



COMPUTER & COMMUNICATIONS
INDUSTRY ASSOCIATION

THE BENEFITS AND COSTS OF I-FILE

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Computer & Communications Industry Association

The Computer & Communications Industry Association (CCIA) is an international industry association representing large, medium and small companies in the high technology products and services sector, including computer hardware and software, electronic commerce, telecommunications and Internet products and services. CCIA's membership collectively represents more than \$200 Billion in annual revenues across the United States and international technology markets. CCIA is the leading industry advocate in promoting open markets, open systems, and full, fair and open competition.

CCIA seeks to help make our industry's technology serve our citizens and our governments alike and has followed with great interest the efforts by all levels of government to utilize technology to improve e-government. We have encouraged and supported the government's efforts to modernize operations and to appropriately utilize the tools and technologies of the Information Age.

One area in which CCIA has sought to help government is in its efforts to increase the percentage of Americans who file their taxes electronically. One of the current proposals being considered by the government to further this goal is "I-File", in which the Internal Revenue Service would develop an online tax preparation and e-filing system that would allow individuals to prepare their returns and submit them directly to the IRS.

CCIA has commissioned this study to provide an economic analysis that examines and puts into perspective the costs and benefits of such a system, and reflecting on lessons that can be learned from the experiences of others. We hope that this analysis will add to an informed understanding of the economic issues involved and contribute constructively to the public policy debate.

For further information, please contact Ken Kurokawa (Director, International and Legislative Affairs) at 900 17th Street, NW, Washington, DC 20006, TEL 202-783-0070.

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I. INTRODUCTION AND EXECUTIVE SUMMARY

In 2007, nearly 60 percent of all Federal individual tax returns were filed electronically, about three times the proportion 10 years earlier. Because electronic filing is both more efficient and more accurate than filing by mail, it generates substantial savings for taxpayers: The Internal Revenue Service (IRS) estimates it saves \$2.36 for each electronically-filed return.

The increase in electronic tax filing is due to two factors. First, as the tax laws have grown more and more complex, more Americans are turning to paid tax preparers, and many (but not all) paid tax preparers submit returns electronically. Second, increasing numbers of Americans are utilizing online tax preparation software, such as TurboTax and TaxCut, which allows individual taxpayers to file electronically. In most cases, thanks to the “Free File Alliance” between the IRS and most major tax preparation software providers, they can do so without paying a fee. In either case, returns are transmitted to the IRS by an intermediary (either the paid tax preparer or the software provider) through a secure interface. The IRS does not currently have the ability to accept electronic returns directly from individuals.

The clear benefits of electronic filing have led policymakers to ask what steps can be taken to accelerate its adoption.¹ One such proposal, commonly referred to as “I-File,” calls for the IRS to develop and operate an online tax filing system that would allow individuals to

¹ Indeed, in the IRS Restructuring and Reform Act of 1998, Congress established the goal of 80 percent of returns filed electronically by 2007. As indicated above, the goal was not achieved.

prepare their returns online and submit their returns directly to the IRS.² In this paper, we analyze the likely benefits and costs of I-File.³ Our findings are not encouraging.

First, we find that the benefits of an IRS-operated I-File system would be at most *de minimis*, and more likely non-existent. Taxpayers already have the ability to file their returns electronically; as a result of the Free File program, most taxpayers have the ability to do so for free. Firms in the highly competitive tax preparation software business have strong incentives to increase the rate at which taxpayers file electronically, as well as to continue to innovate and improve the usability of their products. There is little reason to believe that an IRS-operated system would represent an improvement over the products already available in the market – and many reasons to believe it would not. Indeed, the low rates of adoption of government-operated tax filing systems in other jurisdictions suggest that a Federal I-File program would not be well-accepted by Federal taxpayers.

Second, we find that the costs of attempting to develop an I-File system would be large. We emphasize the word “attempting,” because the history of IRS information technology initiatives (and, for that matter, of Federal information technology initiatives generally) calls into question whether the agency is capable of implementing an I-File system within any reasonable set of time and budget constraints. Our conclusion in this regard is not a criticism of the IRS or its personnel, but rather a recognition of the difficulties inherent in procuring and operating

² As this paper was nearing completion, the IRS announced plans to study “the options for expanding e-filing,” including I-File. *See, e.g., IRS to Study Direct Filing Portal, 2-D Bar Coding to Boost E-Filing*, Bureau of National Affairs, ISSN 1523-567X (January 2008). We hope this study will provide useful information as the IRS examines these issues.

³ The concept of an I-File system should be distinguished from the concept of a “return-free” filing system. Under an I-File system, the IRS would provide online filing services directly to taxpayers, but taxpayers would be responsible for completing their own tax returns. In contrast, under a “return-free” system, the IRS would complete tax returns on taxpayers’ behalf. In a companion piece, we examine “return-free” filing in greater detail. *See* Jeffrey A. Eisenach and Robert E. Litan, *Should Uncle Sam Do Your Taxes? An Analysis of “Return-Free” Tax Proposals*, CRITERION ECONOMICS (forthcoming) [hereafter *Criterion “Return-Free” Filing Report*].

information technology systems in the Federal government.⁴ Indeed, the IRS itself has been the first to acknowledge the challenges associated with attempting to implement I-File.⁵

Third, based on our first two findings, we conclude that the net present value of attempting to implement an I-File program is negative. Simply put, there are no plausible assumptions under which an I-File system could produce sufficient savings to pay back its development, implementation and operating costs. Using assumptions which are extremely (even implausibly) favorable to I-File, we estimate that I-File would, in present dollars, cost at least \$132 million more over the next 10 years than it would save.

Based on these findings, we conclude that I-File proposals do not represent a viable approach to increasing electronic filing, improving the efficiency of the IRS, or reducing the costs to taxpayers of filing tax returns. As suggested above, however, we do believe that additional steps can and should be taken to increase the proportion of returns filed electronically. Among the more cost-effective alternatives we favor are measures to continue improving the Free File program and policies designed to increase assistance to low-income individuals through traditional IRS taxpayer assistance programs.

The remainder of this report is structured as follows. Section II describes the current state of electronic filing, including specifically the Free File program, and shows that private firms are already providing efficient (and, for most taxpayers, free) online tax filing capabilities. Section III discusses proposals to establish an I-File system and briefly reviews the arguments

⁴ Two of the authors, Eisenach and Litan, have served in positions in the Federal government where they had direct responsibility for and experience in procuring Federal information technology systems (including such systems at the IRS). Thus, our understanding of the challenges and our high degree of respect for Federal IT professionals have been gained through personal experience.

