WHY SIMPLIFYING INCOME TAX FILING IS ANYTHING BUT

A legacy of shifting priorities and technology modernization challenges slow progress and escalate costs for the Internal Revenue Service

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By: Tony Scott and

Gretchen Ruck

INTRODUCTION

The call for an improved process for filing taxes that both reduces the burden on taxpayers while also decreasing the balance of unpaid taxes due to the government is far from new. This idea isn't unique to the United States; however, implementing it in the United States is exacerbated by the vast size and diversity of our population, an aging, institutionalized tax processing technology infrastructure, and by the complex hodgepodge of federal, state and local tax codes and shifting governance priorities that can be found across our country. The result is a tax calculation and filing process challenge that's unparalleled in its complexity and lacks an obvious, affordable solution.

EXECUTIVE SUMMARY

Over the last twenty-five years, there have been many ideas floated for some form of "simplified income tax filing process for federal taxes" where the IRS would prepare an individual's tax return, and the taxpayer, in turn, would simply sign off on the pre-prepared form, and then pay whatever amount is due, or get a refund if one was due. The rationale for doing this is attractive: taxpayers would no longer have to pay out of pocket for the costs of preparing their own returns, and it is argued, there are many taxpayers that don't have sophisticated tax situations. Proponents say the government already has most of the information it needs (largely provided by employers and financial institutions) to prepare the return.

Despite the seasonal enthusiasm for tax filing simplification, almost no one argues the point with a real-world pragmatic analysis of what it would take in terms of time, money, required changes in the tax law, and prioritization from a governance perspective over a sustained period of time. Without facts, it is easy for proponents to make the claim that such a change would be simple to do or require little change in legislation or IRS processes. Further, the proponents of such an approach almost always talk about potential benefits, but never address fundamental questions of cybersecurity and privacy which are bound to come up when the government has access to and stores even more personal information than is currently the case.

As leaders of change in large organizations, we've seen what it takes to bring about significant change when business process change and technology come together, and we've also seen our share of failures. Often, what seems like a fantastic idea at first fails – usually because of one or more of three issues:

- There is a flaw in the underlying premise. There are many reasons for this, but it comes down to the fact that the underlying assumptions are wrong in some way.
- There's a lack of sponsorship. Massive change usually requires strong commitment up and down the organization and durable commitment over time. This is necessary because massive change requires consistency, resources, and willingness to prioritize the necessary activities over time. The lack of any of these has doomed many projects.
- There's too much bundled into too long of a timeframe. These foundational changes can fail because as the going gets tough, budgets become enlarged, time to completion gets prolonged, management commitment fades (and

management swaps out), and technology advancements make the original design obsolete.

This paper examines the reality of what it would take (in terms of time, money, legislative prioritization, and executive branch support) for the IRS to provide such a service. As a part of our research, we looked at prior experiments of this nature at the state level and examine efforts in other countries to provide similar services. We also interviewed more than a dozen individuals with direct knowledge of the IRS' technical capabilities, budget and operational priorities, and current challenges.

Further, we examined several other issues and challenges which complicate the situation – even if the other obstacles we have identified were able to be overcome. These include privacy and cybersecurity concerns, downstream impacts on state and local taxing authorities, cultural and legal obstacles, and a fundamental shift in a core principle of American history and heritage around individual responsibilities vs. state and federal provided/required capabilities.

Finally, we conclude that an effort to have the IRS offer pre-prepared tax returns would be operationally impractical, prohibitively expensive, legally questionable, and would likely fail to deliver the promised benefits because all three of the above-mentioned failure modes are present.

BACKGROUND

Common Approaches to Return-Free Tax Filing

It's important to note that when discussing return-free tax filing, there are two general approaches that are considered, Final Withholding (hereinafter referred to as FW) and Tax Agency Reconciliation (hereinafter referred to as TAR). In the first approach, FW, individual income taxes are withheld by employers and by other payers who are responsible for withholding taxes from payments made to individuals. These employers and other payers are then held responsible to remit payments from these withholdings to the tax agency. In this approach, unless employees have additional sources of income, the amount withheld by their employer or other paying agent becomes their tax payment.

The challenge with the FW approach currently is that there are many "payer" agents that currently do not withhold taxes and would be required to do so in the future if this scheme were adopted. Examples include businesses that employ independent contractors who are paid on form 1099, institutions that make interest and dividend payments, interest paid to sellers on seller-financed loans, trust income, and many others.

In FW, even where some amount is withheld, it often isn't the correct amount of withholding when aggregated with other income. For example, under the current process, some long-term capital gains income, such as the sale of stock options, are typically subject to withholding for income tax purposes. While the amount can be between 0% to 20% depending on filing status and income of the person, some taxpayers find that this amount isn't enough due to the impact of other sources of income on their annual earnings and taxes.

Alternatively, under a TAR approach, at the end of the tax period, the taxing authority, such as the IRS, would prepare and distribute a tax return to the taxpayer.

Taxpayers would be responsible to validate its correctness and then either challenge the return or remit payment for the amount due. Like the FW approach, under the TAR approach, the IRS would need vast amounts of additional information the agency does not currently collect to prepare a return for an individual in contrast to the current approach.

In countries like Singapore, where the majority of financial transactions flow through the government already, a TAR approach is more conceivable. In the U.S., where few transactions directly flow through government agencies, the TAR approach is more complex and a much bigger hurdle from an execution and management perspective, not to mention all of the obvious concerns around privacy where significantly more data would be in government hands.

Under both approaches, some long-held traditions and principles are implicated as well. First, the notion that individuals are responsible for their actions, and have the primary responsibility for calculating and paying their taxes would shift to a government-first responsibility for taxes, and away from individual responsibility.

Second, under the current law, there are many choices that taxpayers can make, with guidance from the IRS. Examples include the Earned Income Tax Credit, mortgage interest deductions, donations to charity, moving expenses, business expense deductions, and the like. Most of these rely on data that the government currently does not possess in advance.

While providing a potential tax benefit to the individual taxpayer, this is a choice the taxpayer makes, not one the government is well-positioned to decide. It is certainly conceivable to believe that when the government makes the choice, it is likely to result in the paying of more taxes rather than less, and easier to impose on those who are least likely to challenge the government's assessment.

So, the question that can be asked when considering these various tax proposals is whether the benefit of easing the burden on some individuals is worth shifting the responsibility, removing choice, and increasing costs? And that question doesn't even begin to address the feasibility issues we consider next.

