





Modernized e-File

FTA Meeting
June 13, 2005
Internal Revenue Service
Electronic Tax Administration





What is Modernized e-File?

- Modernized e-File (MeF) is a new *e-file* system which processes Forms 1120/1120S and Form 7004 (extension)
- After three years of design and development MeF was successfully launched
- MeF is scheduled to replace the existing electronic filing system



Design of MeF

- In October 2000 IRS created a stakeholder group to help IRS design a new electronic filing system
- Ensure the needs of large and small corporate taxpayers were understood
- Big 4 accounting firms, Electronic Return Originators, and Software Developers have been actively involved in design of Modernized e-File since October 2000
- IRS used contractors to design and develop MeF
 - Contractors attended all meetings and discussions with the stakeholder group



What Did Partnership Achieve?

- Complex returns – MeF provides the ability to electronically file complex consolidated returns with multiple subsidiaries and foreign entities
- All Forms - MeF provides specifications for all 96 forms that can be filed with Forms 1120 and 1120S
- Attachments - IRS identified 400+ possible requirements to attach additional information to the 96 forms filed with 1120/1120S
 - MeF requires most attachments to be submitted to IRS in XML structured or unstructured statement records
 - Only attachments that do not have a defined XML schema can be scanned and attached to the electronic return in PDF





What Did Partnership Achieve?

- Internet filing
 - Current 56K modem would not accommodate large returns.
 - Internet filing option designed to meet needs of the large corporate taxpayer and submit return over secure internet connections
- Eliminated drain processing
 - MeF system processes returns as they are received and returns acknowledgements immediately. Sender does not have to wait until scheduled drain times to receive processing acknowledgements
- Redesign of reject codes
 - MeF made the rejects in easy to read and understand language that points to exactly where the error was made



Processing Year 2004 Successful MeF Launch

- Volume 1120 - 14,939
- Volume 1120S - 36,948
- 300+ LMSB returns filed
- 4,000+ Third Parties filed returns
- MeF system performed beyond expectations

Processing Year 2005 April 24, 2005

- Volume 1120 - 25,727
- Volume 1120S - 105,621
- 500+ LMSB returns filed
- 9,500+ Third parties filed returns






IRS MeF Receives “Best of the Best” Award

Modernized e-File was voted “Best of the Best” at the annual Government Solutions Forum on June 2-3. 160 nominations resulted in 15 award winners with MeF at the top. Rob Ragano, the Business Systems Modernization (BSM) Project Director for MeF says, “For MeF to take an honor like this means a great deal to Modernization and to MITS. What’s really impressive is that we were recognized by our Government counterparts, our peers, in the voting.”





Chuck Piekarski, Rob Ragano, Darius Taylor, Karen Evans, Fred Forman, Steve Peck and Ron Rosh

Why Mandate?



Commissioner's comments in News Release

- E-filing can improve both our service and enforcement missions
- E-filing will speed tax processing and reduce audit cycle time. Taxpayers will benefit by resolving uncertainties earlier.
- Audits on average, take five years to complete for large corporations—
- Speeding processing will help identify emerging trends and abuses earlier, enabling the IRS to address problems before they get out of hand.



Why Mandate?

- Large Taxpayers and Software Developers have been consistent in telling IRS they would not e-file voluntarily
 - _ For Corporations, uniform compliance treatment
 - _ For Software Developers, the costs of development
- Fairness to Corporate filers dictates a mandate to eliminate a paper / electronic dichotomy
- Corporate e-filing has been mandated by several States and Countries.



Required To e-File

- Corporations with assets of \$50 million and above required to e-file their 1120/1120S, if required to file at least 250 returns during calendar year
- Effective for taxable years ending on or after December 31, 2005
- IRS intends to require e-filing of additional corporate returns as it increases its capability to receive these forms electronically
 - No e-filing requirement with respect to amended or corrected returns





250 Return Requirement

- Determined by counting the number of returns the entity is required to file over the calendar year, regardless of the type of returns filed.
 - Count includes information returns (W-2s)
 - Controlled groups are to aggregate the returns they file for determining whether 250 are filed





Partnership With Industry

- IRS met with Tax Executive Institute (TEI) February 9, 2005 and identified issues concerning mandate
- IRS met with software developers that support large corporations on March 9, 2005
- IRS held follow-up sessions with TEI staff, TEI members, software developers March 10, 2005



