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IRS Direct File Program: An Overview

The assessment and collection of federal taxes owed depend on the level of taxpayer compliance with tax laws and regulations. Two factors shaping this compliance are the cost and ease of preparing and filing a tax return.

Electronic filing (e-filing) provides benefits to taxpayers and tax administrators like the IRS. The main benefits to taxpayers are faster delivery of refunds and resolution of filing errors. For the IRS, processing costs are much lower than they are for paper returns. E-filing rates for federal individual income tax returns now exceed 90%.

The IRS offers certain taxpayers three options for free e-filing. One option is the IRS-run Free File program, which allows lower-income taxpayers to e-file free of charge through the websites of participating tax software companies. Another option is the Volunteer Income Tax Assistance (VITA) grant program, in which the IRS partners with local community organizations to help low-income individuals, disabled individuals, and persons with limited English proficiency e-file their returns free of charge. The third option is the Tax Counseling for the Elderly program, which provides free tax preparation and filing for taxpayers 60 years of age and older.

Historically, the IRS had not offered taxpayers the option of filing directly through a secure portal on its website, an option known as direct-file (DF). Such an option first became available as a pilot program for a limited number of taxpayers during the 2024 filing season.

This In Focus discusses how the pilot DF program came to be, how it operated, and whether the IRS may offer it (or something similar) again in the future.

Evolution of IRS Direct-File Option

Arguably, the IRS's efforts to create a DF system began with the Internal Revenue Service Restructuring and Reform Act of 1998 (P.L. 105-206, RRA98). The act directed the IRS to develop and implement a plan to achieve an e-filing rate of 80% for individual tax returns by 2007, with input from the private sector. The act also required the IRS to develop procedures for implementing a return-free filing system for tax years beginning after 2007. Nothing came of the second requirement, except for a report the IRS issued in 2003 that focused on the additional resources the IRS would require to create and operate such a system and changes in federal tax law that would facilitate taxpayer use of such a system.

The first directive initiated a process that seems to have culminated in the 2024 DF pilot program. The process began with a 2001 directive from the Office of Management and Budget to the IRS to expand e-filing as

part of a broader push by the George W. Bush Administration to expand the range of online federal government services.

In 2002, the IRS elected to reach this goal through a partnership with a number of commercial tax software firms to provide free online tax preparation and filing to lower-income taxpayers through a program called Free File. At the start of the program, member companies agreed to provide free e-filing to eligible taxpayers through their online platforms, and the IRS agreed not to develop its own DF system.

This commitment lasted until 2019, when it was dropped from the memorandum of understanding governing the year-to-year operation of the Free File program. Critics of the program had been pushing for the IRS to develop its own DF tool in part because of concerns about Free File. They said the program had achieved its main objective of substantially boosting e-filing among lower-income taxpayers. Several 2019 reports noted that eligible taxpayer usage rates had largely remained between 3% and 4%, the IRS invested little in promoting the program, and there was evidence that some member companies had sought to increase revenue by diverting Free File-eligible taxpayers to their paid filing services.

Congressional interest in an IRS free DF tool appears to have grown since 2019. The Inflation Reduction Act of 2022 (IRA, P.L. 117-169) provided the IRS with \$15 million to create a DF task force and deliver a report to Congress by May 16, 2023, that included the opinions of an "independent third party."

IRS Taskforce Report

The IRS task force report addressed two topics: (1) taxpayer "opinions, expectations, and level of trust" for an IRS-run DF system and (2) the cost of developing and operating such a system under different levels of taxpayer income and tax return complexity.

To assess taxpayer opinions of a "hypothetical free IRS-provided online tool," the IRS task force reviewed the results of two recent taxpayer surveys and interviewed 14 taxpayers about their experiences using an IRS-built prototype of a DF system. The survey results indicated that over 70% of taxpayers would be "very or somewhat interested" in using an IRS-run DF tool.

The task force also found that taxpayer interest in such a tool varied with (1) the percentage of taxpayers who regarded the IRS as a legitimate provider of such a service; (2) the availability of concurrent filing for federal and state income tax returns; (3) the availability of prefilled returns;

and (4) possible advantages of using an IRS filing tool relative to other filing options, such as faster refunds and reduced audit risk.

The IRS report noted that the cost of developing and updating a DF system would be driven by (1) the acquisition of critical software and equipment; (2) system maintenance and updating to reflect tax code and taxpayer eligibility changes; and (3) customer support.