MODERNIZING THE IRS

A History of Stalled Innovation and Project Failure

If we look back thirty-five years, one key objective of the Tax Reform Act of 1986, which was passed into law by the United States Congress and signed by President Ronald Reagan, was to simplify the U.S. income tax code.[1] In response to this act, the Internal Revenue Service evaluated and proposed potential strategic initiatives to help simplify the taxpayer experience and improve the sense of fairness. One such

[1] "H.R.3838 - Tax Reform Act of 1986", *99th Congress*, 22 Oct. 1986 congress.gov/bill/99th-congress/house-bill/3838, See website Summary tab, Chapter 4: Amendments Related to Title IV of the Act

initiative, which was proposed by the IRS in 1987, was the development of a return-free tax filing system.[2]

After proposing a return-free filing alternative in 1987, the IRS conducted a feasibility analysis, which the Government Accountability Office (GAO) subsequently validated in a report to the Senate in 1992. In their report, the GAO concurred with the IRS, finding that while such a solution could be technically feasible, it would be extremely costly, could create processing and correction delays, and might yield limited benefits. The IRS estimated that it would cost over $1 billion, or $2.4 billion adjusted for 2021, and require about 17,000 additional staff to implement this program.[3] We note that the tax code is now more complex than in 1987.

Despite these findings, because of the ongoing popularity of the return-free tax filing concept, in 1996 the GAO released another analysis of tax filling alternatives, in which they recommended the IRS reexamine the possibility of return-free filing. GAO urged the IRS to take into account recent technology developments and consider the steps necessary to build taxpayer trust and to test receptiveness to this new method.[4]

The IRS rejected the recommendation because it stated that the costs of a tax agency reconciliation system would be more than the costs to process electronically filed returns. Nonetheless, two years later, Congress approved the Internal Revenue Service Restructuring and Reform Act of 1998, which included provisions requiring the IRS to develop and test a system and supporting procedures for implementing a return-free filing system for taxable years beginning after 2007.[5]

While all of this was transpiring at the federal level, a handful of states, including Michigan, Minnesota, Louisiana, and California, proposed development of their own return-free filing alternatives[6], as outlined in **Figure 1**. Most of these proposals were ultimately unsuccessful, due to taxpayer adoption, technology challenges, or overall acceptance. California piloted a program called ReadyReturn in 2004, components of which were incorporated into CalFile and continue to be in operation.[7] Often

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[2] "Internal Revenue Service: Opportunities to Reduce Taxpayer Burden Through Return-Free Filing, GGD-92-88BR", *U.S. Government Accountability Office*, 08 May 1992

gao.gov/products/ggd-92-88br, see Appendix I

[3] "Internal Revenue Service: Opportunities to Reduce Taxpayer Burden Through Return-Free Filing, GGD-92-88BR", *U.S. Government Accountability Office*, 08 May 1992

gao.gov/products/ggd-92-88br, see Appendix I

[4] "Tax Administration: Alternative Filing Systems, GGD-97-6", *U.S. Government Accountability Office*, 16 Oct. 1996

gao.gov/products/ggd-97-6, see Full Report, Results in Brief section

[5] "Tax Administration: Alternative Filing Systems, GGD-97-6", *U.S. Government Accountability Office*, 16 Oct. 1996

gao.gov/products/ggd-97-6, see Recommendations section of webpage

[6] "States Allowing Income Tax "Return-Free Filing"", *OLR Research Report*, 24 Jan. 2017

cga.ct.gov/2017/rpt/pdf/2017-R-0019.pdf

[7] "States Allowing Income Tax "Return-Free Filing"", *OLR Research Report*, 24 Jan. 2017

cga.ct.gov/2017/rpt/2017-R-0019.htm

highlighted as the most successful of such efforts, less than 4.5% of the 2 million Californians sent an already filled out CA ReadyReturn were willing to use it.[8]

U.S. States That Have Considered or Deployed Return-Free Tax Solutions[9]

U.S. State	Year	Progress towards Return-free Filing Rollout
Connecticut	2017	Legislative research report published in 2017
Minnesota	2007	Introduced senate and house bills in 2007, failed to enact
California	2003	Piloted in 2004 for 2003 tax year, launched in 2007, expanded in 2009, certain components wrapped into state electronic filing system
Louisiana	1997	Enacted legislation in1997, failed to implement system due to Y2K prioritization
Michigan	1996	Enacted in 1996, suspended after 1998 due to low participation
Colorado	1995	Began review in 1995, decided to launch limited program in 1998

Figure 1

Moving forward to 2010, while many of the objectives of the landmark 1998 IRS Act were fulfilled, according to the Treasury Inspector General for Tax Administration (IG), electronic filing goals and computer modernization both remain challenges for the agency.[10] The IG broadly concluded that goals of the 1998 IRS Act, and previous business system modernization initiatives as well, had failed because the agency's "… technology deficiencies are an outgrowth of management and governance problems and the agency's inability to pursue a long-term strategic vision in its business operations."[11]

This report then delves into specific weaknesses noted by the IG, citing corroborating findings from reviews conducted by the GAO and the National Research Council, in which they highlight poor governance accountability and authority, lack of a cost-

[8] "States' Free Online Tax Filing Services Often Overlooked", Pew Stateline, April 11, 2013 https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2013/04/11/states-free-online-tax-filing-services-often-overlooked

[9] "Report to The Congress on Return-Free Tax Systems: Tax Simplification Is a Prerequisite", *Secretary of Treasury*, 23 Dec 2003, see details concerning Michigan, Louisiana, and Colorado

[10] "The Internal Revenue Service Restructuring and Reform Act of 1998 Was Substantially Implemented but Challenges Remain, 2010-IE-R002", *Treasury Inspector General for Tax Administration*, 01 Mar. 2010

treasury.gov/tigta/iereports/2010reports/2010IER002fr.html, Results of Review section IV

[11] "The Internal Revenue Service Restructuring and Reform Act of 1998 Was Substantially Implemented but Challenges Remain, 2010-IE-R002", *Treasury Inspector General for Tax Administration*, 01 Mar. 2010 treasury.gov/tigta/iereports/2010reports/2010IER002fr.html, Results of Review section IV

effective strategy, immature procedural and program formality and oversight, and technology and skills insufficiency.[12]

While, at face value, these challenges could appear to fall squarely on the shoulders of IRS leadership, many of these issues were amplified, if not largely caused, by Congress' reductions in appropriations and other resource reductions that have consistently plagued the agency's modernization efforts for more than ten years.

The IG notes that the "IRS originally estimated the Modernization Program effort would last up to 15 years and incur contractor costs of about $8 billion. The Program is now in its 11th year and has received approximately $2.71 billion for contractor services, plus an additional $353 million for internal IRS costs."[13] This lack of financial support from Congress, and the resulting slow progress in a critical priority area like modernization is just one indicator of how a large-scale transformation like FW or TAR might proceed in the future. One can easily imagine a lofty goal like return-free filing completely harpooned by persistent underfunding, lack of consistent political support, and changing priorities among administrations.