⁵ See United States Government Accountability Office, *State Experiences Indicate IRS Would Face Challenges Developing an Internet Filing System with Net Benefits* (GAO-07-570, April 2007) [hereafter *GAO I-File Report*], at Appendix IV (letter from IRS Commissioner Everson noting the “significant investments in hardware, software, and business process redesign” associated with development of such a capability).

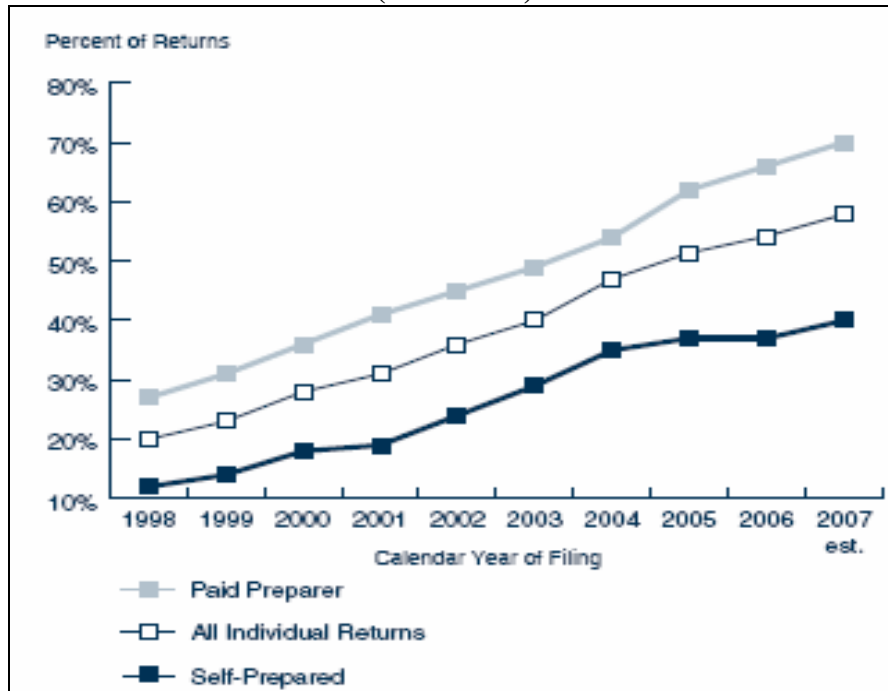
that have been advanced for (and against) them. Section IV reviews the practical steps the IRS would need to take to establish an I-File service and explains our reasons for concluding the IRS would be unlikely to do so successfully. Section V explains why an IRS-operated I-File service is unlikely to produce significant benefits. In Section VI, we review the experiences of other jurisdictions, including the United Kingdom and several U.S. states, which have experimented with I-File-like systems, and explain why these experiences support our findings. Section VII provides recommendations for alternative steps that could be taken to accelerate the trend towards electronic filing and reduce taxpayer compliance costs. Section VIII presents a brief conclusion.

II. PRIVATE FIRMS ALREADY PROVIDE ONLINE TAX FILING CAPABILITIES

Approximately 58 percent of all individual tax returns were filed electronically in 2007, including roughly 46 percent of returns prepared by individuals and roughly 65 percent of returns filed by paid preparers.⁶ As shown in Figure One below, the proportion of those filing electronically has risen rapidly in recent years.

⁶ Source: IRS, *Tax Year 2006 Taxpayer Usage Study*. (See Table One, *infra*, for details). Note that these figures differ slightly from the 2007 estimates displayed in Figure One.

**Figure One:
Percentages of Individual Tax Returns Filed Electronically
(1998-2007)**



Source: IRS Oversight Board, *Electronic Filing 2007, Annual Report to Congress* (February 2008) at 23.

Taxpayers who prepare their own returns can file them electronically by using any of a number of commercially-available tax preparation software programs. Once a return is complete and ready for filing, a simple mouse click uploads the file to the software provider’s system, where it is grouped with other returns into a “batch” file and submitted electronically to the IRS through a secure interface. More than 23 million tax returns were e-filed this way in 2006. Electronic filing has had large and undisputed benefits. The Government Accountability Office’s (GAO’s) 2007 *I-File Report* notes that, “[b]y 2006, the growth of electronic filing had allowed IRS to close two paper processing centers and eliminate 1,600 staff years, resulting in a savings of tens of millions of dollars.”⁷

⁷ See GAO *I-File Report*, *supra*, at 1(letter to Sens. Baucus and Grassley).

In the tax preparation software industry, competition has frequently led to innovation and increased focus on taxpayer needs. Tax software development efforts pose substantial challenges, frequently requiring innovative solutions. Within a rigid timetable, companies must adhere to a demanding software engineering development cycle that must accurately incorporate modifications to tax laws, tax regulations, and tax forms. Indeed, simply keeping pace with modifications in the Federal tax code represents a substantial product development effort on its own, above and beyond product improvements in functionality, format, and usability. For example, from 1986 to 2005 there were roughly 15,000 changes to the tax code, implemented by more than 100 Acts of Congress, implying an average of over 700 tax code changes *per year*.⁸

Tax preparation software typically offers an array of features allowing taxpayers to file in accordance with the latest regulations, and offers multiple levels of assistance that guide users through the filing process in an intuitive, stepwise manner. For instance, many programs provide hyperlinks allowing customers to view frequently asked questions and to access web-based support. Many companies also offer live advice for tax preparation questions. When taxpayers have finished entering their information, tax preparation software can pinpoint errors, omissions, and overlooked deductions and credits, including refundable credits such as the Earned Income Tax Credit (EITC). The value proposition that has built the electronic tax preparation software industry has been the combination of simplification of the compliance process and the ability to produce accurate and error-free returns that reflect the taxpayer's lowest lawful tax liability.

Competition in the industry obligates companies to focus resources on designing software to be as user-friendly as possible. For instance, it is standard industry practice to test software extensively in "usability labs," in which customers attempt to file hypothetical returns while

⁸ See *The President's Advisory Panel on Federal Tax Reform*, Chapter 2, at 16, available at:

providing detailed feedback to product development personnel. In addition, tax preparation software allows taxpayers to import data from commonly used personal finance software, as well as to import information from the previous year's tax return. It is also possible to electronically import wage and salary information directly from employers, as well as interest earnings from banks and equity transaction information from brokerage houses. These innovations have not only enhanced the ability of commercial tax preparation products to simplify the work involved in creating tax returns, but have also further reduced error rates in those returns by providing a controlled, automated environment for the automatic transfer of basic financial data from original sources directly into tax returns.

