



Report to Congress: IRS-run Direct e-File Tax Return System

Overview

May 2023





Background

As directed by Congress in §10301(1)(B) of the Inflation Reduction Act (IRA), the IRS has spent the last several months studying the feasibility of an IRS-run free direct e-file tax return system (Direct File). Specifically, the IRA appropriated \$15 million for an IRS Task Force to deliver a report to Congress by May 16, 2023 covering three primary areas of a potential Direct File system:

Cost

Of developing and running a free direct e-file tax return system, including costs to build and administer each release, with a focus on multi-lingual and mobile-friendly features and safeguards for taxpayer data (including options for differential coverage, based on taxpayer adjusted gross income and return complexity)

Taxpayer opinions

Expectations, and level of trust, based on surveys, of a free, IRS-run Direct File system.

Opinions of an independent third-party

On the overall feasibility, approach, schedule, cost, organizational design, and IRS capacity to deliver such a Direct File system



Context: IRS - Inflation Reduction Act Operating Plan

- Given the Congressional directive within the Inflation Reduction Act, the IRS included the study of the feasibility of Direct File within its Strategic Operating Plan (SOP).
- The SOP has five core transformational objectives, each of which contains several initiatives to help drive transformation within the IRS.
- Objective 1 from the SOP focuses on improving service to taxpayers, and Initiative 1.5 states:

“The IRS will explore providing taxpayers the option to file certain tax returns directly with the IRS online.”

- This congressionally mandated report for Direct File also serves as the first milestone for this initiative, and one of the first major deliverables under IRS’s SOP.

- Strategic

Objective 1: Dramatically improve services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible.

Objective 2: Quickly resolve taxpayer issues when they arise.

Objective 3: Focus expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance to address the tax gap.

Objective 4: Deliver cutting-edge technology, data, and analytics to operate more effectively.

Objective 5: Attract, retain, and empower a highly skilled, diverse workforce and develop a culture that is better equipped to deliver results for taxpayers.



Structure of the Direct File Report

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Section 1. Taxpayer Opinions: Methodology

For this section of the report, the IRS relied on three primary data sources to gauge taxpayers’ “*opinions, expectations, and level of trust*” with an IRS-run Direct File system:

	2022 IRS Taxpayer Experience Survey (TES)	MITRE Corporation Independently conducted Survey	Direct File Taskforce-led Qualitative User Research
<i>Selection criteria</i>	Random selection	Opt-in	Recruitment based on demographic and income criteria
<i>Sampling</i>	Weighted, representative sample	Unweighted, non-representative sample	Unweighted, non-representative sample
<i>Number of participants</i>	N = 4,219	N = 2,000 (across two surveys)	N = 14
<i>Timespan</i>	August 22, 2022 – October 10, 2022	December 7 – 12, 2022	December 16, 2022 – ongoing
<i>Language</i>	English + Spanish	English only	English only
<i>Modality</i>	Online + phone	Online only	Videoconference
<i>Question and response options</i>	One survey, multiple-choice responses for each question	Two surveys, choice-based conjoint analysis of four scenarios + reasons for each choice in each scenario	Unstructured, one-on-one interviews and usability tests with a functioning internal prototype



Section 1. Taxpayer Opinions: Key Findings

The taxpayer surveys and qualitative user research yielded a number of findings, including:

- A majority of taxpayers across both surveys and user research report interest in using an IRS-provided tool to prepare and file their taxes;
- Taxpayers are sensitive to cost, privacy, and security in their tax filing choices;
- Some taxpayers would be interested in using Direct File specifically because it would be built by the IRS;
- Some taxpayers report concern about the motives of the IRS in providing a Direct File tool and potential implications for tax enforcement;
- Taxpayers who currently self-prepare their taxes, are younger, or have limited English proficiency are more likely to be interested in a Direct File tool;
- Taxpayers are least likely to adopt a Direct File option when they are comfortable with their current filing option; and
- Taxpayer preferences regarding Direct File tend to be based on the assumption that a Direct File option would be about the same as or easier to use than other tax preparation software. Taxpayers shown a functioning internal prototype of Direct File reported that the software exceeded their expectations in terms of ease of use and simplicity.



Section 1. Taxpayer Opinions: Key Findings

72%

Of Taxpayer Experience Survey (TES) respondents indicated that they would be either “very interested” or “somewhat interested” in using a free IRS-provided online tool to prepare and file their taxes.

68%

Of TES respondents who currently self-prepare their taxes using commercial software indicated that they would be either “very likely” or “somewhat likely” to switch to a free IRS-provided online tool.

52%

Of MITRE survey respondents when asked to choose between three hypothetical tax preparation and filing options stated that they would prefer to use one of the two IRS-provided options (15% manual entry option, 37% pre-filled option).

Taxpayer motivations for tax preparation and filing preferences:

- A large share of taxpayers expressed their view that tax filing assistance is a proper role for the IRS.
- Cost is a major factor for most taxpayers when selecting a filing method.
- Taxpayers trust the IRS to keep their data secure and trust that it won’t be used for commercial benefit.
- Taxpayers who self-prepare are more likely to be interested in a self-preparation tool from the IRS.