More recently, between 2010 and 2015, Congress cut $1.2 billion from the IRS' budget, an overall loss of 17 percent.[14] Since 2015, the agency's budget has generally crept upward, but not by nearly enough to get the modernization effort on track.

Current Modernization Initiatives Are Rapidly Falling Behind

The demand for simplified and effective digital tax solutions continues to be a pressing concern for federal lawmakers. In both 2015[15] and 2017[16], bills titled the Simpler Tax Filing Act were introduced and similarly the Tax Filing Simplification Act of 2016. The Taxpayers First Act was enacted in July of 2019.[17]

[12] "The Internal Revenue Service Restructuring and Reform Act of 1998 Was Substantially Implemented but Challenges Remain, 2010-IE-R002", *Treasury Inspector General for Tax Administration*, 01 Mar. 2010 treasury.gov/tigta/iereports/2010reports/2010IER002fr.html, Results of Review section IV, summarization of bulleted list of deficiencies

[13] "Annual Assessment of the Business Systems Modernization Program, 2009-20-136", *Treasury Inspector General for Tax Administration*, 14 Sep. 2009

treasury.gov/tigta/iereports/2010reports/2010IER002fr.html, see footnote 60

[14] "Past IRS Commissioners to Congress: Enough with the Budget Cuts." *Federal News Network*, 25 Nov. 2015, federalnewsnetwork.com/budget/2015/11/past-irs-commissioners-congress-enough-budget-cuts/

[15] "S.940 - Simpler Tax Filing Act of 2015", *114th Congress*, 15 Apr. 2015

congress.gov/bill/114th-congress/senate-bill/940, see Summary tab

[16] "S.809 - Simpler Tax Filing Act of 2017", *115th Congress*, 04 Apr. 2017

congress.gov/bill/115th-congress/senate-bill/809, see Summary tab

[17] https://www.irs.gov/taxpayer-first-act
https://www.irs.gov/pub/irs-pdf/p5426.pdf

This six-year technology modernization plan, which kicked off in 2019,[18] was estimated to cost about $2.3 billion to $2.7 billion.[19] IRS leadership tempered expectations by noting that, "The speed at which new capabilities can be delivered will depend, in part, on the agency's annual funding levels." Looking back, their concerns were spot-on. The agency has only received about half of the funding requested[20] to pay for the first 3 years of the plan. Sound familiar?

This 6-year strategy identifies 4 modernization pillars, to be addressed through a series of key programs and initiatives that are road-mapped across 2 phases. As illustrated in **Figure 2**, below, each of the ongoing seven major IT modernization programs includes projects that are facing cost overruns of at least 30 percent, as indicated in red. Of these seven programs, four are also struggling with projects that have at least a 10% delay, with some projects 30% delayed or more.

FY 21 Technology Investments, by IRS Modernization Pillar

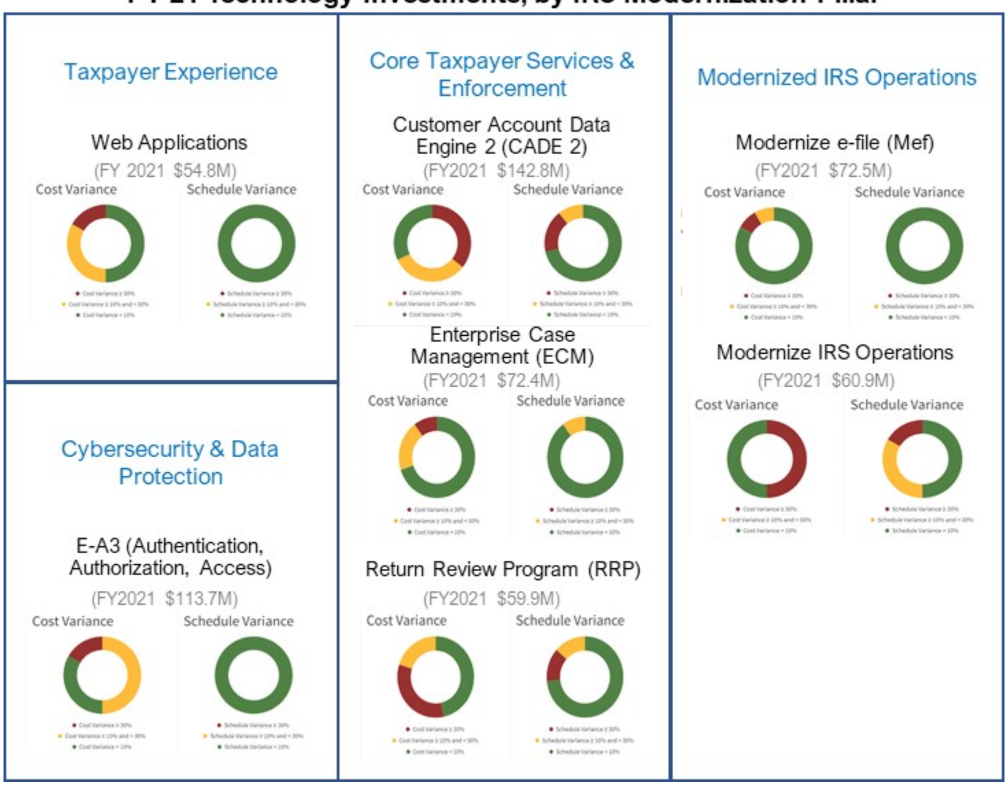

Figure 2

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[18] IRS Integrated Modernization Business Plan, *Internal Revenue Service*, Apr. 2019 irs.gov/pub/irs-pdf/p5336.pdf, see section 5.3, Target Capabilities & Roadmap

[19] "IRS Modernization Plan provides plan to improve services for taxpayers, tax community, FS-2019-9", *Internal Revenue Service*, Apr. 2019 https://www.irs.gov/newsroom/irs-modernization-plan-provides-plan-to-improve-services-for-taxpayers-tax-community, see the Modernization Costs Estimates, Oversight and Accountability section

[20] "Depleted IRS Gains Momentum on Capitol Hill for Funding Boost", *Bloomberg Law*, 2 Mar 2021 news.bloomberglaw.com/litigation/depleted-irs-gains-momentum-on-capitol-hill-for-funding-boost, see Money for IT, Training section

With these technology challenges still impeding modernization progress, some in Washington have shifted their attention to consider having the IRS copy how commercially-available tax filing websites and software support taxpayer needs. The thinking goes, if more taxpayers can easily file their taxes online for low or no cost, then tax payment compliance will improve and as a result, collections will increase.

In July, Senator Elizabeth Warren took to Twitter to amplify a New York Times op-ed[21] in which she called on the IRS to create a free tax preparation and filing system rather than relying on private industry to provide an "essential service".[22] Even if the IRS could create such a system, which, for the reasons listed above we think would be prohibitively expensive and take a long time to create, it is unlikely that the IRS could do a better job than private industry, and more likely that it would be inferior, while destroying a healthy private sector capability.

