but also regarding welfare reform. During the welfare deliberations, you all came to us and said we have got to have the EFTPS so that we can have the electronic transferred benefits for welfare recipients. So, actually, in some degree, this is a good lesson because one group of people are saying this is what has to happen. It is going to be very confusing to them. I hope that people are listening to some of this testimony today so that when we start getting into that whole issue we can calm some of those folks down as well.

But a lot of this is taking place because of the technology. We are moving ahead, and I somewhat agree that it is going to be difficult to stop it. Because I think if we stop it, then we are going to end up having people opt out of it, and then we are going to have two or three different kinds of systems out there. And I think that could even be more confusing and less efficient for our government and for the people that we represent.

Thank you, Madam Chairman.

Chairman JOHNSON. Thank you very much. I appreciate this panel's input, and certainly, Mr. Thayer, Mr. Mason, and Mr. Cole have certainly made very clear the lack of information that is out there. And when I look at the information that IRS provided to Members of Congress late in July and the job that Mr. Harris and Ms. Akin have provided for the businesses they deal with, there really is a terrific educational problem. And that really has to be dealt with or we cannot move forward in a way that is good for everybody.

Thank you very much.

Let me call the last panel, if I may: Regina Lee, the vice president of government affairs for Automatic Data Processing; Carolyn Kelley, director of government affairs for American Payroll Association; and John Foehl, chief financial officer and treasurer of the Housing Authority Insurance, on behalf of the Treasury Management Association, accompanied by Arlene Chapman.

I am sorry to keep this last panel waiting so long. We appreciate your patience, and we will appreciate your input.

Regina Lee, please, would you proceed? You know that your testimony will be submitted in its entirety, and you have 5 minutes. The yellow light will warn you when you are within 1 minute.

STATEMENT OF REGINA R. LEE, VICE PRESIDENT, GOVERNMENT AFFAIRS, AUTOMATIC DATA PROCESSING, INC.

Ms. LEE. Madam Chairwoman and Members of the Subcommittee, I am pleased to have the opportunity to testify on behalf of ADP at today's EFTPS hearing. ADP has provided payroll, human resources, tax deposit, and reporting services to a broad range of clients for over 40 years. We are proud to serve more than 375,000 employers, many of whom are members of the small business community.

Over a period of many years, ADP has demonstrated its commitment to assist the IRS and various other governmental entities with a broad array of automation-related initiatives such as the TaxLink pilot, the Electronic W–2 pilot, and STAWRS. We believe that EFTPS can provide a significant benefit for Federal tax administrators in moving toward a more efficient tax deposit system.

ADP is a leading member of the service bureau industry, which provides payroll processing and employment tax services for over one-third of the private-sector work force. Along with other providers, ADP has worked closely with the IRS during the past 3½ years in an attempt to ensure a smooth transition to EFTPS.

We have assisted the IRS with its public education efforts to promote employer awareness, understanding, and enrollment in the new system. We have made EFTPS implementation the number one priority in our tax service business and have spent a considerable amount of time and resources to modify our systems as well as educate and prepare our clients. Every one of our clients has been successfully enrolled in the system for deposits ADP will make on their behalf.

However, we are concerned that serious issues remain to be addressed before the system can expand without serious negative consequences from 1,500 mandated employers to 1.2 million mandated on July 1. These include the need for timely notification to taxpayers of mistakes, the lack of emergency backup procedures, and the ability to make file reversals. I will now briefly review each of these issues.

First, timely notification. Understand the current structure of the EFTPS System. The IRS will not notify taxpayers of a failure to correctly use EFTPS until several months after the mistake has been made. A taxpayer, unnotified of the problem who continues to pay all his taxes by the FTD coupon, will be assessed a 10-percent penalty on that deposit and each successive deposit until actually notified. This could amount to as many as 5 months of Federal tax deposits.

Each deposit would be subject to a 10-percent penalty, even if all the tax deposits were made in a timely manner. This taxpayer would be subject to a penalty that is 4 times greater than its actual semiweekly tax liability. We have a chart that illustrates our con-

cern and shows that a taxpayer who paid his liability on time ended up with a $50,000 penalty.

The IRS has recently indicated that employer readiness and enrollment in the system have increased dramatically, and they are prepared to go forward. Nonetheless, there are still more than 200,000 mandated employers not prepared to switch to electronic payment less than 100 days from today.

In addition, we project that in the early months of operation, there will be considerable taxpayer confusion as to how EFTPS operates and how to determine which taxes are covered by the rules. Nothing will do more to harm taxpayer acceptance of EFTPS than the triggering of tens of thousands of notices to employers next December. Given the harshness of the penalty, 10 percent per deposit on all taxes paid, a solution for this notification issue must be in place before taxpayers are subjected to this penalty.

Second, emergency procedures. The IRS has not provided a method for responding to system interruptions caused by unforeseen disasters or emergencies. Given the extremely tight timeframe for transferring funds and data under EFTPS, any one of a number of breakdowns, even 1 hour or less at a critical time, could result in a failure to complete timely deposits successfully.

The emergency procedure exists for EFTPS primarily because, unlike the current system, EFTPS requires transmission of both taxes owed and all related payroll data at the same time. In contrast, under the current system, IRS procedures allow for separation of funds and data. This offers service providers the flexibility to respond to situations where data is not available or, because of last-minute employer payroll adjustments, the data is in need of refinement before submission.

Currently, when there is a breakdown, service providers can estimate tax deposits due and transfer by wire all the necessary funds on the due date. Specific payroll data underlying a tax payment can be provided within the 4 days after the payment due date. Even in emergency situations, the 4-day cleanup period has always been sufficient to overcome submission problems.

No similar mechanism exists for EFTPS. Even in an emergency, the IRS has said it cannot accept the payment of funds without all the supporting data. The elimination of the 4-day cleanup period means that in an emergency situation, the lack of data will preclude the making of a timely funds deposit. The result is that the IRS will issue thousands of late payment notices to taxpayers. Taxpayers would be required to seek abatement of the penalties on the basis of reasonable cause either through their service provider or on their own.

To eliminate these serious consequences and associated burdens, an emergency procedure must be established prior to the next phase of implementation. The procedure should allow timely submission of funds while providing flexibility for transmission of supporting data. Such an emergency procedure clearly can be developed within the statutory requirements of EFTPS.

We have a chart that demonstrates what the current practice is and compares it to the requirement under EFTPS. It also lists a proposed standby procedure.

Third, file reversals. The IRS has not provided procedures regarding reversal of a bulk file in the event of a computer or human error. Bulk providers deposit on behalf of hundreds of thousands of taxpayers. Therefore, a systemic means to reverse a duplicate file once submitted is essential. One bulk provider file may contain funds and data for hundreds or thousands of taxpayers. Absent such a procedure to reverse files, thousands of erroneous notices could be sent to taxpayers.

While we appreciate the comment that was made this morning by the financial agent regarding an edit that exists, we do not believe that that edit is adequate to handle the concerns that we have.

Madam Chairwoman, service providers such as ADP are in the business of furnishing a broad range of payroll and employment services to our employer clients. Our clients look to us to simplify the tax payment process and to assure that they comply with their obligations in an accurate and timely manner. When things go wrong and they receive a government penalty notice, they look to us, as they should, to deal with the problem. We remain quite concerned that, despite several years of effort, important bulk filer issues have not been fully addressed. Each of these problems could result in the issuance of sizable penalty notices to tens of thousands of taxpayers in the next year. Nothing would do more to undermine the acceptance of the new system with either the Congress or the taxpayers than such an occurrence.

We urge the Subcommittee to examine these issues closely. We hope you will encourage the IRS to acknowledge their significance and announce specific plans to resolve them within the next few weeks. We are prepared to provide any technical assistance needed.

I would like to note that we were very encouraged by Mr. Donelson's testimony this morning, specifically regarding his willingness to look at separating funds and data in the event of an emergency. We look forward to meeting with him to further discuss that.

Mr. Chairman, we strongly believe that significant work must be completed within a very short timeframe in order for the next phase of EFTPS implementation to succeed.

Thank you, and I would be very happy to answer any questions you may have.

[The prepared statement and attachments follow:]

Statement of Regina R. Lee, Vice President for Government Affairs, Automatic Data Processing, Inc.

INTRODUCTION.

Madam Chairwoman and members of the Subcommittee, I am pleased to have the opportunity to testify on behalf of ADP at today's EFTPS hearing. ADP has provided payroll, human resources, tax deposit and reporting services to a broad range of clients for over 40 years. We are proud to serve more than 350,000 employers. Over a period of many years, ADP has demonstrated its commitment to assist the Internal Revenue Service ("IRS") and various other governmental entities with a broad array of automation-related initiatives such as the TaxLink Pilot, the Electronic W–2 pilot and STAWRS. We believe that EFTPS can provide a significant benefit for federal tax administrators in moving toward a more efficient tax deposit system.

ADP is a leading member of the service bureau industry, which provides payroll processing and employment tax services for over one-third of the private sector work force. Along with other providers, ADP has worked closely with the IRS during the

past three and one-half years in an attempt to ensure a smooth transition to EFTPS:

• ADP has worked with the payroll service community to identify and resolve issues of concern to bulk filers; we have made numerous technical submissions regarding these issues and have participated in more than 20 industry meetings with the IRS;

• We have assisted the IRS with its public education efforts to promote employer awareness, understanding, and enrollment in the new system. These efforts include CPA seminars, videos, educational information packets and a unique public/private partnership with the Small Business Administration to develop materials and conduct small business seminars throughout the United States; and

• We have made EFTPS implementation the number one priority in our tax service business and have spent a considerable amount of time and resources to modify our systems as well as educate and prepare our clients; every one of our clients has been successfully enrolled in the system for deposits that ADP will make on their behalf.

EFTPS IMPLEMENTATION SCHEDULE.

The IRS has been required to implement a very complex system under difficult time constraints. Since EFTPS was phased-in to accommodate the year-by-year revenue funding needs of NAFTA, sufficient flexibility was not provided to implement this complex new system. For example, new IRS and related banking systems had to be developed and fully tested. Millions of employers had to be made aware of the significant changes in the payment methods, learn about specific requirements, and become properly enrolled.

In private industry, any systems change of such magnitude and complexity would be phased-in by manageable increments over reasonable time intervals. This would allow for ample testing and refinement to ensure smooth implementation and minimize the risk and serious consequences of system failures.

SERIOUS PROBLEMS STILL EXIST.

Last summer, it had become clear that EFTPS was not ready for the scheduled January 1, 1997 dramatic increase in mandated employers. At that time, we believe that the Congress acted prudently to enact a six-month delay.

Progress has been made since then on system development and employer readiness. At the same time, despite the collaborative efforts of many, we are concerned that serious issues remain to be addressed before the system can expand without serious negative consequences from 1,500 mandated employers to 1.2 million mandated on July 1. These include the need for timely notification to taxpayers of mistakes, the lack of emergency back-up procedures, and the ability to make file reversals. In recent weeks, we have had meetings with both your Committee staff and the IRS on these implementation issues. However, we have not yet received assurance that the IRS is willing, or technically able, to address these "bulk filer" issues of critical concern to payroll service providers, prior to July 1.

I will now briefly review each of the major bulk filer issues:

1. *Timely Notification*: Under the current structure of the EFTPS system, the IRS will not notify taxpayers of a failure to correctly use EFTPS until several months after the mistake has been made. A taxpayer, unnotified of the problem, who continues to pay all his taxes by the FTD coupon method, will be assessed a 10-percent penalty on that deposit and each successive deposit until actually notified. This could amount to as many as five months of federal tax deposits. Each deposit would be subject to a 10-percent penalty—*even if all tax deposits were made in a timely manner*. This taxpayer would be subject to a penalty that is four times greater than his actual semi-weekly tax liability.

The IRS has recently indicated that employer readiness and enrollment in the system have increased dramatically, and they are prepared to go forward. Nonetheless, there are still more than 200,000 mandated employers not prepared to switch to electronic payment less than 100 days from today.

In addition, we project that in the early months of operation, there will be considerable taxpayer confusion as to how EFTPS operates, how to properly access the system, and how to determine which taxes are covered by the rules. Nothing will do more to harm taxpayer acceptance of EFTPS than the triggering of tens of thousands of penalty notices to employers next December.

We understand that the IRS is now aware of the penalty notification problem and is trying to develop a procedure for more timely notification to taxpayers. *Given the harshness of the penalty—10 percent per deposit on all taxes paid—a solution for this notification issue must be in place before taxpayers are subjected to this penalty.*

2. *Emergency Procedures*: The IRS has not provided a method for responding to system interruptions caused by unforeseen disasters or emergencies. Recent examples include the nine-state West Coast blackout and a 1995 system failure at the Minneapolis Federal Reserve Board. Given the extremely tight timeframe for transferring funds and data under EFTPS, any one of a number of breakdowns, even an hour or less at a critical time, could result in failure to complete timely deposits successfully. These interruptions could be between an employer and its service provider or between the service provider and the government's financial agent.

The emergency procedure issue exists for EFTPS primarily because, unlike the current FTD system, EFTPS requires transmission of both taxes owed *and* all related payroll data at the same time. In contrast, under the current deposit system, IRS procedures allow for separation of funds and data. This offers service providers the flexibility to respond to situations where the data is not available or, because of last-minute employer payroll adjustments, the data is in need of refinement before submission. Currently, when there is a breakdown, service providers can estimate tax deposits due and transfer by wire all necessary funds on the due date. Specific payroll data underlying the tax payment can be provided within four days after the payment due date. Even in emergency situations, the four-day "clean up" period has always been sufficient to overcome submission problems.

No similar mechanism exists for EFTPS. Even in an emergency, the IRS has said it will not accept the payment of funds without the supporting data. The elimination of the four-day data clean up period means that in an emergency situation, the lack of data will preclude the making of a timely funds deposit. The result is that IRS would issue thousands of late payment penalty notices to taxpayers. Taxpayers would be required to seek abatement of the penalties on the basis of reasonable cause, either through their service providers or on their own.

To eliminate these serious consequences and associated burdens, an emergency procedure must be established prior to the next phase of implementation. At a minimum, the procedure must allow timely submission of funds while providing flexibility for transmission of supporting data. Such an emergency procedure clearly can be developed within the statutory requirements of EFTPS.