While tax preparation software is hardly unaffordable,⁹ most taxpayers can obtain both the software and the ability to file their taxes electronically free of charge through the Free File Alliance.¹⁰ In Tax Year 2007, taxpayers with Adjusted Gross Incomes of \$54,000 or less – approximately 70 percent of all taxpayers – qualified for Free File.¹¹ Since its initiation in 2003, more than 19.3 million tax returns have been filed through Free File, with estimated savings to the IRS of \$45.5 million.¹²

Free File is widely regarded as a success, and 20 states have adopted parallel Free File programs that operate under the national terms, conditions, rules and agreements of Free File.

http://www.taxreformpanel.gov/final-report/TaxReform_Ch2.pdf [hereafter *President's Advisory Panel*].

⁹ According to the IRS's Individual Taxpayer Burden Model, self-preparers who use tax software incur an average of \$44 in out-of-pocket costs. See Section VI.A, *infra*. The most commonly purchased "box software" packages, which include the software needed to prepare and electronically file both Federal and state tax returns, typically sell for approximately \$50, with high-end software in the \$70 range. In addition, online tax software is typically less expensive, with providers frequently charging well under \$50, including electronic filing.

¹⁰ *Internal Revenue Service, Free File: Frequently Asked Questions*, available at: <http://www.irs.gov/efile/article/0,,id=118993,00.html> [hereafter *IRS Free-File FAQs*].

¹¹ *Id.*

¹² See Office of Management and Budget, *Report to Congress on the Benefits of the President's E-Government Initiatives*, Fiscal Year 2008 [hereafter *OMB Report to Congress*], at 155. In addition to the Free File program, some companies offer free online filing outside of Free File. See United States Government Accountability Office, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and*

User satisfaction is high. According to the IRS Free File Program satisfaction survey, 94 percent of all Free File users found the program “easy to use.”¹³ More than three quarters (78 percent) of those who used Free File in the 2006 filing season reported “very” high satisfaction with the program, and 95 percent indicated they plan on using Free File again in 2007.¹⁴ The Office of Management and Budget has highlighted the program as among the most successful E-government initiatives.¹⁵ The IRS itself has expressed its satisfaction,¹⁶ and in March 2008 noted that Free File usage for Tax Year 2007 usage is running 12 percent above 2006.¹⁷

Free File operates under a formal agreement between the IRS and commercial software companies, under strictly defined terms. In addition, continuous efforts are being made to further improve the program. For example, cross-marketing of ancillary offerings was eliminated in 2006.¹⁸ As discussed below, we believe additional steps can and should be taken to improve Free File and to expand participation in the program. However, there is no question that the program is serving the needs of millions of Americans, while saving the U.S. Government and consumers millions of dollars.

Increase Tax Compliance Should be Evaluated (GAO-08-38, November 2007), [hereafter *GAO 2007 Filing Season Report*] at 11.

¹³ See United States Treasury Inspector General for Tax Administration, *Additional Action Is Needed to Expand the Use and Improve the Administration of the Free File Program*, (Ref. No. 2007-40-105), June 2007, [hereafter *TIGTA Free File Report*], at 2.

¹⁴ See *OMB Report to Congress, supra*, at i. See also *Most Taxpayers Eligible to File Their Taxes Online for Free*, Internal Revenue Service, Press Release IR-2008-6, January 10, 2008, available at: <http://www.irs.gov/newsroom/article/0,,id=177380,00.html>.

¹⁵ See *OMB Report to Congress, supra*, at i.

¹⁶ “The IRS believes that private industry, given its established expertise and experience in the field of electronic tax preparation, has a proven track record in providing the best technology and services available. Rather than entering the tax software business, IRS’ partnership with private industry: (1) provides taxpayers with high quality services by using the existing private sector expertise; (2) maximizes consumer choice; (3) promotes competition within the marketplace; and (4) meets these objectives at the least cost to taxpayers.” See *Statement Of the Mark W. Everson, Commissioner, Internal Revenue Service, Before the House Ways and Means Subcommittee On Oversight* (April 6, 2006) [hereafter *Everson 2006 Statement*].

¹⁷ *Use of Free File Growing in 2008*, Internal Revenue Service, Press Release IR-2008-47, March 20, 2008, available at: <http://www.irs.gov/newsroom/article/0,,id=180310,00.html>.

¹⁸ *RALs Removed on Free File; 93 Million Eligible for Program*, Internal Revenue Service, Press Release IR-2006-187, December 5, 2006, available at: <http://www.irs.gov/newsroom/article/0,,id=164711,00.html>. See also

It should be noted in this context that I-File would not be “neutral” with respect to the existing marketplace. Although, for reasons we explain further below, we doubt that a Federal I-File service would achieve widespread use, a Federal government commitment to developing what amounts to a competitor to the existing commercial tax preparation software business could not help but discourage investment in the existing private marketplace. Moreover, to the extent that an I-File system might ultimately replace the existing industry (an outcome we regard as highly unlikely), it is highly questionable whether this would represent an improvement over the current state of affairs. For example, a government-run monopoly system would surely be less innovative and consumer friendly than the current system, and would represent a “single point of failure” – a non-trivial concern given the threat of cyber attacks.¹⁹ As we note below, government I-File programs in other jurisdictions have been prone to service interruptions.

Even if I-File did not supplant the private tax preparation software business, or even cause it significant harm, it would likely endanger the currently, highly successful Free File program, as firms that currently offer free services through Free File would have reason to question the benefits of continuing to do so.²⁰

III. PROPOSALS FOR FEDERAL I-FILING ARE NOT WELL-DEFINED

Despite the growth of electronic filing in general, and the success of Free File in particular, some have argued that the IRS itself should develop online tax preparation software

H.R. 3457, 110th Cong. § I.A.1 (2007) (“...participating companies in the Free File program may not advertise, market, or offer to sell any products or services to taxpayers while using the tax preparation programs...”).

¹⁹ See U.S. Department of Homeland Security, *National Strategy To Secure Cyberspace*, available at: http://www.whitehouse.gov/pcipb/executive_summary.pdf (“A spectrum of malicious actors can and do conduct attacks against our critical information infrastructures. Of primary concern is the threat of organized cyber attacks capable of causing debilitating disruption to our Nation’s critical infrastructures, economy, or national security.”).