In terms of feasibility, the IRS must first focus on modernizing its technology platform and operations before it could successfully build and support a solution of this magnitude. If Congress were to redirect the IRS' budget priorities now, it would very likely derail the ongoing modernization program, putting both that program and a tax preparation and filing solution in jeopardy.

Finally, any system built and run by the IRS would likely be focused on fulfilling the interests of the government, such as maximizing tax collection. By contrast, industry solutions thrive by helping taxpayers take advantage of all of the deductions available to them and offer the support of tax and legal professionals should the IRS choose to audit them.[23]

Security and identity fraud remain an urgent challenge

Each year, Treasury Inspector General for Tax Administration (TIGTA) "evaluates IRS programs, operations, and management functions to identify the areas of highest vulnerability to the Nation's tax system." The result is a list, which is included in the annual Department of the Treasury Agency Financial Report, of the critical areas that TIGTA believes will be of greatest concern in the upcoming year. As illustrated in **Figure 3**, over the past ten years, the ability to secure taxpayer data and protect

[21] "Good Riddance, TurboTax. Americans Need a Real 'Free File' Program.", *Binyamin Appelbaum, New York Times, Opinion Section*, 19 Jul. 2021 nytimes.com/2021/07/19/opinion/intuit-turbotax-free-filing.html
[22] "Tweet posted by Elizabeth Warren", *@SenWarren*, 20 Jul. 2021 twitter.com/SenWarren/status/1417628074569609218?ref_src=twsrc%5Etfw
[23] "Elizabeth Warren Wants the IRS To Create Its Own TurboTax. What Could Go Wrong? A simplified tax code is the answer, not giving the IRS more funding.", *Liz Wolfe, Reason.com*, 23 Jul. 2021 reason.com/2021/07/23/elizabeth-warren-wants-the-irs-to-create-its-own-turbotax-what-could-go-wrong/

IRS systems remains an urgent issue, as does the agency's ability to detect and prevent identity fraud through cyber means.[24]

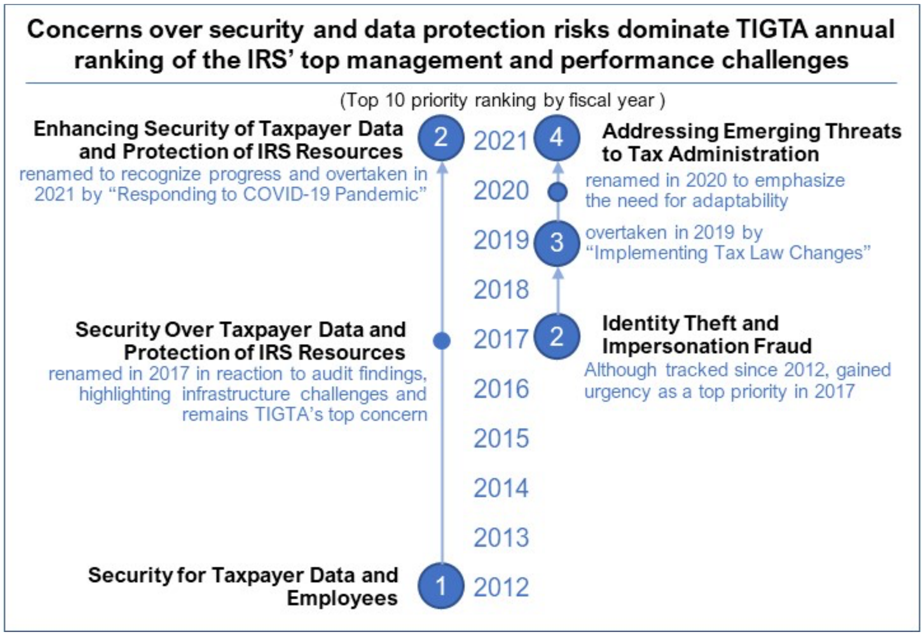

Figure 3

Concern for the security of taxpayer data is hardly new. After the IRS began redesigning its systems in 1968 to take advantage of technology innovations, it abandoned these efforts ten years later, citing costs and taxpayer information security as key barriers to success.[25] Later, when evaluating the ongoing challenges which hindered the agency's technology modernization plans that were initiated in 1998, TIGTA concluded in 2010 that the failure to develop an enterprise-wide technical security capability was a key factor.[26]

One highly reported manifestation of these risks was a 2015 breach of over 700,000 taxpayer accounts, whereby criminals used information stolen from poorly secured tax preparers and other sources to spoof identities, allowing them to download confidential information.[27] This breach could potentially have been avoided had the IRS implemented stronger identity authentication features, account-based fraud

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[24] "Memorandum for Secretary [*ed. Mnuchin for 2017 to 2021, Lew for 2014 to 2016, Geithner for 2012 to 2013*]" – Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year [*ed. Each year from 2012 to 2021*]", *Inspector General for Tax Administration*, Report date of 14 Oct. 2020 for FY 21, 15 Oct. 2019 for FY 2020, 15 Oct. 2018 for FY 2019, 13 Oct. 2017 for FY 2018, 6 Oct. 2016 for FY 2017, 15 Oct. 2015 for FY 2016, 15 Oct. 2014 for FY 2015, 8 Nov. 2013 for FY 2014, 15 Oct. 2012 for FY 2013, and 14 Oct. 2011 for FY 2012
[25] "Tax System Modernization - IRS' Challenge for the 21st Century", *Government Accountability Office*, Feb. 1990
[26] The Internal Revenue Service Restructuring and Reform Act of 1998 Was Substantially Implemented but Challenges Remain, 2010-IE-R002", *Treasury Inspector General for Tax Administration*, 01 Mar. 2010
[27] "Massive IRS data breach much bigger than first thought", *CBS This Morning*, 29 Feb. 2016
cbsnews.com/news/irs-identity-theft-online-hackers-social-security-number-get-transcript/

prevention flagging, and mandated third-party security requirements.[28] [29] It's likely that this incident contributed to TIGTA adding Identity Theft and Impersonation Fraud to its list of top challenges and expanding Security Over Taxpayer Data and Protection of IRS Resources, as shown above in **Figure 3**.