3. *File Reversals*: The IRS has not provided guidance or procedures regarding reversal of a bulk file in the event of computer or human error. Bulk providers deposit on behalf of hundreds of thousands of taxpayers. Therefore, a systemic means to reverse a duplicate file once submitted is essential. One bulk provider file may contain funds and data for hundreds or thousands of taxpayers. Absent such a procedure to reverse files, thousands of erroneous notices could be sent to taxpayers. These taxpayers, who have paid their taxes in a timely way and who have made every effort to deposit correctly using the new EFTPS system, will be confused and frustrated with both their service provider and the government. *This confusion, frustration, and perhaps ultimate distrust can be avoided if critical systems issues, including the ability to reverse a duplicate bulk file, can be resolved in advance of the next stage of implementation.*

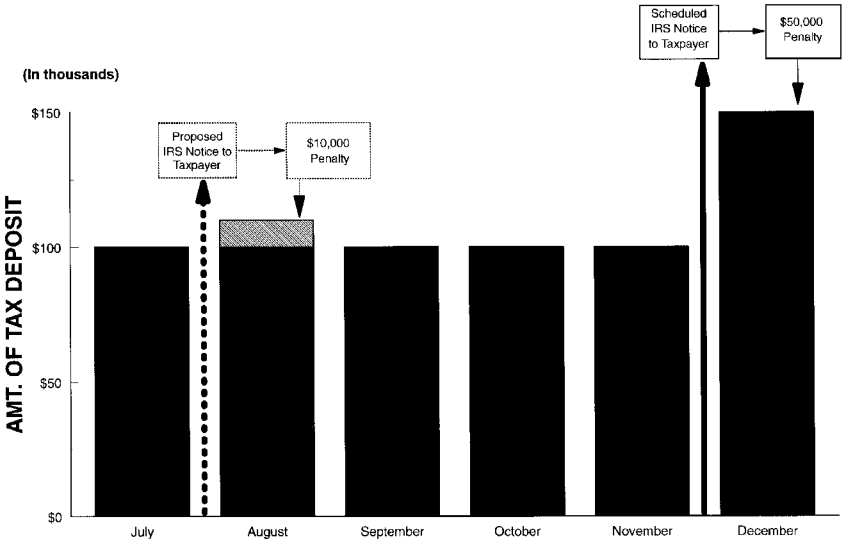
Madam Chairwoman, service providers such as ADP are in the business of furnishing a broad range of payroll and employment services to our employer clients. Our clients look to us to simplify the tax payment process and to ensure that they comply with their obligations in an accurate and timely manner. When things go wrong and they receive a government penalty notice on a tax deposit or payment question, they look to us—as they should—to deal with the problem.

We remain quite concerned that despite several years of effort by the IRS and service providers, important bulk filer issues have not been fully addressed. Each of these problems could result in the issuance of sizeable penalty notices to tens of thousands of taxpayers in the next year. Nothing would do more to undermine the acceptance of the new system with either taxpayers or the Congress than such an occurrence.

We urge the Subcommittee to examine these issues closely. We hope that you will encourage the IRS to acknowledge their significance and announce specific plans to resolve them within the next few weeks. We are prepared to provide any technical assistance needed.

Madam Chairwoman, we strongly believe that significant work must be completed within a very short timeframe in order for the next phase of EFTPS implementation to succeed.

EFTPS FILING PENALTY: THE NEED FOR TIMELY TAXPAYER NOTIFICATION



The Need for an Emergency/Disaster Procedure

	Current IRS Procedure	EFTPS	Proposed Standby Emergency Procedure
Due Date -1		Data Transmitted Funds Amount Fixed Receive Confirmation from Financial Agent	Obtain IRS Pre-Approval for Use
Due Date	$ Funds Paid $	$ Funds Paid $	$ Funds Paid $
Due Date +1	Refine Data		Data Delivered as Recovered
Due Date +2			
Due Date +3			
Due Date +4	Data Delivered		Deadline for Data Delivery

Mr. PORTMAN [presiding]. Thank you, Ms. Lee.

Our next panelist is Carolyn Kelley, director of government affairs of the American Payroll Association.

Ms. Kelley.

STATEMENT OF CAROLYN KELLEY, DIRECTOR OF GOVERNMENT AFFAIRS, AMERICAN PAYROLL ASSOCIATION

Ms. KELLEY. Good afternoon, Mr. Chairman and Members of the Subcommittee. I am Carolyn Kelley, director of government affairs for the American Payroll Association, and although I think I have managed to keep my remarks to 5 minutes, I would like to submit our longer written testimony and these oral remarks for the record.

APA represents more than 14,000 U.S. businesses and the payroll managers in them who will be responsible for meeting the new requirements of the EFTPS System. A large majority of the currently mandated businesses are APA members, and the July 1, 1997, phase-in of 1.2 million taxpayers will include over 90 percent of our members. APA has sought to work with the Federal Government during the design and implementation phases of EFTPS since early in 1993.

APA has also placed articles in newspapers and magazines, reaching millions of taxpayers and hosted or participated in hundreds of EFTPS seminars across the country to inform taxpayers about requirements. Our goal has been and continues to be a successful implementation of the system.

APA is going to urge Congress to move forward with the EFTPS implementation but provide an amnesty period which would protect taxpayers from penalties until certain critical issues and the need for system enhancements and further taxpayer education are resolved. We also have specific recommendations on how to do this.

Regarding the current status of EFTPS implementation, as Commissioner Morris stated this morning, no final EFTPS regulations or revenue procedures currently exist to guide taxpayers. Information on EFTPS requirements available to taxpayers is inadequate, and many taxpayers remain unaware or misinformed about the full extent of the requirements. To illustrate, APA talked to a reporter from New Mexico who recently contacted IRS and was told that only employment taxes are due through the EFTPS. She thought that this was wrong and went on the Internet. She came across information on EFTPS from an accounting firm, which was reputable in her State, which was incomplete and inaccurate. She finally called Senator Pete Domenici's office and was finally given correct information. It is no wonder that some 177,000 mandated taxpayers are not correctly enrolled.

But this number is not the whole story, frightening as it is to imagine that many penalty assessments. There is, in fact, a critical distinction between the 1.2 million taxpayers who are mandated to use the EFTPS on July 1 and the number of taxpayer enrollments which will be needed to meet the mandate. The fact is many taxpayers will have to enroll more than once to comply with EFTPS.

For example, there are those who will need to enroll more than one bank account. There are also those who have to enroll sepa-

rately for any tax types that their payroll service providers does not handle for them.

Come July 1, many more taxpayer enrollments will be outstanding than the numbers stated today suggest. In fact, many more than 1.2 million taxpayer enrollments will have to be processed. We predict tens, if not hundreds, of thousands more.

We urge IRS and Congress to consider what happened after the 1995 and 1996 implementation dates. There was confusion on the part of the largest and most sophisticated companies in the United States, and IRS contacted unenrolled companies to help them to comply. How much more confusion may exist now with smaller, less sophisticated companies? This time, however, there will be too many to call.

The next issue is penalties. As previously discussed, IRS has chosen to assess a 10-percent avoidance penalty on every mandated tax deposit that is not made through the EFTPS. These penalties are inappropriate and grossly punitive, and to our minds, indicate that IRS is willing to educate taxpayers through penalty assessment. In fact, according to testimony submitted today by FMS, IRS has been advised by contractors that penalties are necessary to stimulate compliance. Why is this penalty 5 times that of the first late payment penalty of 2 percent? If a taxpayer mistakenly uses the FTD coupon instead of the EFTPS System, taxes are still paid accurately and on time.

But it gets worse. IRS' penalty system, as Ms. Lee pointed out, is not able to notify taxpayers that they are not depositing correctly until potentially 4 or 5 months after July 1. Thus, taxpayers who fail to understand that they have to enroll in EFTPS but who are still paying the correct amount of tax on time, using their paper coupons, will receive penalty notices of 10 percent for every single deposit made from July 1 until the IRS notifies them potentially in December.

In addition, the EFTPS' enrollment process is manual and currently takes 2 to 10 weeks. So if a taxpayer manages to discover his error after July 1 and tries to enroll, he will find that the EFTPS will reject his payments until the enrollment process is completed. Meanwhile, the 10-percent avoidance penalties will continue to mount even though the taxpayer is doing everything within his power to pay his taxes.

Next is the unknown strain on EFTPS Systems and taxpayer service functions that will be caused by the jump from the current mandate of some 1,500 U.S. businesses to 1.2 million all at once. We have heard testimony today that seeks to convince us to have confidence in the EFTPS System. APA is not here to dispute the merits of the system; rather, we caution that in any system implementation of this size, problems will occur. That is a simple fact of life.

In the case of EFTPS, this means taxpayers will be assessed penalties. One example that we know of is one of our members who tried to make a deposit of $1.7 million on Monday, March 24, and that deposit was not accepted until 3 p.m., despite repeated efforts to make it. This Monday, I myself could not get through to one financial agent's taxpayer service line until close to noon. I received

a recorded message telling me my call could not be completed as dialed.

What would have happened in these situations if 10 times the number of mandated taxpayers had been competing against each other to pay their taxes on time? We don't know.

APA cautions that although, as has been said today, some 200,000 taxpayers are currently using the system, all but 1,500 of them are using it voluntarily. So, in fact, we do not know how the system will handle the volume of mandated taxpayers about to use it under penalty, because if you have a problem in the voluntary system, all you need do is simply deposit by coupon.

There are unresolved system issues which affect these taxpayers. The number one issue is the lack of emergency procedures. A recent survey indicates that 50 percent of financial—excuse me, that less than 50 percent of financial institutions will offer the EFTPS Fedwire emergency same-day settlement procedure. In addition, EFTPS enrollment document instructions regarding the Fedwire emergency procedures are not adequate. Taxpayers will not understand, first of all, that this procedure is available, if it is, and, second of all, how to use it.

Taxpayers who do not have access to or know about the Fedwire emergency procedure after July 1 will be issued late deposit penalties. Further, FMS in its proposed regulations is contemplating restricting the use of the same-day option. And, finally, no emergency procedures exist in EFTPS for payroll service bureaus, as has been discussed.

Because of time, I will leave the issues of inadequate procedures for file reversals and refunds in case of erroneous deposits for individual taxpayers to my colleagues at the Treasury Management Association. One last issue, however, is the lack of an electronic acknowledgment of ACH credit deposits that is equal to the ACH debit acknowledgment for purposes of tax controversy, and we encourage Congress to examine the system that ACH credit taxpayers have to go through of calling their financial institution on the tax-due date in the morning to make sure that their tax has settled.

The Federal Government should not allow the EFTPS mandate to go forward July 1 of this year unless these issues are resolved. IRS urges Congress to insist on and continually monitor an IRS and FMS plan to resolve systems issues and prevent inappropriate penalty assessments during the critical first two quarters of the EFTPS implementation. This plan should ensure that: One, taxpayers are immediately notified that they are noncompliant, the notification is by tax type; two, that the taxpayer is allowed a penalty-free period while the EFTPS manual enrollment process takes place; three, all deposits made during the enrollment period are accepted by the EFTPS; four, an emergency same-day settlement procedure is available to all taxpayers who need it and that they have clear instructions regarding its use; five, the grossly punitive 10-percent avoidance penalty should be rescinded and replaced with a penalty lower than that of the first late payment penalty of 2 percent; six, file reversal procedures consistent with ACH operating rules and an expedited refund procedure should be adopted; seven, the system bias against ACH credit acknowledgments is eliminated; eight, proposed regulations providing guidance, including

emergency procedures to taxpayers, payroll service bureaus, banks, and tax practitioners are released for public comment and then issued as soon as possible; and, nine, an amnesty period of no less than 180 days is instituted, to remain in effect until these issues are resolved.

As several members have said, we hope IRS and FMS will start working immediately with their tax partners—the U.S. businesses, payroll service bureaus, and financial institutions—to resolve these issues and make the systems changes necessary for a successful implementation. The solutions are available, and the private sector is willing to work with the government to help provide them. It is our hope that Congress will monitor this process.

In closing, APA supports the successful implementation of the EFTPS System and hopes it can work with the Federal Government to quickly resolve these issues.

I thank you for the opportunity to present APA's concerns, and I am pleased to answer any questions you may have.

[The prepared statement follows:]

Statement of Carolyn Kelley, Director of Government Affairs, American Payroll Association

The American Payroll Association (APA) represents more than 14,000 U.S. businesses on issues relating to payroll tax withholding, depositing, and reporting. According to the IRS's annual report, more than 70 percent of all federal revenue is collected, reported and deposited through the payroll functions of U.S. businesses. As such, APA's members are tax collectors for the nation. Our members are responsible for carrying out the requirements of the new Electronic Federal Tax Payment System (EFTPS), including withholding and depositing the majority of taxes (and deposit volume) that are subject to these requirements. A large majority of the U.S. businesses currently mandated to use the EFTPS are APA members. The next phase-in of 1.2 million taxpayers will include over 90% of our members.

The American Payroll Association has actively sought to work with the federal government during the design, development and implementation phases of the EFTPS since early in 1993. We have worked closely with our banking, tax practitioner, and payroll service bureau colleagues during this time. APA's goal was to help with the successful implementation of the EFTPS by articulating the needs of the front-end users of the system—the U.S. businesses that are this nation's tax collectors. This is still our goal. APA representatives have attended dozens of meetings in Washington and elsewhere with members of Congress and their staffs, IRS, Treasury, the Federal Reserve, and EFTPS financial agents. APA representatives have also met with the commissioners of both IRS and Treasury's Financial Management Service (FMS).

Further, APA has been a major contributor to the nationwide education effort mounted to inform taxpayers, tax practitioners, and the banking community of EFTPS requirements. APA has placed educational articles in its publications and in newspapers and magazines across the country, reaching millions of readers. In addition, APA has hosted or participated in hundreds of EFTPS seminars across the country.

In general, APA supports the efforts of the federal government to reduce high costs and error rates associated with paper processing. However, there are several critical issues which must be solved before a successful implementation of the EFTPS can be achieved. We support the eventual full (or nearly full) implementation of the EFTPS once these issues are resolved.

I. SUMMARY OF THE CURRENT UNRESOLVED PROBLEMS INVOLVING ENROLLMENTS AND PENALTIES

EFTPS is a complete change in the way taxpayers deposit their taxes. It takes taxpayers from the traditional paper coupon system to a brand-new electronic system. This change affects not only taxpayers, but their service providers, their advisors, and their banks. Despite education efforts by both the public and private sectors, a significant number of taxpayers remain unaware of either EFTPS require-

ments as a whole or the full extent of the requirements. These taxpayers will thus be in a penalty situation come July 1, 1997.

IRS has chosen to assess a 10% avoidance penalty on every mandated tax deposit that is not made through the EFTPS. However, the IRS penalty system is not able to notify taxpayers that they are not depositing correctly (i.e. electronically through EFTPS) until four or five months after July 1, 1997.

Thus, taxpayers who failed to understand that they must enroll in EFTPS but who are still paying the correct amount of tax on the tax due date with their paper coupons will receive penalty notices of 10% for every deposit made from July 1, 1997 until the IRS finally notifies them (potentially) December 1997.

Further, if an unenrolled taxpayer discovers his error after July 1, 1997 and tries to correct it by immediately enrolling in EFTPS, he will find that the current EFTPS enrollment process is manual and takes from two to ten weeks to be completed. This means that the EFTPS will reject his deposits until the enrollment process is completed. The 10% avoidance penalties will continue to mount, even when the taxpayer is doing everything in his power to comply.