Under a set of assumptions about these cost drivers, the report provided cost estimates for six filing scenarios ranging from 5 million to 25 million filers under simple and more complicated tax situations. According to the results, the annual cost of developing and operating a DF tool used by taxpayers with simple tax situations rose from \$64 million for 5 million filers to \$221 million for 25 million filers. Customer support accounted for 63% of the estimated cost for 5 million filers and 86% of the estimated cost for 25 million filers. Economies of scale lowered the estimated cost per return for a simple tax situation from \$13 for 5 million filers to \$9 for 25 million filers.

Independent Third-Party Opinion

As required by IRA, the IRS selected New America and law professor Ariel Jurow Kleiman to comment on the “overall feasibility, approach, schedule, cost, organizational design, and Internal Revenue Service capacity to deliver ... a direct efile tax return system.”

In the third party’s view, the success of such a system depended on (1) consistent IRS managerial support; (2) a gradual and flexible approach to system development; (3) sustained funding; (4) the availability of concurrent and coordinated e-filing for federal and state income tax returns; (5) accurate, timely, and reliable customer service; and (6) secure protection of taxpayer information.

New America and Kleiman estimated the cost of a DF system for five filing scenarios (1 million, 2 million, 5 million, 10 million, and 25 million filers) covering a range of uncertainty about such a system’s long-term costs. The annual cost ranged from \$22 million to \$47 million for 1 million filers and from \$126 million to \$213 million for 25 million filers. Economies of scale reduced the per-return cost as the number of filers rose.

Government Accountability Office (GAO) Report

The IRA directed the GAO to oversee the use of IRA funds, including DF funds. In a 2024 report, GAO contended that the IRS had not provided the “comprehensive cost and benefit estimates” required to guide decisions regarding the future of the pilot program. It also asserted that the IRS task force’s 2023 cost estimates were not properly documented and failed to account for a DF tool’s start-up costs. It further noted that the IRS had not identified the “metrics” it will use to evaluate the costs and benefits of the pilot program.

Preliminary Pilot Results

Testing of the pilot began in early February 2024, and the IRS opened it in mid-March for use by eligible taxpayers

during the 2024 filing season. According to the IRS, 19 million individual taxpayers with relatively simple returns residing in Arizona, California, Florida, Massachusetts, Nevada, New Hampshire, New York, South Dakota, Tennessee, Texas, Washington, and Wyoming were eligible to file their 2023 tax returns through the pilot.

Filers’ income was limited to W-2 wages, Social Security and railroad retirement income, unemployment compensation, and interest of \$1,500 or less. They were allowed to claim three credits (i.e., the Earned Income Tax Credit, the Child Tax Credit, and the Credit for Dependents) and three deductions (i.e., the standard deduction and those for student loan interest payments and educator expenses).

According to the IRS, 3.3 million taxpayers looked into their eligibility to file through the pilot and over 140,800 taxpayers filed accepted returns, saving an estimated \$5.6 million in tax preparation fees. A General Services Administration TouchPoints survey of over 11,000 users found that 90% of respondents viewed their experience as “excellent” or “above average.”

The IRS’s FY2024 budget for the pilot is \$114 million. By the end of the 2024 filing season, the IRS had spent \$24.6 million on the program, including \$2.4 million for operating costs and \$10.5 million for system development.

Future Status

A key question is whether the IRS will continue to develop and offer a DF tool capable of handling a wider range of returns. Several factors likely will influence the decision.

One factor is the level of support for such a tool among senior IRS managers. The IRS Commissioner has made no decision about continuing a DF option for the 2025 filing season. The IRS is reviewing the pilot results and plans to issue a report later this year on its costs, benefits, customer support, and user experiences.

Another factor is the availability of congressional funding for an IRS-run DF tool. Some Members oppose such a system and may be willing to bar the IRS from using FY2025 discretionary funds to offer a DF option. Critics argue that it is a waste of public funds for the IRS to provide a free DF service when it already provides three free e-filing options and tax software companies offer free e-filing to many taxpayers with simple returns. Some also argue that an IRS DF tool would create a conflict of interest between the IRS’s responsibility to collect taxes owed and an obligation under the tool to ensure that taxpayers receive the tax benefits they are due.

Backers of an IRS DF tool say the IRS should at least offer an expanded pilot DF program in the 2025 filing season to shed light on the costs and benefits of a program covering a broader range of returns.

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