²⁰ Indeed, the terms of the formal agreement governing Free File permit private sector firms to terminate their free offerings in the event that the IRS itself attempts to offer analogous services. See Free On-Line Electronic Tax Filing Agreement, at § VII.D, available at <http://www.irs.gov/efile/article/0,,id=103626,00.html> (“Should the IRS decide to offer Free Services to taxpayers... the Consortium may, by written notice to the IRS, terminate this Agreement...”)

and create a direct electronic interface between taxpayers and the IRS, either through public procurement of commercial products and services at taxpayer expense, or through government design and development of a federal Internet portal and tax filing software. As noted previously, these proposals are typically referred to as “I-File.”

Legislation requiring the IRS to develop a free Internet-based tax filing system was introduced in the Senate in both the 109th and 110th Congresses. The current I-File proposal, S. 1074 (the “Free Internet Filing Act”), is short on specifics: It simply directs the Secretary of the Treasury to make a free Internet filing capability available to the public within three years of enactment. To do so, S. 1074 proposes that Congress appropriate “...such sums as are required to carry out the direct e-file program.”²¹

Proponents have suggested I-File would generate three primary benefits. First, they argue it would mitigate the high costs of complying with current tax laws, such as the time and expense taxpayers incur in filing tax returns. For example, in a November 2006 letter to the IRS, Senators Grassley and Baucus argued that an IRS-provided “direct filing portal” would “enable all taxpayers to file electronically and without cost.”²²

Second, proponents argue that I-File would further reduce tax return processing costs incurred by the IRS. Thus, when the GAO was asked by Senators Grassley and Baucus to “describe various I-file options and what is known about their use,” one of the three primary objectives of the GAO’s study was to “describe the potential for IRS to realize cost savings from providing an I-file service.”²³

²¹ S. 1074, 110th Cong. § 2 (2007). Identical legislation was introduced in the 109th Congress; see S. 2550, 109th Cong. § 2 (2006).

²² See United States Senate Finance Committee, Press Release: *Grassley, Baucus Express Concern Over Continued Tax Free File Program Problems*, November 2, 2006, available at: <http://www.senate.gov/~finance/press/Gpress/2005/prg110206a.pdf> [hereafter *Grassley-Baucus Press Release*].

²³ See *GAO I-File Report, supra*, at 2 (letter to Sens. Baucus and Grassley).

Finally, it has been suggested that I-File could help close the federal “tax gap.”²⁴ For example, Senator Baucus has opined that “[i]mproving the Free File program would make many taxpayers’ lives easier and help us close the tax gap,” but that if Free File improvements are not sufficient, a “direct filing portal” should be considered as an alternative.²⁵

By and large, reactions to I-File proposals have not been positive. In the months following the November 2006 letter from Senators Grassley and Baucus, a report by the GAO to the Senate Finance Committee found that the IRS faced “challenges developing an Internet filing system with net benefits.”²⁶ The IRS agreed: In comments filed in conjunction with the GAO report, it endorsed the current Free File system of partnerships with private tax preparation software companies as an alternative to enabling individuals or preparers to fill out and file returns directly with the IRS online.²⁷ The Electronic Tax Administration Advisory Committee (ETAAC), a formal Federal advisory committee established by the Congress in 1998 to advise on electronic tax filing issues, also agrees that improving Free File is a better option than having the IRS develop its own I-File system:

Given the considerable investment that would be required by an IRS Internet filing solution that might produce marginal benefits, combined with substantial infrastructure investment required by the IRS on many other fronts – not the least of which is connected to our findings contained in the second part of this report – we suggest that Congress proceed with caution in compelling the IRS to provide its own Internet filing portal. A more effective and prudent use of resources at this time would suggest more investment in growing participation within the Free File program. To this point, ETAAC recommends that the IRS invest more to market the Free File program and to assess the reasons why more taxpayers do not take advantage of the program’s services.²⁸

²⁴ For a discussion of the “tax gap” and its relationship to the tax return filing process, see *Criterion “Return-Free” Filing Report*, *supra*.

²⁵ See *Grassley-Baucus Press Release*, *supra*.

²⁶ See *GAO I-File Report*, *supra*.

²⁷ *Id.* at Appendix IV.

²⁸ See Electronic Tax Administration Advisory Committee, *Annual Report to Congress* (Publication 3415 Rev. 6-2007, June 20, 2007) [hereafter *ETAAC Report*], at 8.

Despite these concerns, I-File remains a serious proposal with influential proponents. Indeed, as this report was nearing completion, the IRS announced that it is conducting a major study of alternatives for expanding electronic filing, and that I-File will be among the alternatives studied. For the reasons explained below, we conclude that I-File would not achieve the objectives its proponents suggest, and that other approaches to improving and expanding electronic filing would yield much larger benefits.

IV. IMPLEMENTING I-FILE WOULD BE COSTLY AND RISK-PRONE

In a world in which so many transactions are now routinely conducted online, it might seem a simple matter for the IRS to set up an online tax filing system that would allow taxpayers to log on, fill out their returns, hit a button and be done. In this section, we explain that implementing I-File would in fact be a substantial and complex undertaking, that the history of IRS information technology efforts is, at best, not reassuring, and that the challenges faced by government agencies generally in implementing e-government initiatives give further reason for concern. In short, we conclude that the IRS likely does not have the capability to implement I-File effectively and efficiently – or, perhaps, at all.

A. Implementing I-File Would Be a Large and Complex Undertaking

Neither the IRS nor I-File proponents have described the specific steps that would be required to implement an I-File system in any detail, in part due to the lack of specificity of the I-File proposals themselves. However, the GAO's 2007 *I-File Report* outlines the primary options and challenges.²⁹ Though it falls short of a comprehensive assessment, the *I-File Report* represents the most thorough analysis to date of the technical and operational obstacles that a federal I-Filing initiative would likely confront.

1. Development of Online Transactional Capabilities

The first step to creating a successful IRS I-File system outlined by the *I-File Report* would be the development of transactional software capable of handling taxpayer-generated data.