II. Inappropriate penalty exposure

A. Unenrolled taxpayers will be penalized.

According to the IRS, over 220,000 taxpayers mandated to begin depositing electronically on July 1, 1997 were not enrolled by April 11th. APA believes the large majority of these unenrolled taxpayers are unaware of the new requirements.

B. Partially enrolled taxpayers will be penalized.

There is a critical distinction between the 1.2 million taxpayers who are mandated to use EFTPS on July 1, 1997 and the number of enrollments which will be needed to meet the mandate. According to IRS, 970,000 (of the 1.2 million) mandated taxpayers are currently enrolled in EFTPS. However, there are many taxpayers who will have to enroll more than once to comply with EFTPS requirements:

For example, approximately 300,000 to 400,000 taxpayers have been enrolled in EFTPS by their payroll service bureau. However, many of these taxpayers use the payroll service bureau only for their employment taxes. These taxpayers will have to enroll separately for corporate income and any other tax types that the payroll service bureau doesn't handle.

This is poorly understood by these taxpayers despite the best efforts of the APA, payroll service bureau industry and IRS to educate them. Recognizing this problem, IRS sent some 228,000 notices in March to mandated taxpayers whose only enrollment action was by their payroll service bureau. Although this will help, we are certain that a significant number of these taxpayers will remain confused regarding the requirements or erroneously assume that everything is taken care of by their service provider.

Moreover, taxpayers can also enroll separate bank accounts for different tax types under the ACH debit option. This requires additional enrollments. For example, if payroll taxes and corporate income taxes are paid through different accounts, taxpayers using the ACH debit option would have to enroll twice.

Thus, though the number of taxpayers mandated to use the EFTPS as of July 1, 1997 may be 1.2 million, the actual number of enrollments needed to be processed before all taxpayers are ready to use the system without being penalized could be significantly more than 1.2 million.

Therefore, although 970,000 taxpayers are enrolled, it is probable that come July 1, 1997 hundreds of thousands of enrollments in addition to the 230,000 already identified by IRS will be outstanding. A 10% avoidance penalty will be assessed for each non-electronic deposit.

C. Because the EFTPS enrollment process is manual and currently takes two to ten weeks, taxpayers who are trying to use the EFTPS will still be penalized.

The EFTPS cannot accept unenrolled deposits. After July 1, 1997, any taxpayer who is unenrolled or partially enrolled and who then tries to enroll in EFTPS will have to wait for the two-to-ten week enrollment process to be completed before a deposit can be accepted. The penalties will continue to mount during this time.

D. Going from less than 2,000 to 1.2 million mandated taxpayers all at once will likely result in taxpayer penalties.

APA is very concerned about the implications for taxpayers of jumping from the current mandate of some 1,550 U.S. businesses to 1.2 million all at once after July 1, 1997. Although IRS's most recent news release (IR 97–20) states that "over 100,000" taxpayers are currently using the EFTPS, it is very important to note that

this participation is voluntary and allows for a FTD coupon backup for emergencies. After July 1, 1997, taxpayers who try to use the FTD coupon for emergencies will be assessed a 10% avoidance penalty. However, it is likely that the EFTPS's Fedwire emergency same-day settlement procedure will not be widely available to taxpayers. (See below.)

Going from "over 100,000" largely voluntary taxpayers to 1.2 million mandated taxpayers is going to have an unknown impact on systems and customer service functions at the EFTPS financial agents. This five to-tenfold increase of system use all at once without testing is unwise. Regardless of how many internal tests have been done, if the system fails to service taxpayers, they are subject to penalty assessment and costly tax controversy will result. Recently, one financial agent's system was unavailable to accept deposits through a good part of Monday, March 24th. One APA member, after repeated attempts to deposit, finally was able to make a $1.7 million deposit at 3:00 p.m. What would have happened if five to ten times the number of taxpayers had been competing to pay their taxes on time?

E. We know of no evidence indicating banks will provide the Fedwire emergency same-day settlement procedure to all taxpayers who need it. APA predicts taxpayers who do not have access to emergency procedures will be penalized.

Under EFTPS, taxpayers have a choice of three deposit options: (1) ACH debit, (2) ACH credit, and (3) the Fedwire emergency same-day settlement procedure. ACH debit taxpayers must initiate their payment through the Automated Clearing House (ACH) system one day before due date by 8 p.m. Eastern time. ACH credit taxpayers must initiate their payment by deadlines specified by individual bank requirements. These deadlines may be as early as several days before the tax due date depending on the bank. The Fedwire emergency same-day settlement procedure must be initiated in time to settle the same day by 2:00 p.m. Local time of the taxpayer's Federal Reserve home office.

If for any reason the taxpayer cannot initiate the tax deposit timely for the ACH credit and debit options, the only emergency procedure available in EFTPS is the Fedwire emergency same-day settlement procedure. The government freely acknowledges that there are situations in which a same-day settlement procedure will be necessary, and that taxpayers need one to avoid late payment penalties.

A recent survey by Thomson Financial Publishing indicates less than 50% of financial institutions will offer the Fedwire emergency procedure. This means that taxpayers who do not have access to the Fedwire emergency procedure after July 1, 1997 will be forced into making late deposits.

Further, proposed rules 31 CFR Part 203, RIN 1510–AA37, "Treasury Tax and Loan Depositaries and Payment of Federal Taxes," Part VI 61 FR 51086 states "FMS is contemplating restricting the use of the same-day option..." This should not be done.

F. Taxpayers will be penalized due to confusion regarding the availability of ACH credit services.

Whether or not banks offer the ACH credit deposit option to clients is a decision based on the amount of risk the bank is willing to incur. Not all banks will provide this option to all clients. Those banks that will provide this service will charge for it. As stated above, the bank may require the taxpayer to initiate transactions several days prior to the tax due date. We believe that some number of already-enrolled taxpayers will be uninformed regarding these circumstances and find on July 1, 1997 that even though they enrolled for the ACH credit option, (1) their bank will not offer them ACH credit services, (2) they are unable/unwilling to initiate a deposit several days in advance of tax due date and/or (3) they cannot afford/do not want to pay what the bank is charging for it. Thus, under EFTPS's enrollment procedures, they will have to re-enroll and wait for the manual enrollment process to be completed while the 10% avoidance penalties mount.

Note: Little public information exists regarding procedures taxpayers need to follow. We believe taxpayers are not adequately instructed in the enrollment documents regarding their options, especially in the case of the Fedwire emergency procedure. We encourage Congress to examine EFTPS's enrollment documents to conclude for themselves whether the enrollment documents and payment instructions are clear and complete.

G. Taxpayers are not the only users of the system who are confused regarding system requirements. Nonetheless, taxpayers are the ones who will be penalized.

Despite all efforts of the IRS, Treasury, Small Business Administration, tax practitioners and various professional associations, and the banking, payroll and payroll service bureau industries to increase the awareness of the full extent of EFTPS re-

quirements, work remains to be done. For example, APA talked to a reporter in New Mexico who recently contacted an IRS public affairs officer who she knew had "a reputation for providing accurate information." She was told by the IRS officer that only employment taxes are due through EFTPS. The reporter thought that was wrong, and went on to the Internet. She came across information on EFTPS from a "major accounting firm" which was incomplete and inaccurate. She then called Senator Pete Domenici's office and was finally given correct information.

It is important to note that no final regulations exist to guide taxpayers about requirements, use of the system and how to keep the records necessary to prove timely deposits in case of erroneous penalties. The existing proposed guidance either was written for the TAXLINK pilot or is vague. This lack of definitive guidance from the IRS contributes to the confusion and forces taxpayers to rely on whatever information is available to them, whether accurate or not.

We urge IRS and Congress to consider what happened after the 1995 and 1996 EFTPS implementation dates. There was confusion on the part of the largest and most sophisticated companies in the United States. IRS spent time contacting companies to help them comply. How much more confusion may exit now with smaller, less sophisticated companies?

III. Unresolved Technical Issues

A. The IRS's penalty system will not provide timely notification to taxpayers of 10% avoidance penalties.

After July 1, 1997, taxpayers will not be notified immediately that they are not depositing correctly. Rather, 10% avoidance penalties for every successive deposit will stack through the end of the next quarter.

B. No emergency procedures exist in EFTPS for payroll service bureaus and other third-party providers who will be processing employment and other taxes for almost 50% of the July 1, 1997 mandated taxpayers.

Currently, under Revenue Procedure 86–33, third party service providers have an emergency procedure which prevents late deposits in cases of emergency or natural disaster. Without this emergency procedure, unnecessary penalty notices will go out to potentially hundreds of thousands of taxpayers. It is important to note that this would not happen today. This procedure was not provided for in the EFTPS system.

C. ACH Operating Rules for file reversals in cases of erroneous deposits have not been followed in EFTPS.

Under current ACH Operating Rules, ACH reversing entries and files are allowed to be sent when transmitted within five days of settlement. Stated simply, under today's system, taxpayers and banks can quickly retrieve their money if they make an error.

The EFTPS system does not allow this. Under EFTPS, the ACH credit taxpayer must ask IRS's permission to reverse a file. It is unclear under what circumstances this permission will be granted or denied or the criteria on which the decision will be based. For the debit option, there is no reversal documentation provided to the taxpayer. This refusal to follow ACH Operating Rules has resulted in decreased confidence in the EFTPS.

Further, under current IRS refund procedures, if an erroneous deposit is made electronically, a taxpayer will wait up to 17 weeks to receive a refund. In addition to the omission of the ACH reversal procedure, this lack of a timely method of recovering monies transmitted in error is eroding confidence in the system still further.

D. There is no immediate, electronic acknowledgment of ACH credit deposits that is equal to the ACH debit acknowledgment.

While the debit method provides a deposit acknowledgment number equal to the postmark on the FTD coupon for proving compliance, the ACH credit method does not. Rather, taxpayers will have to call their financial agent's customer service line on the morning of tax due date to make sure their deposit arrived. It is unknown how this system will service potentially thousands of taxpayers trying to confirm their deposits within a window of the few hours they have before a Fedwire emergency deposit will be needed. Taxpayers who choose the ACH credit option should have the same ease and assurance as debit taxpayers in receiving acknowledgment of deposits.

The National Automated Clearing House Association has recently approved a change to the ACH Operating Rules that will allow for such an ACH credit acknowledgment. APA urges Congress to insist on its inclusion in the EFTPS.

IV. RECOMMENDATIONS.

In order to ensure a successful EFTPS implementation without inappropriate taxpayer penalties and the resulting loss of confidence in the new system, APA recommends the following:

A. Congress should insist on and continually monitor an IRS plan to prevent inappropriate penalty assessments during the critical first two quarters of EFTPS implementation. This plan should ensure that:

1. taxpayers are immediately notified they are non-compliant;
2. the notification is by tax type;
3. the taxpayer is allowed a penalty-free period while the EFTPS manual enrollment process is being completed;
4. deposits made by either ACH credit or debit or the Fedwire emergency same-day settlement procedure should be accepted by EFTPS during this time; and
5. this amnesty period should be no less than 180 days.

B. IRS and FMS should work with the payroll service bureau industry to immediately develop emergency procedures.

C. The government should work with the banking industry to ensure that the Fedwire emergency same-day settlement services are available to every taxpayer who needs it. If the private sector cannot provide this, EFTPS must be altered to provide an alternate emergency same-day settlement procedure which would be available to all taxpayers.

D. The EFTPS should be altered to follow file reversal procedures that fall within the current ACH Operating rules and an expedited refund procedure should be developed.

E. System bias between the ACH debit and ACH credit options should be eliminated insofar as confirmation of tax deposits is concerned.

F. The unnecessarily punitive 10% penalty should be eliminated. If a taxpayer mistakenly uses the FTD coupon instead of the EFTPS system, taxes are still paid accurately and on time. Why is the penalty for that higher than for a late payment? The 10% penalty is grossly punitive and should be drastically reduced after the amnesty period expires.

G. Final regulations providing guidance to taxpayers, payroll service bureaus, banks, and tax practitioners should be issued as soon as possible.

In closing, APA feels it is essential that Congress closely monitor the progress of solutions to all of the above. APA supports the successful implementation of the EFTPS system and hopes that it can work with the federal government on the resolution of these issues.. I thank you for this opportunity present APA's concerns. I am pleased to answer any questions you may have.

Chairman JOHNSON [presiding]. Thank you very much, Ms. Kelley.

Mr. Foehl.

STATEMENT OF JOHN M. FOEHL, JR., CHIEF FINANCIAL OFFICER AND TREASURER, HOUSING AUTHORITY INSURANCE; ON BEHALF OF THE TREASURY MANAGEMENT ASSOCIATION; ACCOMPANIED BY ARLENE S. CHAPMAN, STANDARDS MANAGER, TREASURY MANAGEMENT ASSOCIATION

Mr. FOEHL. Good afternoon, Madam Chairman and Members of the Subcommittee. Arlene Chapman, TMA's standards manager, and I would like to offer these brief comments on EFTPS. I currently serve as chair of the TMA's EFTPS task force and am also a member of their government relations committee.

TMA represents approximately 10,000 Treasury professionals who, on behalf of over 4,000 corporations and other organizations, are significant participants in the Nation's payment systems. Many of our members are responsible for making Federal tax payments and using EFTPS. Housing Authority Insurance, the company for which I work, is a mandated taxpayer as of July 1 of this year. TMA has been actively involved in presenting its members' views on Treasury's electronic tax collection initiatives for over 5 years. We support the government's planned transition from paper to electronic payments, a move which is also underway in the private sector.

In the association's view, EFTPS offers cost-effective payment and reporting efficiencies that benefit both businesses and the Federal Government. The concerns that TMA will express today are offered in the spirit of constructive criticism, based on the experience of having successfully worked with both the IRS and the FMS to deal with problems similar to those that are faced today.

Our testimony will describe three specific problem areas where inefficient or nonexistence procedures and confused communications impose burdens on corporate taxpayers who would otherwise welcome the transition from paper to electronic payments. The IRS and the FMS can and should be able to address and resolve these problems in a timely manner.

The three problems we would like to address are: Barriers to the use of same-day payment methods, such as Fedwire; difficulties in reversing ACH tax payments made to the government in error; and excessively harsh penalties for incorrectly formatted or late payments and for failure to pay taxes electronically.

Barriers to the use of same-day payment methods continue to plague taxpayers who need to employ this option. Without such mechanisms, tax payments may be late because the main electronic payment method requires the taxpayer to report the amount of the tax payment 1 day in advance of the due date. Same-day tax payments may have to be made for three reasons: As a backup in the event of emergencies, by companies that do not have the information on the amount of their tax payment 1 day in advance, or for better management of cash flows and timing of large funds transfers.

However, the government continues to communicate confusing messages to taxpayers on the availability of same-day methods. The procedures for enrollment are either nonexistent or vague, and no government agency is responsible for helping taxpayers use the Fedwire system. What are the consequences of this failure to communicate with the taxpayer? The experience of a recent caller to TMA reveals that the taxpayer is left completely in the dark.