More recently, in 2021, a new data breach disclosed private, personal information on the taxes paid, and presumably the loopholes taken, by the richest Americans.[30] While the revelations in the exposé quickly grabbed headlines and prompted lawmakers to call for tax code reforms[31], less has been said about the source of the breach. The IRS has yet to share any information it has uncovered concerning the source of the breach (details of which may never be disclosed); any examination should be expected to consider whether the IRS was hacked by an external party or if data was exposed by someone inside the organization or those who oversee them.[32]

Operating Under Budget Constraints

Budgets Cuts and Workforce Reductions Beleaguer Agency Performance

It's not just plans to modernize that have been impacted by budget cuts, but ongoing operations have been affected as well. IRS staff reductions of about 20,000 employees since 2010[33] have diminished the IRS' ability to provide adequate taxpayer support and fulfill the agency's compliance responsibilities. As shown in **Figure 4**, the IRS reports that agency spending, along with its workforce, has trended downward significantly over the past decade. With the Enforcement division taking the greatest budget hit, the agency is collecting less than half of the revenue from audits than it had a decade ago and is failing to capture as much tax debt before it expires as it had previously.[34]

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[28] "IRS 'Get Transcript' Security Breach: What happened? Will it happen again?", *Claudine Gindel, IRS Medic*, 21 Jun. 2016
irsmedic.com/blog/2016/06/irs-get-transcript-security-breach.html

[29] "IRS, GAO at odds over cybersecurity requirements on tax preparers", *Tim Starks, CyberScoop*, 14 Jun. 2021
cyberscoop.com/irs-gao-cybersecurity-regulations-tax-preparers/

[30] "The Secret IRS Files - Inside the Tax Records of the .001%", *ProPublica*, articles series published June-August 2021
propublica.org/series/the-secret-irs-files

[31] "ProPublica's Tax Revelations Lead to Calls for Reforms — and Investigation -- The Secret IRS Files series has already sparked a conversation about the fairness of the U.S. tax code and raised privacy concerns.", *Robert Faturechi, ProPublica*, 9 Jun. 2021

[32] "What's the Fallout From the ProPublica Leak?", *Andrew Wilford, Andrew Moylan, National Taxpayers Union* Foundation, 27 Jul. 2021
ntu.org/foundation/detail/whats-the-fallout-from-the-propublica-leak

[33] "Depleted IRS Gains Momentum on Capitol Hill for Funding Boost", *Bloomberg Law*, 2 Mar. 2021
https://news.bloomberglaw.com/litigation/depleted-irs-gains-momentum-on-capitol-hill-for-funding-boost, see Years to Rebuild section

[34] "Has the IRS Hit Bottom?", *ProPublica*, 30 Jun. 2020
propublica.org/article/has-the-irs-hit-bottom, see charts titled, "The IRS Is Collecting Far Less Revenue From Audits Than It Used To" and "The Amount of Tax Debt Expiring Has Risen Dramatically"

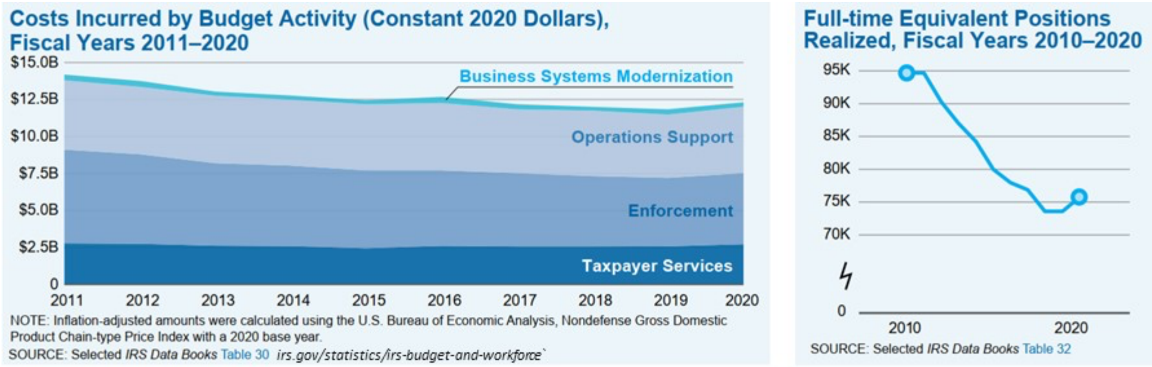

Figure 4

Less dedicated taxpayer support has compounded recent frustrations as agency call centers and tax return processors[35] have failed to keep pace with increased demands caused by the COVID pandemic.

Tightened budgets and lagging modernization efforts have also contributed to a number of the outstanding, priority IRS findings tracked by the GAO. As of June 2021, the GAO lists 17 unresolved priority findings,[36] six of which have been lingering for five or more years. While many of these findings relate directly to technology-related issues, the remainder would see progress through improved processes, greater automation, and more readily available data resulting from modernization.

Looking forward beyond 2021, White House[37] and Treasury[38] budgeting plans for 2022 demonstrate the administration's support for rebuilding the technical capabilities of the IRS, dedicating both increased funding and long-term workforce growth. As prior decades have taught us, while the IRS should remain optimistic, it could be problematic that these budget priorities continue long enough to realize material improvements.

IRS processes and historical Costs

The IRS, just like any other government agency is driven by administration policy and by changes in the law. When a law is passed that changes the way taxes are

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35 "If you call the IRS, there's only a 1-in-50 chance you'll reach a human being - The agency has a backlog of 29 million tax returns it's holding for manual processing, according to the national taxpayer advocate", *Washington Post*, 23 Apr. 2021

washingtonpost.com/business/2021/04/23/irs-1040-hotline/

36 "Recommendations Database, Search Open Recommendations webpage", *U.S. Government Accountability Office*, search performed on 15 June 2021

gao.gov/reports-testimonies/recommendations-database, filter by selecting Tax Policy and Administration as the Topic and Internal Revenue Service as the Agency

37 "Department of the Treasury, The Budget for Fiscal Year 2022", *The White House*, May 2021 whitehouse.gov/wp-content/uploads/2021/05/tre_fy22.pdf, see Taxpayer Services section

38 "The American Families Plan Tax Compliance Agenda, *U.S. Department of the Treasury*, May 2021 home.treasury.gov/system/files/136/The-American-Families-Plan-Tax-Compliance-Agenda.pdf, see Executive Summary and Introduction

calculated, or a policy is put in place to clarify the specifics of a mandate to do something different, the IRS must figure out how to implement that change. The desired changes must then be implemented in the various IT systems within the IRS, paper forms and publications must be updated, and many people must be trained. Externally, there are many third parties (including other agencies) that may need to make changes in their own systems as the result of the change at the IRS.

As shown in **Figure 5**, in any given year, both the amount of funding obligated and the staff appropriated for technology modernization initiatives can vary significantly. The amount allotted for modernization is based on a number of factors including estimated cost, urgency and dependencies, political influences, and competing priorities both within and external to the agency.