The report notes that:

Currently, IRS's Web site is mostly informational, meaning taxpayers can obtain information from IRS but they cannot submit information to IRS's tax return databases. The information that taxpayers can obtain includes instructions, downloadable forms, and refund status. Developing an I-File system would require IRS to develop a transactional Web site, where taxpayers could enter information that would be submitted to IRS's tax return databases. Transactional Web sites require more security and other features not necessary for an informational Web site.³⁰

Unlike the IRS, several states that have attempted to launch I-File programs had already developed transactional software for their websites prior to the deployment of their I-File programs.³¹ As the IRS has no comparable system in place, the GAO notes that "[t]o provide I-File, IRS would need to incur the costs of developing a transactional capability."³² As discussed further below, the Federal tax system is far more complex than state systems, a fact which would complicate development of a transactional capability relative to the systems developed in the states.³³

2. Procurement of Computer Hardware

Due to low usage rates, state I-File systems have typically not heavily taxed existing hardware capabilities.³⁴ In contrast, a federal I-File program – to the extent it was used by any significant proportion of taxpayers – almost certainly would exceed current IRS computer hardware capacity and capabilities. As the *I-File Report* notes, "...the states profiled built their

²⁹ See *GAO I-File Report, supra*, at Appendix III.

³⁰ *Id.* at 27.

³¹ These include Kansas, California, Indiana, and Utah. *Id.* at 27.

³² *Id.* at 27.

³³ *Id.* at 28 ("The federal income tax system is more complex than states' tax systems, which generally piggyback on the federal return...Similarly, the features offered on an I-File system would affect the complexity of the software.").

systems using existing capacity while IRS would likely have to purchase additional computer hardware.”³⁵ The variety of functions and sheer processing volume inherent in I-File would, at the very least, demand significant investments in servers, storage capacity, and network and switching technology.

3. Overcoming System Complexity

System complexity, and thus development and maintenance costs, would be heavily dependent on the level of service and number of features a potential federal I-File system would offer. For example, the IRS might seek to offer taxpayers the option of saving a partially-finished return and resuming the session later. (Existing Free File programs already offer this feature.) Such features are valuable from the point of view of the taxpayer, but potentially burdensome to implement. The GAO has recognized the link between complexity and cost, noting that “[f]eatures such as save and return and auto-populating can require additional memory and potentially increase costs.”³⁶ While I-File implementation might be facilitated if the program offered a more limited range of service features, such restrictions on functionality would also limit the value of the system to taxpayers.

In addition to service features, the complexity of the Federal tax code itself presents a significant challenge to I-File systems development. The Federal tax code is substantially more complicated than state codes, and requires many additional forms and schedules. In evaluating this concern, the GAO compares Maryland, which currently offers an I-Filing service, with the Federal code:

³⁴ See Section V.

³⁵ See *GAO I-File Report, supra*, at 4.

³⁶ *Id.* at 28.

[T]he federal Form 1040 for tax year 2006 contains 77 lines and can require up to 41 other forms, schedules, or worksheets to complete, while Maryland's Form 502 contains 52 lines (starting with federal adjusted gross income) and can require only 7 other forms, schedules, or worksheets to complete.³⁷

The complexity of the Federal tax code would not only add to the complexity of developing an I-File system, but also to the challenges of maintaining it, as every change in the Tax Code would generate a corresponding requirement to rewrite the underlying software supporting I-File.³⁸ Furthermore, the Internet environment in which the I-File service would be offered is in a constant state of flux, with new websites, new competitors, new offerings, and new features constantly coming online. In order for I-File to succeed with consumers, the IRS would need to continuously improve the interfaces and services offered by the program – a capability that it does not currently possess – and which we doubt it could develop and maintain successfully.

4. Acquiring Budgetary Resources

Perhaps as a result of the amorphous nature of current I-File proposals, there appear to be no official estimates of the cost of implementing and operating I-File.³⁹ We did, however, identify one analogous IRS project which we believe provides a *very* conservative lower bound: The IRS initiative to upgrade and expand the “Modernized e-File” system to accept individual returns (“MeF 1040”).

³⁷ *Id.* at 28.

³⁸ As noted previously, from 1986 to 2005 there were an average of over 700 tax code changes per year. *See President's Advisory Panel, supra*, at 16.

³⁹ One press report suggests that the Treasury has estimated the cost of I-File at \$400 million. *See* Diane Freda, *IRS Chief Says Tax Preparation Portal Would Be Difficult Undertaking for Service*, Bureau of National Affairs, ISSN 1523-567X (November 2006). However, we were not able to identify any formal study supporting this estimate.

Modernized e-File was initially developed to permit the IRS to accept electronic filing of certain corporate, small business and tax exempt returns.⁴⁰ In 2007, the IRS proposed to upgrade and expand the system for use with individual returns, thus eventually replacing the current legacy electronic filing system used for individual returns. MeF 1040, which is expected to be released initially in 2009, would allow for submission of the basic 1040 form as well as approximately 10 commonly filed schedules, but many forms (e.g., Forms C, E and F) would not be supported until at least 2011. As a result, paid preparers expect the program to have “limited impact” until it becomes fully functional three years from now.⁴¹

MeF 1040 clearly represents a dramatically less ambitious undertaking than I-File. Whereas I-File would require the IRS to develop a new system virtually from scratch, MeF 1040 represents an upgrade to an existing system upon which the IRS has already spent tens of millions of dollars. Moreover, MeF 1040’s functionality is limited to facilitating the electronic submission of tax returns that *have already been prepared*, whereas I-File would by definition include tax preparation functionality. Finally, MeF 1040 does *not* provide the IRS with an interface capable of accepting electronically returns directly from taxpayers; all electronically filed individual returns would continue to be routed through third parties.⁴² Given these differences, it is virtually certain that I-File implementation costs would significantly exceed the costs of MeF 1040. At the very minimum, MeF’s costs represent an extremely conservative lower bound on the costs of I-File. That is, it is unlikely that anyone could reasonably argue that

⁴⁰ The purpose of Modernized e-File is “to provide a single standard” for electronic filing. The scope of the program was initially limited to “large corporations, small businesses, and tax-exempt organizations.” See United States Government Accountability Office, *Interim Results of the 2007 Tax Filing Season and the Fiscal Year 2008 Budget Request* (GAO-07-673, April 2007) [hereafter *GAO BSM 2007*], Appendix I, at 40.

⁴¹ See Robert Caplan, “IRS Announces New Release Date for 1040 Modernized E-File Program,” *The Tax Adviser* (January 2008) (available at www.cpa2biz.com/Content/media/PRODUCER_CONTENT/Newsletters/Articles_2008/CPA/Jan/eFile.jsp).

⁴² See *TIGTA Free File Report*, *supra*, at 3 (“Neither the Modernized e-File Project nor the 2-D Barcode filing option will eliminate the need for third-party involvement in the electronic filing process.”).