The caller's company is mandated to pay electronically starting July 1. The company has more than $100,000 in payroll tax liability and is required to pay taxes 1 day after payday. It does not know the amount of the tax payment 1 day in advance of the tax-due date and must use the same-day method. The company bank calling officer—from one of the Nation's top five banks—was not able to explain to the taxpayer the information such as name control and tax type that needs to be included in the Fedwire. The taxpayer called the EFTPS customer service hotline of both financial

agents. He was told that this customer service is provided by a subcontractor to the IRS, which is only responsible for handling ACH. They had no information on Fedwire.

How can the IRS, with a system that lacks clear and concise instructions, legitimately penalize a taxpayer for erroneous or delayed payments?

Second, the IRS continues to block the use of industry practices to correct erroneous ACH payments. TMA recognizes the regulatory challenges that confront the IRS and FMS arising from the need to develop procedures to correct errors that were not prevalent in the paper check environment. Such a situation exists when a financial institution that originates an ACH credit at the direction of the taxpayer finds it necessary to correct an error. Treasury, which has chosen not to adopt industry rules, requires both the taxpayer and the financial institution to obtain advance approval to correct an error by means of unexplained procedures.

This is a recipe for confusion, delay, and dissatisfaction with EFTPS, and it will cost taxpayers money whether they use ACH credits or debits because they cannot obtain compensation for the government's use of their funds. I will note, though, that Mr. Donelson of the IRS stated today that they were exploring using NACHA operating rules. We would strongly support this position.

Third, penalties imposed by the IRS for erroneous or late payments are unduly harsh. We refer to the 10-percent failure-to-deposit penalty for not making a tax payment by EFT, and the penalty of up to 10 percent for the failure to make a timely tax deposit. We believe that compliance is always easier when the carrot is larger than the stick.

In summary, the deficiencies outlined in our testimony today can be remedied if the IRS and the FMS recognize them and take prompt and thorough steps to address them. They need not and should not stand in the way of the transition from paper to more efficient electronic payment methods or the scheduled implementation of EFTPS.

We would recommend the following: That the IRS and FMS should clarify and improve procedures for same-day payment mechanisms; that they should adopt NACHA operating rules for the reversal of erroneous ACH tax payments; and, finally, that they should adjust the penalty rules for 6 months following the effective date of the mandate to use EFTPS.

We appreciate the opportunity to present the views of the Treasury Management Association on this important transition to electronic tax payments, and we will welcome any questions that you may have. Thank you.

[The prepared statement follows:]

Statement of John M. Foehl, Jr., Chief Financial Officer and Treasurer, Housing Authority Insurance; on Behalf of the Treasury Management Association

Good morning, Madame Chairman and members of the Subcommittee on Oversight of the Committee on Ways and Means. I am John M. Foehl, Jr., Chief Financial Officer and Treasurer of Housing Authority Insurance, an insurance company based in Connecticut that provides insurance coverage to public and non-profit housing authorities throughout the United States. I am honored to offer this statement on behalf of the Treasury Management Association (TMA). I serve as Chair of the TMA EFTPS Task Force and am also a member of the Association's Government

Relations Committee. Today, I am accompanied by Arlene S. Chapman, TMA Standards Manager.

TMA represents about 10,000 treasury professionals who, on behalf of over 4,000 corporations and other organizations, are significant participants in the nation's payment systems and manage their organizations' banking relationships. Corporations represented by our members are drawn generally from both Fortune 1000 and middle market companies. Many of our members are responsible for making federal tax payments and using the Electronic Federal Tax Payment System (EFTPS). Corporations employing TMA's members were among the approximately 800 taxpaying organizations mandated to pay electronically in 1995 and among the 700 mandated last year. A significant percentage of our member's employers will be mandated starting July 1, 1997.

TMA has been actively involved in presenting its members' views on the Treasury's electronic tax collection initiatives for over five years, even before the inception of TAXLINK, the test system that preceded EFTPS. We have sought to work with the Internal Revenue Service (IRS) and the Financial Management Service (FMS) in support of their stated goals: to automate and expedite federal revenue collection procedures and to reduce the administrative burden imposed on taxpayers and the government by the collection system.

We support the government's planned transition from paper to electronic payments, a move which is also underway in the private sector. In the Association's view, electronic commerce generally—and EFTPS specifically—offers cost-effective payment and reporting efficiencies that benefit businesses, the tax-paying public, and the federal government.

TMA has not hesitated to voice its concerns, however, when we believed that the government's regulations, procedures and instructions to the public *increase* administrative burdens on corporate taxpayers, lack clarity and consistency in their definition and application, and impede the efficiency of the electronic tax collection process.

In our view, the exchange of information and a process of discussion and negotiation between the private sector and the government are critical to increased public understanding and user-friendly implementation of EFTPS. The concerns that TMA will express today are offered, therefore, in a spirit of constructive criticism, based on the experience of having successfully worked with IRS and FMS to deal with significant payment system and liability issues and communications problems similar to those that are faced today.

The Subcommittee's announcement of this hearing identified three issues to be examined: the current status of EFTPS implementation; concerns about specific features of EFTPS; and the need for an additional delay or changes to the program. Our testimony will describe three specific problem areas where inefficient or nonexistent procedures and confused communications impede public understanding and impose burdens on corporate taxpayers who would otherwise welcome the transition from paper to electronic payments. The IRS and the FMS can and should be able to address and resolve these issues promptly and successfully.

PROBLEM IDENTIFICATION

TMA has recently called the attention of the IRS and the FMS to unresolved problems in three EFTPS operating areas that have the potential to significantly increase the time and cost of taxpayer compliance with EFTPS, masking the real advantages of electronic payment methods and giving rise to resistance among taxpayers who might benefit most. They involve:

- Barriers to the use of same-day payment methods, such as Fedwire.
- Difficulties in reversing ACH tax payments made to the government in error.
- Excessively harsh penalties for incorrectly formatted or late payments and for failure to pay taxes electronically.

1. Barriers to the Use of Same-Day Payment Methods Continue to Plague Taxpayers Who Need to Employ this Option.

Taxpayers making electronic tax deposits need a way to pay the government on the same day that the tax payments are due. Without such mechanisms, the tax payments may be late, because the primary payment method—the ACH—requires the taxpayer to *report* the amount of the tax payment one day in advance of tax due date. There are three reasons that same-day tax payment mechanisms are critical to all taxpayers:

- As an emergency back-up: Prudent risk management of electronic systems requires taxpayers—especially those paying by ACH credit—to have a back-up, contingency payment mechanism in the event of ACH systems failures, emergencies or

disasters. The Federal Reserve's Fedwire electronic system settles payments on a same-day basis. The ability to use Fedwire to make urgent, time-critical tax payments is essential to compliance by taxpayers with IRS payment deadlines and to avoiding the time-consuming penalty assessment and abatement process.

- For next-day deposits: Companies with $100,000 or more in payroll tax liability are required to pay their taxes one day after pay day. Many of them are unable to report the amount of their tax payment one day in advance—that is, on pay day—as is necessary in the ACH environment. A same-day payment method allows taxpayers to both report and pay their taxes on tax due date.
- For better management of cash flows and the timing of large funds transfers: A company may be required to transfer funds early in the morning to pay for large securities settlements or to repay loans. If a large ACH tax payment is posted to the company's account at 8:30 a.m. Eastern Time—which is the time that funds are deducted from the accounts of taxpayers who use the ACH credit method—the company may be unable to meet its business obligations. Requiring the company to maintain idle balances in its account in anticipation of an early morning tax payment posting would represent an added cost of paying taxes. Fedwire tax payments are not due to the government until 2:00 p.m. local Federal Reserve head office zone time.

Three same-day Fedwire tax payment mechanisms have been developed by the Federal Reserve. They are in place and available for use by taxpayers. TMA has recommended to the IRS and the FMS a number of times over the past few years that these same-day payment mechanisms be available to all business taxpayers who need to use them, without restrictions and without prior written approval from Treasury.

Nevertheless, confusing messages on Fedwire availability continue to be conveyed by the government, the procedures for enrolling in and using Fedwire are either non-existent or vague at best, and no government agency is taking the responsibility to help taxpayers understand and use the Fedwire system for tax payments.

Availability of same-day payment mechanisms: confusing messages

The FMS, in its proposed rule for financial institutions and Federal Reserve Banks processing tax payments through EFTPS (31 CFR Part 203), would restrict same-day methods to "certain taxpayers that do not have information available to initiate the transaction one business day prior to the tax due date, or to correct a deficiency in an ACH payment." This would appear to eliminate the category of taxpayers that requires a same-day payment mechanism for cash management purposes.

It also contradicts the EFTPS Payment Instruction Booklet issued by the Treasury's Financial Agents to enrolled taxpayers. These instructions state that "taxpayers who *cannot* [emphasis added] use the Automated Clearing House (ACH) payment mechanisms may use one of the Same Day Payment mechanisms." Later in the same paragraph, however, taxpayers are advised that "these mechanisms...are available to *all* [emphasis added] business taxpayers who have enrolled in EFTPS."

Same-day payment mechanisms: non-existent enrollment procedures

A same-day payment mechanism is not listed—or even mentioned—as a payment option on IRS's EFTPS Business Enrollment Form 9779. TMA has received a number of calls from its members asking how they can arrange to use a same-day payment method.

The instructions to taxpayers that accompany the enrollment form state only that "in some instances a business may find it necessary to make a same day payment," adding that "further information on Same Day Payments will be provided in your enrollment confirmation package." These statements strongly imply that same-day payments are a rarely used exception procedure, they do not explain the importance of same-day mechanisms, and they fail to educate the taxpayer seeking information on how to enroll for them.

Same-day payment mechanisms: Instructions for use are unclear or non-existent

When their enrollment is processed, each taxpayer receives an EFTPS Payment Instruction Booklet prepared by one of the Treasury's EFTPS Financial Agents.

Nowhere in the instructions to taxpayers chosing the ACH Credit payment method is there mention of the need to be prepared to use a back-up, same-day electronic payment method in the event of emergencies. There is no reference to the availability of Fedwire same-day payment mechanisms for this purpose and no instruction on how to use them.

In a separate section on Same Day Payments, the instruction booklet advises taxpayers to contact their financial institutions to ensure that their bank has received

Fedwire tax payment instructions from the Federal Reserve, which operates same-day mechanisms. The taxpayer is instructed to include specific information—such as taxpayer name control and tax type—when sending the payment. That is the only guidance the taxpayer receives from the government on how to use an emergency, time-critical payment mechanism.

What are the consequences of this failure to communicate with the taxpayer? The experience of a recent caller to TMA reveals that the taxpayer is thereby left completely in the dark, because financial institutions—even the largest of them—may not be prepared to instruct taxpayers on how to use Fedwire mechanisms, and the Treasury Financial Agent's Customer Service Hotline disclaims all responsibility.

The caller's company is mandated to pay electronically starting July 1. The company has more than $100,000 in payroll tax liability and is required to pay taxes one day after pay day. It does not know the amount of the tax payment one day in advance of tax due date, and must use a same-day method.

The company's bank calling officer—from one of the top five banks in the country—was not able to explain to the taxpayer the information, such as name control and tax type, that needed to be included in the Fedwire.

The taxpayer called the EFTPS Customer Service Hotline Numbers of both Financial Agents. He was told that this Customer Service is provided by a subcontractor of the IRS which is only responsible for handling ACH. They had no information on Fedwire.

An electronic tax system that is not prepared to communicate emergency instruction procedures to taxpayers facing severe penalties for untimely payments is a system that is not prepared to deal with the emergencies that may be faced by taxpayers, whether they be flood, electrical outages or system failures.

An electronic tax system whose agents do not provide instruction to taxpayers on the proper use of one of the authorized payment mechanisms is not a system that can legitimately penalize taxpayers if the tax payment information is erroneous or the tax payment is delayed.

Same-day payments: reversed for format errors

Taxpayer grievances resulting from these failures to adequately define procedures and communicate instructions will be compounded if FMS's Rule 31 CFR Part 203 takes effect as proposed. Section 203.14 (1)(iii) of the rule states that the Federal Reserve Banks (FRB) may reverse a same-day transaction if it "does not meet the edit and format requirements set forth in the procedural instructions."

Given the complexity of the Fedwire format and the lack of adequate training and instruction, errors will be made, especially at first, by taxpayers and financial institutions. The FMS and the Federal Reserve Banks should not lightly undertake to reverse high dollar tax payments made in good faith, causing taxpayers to incur potentially huge penalties. A major U.S. oil company has already suffered penalties in excess of $100,000 as a result of a simple format error.

2. IRS Continues to Block the Use of Traditional Procedures to Correct Erroneous ACH Payments

TMA recognizes the regulatory challenge that confronts the IRS and FMS arising from the need to develop procedures to correct errors that were not prevalent in the paper check environment.

Such a situation exists when a financial institution that originates an ACH credit at the direction of the taxpayer finds it necessary to correct an error. The financial institution might have transmitted duplicate payments—a single duplicate tax payment, a batch of duplicates, or an entire file—multiple batches—of duplicate credits. Or the taxpayer might have made the error, designating the Treasury as the recipient of a payment that should have gone to another party, or specifying the wrong payment amount.

The NACHA Operating Rules that govern the ACH have procedures to deal with these types of errors. They are efficient, timely and responsible procedures that have served the originators and receivers of payments as well as the financial industry for many years.

The NACHA rules governing "Reversing Entries" state that a reversal to correct an erroneous entry must be transmitted or made available to the receiving financial institution by midnight of the fifth banking day following the settlement date of the erroneous entry. Under NACHA rules, the originating financial institution—in this case the taxpayer's bank—agrees to indemnify all parties against claims or losses resulting from that reversing entry. Advance approval is not required to reverse the erroneous payment.

However, Treasury has chosen not to adopt industry rules, although it has yet to spell out its procedures.

The EFTPS Payment Instruction Booklet sent to enrolled taxpayers warns taxpayers that "if a duplicate payment has been made, IRS must approve an ACH Credit reversal." If approval is not received in advance, the reversal "will be returned to your financial institution as an unauthorized entry. For specific instructions for initiating an ACH Credit reversal, contact EFTPS Customer Service." Instructions are not explained in the booklet.

The FMS is also developing reversal procedures that the banks must follow. FMS's proposed rule, 31 CFR Part 203, Section 203.13, states that "correction of ACH credit entries must be approved in advance by the IRS. The financial institution will find procedures for requesting corrections in the procedural instructions." The proposed rule was not accompanied by procedural instructions.

Requiring both the taxpayer and the financial institution to obtain advance approval to correct an error by means of unexplained procedures is a recipe for confusion, delay and dissatisfaction with EFTPS by all parties. Taxpayer grievances will be compounded by the FMS's proposed ruling in Section 203.12 that "Treasury will not pay interest on any payments erroneously paid to Treasury and subsequently refunded to the financial institution."