Section 1. Taxpayer Opinions: Key Findings

Understanding why taxpayers may be unlikely to switch

- Over one-third of taxpayers who responded to the TES said they were unlikely to switch to an IRS-provided tool, noting that they already file for free; the top reason why taxpayers said they were unlikely to switch was “I prefer not to make changes on the tax filing method/software I used previously”
- Similarly, respondents to the MITRE survey indicated that one of the main reasons they prefer a commercial option is because they are comfortable with those filing options they have used in the past.

Factors that May Affect Interest in Direct File

Factor 1: State and Local Tax Preparation Support

Taxpayer interest in Direct File is likely to be greater if Direct File were to include support for filing state tax returns.

Factor 2: Tax Information Pre-population

Taxpayer interest in Direct File is likely to be greater to the extent that Direct File includes capabilities to pre-populate returns with taxpayer information.

Factor 3: Erroneous Expectations of Preferential Treatment for Direct File Users

Some taxpayers erroneously expected that returns filed via an IRS-provided tool would receive preferential treatment; more research is needed to ascertain the drivers of this expectation and how to communicate that this would not be the case.



Section 2. Costs

The IRA instructed the IRS to estimate “the cost (including options for differential coverage based on taxpayer adjusted gross income and return complexity) of developing and running a free direct e-file tax return system, including costs to build and administer each release [...]”

- The report identifies key considerations and cost drivers of such a system and provides estimates of initial and ongoing costs of an end-to-end service; including the cost of development and maintenance, as well as customer support and underlying technology.
- Estimated costs vary widely and are subject to considerable uncertainty. Customer support accounts for a large portion of the cost in all scenarios.
 - Estimates substantially depend on assumptions regarding (1) the number of taxpayers who would choose to use a Direct File option; and (2) the complexity of their respective tax situations.
- Cost estimates assume that if a decision is made to implement Direct File, the IRS would leverage iterative product development practices, starting with a limited initial tax scope and adding additional tax situations over time. The assumptions underlying cost estimates are not intended to foreshadow an agency position on the scope of a potential Direct File option.



Section 2. Costs

Assumptions and potential scopes of covered tax situations for Direct File cost modeling:

- Narrow Scope:** Assumes Direct File eventually matches the scope of the VITA program; taxpayers of any income would be able to use tool if they did not require support for out-of-scope provisions.
- Broader Scope:** Assumes Direct File would be able to eventually support a more expansive set of tax situations, including income types, deductions, and credits not supported by VITA.

	<i>Annual Cost (Narrow Scope)</i>	<i>Percent of Total Cost</i>	<i>Annual Cost (Broader Scope)</i>	<i>Percent of Total Cost</i>
<i>5 million taxpayers</i>				
Technology & Product	\$23.7m	36.9%	\$33.8m	43.4%
Customer Support	\$40.6m	63.1%	\$44.1m	56.6%
Total	\$64.3m		\$77.9m	
<i>10 million taxpayers</i>				
Technology & Product	\$25.5m	24.6%	\$35.5m	29.4%
Customer Support	\$78.1m	75.4%	\$85.1m	70.6%
Total	\$103.6m		\$120.6m	
<i>25 million taxpayers</i>				
Technology & Product	\$30.7m	13.9%	\$40.8m	16.4%
Customer Support	\$190.6m	86.1%	\$208.1m	83.6%
Total	\$221.3m		\$248.9m	



Section 2. Potential Benefits and Operational Challenges

The IRS also covered potential benefits and operational risks in its Direct File Report to Congress.

Potential Benefits:

- **Improved Taxpayer Experience:** A Direct File tool could directly benefit taxpayers by making tax filing a simpler and less expensive process, making it easier to file an accurate return.
- **Cost Savings:** The IRS could see a burden reduction if taxpayers switch from filing paper returns to an e-filed product.
- **Reducing Complexity:** A Direct File option could also reduce barriers for taxpayers to access the tax credits and deductions they may be eligible for, improving the customer experience.

Operational Challenges

- **Fostering Technical Product Development Expertise:** Developing a Direct File tool would require the IRS to develop new skills and processes to operate, maintain, and improve complex technological products.
- **Developing Customer Service Capabilities:** Customer support introduces additional challenges in order to be viable in the longer term.
- **Supporting State Tax Administration:** State income tax filings remain a challenge, as they are often filed in conjunction with federal taxes. Any solution would need to avoid creating additional burden for filers and to avoid disrupting the work of state and local tax administrators.



Conclusion

- Taxpayer survey data, user research, and the prototyping work conducted by the Direct File Task Force have demonstrated that there is taxpayer interest in an IRS-run Direct File option.
- The IRS's ability to deliver such a system would require ongoing funding at adequate levels, and other operational considerations and challenges remain.
- With these considerations in mind, Direct File should be considered among future options for agency technological transformation and customer experience improvement.