I-File would cost less than MeF 1040, and likely that most would agree it will cost substantially more.

In its 2008 budget request, the IRS requested, and Congress approved over \$55 million to implement MeF 1040.⁴³ While the IRS has not announced how much will be required to complete the project, it has indicated an additional \$25 million will be required in 2009.⁴⁴ We believe it is reasonable to assume that a similar amount will be required in 2010 to complete implementation, bringing the total development costs to over \$105 million.⁴⁵ We do not believe any lower figure could plausibly be assumed for the costs of implementing an I-File system.

The costs of I-File would not, of course, end with implementation. I-File would require continuous maintenance and updates, and the budgetary resources to match. A rough estimate of the potential recurring costs of I-File can be obtained from the GAO's 2007 *I-File Report*, which reports the costs that certain states incurred in attempting to implement I-File, and in some cases provides cost estimates divided into development and operating expenses.⁴⁶ Specifically, California incurred operating costs equal to approximately 40 percent of development costs; Pennsylvania reported annual operating costs equal to about 31 percent of development costs; and, data for the District of Columbia indicate operating to development cost ratios of between

⁴³ See United States Government Accountability Office, *Assessment of the 2008 Budget Request and an Update of 2007 Performance* (GAO-07-719T, May 2007) [hereafter *Budget Request Assessment 2008*], at 7-8. (“... IRS is requesting \$282 million for its BSM program...[t]his includes over \$55 million for developing and deploying the capability to accept individual income tax returns on Modernized e-File...”). See also United States Government Accountability Office, *Fiscal Year 2009 Budget Request and Interim Performance Results of IRS's 2008 Tax Filing Season* (GAO-08-567, March 2008) [hereafter *Budget Request 2009*], Appendix II, at 33, 36.

⁴⁴ *Budget Request 2009*, *supra*, at 33.

⁴⁵ This estimate is itself likely conservative, as the MeF program has a history of running over budget and behind schedule. See, e.g., United States Treasury Inspector General for Tax Administration, *The Modernized e-File Project Can Improve the Management of Expected Capabilities and Associated Costs* (Reference Number 2007-20-005), December 27, 2006. See also *Budget Request Assessment 2008*, *supra*, at 4 (“[T]wo key projects—CADE and Modernized e-File (a new electronic filing system)—experienced significant cost overruns during 2006.”).

⁴⁶ *GAO I-File Report*, *supra*, at 23.

24 percent and 48 percent.⁴⁷ In any case, even the smallest of these estimates (24 percent of \$105 million) implies that I-File's annual operating costs would be at least \$25.2 million.

B. The IRS Has a Long History of Difficulties in Implementing Large IT Projects

Despite several efforts at modernization, the IRS has relied for decades on archaic computer systems to perform crucial operational and financial management roles. As detailed below, the Service's efforts to upgrade its systems – including the current Business Systems Modernization project – have often run over budget or behind schedule, or have failed to achieve their objectives altogether.

It should be noted that the IRS is not alone among government agencies in the difficulties it has faced in implementing information technology systems. Moreover, by any standard, the IRS is an extremely large and complex organization, tasked with sweeping responsibilities. Its core mission is to “[p]rovide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.”⁴⁸ The agency employs over 90,000 full time equivalent (FTE) employees, and has a total annual operating budget of over \$11 billion.⁴⁹ Its duties include processing hundreds of millions of tax returns annually, along with associated tax revenue, refund processing, and enforcement activities. Given the sheer scale and complexity of its operations, as well as its status as a government agency, the IRS' difficulties with its information technology modernization efforts are not surprising.⁵⁰

⁴⁷ *Id.* Note that the available information for the District of Columbia reflects costs associated with electronic filing for both individuals and businesses.

⁴⁸ Internal Revenue Service, *The Agency, Its Mission, and Statutory Authority*, available at: <http://www.irs.gov/irs/article/0,,id=98141,00.html>.

⁴⁹ See United States Government Accountability Office, *Statement of James R. White and David A. Powner, Assessment of the 2008 Budget Request and an Update of 2007 Performance* (GAO-07-719T, May 2007), at 6-7.

⁵⁰ In Fiscal Year 2006, IRS gross collections totaled over \$2.5 trillion, refunds were issued in excess of \$280 billion, and roughly 3,900 criminal investigations were initiated; at the same time, 130 million individual income tax returns and two million corporate income tax returns were processed, in addition to returns for employment, gift,

This said, it cannot be denied that the IRS has made large-scale investments in various IT modernization initiatives, and that these initiatives have experienced chronic difficulties. In evaluating the likelihood that that the agency could efficiently and effectively implement an I-File program, we believe this historical experience must be taken into account.

1. Past Modernization Efforts Have Run Behind Schedule and Over Budget

The IRS began using computerized tax databases in the 1950s. Considered relatively advanced for their time, these mainframe-based systems relied on “Master Files” to store and process tax information. However, as the volume and complexity of data processing demands increased with changes in the economy, the tax code, and new laws mandating privacy and nondisclosure requirements for confidential taxpayer information, the IRS’ data processing capabilities failed to keep pace.

In response, the IRS decentralized, implementing a “stovepipe” system that was intended to make information locally available by housing taxpayer information in a number of dispersed databases in the Service’s district offices. The decentralization, however, led to problems of its own. In effect, the district offices, with their array of legacy and stand-alone computer and data systems, became silos that could not effectively communicate with each other. Moreover, with many different systems in place, it became increasingly costly and problematic to perform both general system maintenance and system updates to reflect annual changes in the tax code.⁵¹

In 1986, Congress approved the Tax System Modernization (TSM) program, a \$4 billion effort to thoroughly overhaul the IRS’ technology and related business processes. TSM was

excise, and estate taxes. Internal Revenue Service, *Tax Stats at a Glance*, available at: <http://www.irs.gov/taxstats/article/0,,id=102886,00.html>; See also Internal Revenue Service, *SOI Tax Stats-IRS Data Book: 2006*, available at: <http://www.irs.gov/taxstats/article/0,,id=168593,00.html>.

⁵¹ See Statement of Paul Cofoni, President, Federal Sector, and Corporate Vice President, Computer Sciences Corporation, El Segundo, California Testimony Before the Subcommittee on Oversight of the House Committee on

envisioned as a massive information systems development effort and was not expected to be fully operational until 2000.⁵² However, the TSM project was plagued with problems almost from the outset, and, as it proceeded, continued to experience schedule delays and cost overruns.