Failure to adopt equitable, efficient procedures for reversing erroneous credit entries will discriminate against taxpayers choosing to pay via ACH credit. It will also give rise to substantial criticism from taxpayers who experience significant loss of time and money as a consequence of their inability to correct errors on a timely basis or obtain compensation for the government's use of their funds.

3. Penalties Imposed by the IRS for Erroneous or Late Payments Are Unduly Harsh.

The IRS is concerned that all mandated taxpayers comply with the law and use electronic methods to pay federal taxes. The agency also requires that the taxpayer's electronic payment information be correctly formatted and error-free, so that the payment can be processed in an automated, timely and cost-effective manner.

While these concerns are understandable, the unnecessarily harsh penalties imposed by the IRS for failure to comply with its requirements undermine the agency's stated intention to work in partnership and cooperation with the business community to achieve its goals and benefit taxpayers at the same time. We refer specifically to (1) the 10% failure-to-deposit penalty for not making a tax deposit by EFT and (2) the general penalty of up to 10% for failure to make a tax deposit on a timely basis.

We believe that adjustments should be made to the penalty assessment rules for newly mandated taxpayers for six months following the effective date of the mandate to use EFTPS. Special forebearance during the early implementation stages is amply justified by the confusion, concerns and fears of taxpayers caused by the government's poorly defined procedures and inadequate, incomplete communication about how the system works. Adjustments to penalties would help overcome taxpayer resistance to EFTPS by signaling that the IRS is interested in working with taxpayers in a cooperative rather than a confrontational manner.

SUMMARY AND RECOMMENDATIONS

In its testimony today, TMA has focused on three areas where communications to taxpayers about EFTPS are unclear, incomplete or non-existent, where EFTPS procedures cause built-in inefficiencies, delays and taxpayer expense, and where there are significant gaps in taxpayer education and understanding.

The three problem areas are:

1. Barriers to the use of same-day payment methods continue to plague taxpayers who need to employ this option.
2. IRS continues to block the use of traditional procedures to correct erroneous ACH payments.
3. Penalties imposed by the IRS for erroneous or late payments are unduly harsh.

These deficiencies are remediable if IRS and FMS recognize them and take prompt and thorough steps to address them. They need not and should not stand in the way of the transition from paper to more efficient electronic payment methods or the scheduled implementation of EFTPS.

TMA recommends the following:

Clarify and improve procedures for same-day payment mechanisms.

1. IRS and FMS regulations for EFTPS should clearly state that same-day payment mechanisms are available to all business taxpayers who wish to use them, without restrictions and without prior written approval from Treasury.

2. IRS should (1) revise Business Enrollment Form 9779 to include a same-day payment option for mandated taxpayers, and (2) revise Enrollment Form Instructions to explain the use of same-day payment mechanisms in an emergency and the availability of such mechanisms to mandated taxpayers for other purposes.

3. IRS and FMS should provide additional instruction and education to depository institutions and taxpayers on the use of same-day payment methods.

4. IRS and FMS should identify Customer Service responsibility for same-day payment methods and communicate that information to depository institutions and taxpayers.

5. Same-day payments by mandated taxpayers should not be reversed for edit and format errors for six months following the effective date of the mandate or until after the second use of the same-day mechanism, whichever comes later.

Follow industry rules for the reversal of erroneous ACH tax payments

Procedures for reversing erroneous ACH payments should follow time-tested NACHA rules, which are clearly defined, do not require prior approval, and contain indemnification provisions. In TMA's view, such procedures would not be detrimental to the interests of the Treasury in protecting public funds. The FMS states in Sec. 203.16 of 31 CFR Part 203, its proposed EFTPS rule, that it has "instituted operational safeguards to scrutinize all debit entries sent to the Treasury." Procedures are in place, therefore, to monitor and return illegitimate reversals and guard against unauthorized access to government accounts.

Adjust penalty rules for six months following the effective date of the mandate to use EFTPS.

Adjust penalties against newly mandated taxpayers in the following circumstances:

1. *Format or data errors in a timely payment.* Penalties should not be assessed against the taxpayer, nor should the payment be returned, for six months following the effective date of the mandate to use EFTPS if errors in format or data cause a delay in posting the payment to the taxpayer's account. The IRS or the Treasury Financial Agents should work with taxpayers and their financial institutions to identify and correct the errors during this period.

2. *Late payments.* During the first six months of the mandate's effective date, taxpayers may be confused or uncertain about ACH requirements and procedures. As a result, their tax payments may be delayed. During this six-month period, a newly mandated taxpayer whose electronic tax payment is late and who thereby retains use of tax funds should pay compensation to the government based on the time value of those funds, rather than on a percentage of the tax amount as specified in the IRS penalty rule. Traditional compensation rules use a formula involving the amount of the payment and the number of days the payment was late, with the overnight federal funds rate determining the value of the funds.

3. *Failure to deposit by EFT.*

a. *Enrolled taxpayers who fail to deposit by EFT.* A taxpayer who has enrolled in EFTPS on a timely basis but continues to pay taxes with a paper coupon instead of depositing by EFT should be granted a 90-day waiver of failure-to-deposit penalties, effective from the date of the mandate.

b. *Unenrolled taxpayers who fail to deposit by EFT.* A taxpayer who fails to enroll in EFTPS by the mandate date should be granted a 60-day waiver of failure-to-deposit penalties, effective from the date of the IRS notice of non-compliance. The taxpayer thereby is given about 30 days to complete the enrollment process and 30 days to become familiar with the EFTPS system.

Other EFTPS Recommendations

TMA made recommendations regarding other EFTPS procedures in comments to FMS on 31 CFR Part 203, the proposed rule for financial institutions and Federal Reserve Banks that use electronic funds transfer mechanisms to process Federal tax payments through EFTPS. TMA's January 13, 1997, comment letter to FMS is included as an attachment to this testimony.

We appreciate the opportunity to present the views of the Treasury Management Association on this important transition to electronic tax payments.

Chairman JOHNSON. Thank you very much for your excellent testimony that has focused very clearly, I think, on the problems that need to be solved before July. And we look forward to working with

you as we review the material presented here today over the course of the day and work with the IRS as well to see what problems can be addressed in a timely fashion.

Mr. Portman.

Mr. PORTMAN. Thank you, Madam Chair, and I thank the panelists for helping us out with some of the specific, what I would consider mitigating, factors that could be put in place to try to make the program work better, should we move ahead, or even if we were to phase it in.

I have a number of questions first for Ms. Kelley with regard to your proposal on amnesty. As you know, we in essence have already done that. We suspended the program. You can also waive penalties. You can abate penalties—in other words, have them be assessed and then be abated. You mentioned in your closing statement 180 days. Specifically, what kind of amnesty are you talking about and how would it work with regard to penalties?

Ms. KELLEY. Because we support a successful implementation of EFTPS and a broad implementation, we think that the worst thing that could happen to it is a bunch of penalty notices going out to taxpayers. That probably is the thing that will decrease taxpayer confidence the most in the system.

We feel that if the government and the private sector work together to resolve these issues, they can probably be resolved fairly quickly.

We suggested two quarters to allow time for timely notification of taxpayers who are not aware of their obligation, and also we allowed that Congress monitor the process of this and keep the amnesty period open until such a time as the systems issues and the further taxpayer education issues have been addressed.

Mr. PORTMAN. Ms. Lee, do you have any comment on that?

Ms. LEE. Well, I would agree that abating the penalties will not work. We do not want to have tens of thousands of notices going out to taxpayers. Rather, we would support waiving the penalties so that notices will not be issued while we work through these issues.

Mr. PORTMAN. Let me ask you a followup question to one that we got into earlier with the Service and with the bankers, and that was with regard to the data and the payment. In many instances, particularly among our smaller businesses, there might be an instance where payment can be made, but the data would follow. You indicated, Ms. Lee, that you were encouraged by what you heard from Mr. Donelson with regard to emergency situations, that there could be some separation between those two.

The larger concern that I heard expressed here earlier today was that because of financial management concerns, particularly the GAO audits of the Internal Revenue Service, that it would be problematic for them not to have the data accompanying the payment.

I assume you have been in discussions with the Service and others in the private sector on this issue. Can you give us some insight about that? Do you think that is a legitimate concern? If so, how could it be resolved?

Ms. LEE. That concern has never been raised with me by the IRS. However, if the concern is the need to provide how much of the dollars are for Federal withholding versus Medicare or Social

Security, we certainly can do that and give them a very good estimate. We also believe that significant controls can be put in place so GAO would not have a concern. I would think that GAO would support a process that would result in notices not being generated, and payment being made in a timely manner. This would be in contrast to not having such a solution, where the funds do not flow to Treasury; and a lot of penalty notices are issued. In that case, the IRS, the employer and the service provider have to deal with all of those notices. We are happy to work with both the Service and the GAO on this matter.

Mr. PORTMAN. I think that is a constructive comment, and it surprises me that you did not realize that that was a policy concern of theirs. And if indeed it is, it sounds as though there may be ways to address it by, as you say, providing the data in a segregated form so that, in fact, we can know what is going to the Social Security Trust Fund or the Medicare Trust Fund.

Ms. LEE. Right, if that is the question that they have, yes.

Mr. PORTMAN The other final comment, I guess, and question that I would have is with regard to timely notification. Your data there is very compelling, and it is a general concern that many of us have with the tax system, that the notification comes out, in this case a few months later, in other cases a couple of years later. And if it were a more timely notification process, then taxpayers could resolve some of these issues.

I would ask you the same question. With regard to your discussions with the Internal Revenue Service, do you think that this is something that can be realistically handled? If not, what are the barriers to it and how can we get at that?

Ms. LEE. At a recent meeting, the IRS said that they are exploring a solution that would not modify their normal notice process but would complete a one-time run of all of the taxpayers that would have been subjected to penalty because they are not using the system. This would be done perhaps 45 days after July 1. We still think that is not enough time.

Also, under the current notice process, a service provider receives a copy of that notice so that we can work with that taxpayer and we resolve the problem for the taxpayer. If the IRS goes outside the notice process, we will not get a copy of that notice. We have asked them to try to consider a way to allow us to get a copy of the notice.

Mr. PORTMAN. Do you get that notice electronically, or do you get it in the mail?

Ms. LEE. Actually, right now it is paper, but we are working—we have made a proposal through one of the service centers—to come up with a way to get those notices electronically. This would allow us to resolve those issues quickly before the taxpayer even gets the paper notice and help the IRS provide better service to the taxpayer.

Mr. PORTMAN. Just as the government would like the money more rapidly through electronic transfer, I would think the notice coming out electronically would make a lot of sense to the extent you have that kind of communication link with the Service.

Ms. LEE. Yes.

Mr. PORTMAN. And that would certainly be encouraged.

The final related point here is the enrollment period, and I would hope, again, that could be resolved. If it takes 2 to 10 weeks to enroll, people do not learn about this for a lot of reasons until July 1, that would, it seems to me, also fall in that category. We need to come up with some way for that period to be shortened or for some enrollment amnesty to be able to avoid the penalties being assessed.

Again, I thank you all for working with this Subcommittee, with our staff, and with the Internal Revenue Service to try to come up with a constructive way to handle this.

Thank you, Madam Chair.

Chairman JOHNSON. Thank you all for your input. We do intend to put a lot of effort into working with you and the IRS and others on the problems, because we are at this point after 1 year's deferral because we did not plan a good notification and marketing strategy. So we have, in a sense, minimized taxpayers' ability to enter into the system positively and to comply easily.

It is, I think, our responsibility to try to correct those past problems, to work through the difficulties that we see there, because I agree with you. When all of a sudden, many more taxpayers are going to participate, you are going to see little problems mushroom and be very, very big problems.

So we hope to do this, to really take the input that we have heard today seriously, because we want this to go better, but we also want to use what we have learned about this, and we want the IRS to use what they have learned about this next time, in the next implementation of whatever. Because if you look at the modernization challenge before the IRS, this is a very small challenge. And if we cannot figure out how to do this one right, we certainly want to lay the foundation for the next one and the next one and finally the very big modernization challenges that we really have to be capable of meeting both as a bureaucracy and as a people.

Thank you very much for your input, and we look forward to working with you.

Oh, excuse me. Karen, I am sorry. I did not realize you were still here. I will have to excuse myself. We were talking earlier about our schedules. Thank you, Karen.

Ms. THURMAN. Thank you, Madam Chairman. Just a couple of quick questions.

From what I have gathered, is it my interpretation that all of you believe this is a good program? I mean, forget the problems, but you believe that Congress should go forward.

Mr. FOEHL. Yes.

Ms. KELLEY. Yes.

Ms. LEE. Yes. We believe if the problems can be solved, then certainly we should go forward. And we support electronic filing. It is more efficient. It will help the government do their job better.

Ms. THURMAN. OK. Then, Ms. Kelley, in yours—and I imagine Ms. Lee, too; Mr. Foehl, I do not remember. You were involved with the educational process.

Ms. KELLEY. Yes, very much so.

Ms. THURMAN. OK.

Ms. LEE. As were we.

Mr. FOEHL. As we have been, also.

Ms. THURMAN. OK. I needed to know that. And I notice that you also have been sitting here all day listening to the testimony. Would you agree with some of the testimony prior to this about where the problems have been? And do you believe those are some of the myths that are still out there? Or do you believe these things have been looked at, or are just a lack of education? What else can we do? Give us some ideas here because that seems to be the big issue.

Ms. LEE. I would like to compliment the IRS—I do not know that anyone did that today—on their training. ADP has worked very closely with the IRS, and they have been very supportive of our goals. They have worked with us on sharing information, and have even attended some of our seminars. So I think they have made a very big effort. They were given a very difficult task. I know that ADP has done hundreds of seminars, and we are continuing to do hundreds of seminars today. I personally have given many seminars and listened to questions from small business people. I think the problem was you had a tight period of time, taxpayers were notified last June—I believe it was June—of this challenge. And even with the 6-month delay, you really only had 1 year.

We deal with a lot of small business people. And on a technical matter such as this, it is almost repetition, repetition, repetition. There was a major challenge out there. For example, we have had an issue with our taxpayers/clients where they need to enroll on their own. ADP has sent out notice after notice to them, and as of March, we had 200,000 taxpayers/clients who had not enrolled on their own. It is not the fault of the IRS. They have sent notices; we have sent notices.

So I think a lot of it is time and repetition.

Mr. FOEHL. Ms. Thurman, I would also like to comment. I think the issues that were raised today are valid issues, even the small business issues. I think it is a case of communication, and there has to be continued communication back and forth between all of the taxpayers out there and the associations, and the IRS and the FMS. And if that occurs, I think we can get over the issues that were raised, but it has to continue.