Mandate Issues

- Entire electronic return must be transmitted to IRS as one file formatted in XML and/or PDF
- Large corporations often use more than one tax preparation software package to prepare paper corporate income tax returns
 - _ May use other formats (e.g. Word, Excel)
- Corporations may not send Transactional Data on tax forms used for reporting of depreciation expense and the sale of an asset (capital gains) which contain fields for details of each transaction
 - _ such as every asset that's being depreciated and the sales price and cost basis of every asset sold.
 - _ For large corporations, the number of assets sold or assets depreciated can be in the millions
- Electronic filing may change the corporations internal process for return preparation



MeF Capacity & Performance Testing Before Mandates

- Application and Infrastructure contractors performed extensive tests before MeF programs implemented
 - Included tests on all forms and attachments
- IRS Product Assurance performed approximately 14,000 test cases
 - Included tests on all forms and attachments
- IRS conducted numerous performance tests including a model of large corporate return
 - 50,000+ page return
 - 1,800 Subsidiaries
 - 2,000 Foreign entities
 - 1,500 attachments






MeF Capacity & Performance New Assumptions

- IRS will conduct new performance tests based on the total corporate taxpayer population with assets over \$50 million or 22,000 returns
 - Approximately 11,200 corporations meet 1st year mandate criteria of \$50M assets and 250 returns
- Additional volume projected non-mandated returns
 - Due to increased number of software companies providing e-file option
 - Publicity concerning mandates
- Additional equipment will be installed and tested before January 2006 if determined necessary





MeF Security

- MeF design followed a stringent life-cycle process which included a Logical and Physical design
- IRS Security and Privacy offices review and approve all stages of MeF design



MeF Security Requirements

- Secure Sockets Layer (SSL) version 3.0 security with 128-bit encryption currently used by IRS
 - A 128-bit number has a possible 2^{128} different combinations (2 – because it is binary). That's as many combinations as there are water molecules in 2.7 million Olympic size swimming pools.
 - The Modernized System is a secure n-tier, client-server based infrastructure system that resides on a dedicated set of components
- PKI Certificates planned for future





Waivers

- Required e-File may be waived upon a showing of hardship
- The Commissioner will determine the terms and conditions demonstrating hardship
- These factors, along with how to request a waiver, will be published through a revenue procedure



Partnership with States

- April 2003 – IRS invited states to help IRS develop new modernized Fed/State system
- August-September 2003 – Tactical Advisory Group (TAG) & states agreed to high-level system requirements
- October 2003 – Tactical Advisory Group established teams to further define requirements
- Originally 11 states, now grown to over 30





Partnership with States

- Created a state XML schema that makes it easier for software companies to support state electronic filing programs using one set of standards
- Creating the state XML schema is a repeatable process that can save time and effort
- As other e-file programs move to MeF state XML schemas can be modified





What Is Partnership Working on for 2006?

- IRS is on target to implement new Fed/State program January 2006
- MeF will provide transmitters and States with single point of transmission and acknowledgement for state returns
- MeF will start testing with States in October 2005 and with transmitters in November 2005
- Memorandum of Understanding between states and IRS
- Sixteen states indicate they plan to participate in 2006
 - AL, AZ, FL, GA, IL, KS, LA, MD, MI, MO, NC, OK, PA (mid-2006), SC, UT and WI




What Is Partnership Working on for 2006?

- Web Services Internet filing - Current MeF Internet filing is browser-based and requires a person to initiate transaction
- Transmitters asked for “lights out” operations where transmitter system interacts with IRS system.
- This functionality will be available in January 2006 for MeF





What Is Partnership Working on for 2007?

- 1065 *e-file* program will be moved to MeF in January 2007
- MeF will leverage existing 1120 schemas for shared forms and business rules. Six new 1065 forms and 67 shared forms.
- Fed/State option for 1065 will be offered when 1065 moves to MeF
 - _ IRS and states have started working on requirements



Partnership to Determine What is Next for MeF?

- October 2004, IRS established task team to determine feasibility of moving 1040 to MeF before 2010
- Over 20 interviews conducted with EROs, Software Developers and Transmitters
 - _ Interviewed top 5 – 10 in each category
 - _ Interviewed a sampling of smaller providers in each category



Stakeholder Response

- Majority of Software Developers and Transmitters wanted 1040 transitioned first
- Software Developers and Transmitters consider they are prepared for XML but require 18 – 24 months for transition
- Phased Deployment by Forms – Positive reaction to adding entire form type at one time.
- Phased Deployment over Multiple Years – Positive reaction to ability to support multiple programs during 1040 transition
- Communication between IRS and stakeholders viewed as critical