Nearly a decade after TSM was initiated, a GAO report noted:

IRS does not have a comprehensive business strategy to cost-effectively reduce paper submissions, and it has not yet fully developed and put in place the requisite management, software development, and technical infrastructures necessary to successfully implement an ambitious world-class modernization effort like TSM. Many management and technical issues are unresolved, and promptly addressing them is crucial to mitigate risks and better position IRS to achieve a successful information systems modernization.⁵³

After spending over \$3 billion on TSM, the Treasury Department eventually dismantled the program in 1996, citing management and technical weaknesses.⁵⁴ The ultimate failure of the TSM project was highly publicized and explicitly acknowledged by then-Deputy Treasury Secretary Lawrence Summers.⁵⁵ The Treasury Department conceded that IRS efforts at tax system modernization had failed at a time when private firms were harnessing information technology to enhance service capabilities.⁵⁶

Ways and Means February 12, 2004, available at:

<http://waysandmeans.house.gov/hearings.asp?formmode=view&id=1168> [hereafter *Cofoni Testimony*].

⁵² TSM was intended to be “the centerpiece of IRS’s vision of virtually paperless tax processing to optimize operations and serve taxpayers better... where taxpayer information would be readily available to IRS employees for updating taxpayer accounts and responding to taxpayer inquiries.” See United States General Accounting Office, *Results of Review of IRS’ March 7, 2000, Expenditure Plan* (GAO/AIMD-00-175, May 2000) [hereafter *GAO TSM 2000*], at 5.

⁵³ See United States General Accounting Office, *Management and Technical Weaknesses Must Be Corrected If Modernization Is To Succeed* (GAO/AIMD-95-156, July 1995) [hereafter *GAO TSM 1995*], at 3.

⁵⁴ See, e.g., *Cofoni Testimony, supra*; see also Written Statement Of Treasury Inspector General For Tax Administration J. Russell George Before The Joint Congressional Review Of The Internal Revenue Service May 19, 2005, available at: http://www.treasury.gov/tigta/congress/congress_05192005.htm; see also Anne Broache, *IRS trudges on with aging computers*, CNET News.com (April 12, 2007), available at: http://news.com.com/2100-1028_3-6175657.html.

⁵⁵ “A third factor behind the intense debate over the IRS is the *highly publicized failure* of the Tax Systems Modernization project.” [emphasis added]. See Lawrence H. Summers, *Building a Tax System for the 21st Century*, Internal Revenue Service, Press Release RR-1722, June 3, 1997, available at: <http://www.ustreas.gov/press/releases/rr1722.htm> [hereafter *Summers Press Release*].

⁵⁶ “During the same period when private firms were improving customer service using information technology, the IRS proved unable to modernize its systems.” Summers also noted that despite numerous initiatives to integrate the legacy systems, IRS employees still required between five and nine computer terminals to access data. *Id.*

Following the failure of the TSM, the IRS in 1999 initiated a new modernization effort, which is still underway. Known as Business Systems Modernization (BSM), the effort is an expansive and complex program aimed at developing information systems to replace the agency's legacy business and tax processing systems, including tax administration, internal management, and core infrastructure. Thus, BSM is "[a] multibillion-dollar, high-risk, highly complex effort"⁵⁷ which has now been in progress for several years.

In response to the agency's difficulties with TSM, Congress has imposed extensive controls on BSM. In contrast to past computerization efforts, under BSM the IRS must meet tightly specified milestones for each step of a project before receiving additional funds. To receive funding, the IRS is required to submit a modernization expenditure plan to Congressional appropriations committees. To be approved, the plan must satisfy a battery of conditions.⁵⁸ In addition, to implement BSM, the IRS is relying heavily on outside contractors.⁵⁹

The GAO has closely monitored IRS implementation of BSM, providing periodic reports to Congress. In its 2004 report, the GAO found that BSM expenditure plans satisfied both the OMB capital planning and investment control review requirements and Federal systems management standards and acquisition requirements. However, its report also expressed concern that the agency lacked the management resources and systems needed to effectively implement

⁵⁷ See United States Government Accountability Office, *Internal Revenue Service's Fiscal Year 2007 Expenditure Plan* (GAO-07-247, February 2007) [hereafter *GAO BSM February 2007*], at "Highlights."

⁵⁸ Given past experience, it is understandable that Congress would desire some degree of assurance that the funds it has allocated to this ambitious effort are spent wisely, with outputs that can be measured and verified. The conditions require that the IRS "meet the capital planning and investment control review requirements established by the Office of Management and Budget; comply with IRS's enterprise architecture; conform with IRS's enterprise life cycle methodology; comply with federal acquisition rules, requirements, guidelines, and systems acquisition management practices; be approved by IRS, the Department of the Treasury, and OMB; and be reviewed by GAO." See *GAO BSM 2007, supra*, at Appendix I.

⁵⁹ See *Cofoni Testimony, supra*.

the program.⁶⁰ A February 2007 GAO report found some improvements, but also noted that – eight years after the program began – BSM was still lacking a “long-term vision and strategy.”⁶¹ A few months later, in an April 2007 report, the GAO noted that “significant challenges and serious risks remain.”⁶²

As a result of these and many other concerns, GAO has designated IRS systems modernization as a “high risk” area since 1995.⁶³ In its 2007 *I-File Report*, the GAO pointed out that the “high risk” designation calls into question whether the IRS in fact has the necessary “systems management capability”⁶⁴ to successfully develop an I-File program. In particular, the *I-File Report* notes that, although progress has been made, the fundamental weaknesses that originally prompted the “high risk” designation have yet to be fully corrected.⁶⁵

⁶⁰ See United States Government Accountability Office, *IRS’s Fiscal Year 2004 Expenditure Plan* (GAO-05-46, November 2004) [hereafter *GAO BSM 2004*], at “Highlights” (“Although progress has been made, GAO’s previous recommendations on modernization management controls and capabilities related to configuration management, human capital management, cost and schedule estimating, and contract management have not yet been fully implemented or institutionalized. Weaknesses in these controls and capabilities have contributed, in part, to BSM project cost and schedule shortfalls.”).

⁶¹ See *GAO BSM February 2007*, *supra*, at “Highlights” (“IRS has made significant progress in implementing GAO’s recommendations and improving its modernization management controls and capabilities. However, controls and capabilities related to requirements development and management and post-implementation reviews have not yet been fully implemented. In addition, more work remains to be done to fully develop a long-term vision and strategy for completing the BSM program.”).