Ms. KELLEY. I would as well like to compliment the IRS and the Treasury and the financial agents who helped me proof information that I wrote and sent out and who did a lot of phone communication at a time when they were hard pressed to accomplish what they were doing, to say the least. And, again, I think the concerns presented today, I would agree, are legitimate concerns. And I would say that there is a difference between informing and educating, and because this system is so brand new, a good job has been done of informing taxpayers, but it is going to take a little while before that knowledge becomes institutional and people really understand this, so that people are going to their banks and the banks know how to advise them, the tellers are advised to say something other than, "EFTPS? What is that?"; that tax practitioners know where to go for accurate information.

The people on this panel are very lucky. We know the people in the government and at the financial agencies who are very skilled and very knowledgable and can answer our questions so that we can produce education for our members, and I know in everybody's

case here, not only our members but going out to newspapers and magazines to try to get the information out to the country as well as our members.

So I think, yes, that if we keep working together, we can get to a point where taxpayers are adequately informed about the system.

Ms. THURMAN. I guess one of the things that we should have asked as Congresspeople who make these laws is how long we should take to implement this system. I would just like to say that we should remember that we have got a lot of good folks out there with our small businesses. We have people that come talk to us all the time. Maybe it should have been incumbent on us, instead of beating up on the agency that we directed this work to go to, that we should have taken the time and asked those people that were involved with the system what they thought was reasonable and a reasonable time in making a system like this work. And so, quite frankly, I appreciate the testimony because that gives me an idea so that I can ask that question next time we start to take on a new program. Not to say that we still would not do it, it is simply whether we can do it reasonably, and what has to be worked out to make it more efficient. I think this program is a very good program, but because of some of the quirks in it, it is going to get a bad review, and that is unfortunate.

I appreciate you all being here, and I certainly appreciate all of the testimony that we have received today, because I really think it is something we have to think about when we make changes here.

Thank you.

Mr. PORTMAN [presiding]. Thank you. I just have to make one comment here. We do even worse, sometimes, with regard to major substantive changes to the Tax Code and expect them to be effective for the next tax year. So at least we gave the IRS a couple of years here to get that first letter out. But that is an excellent point. We should have had not only the IRS but the private sector more involved at the outset to be sure that we understood these transition issues.

Thank you all very much for being here. I appreciate your testimony. With that, this hearing is adjourned.

[Whereupon, at 2:46 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

Statement of James R. Burkle, Vice President, Corporate Tax, Ceridian Corporation, Minneapolis, MN

Madam Chairman and members of the subcommittee, Ceridian Corporation, headquartered in Minneapolis, Minnesota, is a leading information services company that provides integrated human resource management systems, outsourced payroll processing, tax filing, training and other consulting services to predominantly large and mid-sized businesses. We serve over 40,000 employers in the US, including 40 percent of the Fortune 1,000 and 30 percent of the Fortune 100. As a bulk tax filer, Ceridian makes over $60 billion in federal tax deposits annually with the Internal Revenue Service (IRS)—about 14 percent of all federal taxes deposited. We are proud of the service we have provided to our employer customers and the IRS in over 20 years of tax filing.

With that experience and reputation for customer service, Ceridian has been able to work with the IRS on a number of initiatives to update tax reporting and data collection processes, such as STAWRS. When NAFTA implementing legislation charged them with developing an electronic tax payment system, the IRS called on Ceridian to help with technical aspects. We believe a successful electronic payment system will benefit employer taxpayers and the IRS alike by easing the paperwork

burden, reducing employers' time and effort to make semi-monthly, monthly or quarterly tax deposits and improving the overall efficiency of the Service.

Ceridian was prepared to meet the January 1, 1997, deadline for the next phase of the IRS' electronic tax payment system, EFTPS, and has enrolled all our customers who are now required to comply by July 1, 1997. Throughout the EFTPS development process we worked with the IRS to address a number of system administration problems that concern all bulk tax filers. We are encouraged about upcoming meetings with the IRS, but remain concerned that issues such as timely notification, emergency procedures, the ability to reverse a file and enrollment procedures, if left unresolved, will be exacerbated by the magnitude of taxpayers required to comply with EFTPS on July 1.

Approximately 1.2 million additional employers are required to make their tax payments through EFTPS on July 1, 1997. Only 1,500 employers are currently mandated. An 800-fold increase in taxpayers to be supported by EFTPS—all at once—could undermine the integrity of the system and cost employers unnecessary penalties. EFTPS should be well-tested and outstanding issues resolved before hundreds of thousands of taxpayers enter the system. The principle of tax equity demands that our government not unfairly penalize taxpayers for failures of the system.

While resolution of these systems issues will alleviate many situations in which penalties may be unduly assessed, penalty administration goes beyond this initial enrollment phase and will continue to be a concern for taxpayers who are generally in compliance. One of the greatest fears of employers is that despite a general history of compliance, one inadvertent mistake or technical error will cost them excessive penalties. Appropriate penalty administration is important to Ceridian and our employer customers and key to successful taxpayer compliance with EFTPS. Ceridian appreciates the opportunity it has had to discuss penalty administration with the IRS and subcommittee staff, and looks forward to continuing those discussions in the future.

PENALTY ADMINISTRATION

Taxpayers who in good faith are trying to comply with EFTPS are judged by the same criteria and subject to the same penalties as those who may be purposefully evading the law. Employers are penalized two percent of their payroll tax liability, per deposit, for late payments, and 10 percent of their payroll tax liability, per deposit, for failing to deposit taxes using EFTPS. Penalties are automatically assessed regardless of the reason payment was late, or was not made through EFTPS even if tax funds are deposited on time. The penalty system also does not take into account a taxpayer's compliance record.

For compliant taxpayers and bulk filers, inadvertent human or technical errors occur infrequently, but the price for those mistakes is dear. For example, because of a miscommunication between one Ceridian employee and one employee of a new customer, that customer was not correctly identified as an EFTPS/TAXLINK payer and months of deposits were made incorrectly, all subject to penalties even though the tax was paid on time. In this situation where a bulk filer like Ceridian has a 99 percent accuracy rate in its filing process, penalties were unduly assessed.

A fair and effective penalty system should take into account a taxpayer's compliance experience. An experience rating mechanism would give taxpayers a clear financial incentive to comply and improve the integrity of the system—penalties would be less arbitrary and more focused on non-compliance.

TIMELY NOTIFICATION

Despite education efforts on the part of IRS, payroll associations, payroll service providers and other third party providers, there is a significant number of taxpayers who either don't clearly understand or are unaware of their EFTPS obligations. According to the IRS, over 200,000 employers required to make deposits through EFTPS on July 1 have not yet enrolled. When July 1 arrives these taxpayers may mistakenly continue to pay their taxes by the FTD paper coupon method or magnetic media, not by EFTPS.

The IRS currently will notify taxpayers only on a quarterly basis if they have not paid their taxes through EFTPS, thus, a taxpayer may continue to make tax deposits in the usual way unaware of its new EFTPS obligations for up to five months before IRS notifies them of non-compliance. In the meantime, a 10 percent penalty will have accumulated on each successive deposit over those five months—even if the tax was paid on time. The penalty incurred is significant and can amount to almost as much as the tax due in one quarter. Penalties of this amount and fre-

quency are unwarranted. A more timely notification system would help taxpayers successfully comply with EFTPS.

EMERGENCY PROCEDURES

The EFTPS electronic filing system accelerates the transmission of funds. It also requires related taxpayer information to be transmitted at the same time as the tax payment. A tax payment is considered late if not accompanied by the taxpayer data and therefore subject to a penalty. Because of the tight time frames under EFTPS, a system failure caused by anything from technical complications to natural disasters can interrupt or prevent timely tax deposits—whether that be an hour or a day late. And a system failure could affect any one of the players in the EFTPS process—the taxpayer, payroll service provider, or the Treasury Financial Agent—but the taxpayer would receive the penalty notice for failure to deposit on time.

Currently, payroll service providers making tax deposits via magnetic media have up to five days following a tax deposit to send the IRS the related taxpayer information. This gives bulk filers the flexibility to make any necessary data adjustments when the correct data is not immediately available from the taxpayer. EFTPS minimizes opportunities to make these adjustments. For next day taxpayers, there is no opportunity to adjust data. A penalty situation can be avoided if emergency procedures are provided to allow for flexibility in the transmission of taxpayer data as is provided under the current system.

FILE REVERSALS

The IRS has not yet established clear procedures for payroll service providers on how to reverse an erroneous bulk file after the file has been transmitted. Service providers deposit funds and transfer the accompanying taxpayer information to the IRS on behalf of hundreds of thousands of taxpayers. Because of technical or human error, one bulk file may contain duplicate data or funds. There currently is no procedure under EFTPS to reverse a bulk file after it has been deposited. Without a mechanism to reverse files, numerous unnecessary penalty notices will be sent to taxpayers.

ENROLLMENT

There continues to be confusion surrounding the EFTPS enrollment process. For example, the IRS' TAXLINK unit mistakenly informed a taxpayer that it was not enrolled only to determine two days later that the taxpayer actually was enrolled. This confusion caused the taxpayer's deposit to be late by one day and a penalty was assessed. Despite repeated communication by the public and private sector, many taxpayers do not fully understand their EFTPS obligations or remain unaware that they must pay business taxes as well as payroll taxes through EFTPS.

Enrollment also can take up to 10 weeks during which deposits cannot be made through EFTPS until enrollment is complete. There is no clear procedure yet for making compliant tax deposits for taxpayers who may be partially enrolled on July 1; for newly created companies who must make payroll tax deposits before fully enrolled; and for new customers of payroll service providers. These partially enrolled taxpayers could make timely tax deposits outside EFTPS but would be assessed a 10 percent penalty. Procedures should be developed to accommodate those taxpayers who are making every effort to comply with EFTPS.

Madam Chairman, I appreciate the opportunity to provide this testimony to the Oversight Subcommittee and welcome any comments. Ceridian looks forward to working with Subcommittee Members and the IRS in finding solutions to the issues identified.

Statement of Hon. Scott Klug, a Representative in Congress from the State of Wisconsin

Thank you, Mr. Chairman, for allowing me the opportunity to testify today. I would like to commend my colleague from Washington, Mr. Hastings, for introducing this important piece of legislation.

As I'm sure you are aware, 99.7 percent of the nation's employers are small businesses and they employ 53 percent of the private work force. Small businesses also account for 47 percent of all sales in the United States and are responsible for 50 percent of the private gross domestic product.

Yet, small business owners face a tax and regulatory system that frustrates and discourages them. Government is meant to be the servant of the people, yet the existing federal tax and regulatory state unfairly acts as judge, jury, and master of honest, hardworking Americans.

In the last two years, Congress has tried to help small business escape from under the thumb of the federal government. However, there is still a ways to go. This Congress is dedicated to championing legislation designed to encourage small business growth and prosperity, and I am dedicated to becoming one of its supporters.

A perfect example of federal regulatory tyranny is the impending mandate on small business to comply with the EFTPS. This system requires any business with payroll taxes in excess of $50,000 to file these taxes electronically. If businesses do not comply by July 1, 1997, they will be subject to penalties. What's more alarming is that the compliance level drops to $20,000 for calendar year 1997, affecting an estimated 1 million more of our nation's small businesses. This kind of mandate on small business owners is outrageous.

As the implementation date approaches, several major concerns about EFTPS have been raised beyond the fundamental issue of more Federally imposed regulation. First and foremost, increased fees imposed by banks to process these transactions amount to a new tax on small businesses. Second, there is a perception that the IRS, albeit indirectly, will have electronic access to businesses' bank accounts. Third, in the event of a dispute with the IRS, there is no paper trail for a business to provide in its own defense. Fourth, many groups, including the Chamber of Commerce of the United States, the Small Business Survival Committee, and the National Federation of Independent Business are concerned about the IRS' ability to handle the increased volume of electronic filings.

Again, I commend my colleague, Mr. Hastings, for introducing H.R. 722 to make compliance for small business voluntary—returning decisions about how to conduct business to the small business owner. Mr. Chairman, the Small Business Tax Payment Relief Act will free approximately 2,500 businesses in my district alone from this mandate. I hope this Congress will act quickly to relieve our nation's small business owners from this federal mandate. Thank you, Mr. Chairman.

Statement of Hon. Ray LaHood, a Representative in Congress from the State of Illinois

Mr. Chairman, thank you for holding this hearing and allowing me to testify on behalf of the many small business men and women in the State of Illinois. As you know, I am a sponsor of the Small Business Tax Payment Relief Act (HR 722) which eliminates a costly and unnecessary burden on America's small business. The bill is endorsed by both the National Federation of Independent Business (NFIB) and the Chamber of Commerce. But more importantly, Mr. Chairman, I support the legislation because of the Everett Birdsell's of the world. Everett is a small businessman in Jacksonville, Illinois. He is opposed to the federal government forcing America's small businesses to comply with yet another costly federal mandate.

In 1993, Congress ordered all businesses to begin filing payroll taxes electronically. The Electronic Federal Tax Payment System (EFTPS) was mandated in the NAFTA Implementation legislation as a revenue raiser. Over 1.2 million businesses with an annual federal payroll tax of $50,000 or more are currently facing a mandatory EFTPS compliance date of July 1, 1997. By 1999, all businesses with an annual federal payroll tax of more than $20,000 will be forced to comply.

Many small businesses in my district, and in districts across the country, simply do not want to be forced to comply with this federal mandate. While the EFTPS system has proven to be an efficient method of transferring federal payroll taxes to the Treasury Department, it should be optional. Employers who wish to continue to make their federal tax deposits with traditional paper coupons should not face penalties from the Internal Revenue Service (IRS).

Small businesses are the backbone of our economy, and their existence is already threatened by excessive government regulation. That is why I am a cosponsor and a supporter of legislation sponsored by my good friend and colleague, Mr. Hastings (WA). HR 722, the Small Business Payment Relief Act, will provide small businesses with the option of complying with the EFTPS. The bill will help businesses to maintain control of how their deposits are made and will prevent the imposition of a new, burdensome set of regulations. The decision on how to pay federal payroll taxes should be left in the hands of the small business owners, not dictated by the federal government.

Mr. Chairman, thank you for your time and support.

Statement of Hon. Frank A. LoBiondo, a Representative in Congress from the State of New Jersey

I want to thank Chairwoman Johnson for holding this important hearing on H.R. 722, the Small Business Tax Payment Relief Act. I would like to also thank Representative Doc Hastings for introducing this vital legislation.

The Small Business Tax Payment Relief Act would provide small businesses with the option of complying with the Electronic Federal Tax Payment System (EFTPS). EFTPS was mandated in 1993 in legislation implementing the North America Free Trade Agreement, requiring that all businesses with payroll taxes greater than $50,000 file their payroll taxes electronically. I have heard from small business owners in the Second District who are concerned about the cost of complying with this mandate and are wary of being charged penalties for not filing electronically. I spent more than twenty five years in a small business and the last thing a small business owner needs is another government mandate to worry about. I experienced first hand the frustrations of regulations that do not make sense and paperwork that is onerous and duplicative.