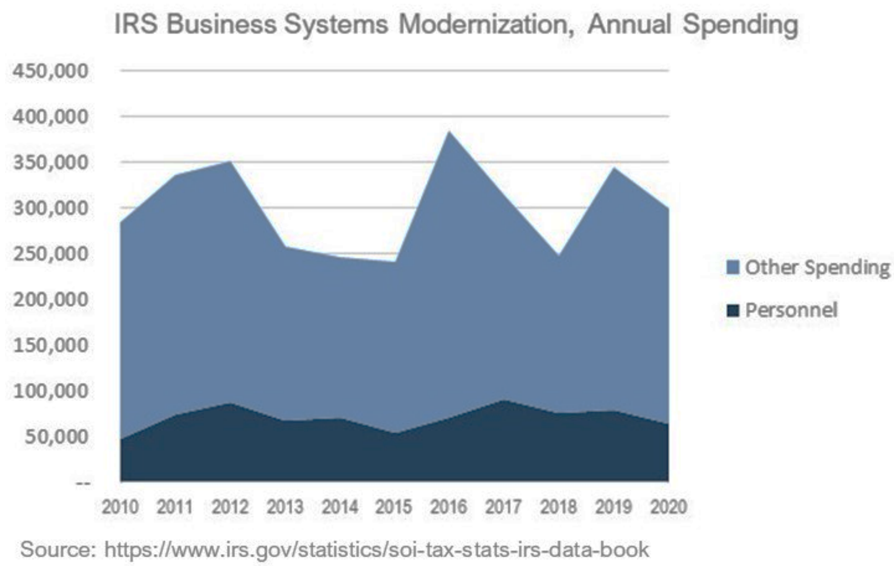

Figure 5

As one former IRS official explained, the IRS has modernized most (but not all) of its databases from older mainframes running COBOL (a computer language made popular in the 1960s) and the rigid database structures of that era to much quicker, and highly adaptable technologies like more modern operating systems, programming languages, and relational databases. This makes implementing changes easier and quicker than it once was. However, these modernization efforts have a consistent history of taking longer, costing more, and failing to deliver fully on the promised benefits, and often have added layers of complexity to the underlying systems architecture that the IRS manages.

Even with the successful modernization efforts, the entire IRS workflow is largely "forms" driven vs. being data-driven. In practical terms, this means that if the data needed to change a report or to support new functionality is already captured on an existing IRS form, these changes are relatively easy to make. However, if new data is needed on a form, or even worse, if a new form is needed, then the process can be elongated and can become significantly more expensive to implement.

For a given tax year, the normal change management cycle begins in the prior year's May-July timeframe with the IRS aggregating and prioritizing the desired changes to the tax process. Then, in the summer and fall, the changes are coded and tested for the tax year beginning the following January. Naturally, if there are late-breaking changes passed by Congress, this cycle can be disrupted and can even cause delays in the start of the tax processing season.

As changes are implemented in the IRS systems, each change goes through a mature and well-understood development → test → staging → production cycle that attempts to make sure that any given change does not have unintended consequences or erroneous results. These types of changes can be implemented in a few weeks from start to finish or, may take longer if overly complex or requiring changes to paper forms.

For simplicity's sake, let's use the t-shirt sizes of S, M, L, and XL as an analogy for the level of effort required to make the change. (Note: this is not the methodology the IRS actually uses – it is for illustrative purposes only.) For example, changing a tax rate, and requiring no change to a form (from a data perspective), and leaving the underlying policy unchanged can be done quickly and is done in the normal course of business. Every year, the IRS makes numerous adjustments of this type. Let's call these types of changes a size "S" (for small) in our t-shirt analogy. According to knowledgeable IRS staff, the cost of making these small changes ranges from $2 million to $5 million per change for development, testing, training, and implementation.

More complicated changes, where entirely new data or a new form is required, or a significantly changed tax policy is being put into place, typically require more effort. Let's call these kinds of changes an "M" (for medium) in our t-shirt size analogy. While going through the same process for application development, testing, training, and implementation, the level of effort is greater, and each phase takes longer and requires more resources. Former IRS staff estimate the cost of this kind of change at $5–25 million per change. Often, the costs of these changes are absorbed in the IRS budget and simply prioritized over other activities such as modernization.

Continuing the t-shirt analogy, a size "L" (for Large) effort is typically one that involves multiple agency processes, a significant change in forms, or may require the capturing of additional data that is not present in existing IRS systems. These changes are rarer, but when they occur, they require a significant effort by the IRS, and quite often require additional budget to execute. An example of this is the recently enacted TCJA which required the updating of more than 500 forms, and nearly every system the IRS uses. The cost of these size "L" efforts can range from $25-$100 million, and sometimes can result in a delay to the start of the tax season.

Finally, size "XL" (for Extra Large) changes are ones that require significant coordination between and amongst agencies, which necessitate extensive testing and validation. Often, these "XL" changes also require the capturing of new data that the IRS does not currently possess, as well as form changes that need to be made. These kinds of changes can run into the hundreds of millions of dollars and up, and usually require the setting up of a special program office to oversee the effort.

A recent example of this, as shown in **Figure 6**, would be the implementation of the Affordable Care Act (ACA). While the IRS was not the executive agency with overall responsibility for the ACA, from 2012 to 2017, preparation for and support of its rollout cost the IRS over $2.25 billion.[39] The four key IRS initiatives for the ACA required nearly half a billion dollars just in 2012 alone.

IRS Annual Budget Allocated to Affordable Care Act Implementation, 2012 to 2017

	2012	2013	2014	2015	2016	2017
Administer New Statutory Reporting Requirements	$ 58,505,000	$ 8,200,000	$ 44,420,000	$ 56,099,000	$ 67,206,000	-
Increase Coverage to Address Tax Law Changes, and Other Compliance Issues	$ 96,718,000	$ 85,400,000	-	$ 16,025,000	$ 16,025,000	-
Ensure Accurate Delivery of Tax Credits	$ 260,293,000	$ 266,894,000	$ 305,645,000	$ 305,645,000	$ 305,645,000	$ 153,240,000
Program Increases Improve Taxpayer Service	$ 81,307,000	-	$ 89,519,000	$ 73,947,000	$ 101,497,000	-
Subtotal	**$496,823,000**	**$360,494,000**	**$439,584,000**	**$451,716,000**	**$490,373,000**	**$153,240,000**
Total						**$2,392,230,000**

Figure 6

Findings and Conclusions

Implementation Complexities

Let's look at what would be required to implement either a Final Withholding (FW) or a Tax Agency Reconciliation (TAR) approach to less taxpayer return filing. The latter appears to be the simplest and most applicable approach as viewed historically by the IRS and the GAO, although both approaches have some issues in common.[40] In any case, both of these are likely to be multiples of the "XL" t-shirt costs described above.