Tax payment decisions should be made by small business owners, not the federal government. While electronic filing of tax information pursues the laudable goal of reducing federal paperwork demands, mandating electronic filing puts a serious burden on small businesses who do not have the technological capabilities to comply with this requirement. This legislation solves this dilemma by simply making electronic filing a voluntary action.

Small businesses provide vital goods and services in our communities and they employ a majority of our workforce. Eliminating this unfunded mandate would give our businesses a helping hand as they work to grow and create jobs in our communities. As a Member of the Small Business Committee, I look forward to working with my colleagues on the committee and with other interested colleagues to provide relief for small businesses from this costly federal mandate.

Statement of Elliott C. McEntee, President and Chief Executive Officer, National Automated Clearing House Association, Herndon, Virginia

The National Automated Clearing House Association (NACHA) appreciates this opportunity to present its views on the federal government's Electronic Federal Tax Payment System (EFTPS) and legislation (H.R.722) that would exempt certain small businesses from the requirement to pay taxes electronically under this program. NACHA is a nonprofit trade association representing the Automated Clearing House (ACH) Network which provides government agencies, businesses, and consumers a safe, reliable, and cost-effective electronic payment mechanism.[1] This payment mechanism supports Direct Deposit, Direct Payment, and many other consumer and commercial electronic payment applications, including federal tax payments under the EFTPS program.

A. THE PROBLEM

The United States Congress, thousands of corporations, and the Nation's financial institutions are concerned with the readiness of the federal government and taxpayers to successfully implement the next phase of the Electronic Federal Tax Payment System (EFTPS), which requires as many as 1.2 million taxpayers to begin paying their federal taxes electronically. These concerns have been magnified because of the fear that the mandate will result in taxpayers incurring Internal Revenue Service (IRS) late payment and avoidance penalties of up to 10 percent of the tax payment due. NACHA believes that virtually all these concerns would be eliminated if the IRS provides temporary relief on avoidance penalties and imposes late payment penalties in a manner similar to those used in the private sector for compensating a party that is "injured" by a late or erroneous payment.

With the EFTPS program, the federal government has elected to use the ACH Network to collect tax payments electronically. The ACH Network was largely built

[1] Through its thirty-eight member associations and more than 14,000 member financial institutions, NACHA establishes the rules, guidelines, and standards for the exchange of commercial electronic payments via the ACH Network.

by the private sector and its use will save the Federal government hundreds of millions of dollars in its revenue collection operations. Because the Federal government has elected to use a private sector payment network, we believe it should follow the rules governing that network except where such rules are inconsistent with public policy.

B. The Solution

NACHA's proposed solution would only apply to business taxes collected through the EFTPS program and addresses the problems facing taxpayers required to begin making electronic tax payments by the July 1, 1997 deadline.

In the private sector, if an electronic payment is delayed, then the party that has not made this payment on a timely basis compensates the party receiving the late payment according to a widely used formula. The amount of compensation is based on the time value of the funds to be paid and the number of days by which the payment was late. The formula, which is incorporated into the ACH Network rules, uses the overnight federal funds rate as its basis for determining the value of funds.[2] The IRS may also want to assess a minimum fee to cover the administrative costs of assessing the penalty.

For example, if a taxpayer owed $100,000 in federal taxes and the payment was two days late, the late payment penalty would be $30.56 (plus any IRS administrative fee), instead of a penalty of up to $10,000.

As an incentive to ensure that this compensation formula for late tax payments is not abused, the current graduated penalty structure could be imposed on taxpayers that frequently make late payments, or those that delay payment for an inordinate period of time following receipt of an IRS notice. Also, for reasons of efficiency and convenience to taxpayers, we believe the entire process of calculating and assessing the penalty should be automated. NACHA would be willing to research this issue further and make recommendations as to how best the IRS could automate this process.

Finally, NACHA recommends consideration of the following modifications to avoidance penalties related to a taxpayer's failure to begin using the EFTPS system when mandated:

- For those mandated taxpayers that have enrolled in the EFTPS program by the applicable deadline (e.g., July 1, 1997), a 90-day waiver of any penalties assessed for a failure to deposit their tax payments through EFTPS should be applied. This 90-day waiver period would commence with the date on which the applicable deadline takes effect; and,
- For those mandated taxpayers that have failed to enroll in the EFTPS program by the applicable deadline, a 30-day waiver of any penalties assessed for a failure to deposit their tax payments through EFTPS should be applied. As with the 90-day waiver for EFTPS-enrolled taxpayers, the 30-day waiver period could commence with applicable implementation deadline or, to accommodate those taxpayers that are unaware of the need to comply, could commence instead with the date on which the taxpayer receives an IRS notice of non-compliance, as opposed to the date upon which the taxpayer became obligated to pay via EFTPS.

By modifying the late payment and avoidance penalties associated with the EFTPS program along the lines we have proposed, NACHA believes that taxpayer concerns will be allayed without compromising the significant benefits to taxpayers, financial institutions and the federal government attributable to the program and the smoother implementation process that would result.

C. Other Comments on the EFTPS Program

The goals of the federal government with respect to the EFTPS program should be supported. NACHA believes that the federal government has taken a significant step forward by developing a program that will reduce the costs and inefficiencies borne by taxpayers, financial institutions and the federal government associated with the current paper-based tax deposit system. To achieve these objectives, we believe it is correct for the federal government to require the use of the EFTPS program for most business taxpayers according to the implementation schedule now in place.

---

[2] Under the NACHA Operating Rules, Appendix Nine (pp. OR 102–103), $ Compensation = (($ amount of entry) × (Fed. Funds Rate) × (# of days back-valued)) / 360. The Fed. Funds rate for April 7, 1997 quoted in the Wall Street Journal was approximately 5.5 percent. For EFTPS payments, the 90-day T-bill rate might be substituted for the Fed. Funds rate. At the market's close on April 7, 1997, the 90-day T-bill rate was quoted at 5.16 percent.

Compliance with the Federal EFTPS mandate is facilitated greatly by the government's selection of the ACH Network as the primary means to handle federal tax payments under the program. The ACH Network is a mature and reliable payments system currently used by over a half-million companies, thousands of financial institutions, and federal and state government agencies in support of daily commerce. It is also used by forty-six states for business tax collection purposes. Finally, the ACH Network represents a low cost alternative to either the current Federal Tax Deposit (FTD) paper-based coupon system or the Fedwire option under EFTPS (which exists more as a contingency so that same-day payments may be accommodated when necessary) offering universal access to taxpayers.

However, some modifications to EFTPS are necessary. With minimal changes to the EFTPS program as currently envisioned, including the modified penalties described above, difficulties associated with its intended implementation schedule should be avoided. As described in the attachment, however, NACHA also has some concerns of a technical or operational nature regarding the EFTPS program that we have communicated to the Treasury Department's Financial Management Service (FMS) and the IRS. It is our hope that these concerns will be resolved as quickly as possible to ensure that the EFTPS program operates in a manner fully consistent with private-sector payments system rules and operating procedures.

Federal Tax Deposit coupon processing costs must be recouped. Maintaining both electronic and paper tax deposit methods for large numbers of taxpayers is redundant and costly. Moreover, we expect that the cost to financial institutions for serving each of their business customers' tax deposit needs will be magnified if the EFTPS mandate is limited, as proposed in H.R.722, or delayed in its implementation. Therefore, as long as the option remains available to a significant number of taxpayers to pay federal taxes through the FTD coupon process, we believe that financial institutions must be capable of recouping the significant processing costs they bear.

Until recently, financial institutions participating as Treasury Tax and Loan (TT&L) depositories were able to recoup the costs of processing FTD coupon payments (which can run upward of $2–$4 per coupon) with the float benefits attributable to holding FTD balances overnight. However, now that the larger taxpayers have begun paying federal taxes electronically under the EFTPS program or its predecessor, TAXLINK, the balances held overnight for federal tax payments have declined substantially. Consequently, the float benefits attributable to these balances have also declined substantially, while the number of FTD coupons processed has only declined marginally since most taxpayers continue to use this method. The result for the typical TT&L depository financial institution is that processing costs now exceed the float benefits associated with the FTD coupon process.

This imbalance between the costs and benefits associated with playing such a critical role in the federal government's revenue collection operations is justified in our view only if it exists for a reasonably brief period. Since limiting the EFTPS mandate to only larger taxpayers would lock in this imbalance, and extending the current implementation period would prolong it, NACHA believes that either action would be unacceptable to the banking industry without adequate compensation for the processing of FTD coupon payments. Moreover, without such relief, financial institutions might be compelled to leave the TT&L program, thus possibly meaning an access problem for taxpayers choosing not to pay federal taxes electronically.

Attachment

NACHA Concerns with EFTPS Technical and Operational Issues

NACHA has the following concerns with certain technical and operational issues raised by the current operation of the EFTPS program and proposed Internal Revenue Service (IRS) and Financial Management Service (FMS) policies and operating procedures.[3] NACHA believes that the policies and procedures governing the operation of the EFTPS program should reflect current operating rules in the private-sector, which for the ACH Network are detailed in the NACHA Operating Rules.

[3] Proposed 31 CFR Part 203 (61 Fed. Reg. 190, September 30, 1996).

ACKNOWLEDGMENTS.

NACHA recently approved a change to the NACHA Operating Rules that will allow Receiving Depository Financial Institutions (RDFIs) to send acknowledgment entries over the ACH Network to confirm the receipt of ACH credit payments. Two new optional standard entry class codes (i.e., ACK and ATX) have been established to send acknowledgments in response to an Originator's request to confirm receipt by the RDFI of a corporate credit payment. This rule change takes effect September 19, 1997. Now that the capability for sending acknowledgments over the ACH Network has been developed, NACHA has asked the IRS to commit to having their Financial Agents send acknowledgments for ACH credit tax payments when requested by the taxpayer.

AUTOMATED ENROLLMENT.

In September 1996, a NACHA rule change took effect that allows RDFIs to send automated enrollment entries (ENR) to Federal Government agencies to enroll consumers for direct deposit. The ENR format is optional for RDFIs and Federal Government agencies. The Social Security Administration has begun using ENR as one of many options for enrollment, and in November 1996 had already received and processed over 50,000 ENR entries. NACHA has asked the IRS to commit to offering an automated enrollment option to taxpayers if NACHA revises the automated enrollment format to accommodate corporate EFTPS enrollments.

REVERSALS.

Proposed 31 CFR Part 203 would require financial institutions to receive approval from the IRS in advance to reverse erroneous or duplicate ACH credit entries. The EFTPS Payment Instruction Booklet states that an ACH credit reversal entry will be returned as unauthorized if the taxpayer has not received prior approval to send the reversal. As reversing entries and files are allowed to be sent without prior authorization under the NACHA Operating Rules when transmitted within five days of settlement, this requirement for prior authorization will cause confusion to taxpayers and financial institutions. As a result, errors may not be corrected in a timely fashion and the likelihood of penalties increases. NACHA has asked the IRS and FMS to consider allowing for the reversal of entries and files to correct duplicate or erroneous entries or files without prior authorization from the IRS.

PRENOTIFICATION/ZERO DOLLAR ENTRIES.

With EFTPS, the corporate taxpayer would have the option of sending a prenotification with an addenda record or a zero dollar payment prior to the first EFTPS ACH credit payment. As proposed, EFTPS would be using both these entries in an atypical fashion. Prenotification entries are typically not sent with an addenda record as the RDFI is only required to verify the account number. As a zero dollar entry is considered a non-value transaction, these entries are not associated with the ten-day waiting period associated with a prenotification. In order to use these transactions in an accurate fashion, the prenotification entry should be required without an addenda record and/or the zero dollar entry should be required without a ten day waiting period. NACHA has asked the IRS and FMS to consider our recommendation to require prenotification entries without an addenda record or to allow for zero dollar entries without a ten day waiting period.

FINANCIAL INSTITUTION REQUIREMENT TO SIGN ACH DEBIT ENROLLMENT FORM.

The EFTPS enrollment form requires that, when a taxpayer elects the ACH debit method, the taxpayer's financial institution must sign the enrollment form. As the enrollment is between the taxpayer and the IRS, it is inappropriate for the financial institution to be required to sign the enrollment form. Taxpayer verification of certain information with the financial institution can be accomplished by telephone or fax without the necessity of a financial institution representative's signature. NACHA has asked the IRS to consider removing the requirement from the enrollment form that the taxpayer's financial institution sign the enrollment for the ACH debit option.

COMPENSATION.

Proposed 31 CFR Part 203 states that FMS will impose a fee on financial institutions to recover the value of funds lost when the financial institution is responsible for a late tax payment. The proposed rule does not explain what procedures FMS

will use to determine whether a financial institution is at fault for a late payment, or what procedure the financial institution should use to demonstrate that it was not at fault, as the case may be. Furthermore, the NACHA Operating Rules define a procedure for compensation where one party is unjustly enriched or injured. NACHA has asked the IRS and FMS to consider adopting NACHA's compensation rules as the appropriate method for recovering the value of funds due for late payments for which a financial institution is held responsible.

Statement of J. Drew Hiatt, Executive Vice President and Director of Government Affairs, National Business Owners Association, Alexandria, VA

Madame Chairman, Ranking Member Coyne, and members of the Subcommittee, my name is J. Drew Hiatt. I am Executive Vice President and Director of Government Affairs for the National Business Owners Association (NBOA). We appreciate this opportunity to present our views regarding the Electronic Federal Tax Payment System (EFTPS).

The National Business Owners Association represents small business owners. Its philosophy is based on the belief that a vibrant and robust private sector and a strong and competitive free enterprise economy are essential to create and increase economic growth, opportunity, jobs, and prosperity for all Americans. NBOA vigorously represents the interests of its members before Congress and the federal government. It works to influence the enactment of policies that promote economic growth and entrepreneurship. As part of its efforts to advocate the adoption of beneficial laws and regulations, NBOA consistently communicates the concerns and legislative priorities of business owners to lawmakers, government officials, the public, and the media.

We commend you, Madame Chairman, for your leadership in convening this hearing to examine the status of the Internal Revenue Service's Electronic Federal Tax Payment System, its announced plans to force small business enrollment in this system, and the new burdens that federally mandated electronic filing would impose on small firms. Many of our small business members will be required to enroll in the EFTPS as of July 1, 1997, unless they are exempted from this requirement and enrollment in the electronic filing system is made voluntary. Rep. Doc Hastings (R–WA) has introduced legislation—The Small Business Tax Payment Relief Act (H.R. 722)—that would provide small businesses with the option of enrolling in the EFTPS. His bill correctly leaves to the discretion of small business owners the method they can elect to pay federal taxes and prevents the imposition of new and costly burdens on them. Our members wholeheartedly endorse H.R. 722 and urge Congress to pass it and President Clinton to sign it into law this year.

BACKGROUND OF THE ELECTRONIC FILING REQUIREMENT

Businesses are required to withhold or pay numerous federal taxes such as income, FICA (Federal Insurance Contributions Act), FUTA (Federal Unemployment Tax Act), excise, and corporate estimated taxes. By law, companies must deposit tax payments in a bank or savings institution identified by the Treasury Department as a tax and loan depository. Tax payments are listed on a federal deposit coupon providing the name of the taxpayer, identification number, tax period, and tax being paid. The bank or savings institution processes the payment, forwarding it to the federal government, along with relevant information indicated on the coupon.

An obscure but seemingly innocuous provision contained in the North American Free Trade Agreement Implementation Act (P.L. 103–182) enacted in 1993 mandated a change in the way federal tax payments are deposited and received by the Treasury Department. This law requires all businesses to gradually begin filing electronically taxes withheld from employees, the employer and employee portions of payroll taxes, excise taxes, and corporate estimated tax payments.

The intent of the law is to effect the transition from the current system to a nationwide system for filing taxes electronically. A new filing system—The Electronic Federal Tax Payment System—was developed to replace the current deposit coupon system and to ensure a more efficient and effective way for businesses to pay taxes to the Treasury. Furthermore, the law requires that the IRS collect, as determined by statute, a percentage of business taxes using the electronic payment method in each year during the five-year phase-in of the new system.

In July 1994, the IRS promulgated regulations to aid the changeover to the EFTPS in stages over the next five years. These new rules require businesses to enroll in the new electronic tax filing payment system if their annual employment

tax deposits exceed certain thresholds. These thresholds were established by regulation as follows:

Annual Deposit of More Than:	In Calendar Year	Deadline for Switch to EFTPS:
$47 million	1993/1994	1/1/96
$50 thousand	1995	1/1/97
$50 thousand	1996	1/1/98
$20 thousand	1997	1/1/99

Under the new regulations, businesses with annual federal payroll tax deposits of more than $50,000—an estimated 1.2 million small firms nationwide—were required to file taxes electronically as of January 1, 1997. The IRS began informing these companies of their responsibilities under the new law and warned them to comply or face a substantial penalty. Those firms that do not file their taxes electronically—insisting instead on using the current method—would face a 10 percent penalty on the taxes owed and could be forced to allow the agency to deduct the amount owed from their bank accounts.

The new law and IRS letters to small companies regarding it provoked an outcry from small firms facing the approaching compliance deadline. Their protest prompted Congress to delay mandatory filing six months until July 1, 1997. Less than two years from this date, if the law is not changed, all businesses—even smaller firms with annual federal payroll tax deposits of more than $20,000—will be forced to comply with the electronic filing requirement.

CURRENT FEDERAL TAX PAYMENT SYSTEM VERSUS ELECTRONIC FEDERAL TAX PAYMENT SYSTEM

On the face of it, electronic filing appears to have many advantages over the current system. Advanced electronic and computer technology offers vastly improved capabilities for the transmission of data and information. Switching to a federal tax payment system that is paperless and speeds tax deposits to the Treasury arguably provides benefits the current system does not. Yet these benefits may not be sufficient in themselves to justify the abandonment of the current system and its replacement with the Electronic Federal Tax Payment System. While the EFTPS solves some problems for banks and the Treasury Department—reducing paperwork burdens for depository institutions and ensuring faster receipt of taxes for the Treasury—it creates an entirely new set of unforeseen and costly burdens for small businesses. It is these problems—the disadvantages of electronic filing—that concern small business owners about switching over to the new system.

From the perspective of the bank and savings institution or the Treasury Department, moving to a paperless filing system makes sense. Yet this change will prove detrimental to small business owners. Because electronic filing does not create documentable, verifiable records taxpayers may need to defend themselves if the IRS makes a mistake or orders an audit, many small business owners oppose it. Small businesses are also reluctant to give the IRS or its designated banking intermediaries direct access to their accounts.

Company owners also object to the additional cost burden the new system would impose on them. For example, some banks assess fees for electronic filing services. Yet what upsets small businesses more than the extra fees is that they would be required to pay their taxes six days in advance of the due date. This is tantamount to a hidden tax increase.

A CASE FOR CHOICE: PRESERVING SMALL BUSINESSES' CHOICE IN HOW THEY PAY THEIR TAXES

At issue in the electronic filing debate is small business owners' vehement opposition to forced compliance with the new federal electronic tax filing requirement. Their opposition turns on a fundamental and well-established principle at the heart of our democratic system—that is, the freedom to choose. Small business owners take seriously their responsibility to pay federal taxes, but how they discharge that obligation, they argue, should be their choice. The federal government should not be allowed to dictate the method small business owners must use to make federal tax payments, particularly when its prescribed method would impose additional burdens on businesses as the Electronic Federal Tax Payment System clearly would do.

We support The Small Business Tax Payment Relief Act (H.R. 722), sponsored by Rep. Doc Hastings (R–WA), that would give small firm owners the option of enrolling in the Electronic Federal Tax Payment System. It would accomplish this by lock-

ing in the effective date for compliance at a much higher qualifying amount, thereby relieving small business owners of their responsibility to enroll in the EFTPS. Making enrollment in the EFTPS an option rather than an obligation for small businesses would preserve their choice in how they pay federal taxes and avoid the imposition of new and costly burdens on them.

CONCLUSION

Madame Chairman, Ranking Member Coyne, and members of the Subcommittee, we appreciate this opportunity to offer our views and comments regarding the Electronic Federal Tax Payment System and the burdens forced in it would place on small businesses. Unless the law is changed soon, 1.2 million small firms will have no choice but to file their taxes electronically with the federal government. We believe that the Small Business Tax Payment Relief Act (H.R. 722) provides a workable alternative to mandatory small business enrollment in the EFTPS, preserves small businesses' options in how they meet their federal tax responsibilities, spares small firms more onerous federal regulation to comply with, and protects them from unwarranted government intrusion in business operations and decision-making. We urge you as members of this Subcommittee and the Congress at large to pass H.R. 722 and the president to enact it into law this year.

Thank you.

Statement of William T. Sinclaire, Senior Tax Counsel and Director of Tax Policy, U.S. Chamber of Commerce

The U.S. Chamber of Commerce appreciates this opportunity to express its views on the Electronic Federal Tax Payment System (EFTPS). The U.S. Chamber is the world's largest business federation, representing an underlying membership of more than three million businesses and organizations of every size, sector and region. This breadth of membership places the Chamber in a unique position to speak for the business community.

INTRODUCTION

In 1993, the EFTPS was enacted as part of the North American Free Trade Agreement Implementation Act (P.L. 103–182). Under the EFTPS, most employers will be required to electronically deposit not only payroll taxes, but also their income and other tax liabilities as well. Traditional paper coupons will no longer be accepted by the Internal Revenue Service (IRS) for these deposits. Taxpayers who fail to timely deposit their taxes electronically will be subject to a 10-percent penalty for each failure.

There are two main methods which employers can choose from in order to make their electronic deposits—the Automated Clearing House debit method (ACH debit method), and the Automated Clearing House credit method (ACH credit method). Under the ACH debit method, an employer authorizes the IRS to withdraw a certain amount of funds from its bank account. Under the ACH credit method, an employer directs its bank to transfer funds from its account to the IRS. Under either method, a business would have to initiate its electronic deposit with its bank at least one day prior to the actual due date of the payment. If a business is unable to initiate a timely deposit under either the ACH debit or credit method, it may be able to use an emergency same-day settlement procedure.

The EFTPS is being phased-in over a five-year period which began in 1995. Under the current stage, only those businesses that deposited more than $47 million in payroll taxes during the 1994 calendar year are presently required to comply with the EFTPS. Given this high deposit threshold, few businesses are currently subject to the EFTPS. It is estimated that less than 1,600 businesses are affected, and many of these had previously been depositing their taxes electronically through TAXLINK.

Beginning July 1, 1997 (delayed from January 1, 1997 by the Small Business Job Protection Act of 1996 (P.L. 104–188)), businesses that remitted $50,000 or more in payroll taxes during calendar year 1995 will be required to deposit their taxes electronically. It is estimated that an estimated 1.2 million businesses will be affected by this next stage of the phase-in of the EFTPS. In addition, beginning January 1, 1999, businesses that remit $20,000 or more in payroll taxes during calendar year 1997 will also be subject to the next and final step of the phase-in of the EFTPS.

This final step of the phase-in will cause an estimated one million additional small businesses to be subjected to the mandate.

The $50,000 payroll threshold was originally scheduled to be phased-in on January 1, 1997, by P.L. 103–182. However, as a result of the many concerns expressed by numerous parties, the IRS announced on July 31, 1996, that it would not impose any penalties until July 1, 1997, on the 1.2 million depositors required by law to begin making their tax payments electronically on January 1, 1997, for their failure to begin making deposits through the EFTPS. In addition, a provision was added to P.L. 104–188 which delayed the effective date for implementation of the January 1, 1997 step of the EFTPS until July 1, 1997. Accordingly, small businesses with payroll tax deposits of $50,000 or more in calendar year 1995 will now become subject to the EFTPS on July 1, 1997.

CONCERNS ABOUT EFTPS

With the July 1, 1997 deadline fast approaching, the U.S. Chamber continues to have concerns about the EFTPS. These include:

• Complexity and burdens the EFTPS will impose on small businesses.

The EFTPS, despite assertions to the contrary by the IRS, will add another layer of complexity to an already Byzantine web of tax rules and procedures. Small businesses currently comply with an array of complicated and administratively burdensome income, payroll, excise, and sales tax laws. In the payroll tax area, employers are required to compute and withhold their employees' share of taxes, file quarterly federal and state payroll tax returns, and timely deposit such taxes manually either on a monthly or semiweekly basis depending on the amount of taxes deposited during a "lookback period." The EFTPS, with its various rules and procedures relating to ACH debit and credit methods, emergency same-day deposits, and penalties, will further complicate an already complicated and burdensome tax system.

• Imposition of another government mandate on small businesses.

In addition to the myriad of tax rules and regulations, small businesses must comply with various other federal, state and local laws such as environmental and workplace regulations. Small businesses have been successfully depositing their taxes manually for years and can ill-afford another burdensome government mandate, especially on how to pay their taxes. Given the low payroll threshold of $50,000 (for July 1, 1997 deposit requirement, and $20,000 for January 1, 1999 deposit requirement), virtually all small businesses will be subject to the EFTPS. Although some small businesses may wish to deposit their taxes electronically, and they should be encouraged to do so, many others will prefer to continue using traditional paper coupons, and should be permitted to do so.

• Will the IRS and the Treasury Financial Agents be able to handle the large volume of electronic deposits?

There is a real fear in the business community that the IRS and the Treasury Financial Agents will be unable to adequately process the electronic deposits of over 1.2 million businesses starting July 1, 1997, and an additional one million on January 1, 1999. The impact that this mass infusion of deposits will have on IRS systems and customer service is unknown at this time. Its ability to handle electronic deposits for approximately 1,600 businesses is not a sufficient basis for determining that it and the financial agents can handle the deposits for an additional 1.2 million businesses on July 1, 1997, and another one million businesses on January 1, 1999. Furthermore, taxpayer confidence in IRS's ability to handle the upcoming onslaught is seriously undermined by the fact that it takes up to ten weeks to enroll in the program, if everything goes smoothly.

• Punitive 10-percent penalty on late deposits.

Beginning July 1, 1997, the IRS could start imposing a 10-percent penalty on every mandated tax deposit that is not made through the EFTPS. Most small business owners are outraged that the IRS may consider imposing such a harsh penalty on them considering they are being forced to switch to a new, untried deposit system. Since taxpayers who use the ACH debit and credit methods will have to initiate their deposits at least one day before the tax due dates, those businesses that are unable to do so in time will be subject to penalties. Furthermore, taxpayers who are unaware that the deposit requirement applies to income and other taxes may be subject to penalties. It is unjust for the IRS to penalize a small business who remits its payroll taxes to a depository bank on the tax due dates.

• Banking fees relating to electronic deposits.

Many smaller banks will not be able to offer the ACH credit or emergency one-day settlement options to their customers, thereby prompting many employers to move their banking business to banks that do offer such services. Banks that offer these services will undoubtedly charge their customers service fees for processing

such transactions. While their is no direct cost to business owners for using the ACH debit deposit method, many employers will want to open a separate bank account, at additional cost, solely for deposit transactions due to privacy concerns.

• Perception that the IRS has access to taxpayers' bank accounts.

While the IRS will not be able to withdraw funds from an employer's bank account unless it is specifically authorized by the employer, there is a misperception by many that the IRS could unilaterally access an employer's account for taxes, interest, or penalties. This is due to a poor communication effort on the part of the IRS.

• Lack of a paper trail.

Many taxpayers will prefer to have a paper trail of their payroll deposits for bookkeeping purposes or in case they are audited by the IRS. While electronic transfers will eventually be shown on customers' bank statements, many taxpayers prefer to have an immediate acknowledgement of their deposits, such as copies of their Federal Tax Deposit Coupons. Electronic deposits are not likely to be evidenced by such an acknowledgement.

• Overall confusion about the EFTPS.

There is a great deal of anxiety, anger, and confusion in the business community about the EFTPS. Much of it has to do with the way in which the IRS informed businesses about the requirement. Even though the EFTPS was created in 1993, taxpayers were first made aware of the new mandate in an IRS letter late last spring or early summer. In this letter, the IRS informed taxpayers that they would have to enroll soon in order to make electronic transfers beginning January 1, 1997, otherwise they would face a 10-percent penalty. The tone and threatening nature of this letter understandably angered many in the business community. While the IRS has since apologized for the way it notified taxpayers of the EFTPS, many business owners are still appalled at the way they were treated and remain confused about how the EFTPS works. Many employers who have since enrolled in the program have done so out of fear of being penalized by the IRS, and not out of desire to make their payroll and income tax deposits electronically.

LEGISLATIVE PROPOSALS IN THE 105TH CONGRESS

Legislation has been introduced in the 105th Congress which would alleviate many of the concerns business has about the EFTPS. In the House of Representatives, Congressman Hastings (R–WA) introduced the Small Business Tax Payment Relief Act (H.R. 722). The bill would provide small businesses with the option of continuing to remit their payroll taxes with traditional paper coupons or through the EFTPS. This would be done by freezing the five-year phase-in of the EFTPS at its current stage and allowing those not mandated to use the EFTPS, to use it voluntarily. The Chamber supports this proposal.

In the Senate, Senator Nickles (R–OK) introduced S. 570. This bill would phase-in the EFTPS more slowly, and would permanently exempt businesses whose annual depository taxes do not exceed $5 million. In addition, the bill would encourage all taxpayers to voluntarily enroll in the EFTPS. The Chamber also supports this proposal.

CONCLUSION

Due to the many concerns about the EFTPS, small businesses should be able to decide for themselves whether or not they want to remit their taxes electronically. Many businesses will no doubt prefer electronic deposits to manual coupon deposits, but they, and not the IRS, should be the ones that choose this method of payment.

○