As was described above, both approaches require that all of the relevant data ultimately be sent to the IRS, and then the IRS would present a tax bill to the individual after performing all of the relevant calculations. To implement this, there are a number of important considerations that would have to be evaluated, such as the following:

1.) Currently, much of the data that the IRS gets in terms of financial transactions (mortgage interest, taxes paid and withheld, interest earned, etc.) comes in as late as 90 days after the tax year starts. Under current practice, taxpayers can start filing their returns in late January and get refunds shortly thereafter.

    Thus, unless the IRS changes its rules to require the needed information be sent to them much earlier than is currently the case, under either approach, refunds would likely be delayed beyond the 90-day window. Earlier reporting could be a burden for small businesses and other institutions that struggle with the current, longer reporting timeline. Even if supplied quarterly, the delay at

[39] See "IRS Budget in Brief", published by the *Internal Revenue Service* for fiscal years 2012, 2013, 2014, 2015, 2016 and 2017. Sections reviewed include highlights, budget adjustments, program increases and explanation of budget activities.

[40] "Tax Administration: Alternative Filing Systems, GGD-97-6", *U.S. Government Accountability Office*, 16 Oct. 1996

gao.gov/products/ggd-97-6, see Results in Brief section the beginning of the year would likely be longer than the current practice due to the volume of data collection, integration, and validation involved.

2.) Some data that would be needed for calculating an individual's tax is not currently supplied to the IRS upfront at the beginning of the tax year. Examples include many of the items that are used for business and personal deductions such as profits and losses from business, medical expenses, gifts, charitable donations, rental income, etc. To implement either approach, the IRS would have to obtain this information from many additional and different sources, including small businesses, charities and non-profits, and sole proprietors. Also, given how much time this could take, the IRS would likely have to be collecting this data continuously throughout the year.

3.) Securing funding to support implementation could be a substantial barrier. As noted in recent IRS Commissioner testimony, the IRS has had a series of funding and resourcing issues over the last 20 years. While the IRS has experienced some funding increases in FY20, and FY21, the agency is still approximately 20% lower in personnel across its divisions as compared to ten years ago.[41] To implement a drastic change in tax business processes, the IRS would have to add significant resources over several years to provide the needed manpower. Even under current proposals, which provide the IRS some increases to implement the Taxpayer First Act (TFA), there is a significant shortfall in terms of what the IRS will need.

4.) In the Taxpayer First Act (TFA), Congress has agreed to fund the IRS to address the following six critical objectives:

- Expand Digital Services
- Seamless Experience
- Expand Proactive Outreach and Education
- Strategies for reaching Underserved Communities
- Community of Partners
- Enterprise Data management and Advanced Analytics

Alternatives for filing-free tax returns, such as pre-prepared returns, have not been prioritized as an objective of TFA, nor is it covered within the scope outlined in the IRS' ongoing six-year technology modernization strategy. At this point, creating urgency around implementing a filing-free solution would upend current planning, adding to existing delays and cost-overruns.

5.) Developing and rolling out pre-prepared tax returns can be expected to be at least as complex and resource intensive as the Affordable Care Act, as previously outlined. This solution would require coordinated engagement across numerous executive-level agencies and require extensive partnering to

[41] "The American Families Plan Tax Compliance Agenda, *U.S. Department of the Treasury*, May 2021

home.treasury.gov/system/files/136/The-American-Families-Plan-Tax-Compliance-Agenda.pdf, see Executive Summary and Introduction, see section B. Budget Shortfalls Worsening over Time, Leading to a Decline in Enforcement Activity gather, process in near-real time, and vigilantly protect a much greater magnitude of private, personal data.

6.) As prior feasibility studies have concluded, without the use of advanced, digital technologies, it would be much too costly to develop accurate and timely pre-prepared tax returns for taxpayers in a country as diversely populated as ours, composed of individuals and families with greatly varied income sources and needs. This is why it's imperative to build upon the successful completion of the current modernization strategy before architecting a filing-free tax return solution.

7.) The IRS can reasonably expect the cost of developing a pre-prepared solution to be at least as much as it cost the agency to support the ACA rollout and could even be significantly higher because the IRS will need to take on an oversight role across agencies participating in this program. Congress would need to approve spending of between $2.5 to $5.0 billion, and that's assuming that the modernization program has been successfully implemented and that the IRS can overcome the challenges that cause most of their major IT initiatives to go far over budget and time.

8.) When budgeting for software development, it's critical to build a comprehensive analysis of the Total Cost of Ownership (TCO), including specific consideration of the resources and investment allocations required over a 15- to 20-year life cycle. TCO is an estimate which includes all anticipated direct and indirect costs over the useful life of the application. In addition to development costs, this includes activities necessary to support:

- Corrective changes (patching and fixing bugs)
- Operational activities (administration, licensing, training, and configuration)
- Perfecting or improving existing functions (improvement, speed, performance)
- Enhancing applications with (minor) new functions or features
- Adapting to new requirements (OS upgrades, new processor, replatforming)
- Decommissioning (upon obsolescence)

After initial development is complete and the system operates in a steady-state, an agency should plan to budget between 20 and 25 percent of the development cost per year for support. Based on the estimated development cost, the IRS can expect support to cost $0.5 to $1.25 billion per year. As the project kicks off, the program team should refer to GAO's cost estimating best practices guide to help formalize their assessment approach.[42]

9.) Working with Congress, the IRS needs clarification concerning what types of activities are covered by their mission and directives and where responsibilities for certain activities in which they may engage may fall. Specifically, in

[42] "Cost Estimating and Assessment Guide – Best Practices for Developing and Managing Program Costs", GAO-20-195G, GAO Best Practices, U.S. Government Accountability Office, Mar. 2020

determining remediation activities after the 2015 breach, the IRS states that it wasn't within the agency's directives to mandate third-party tax preparers that connect to their systems to follow minimum security requirements. Similarly, while certain members of Congress are urging the IRS to offer a tax preparation solution akin to TurboTax, if doing so could be interpreted as implicitly offering tax advice, questions could arise as to whether this falls within the agency's mission. Where the IRS' Mission states that, "The taxpayer's role is to understand and meet his or her tax obligations", it could be inferred that the IRS is taking on this responsibility in offering tax preparation support.[43]

Future-state Alternatives

To help low income taxpayers while a return-free system was in development, the Free Filing Alliance was formed in 2002 to bring together the IRS and industry tax preparer and filing providers to provide free services to those with an income under a set threshold.[44] Until 2019, this program, which had been periodically renewed, barred the IRS from competing against industry solutions in exchange for providing certain free Federal tax preparation and filing services.[45] With this prohibition now removed, it is certain that some will propose variations on old ideas.

Congress could request that the IRS conduct a new feasibility study to evaluate and compare the costs, benefits, and practicality of technology-driven alternatives, deliberating on implications for tax code revision and the agency's charter. Options for such a study might include, but shouldn't be limited to:

- Revising the Free Filing Alliance to consider subsidizing the program to incentivize stronger industry participation,
- Developing or outsourcing an IRS free filing solution for low-income taxpayers,
- Piloting a return-free filing option based on lessons learned from California or built on a model implemented by another country,
- Mailing taxpayers pre-filled tax returns with the IRS' estimate of the taxes that they owe,
- Subsidizing an IRS developed tax preparation and filing solution through a Public-Private Partnership corporate partner that would have future opportunities to generate profit from their investment, or
- Simplifying tax payment complexity and effort driven by changes to the Federal tax code.

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[43] "The Agency, its Mission and Statutory Authority", *Internal Revenue Service*, page last reviewed or updated: 21 Jul. 2021
irs.gov/about-irs/the-agency-its-mission-and-statutory-authority

[44] "Eighth Memorandum of Understanding on Service Standards and Disputes – Between the Internal Revenue Service and Free File, Incorporated", *Internal Revenue Service and Free File, Inc.*, 31 Oct. 2018
irs.gov/pub/irs-utl/Eight Free File MOU.pdf

[45] "Addendum to the Eighth Memorandum of Understanding on Service Standards and Disputes – Between the Internal Revenue Service and Free File, Inc." Internal Revenue Service and Free File, Inc., 26 Dec 2020, see provision II.
irs.gov/pub/irs-utl/FFI Signed MOU Addendum 12-26-19.pdf

Of course, there is a downside to a feasibility study. As history has shown, advocating for a feasibility study could push back any progress towards a solution by up to five years. A study will take at least a year or two to complete and the resulting course of action could take another year or two to build support before funding could get allocated. And most importantly, any feasibility study will divert important and needed resources from other high-priority projects at the IRS.

Conclusion and Summary Comments

The evidence presented shows that shifting the focus of tax filing from individuals to the IRS is impractical from a budget, time, governance, and culture standpoint, and as a result, unlikely to achieve the aspirational results its proponents have hyped. The point is not to argue that the idea of tax filing simplification is a bad idea. We suspect that anyone who has had to file a tax return would support that notion. The IRS' current plans for digitization will aid in that effort, and the IRS' collaboration with the tax industry ecosystem is also well focused on that effort.

Most of the arguments for shifting the burden of filing from citizens to the IRS ignore a key learning from other digitization efforts. Unfortunately, automating a cumbersome process usually only achieves limited results. Namely, automating can make things go faster, and can achieve savings if the costs of automation are significantly lower than business as usual. That does not appear to be the case here. In the end, the IRS would still have a cumbersome and unwieldy process that would be masked by automation and would likely add cost and complexity to an already challenging process.

Ultimately, however, easing the burden of tax filing is a function of tax law simplification, and history would suggest that Congress and the existing complex organic process for creating tax law is a long way from achieving that goal. Changing the process itself, starting with tax law, will lead to further productivity gains and end-user satisfaction. The examples we have all experienced in the modern world are numerous – Uber transportation to self-serve checkout lines at retail, e-commerce with Amazon, and the rise of online learning – each of these is an example of a fundamental simplification of business process coupled with technology innovation.

We urge Congress and the Executive branch to focus on real business process change – and to ignore the temptation to band-aid over the complexities of tax filing by shifting the responsibility for this to the IRS. We believe that completing the IRS' current prioritized modernization and digitization efforts should be fully supported, fully staffed, fully funded, and focused on delivering real benefits for all of the various stakeholders in the IRS ecosystem.

About the Authors

Tony Scott

Tony Scott is CEO of the TonyScottGroup, LLC., a Washington, DC and Silicon Valley-based consulting and venture capital investing firm focused on early-stage cybersecurity, privacy, and emerging technologies. Prior to founding the TonyScottGroup, Tony served in the Obama administration as the Federal Chief Information Officer (Federal CIO) for the U.S. Government and was appointed to that role by President Obama in February 2015. In that role, he led oversight, budget, and management responsibilities for the more than $85 billion that the Federal Government annually spends on IT. In that capacity, he managed the government-wide response plan after the OPM cybersecurity hacking incident, including the Cybersecurity Sprint and Implementation Plan (CSIP), which dramatically improved the information systems security posture of the Federal Government.

He was responsible for the creation of the first of its kind "State of IT" report at the end of the administration, initiated several legislative proposals including the "Modernizing Government Technology Act" (MGT) to improve the way IT is funded within the Federal Government. His numerous appearances before Congress, and many other forums - providing CXO-level public and private sector insight on matters such as digital transformation, cloud adoption, machine learning, AI, cybersecurity, governance, open data, and workforce diversity have been widely recognized.

Immediately before joining the Obama administration, Tony was the Chief Information Officer at VMware. Prior CXO-level roles include the Chief Information Officer at Microsoft Corporation, Chief Information Officer at the Walt Disney Company, and Chief Technology Officer at General Motors Information Systems & Services. Tony has also held senior executive positions at Bristol Meyers Squibb, Price Waterhouse, Sun Microsystems, and Marriott Corporation.

Tony holds a Bachelor of Science Degree from the University of San Francisco in Information Systems Management and a Juris Doctorate (law) degree from Santa Clara University. He was inducted into CIO magazine's "CIO Hall of Fame", and has been a frequent keynote speaker, panelist, and advisor at numerous industry and government events. He is a multi-year recipient of the Fed 100 award and has been recognized for his leadership development skills by multiple organizations. He serves on the boards of The Malcolm Baldrige Foundation, TGEN Systems, and ServicePower, Inc.

Tony is an avid boater and a licensed pilot, and enjoys flying his own plane whenever possible.

Gretchen Ruck

Gretchen Ruck is a partner and a co-founder of the TonyScottGroup. As a trusted advisor to established boards, government leaders and investors, she specializes in examining and addressing the impact of cybersecurity, privacy regulations and technology risks on banking and critical infrastructure, technology services, consumers and healthcare providers.

Gretchen has been instrumental in shifting conversations concerning technology risk and cybersecurity from backrooms to the boardroom. She's a frequent writer and speaker on topics ranging from cybersecurity, privacy, and technology risk to inclusiveness and advocacy. Her insights on current events have been featured in The Economist, Quartz, Bloomberg, Financial Times, USA Today, Mirror, Law360, and numerous other media outlets.

Prior to joining the TonyScottGroup in 2019, Gretchen held key roles at leading organizations including AlixPartners, Moody's, Gartner and KPMG and holds a degree in International Business from American University. She's earned industry credentials in cybersecurity, auditing, project/program management, risk management, privacy and data protection, and engineering.

In her spare time, she advises and serves as a fiduciary in leadership roles on the boards of numerous non-profit and charitable organizations focused on supporting the needs of children and communities and on building a diverse and inclusive society.