⁶² See United States Government Accountability Office, *Interim Results of the 2007 Tax Filing Season and the Fiscal Year 2008 Budget Request* (GAO-07-673, April 2007) [hereafter *GAO BSM April 2007*], at “Highlights” (“Despite progress made in implementing BSM projects and improving modernization management controls and capabilities, significant challenges and serious risks remain, and IRS has more to do to fully address our prior recommendations”).

⁶³ See United States General Accounting Office, *High Risk Series* (GAO/HR-95-1, February 1995); see also *GAO I-File Report*, *supra*, at “Highlights.”

⁶⁴ See *GAO I-File Report*, *supra*, at 30.

⁶⁵ *Id.* (“While IRS has made noteworthy progress improving its systems management capability, it has had a history of cost increases and schedule delays that led us to designate systems modernization as a high-risk area in 1995. Those cost increases and schedule delays were due, at least in part, to deficiencies in various management controls and capabilities that have not yet been fully corrected. In 2003, we noted that IRS had made significant progress in establishing management controls and foundational systems architecture. However, systems modernization remained at risk because the scope and complexity of modernization activities was increasing. In 2005, we reported that balancing the scope and pace of modernization activities with IRS’s ability to manage them remained a challenge. IRS has made further progress since 2005 addressing concerns about systems management. However, critical management controls and capabilities have still not yet been fully implemented or institutionalized. Before proceeding with I-File, IRS would need to consider the impact of the program on its

GAO has not been alone in its concerns regarding the IRS's IT management capabilities. The Treasury Inspector General for Tax Administration (TIGTA) has also found continuing deficiencies in the agency's management of computer resources.⁶⁶ TIGTA recently concluded that "[t]he Internal Revenue Service (IRS) needs to improve management practices over end-user computer server storage to ensure effective and efficient utilization of storage and budget resources."⁶⁷

2. Taxpayer Information Has Not Been Adequately Safeguarded

In addition to its general difficulties with IT modernization efforts, the IRS has also experienced significant setbacks in safeguarding electronic taxpayer information. In response to Congressional inquiry, in 2001 the GAO released a study of the IRS's electronic security systems intended to ensure the security, privacy, and reliability of electronic taxpayer data. The GAO concluded unambiguously that the IRS had failed to properly secure its databases.⁶⁸ Subsequent GAO reviews of IRS electronic security measures have noted that significant information security weaknesses remain. A 2005 report found that "IRS has not implemented

existing portfolio of systems development projects and the impact of the program on its current modernization vision and strategy.").

⁶⁶ A 2003 report found that "the BSM program has been plagued with cost and schedule overruns and has been criticized for its ineffective cost and schedule estimation capabilities." See United States Treasury Inspector General for Tax Administration, *Final Audit Report - The Cost and Schedule Estimation Process for the Business Systems Modernization Program Has Been Improved, but Additional Actions Should Be Taken* (Audit # 200320024) (September 29, 2003) at 1.

⁶⁷ See United States Treasury Inspector General for Tax Administration, *Management Practices Over End-user Computer Server Storage Need Improvement to Ensure Effective and Efficient Storage Utilization* (Ref. No. 2007-20-103, July 2007). In this report, the TIGTA found that the IRS had spent millions of dollars on computer server capacity that was never used, and that the IRS had not established formal policies and procedures to improve computing efficiency and supervise end-user server capacity. The TIGTA identified \$19.9 million of IRS expenditures on server capacity and support in fiscal years 2003-2006, and found that 73 percent of that capacity had not been utilized. The report also found that the IRS did not maintain accurate inventories of server capacity.

⁶⁸ See United States General Accounting Office, *IRS Electronic Filing Systems* (GAO-01-306, February 2001) [hereafter *GAO Electronic Security Report 2001*]. ("During the 2000 tax filing season, IRS did not adequately secure access to its electronic filing systems or to the electronically transmitted tax return data those systems contained... These serious access control weaknesses existed because IRS had not taken adequate steps to assess security risks and monitor the effectiveness of security controls over taxpayer data in its e-file systems on an ongoing basis.").

effective electronic access controls to prevent, limit, or detect unauthorized access to computing resources from the internal IRS computer network,” noting that the fundamental cause of electronic security concerns stems from a lack of a comprehensive agency-wide security apparatus.⁶⁹ A 2006 GAO report also found new and ongoing flaws in IRS information security controls. The GAO again pointed to the lack of a comprehensive electronic security strategy for the agency as a whole, and stressed the fact that, in the continued absence of an agency-wide security program, IRS databases would continue to remain vulnerable.⁷⁰ These themes were repeated in GAO’s March 2007 report, which concluded that lax security controls “could impair IRS’s ability to perform vital functions and increase the risk of unauthorized disclosure, modification, or destruction of financial and sensitive taxpayer information.”⁷¹ Finally, the title

⁶⁹ See United States Government Accountability Office, *Internal Revenue Service Needs to Remedy Serious Weaknesses over Taxpayer and Bank Secrecy Act Data* (GAO-05-482, April 2005) [hereafter *GAO Electronic Security Report 2005*], at 2 (“IRS has not effectively implemented controls over key financial and tax processing systems located at the facility. In addition to the remaining 21 previously reported weaknesses, for which IRS has not completed actions, 39 newly identified information security control weaknesses impair IRS’s ability to ensure the confidentiality, integrity, and availability of its sensitive financial and taxpayer data... These information security control weaknesses exist primarily because IRS has not fully implemented an agencywide information security program to effectively protect the information and information systems that support the operations and assets of the agency.”).

⁷⁰ See United States Government Accountability Office, *Continued Progress Needed to Strengthen Controls at the Internal Revenue Service* (GAO-0-328, March 2006) [hereafter *GAO Electronic Security Report 2006*], at “Highlights” (“Until IRS fully implements a comprehensive agencywide information security program, its facilities and computing resources and the information that is processed, stored, and transmitted on its systems will remain vulnerable.”).

⁷¹ See United States Government Accountability Office, *Further Efforts Needed to Address Significant Weaknesses at the Internal Revenue Service* (GAO-07-364, March 2007) [hereafter *GAO Electronic Security Report 2007*], at “Highlights.” (“IRS has made limited progress toward correcting or mitigating previously reported information security weaknesses at two data processing sites, but 66 percent of the weaknesses that GAO had previously identified still existed... Significant weaknesses in access controls and other information security controls continue to threaten the confidentiality, integrity, and availability of IRS’s financial and tax processing systems and information. For example, IRS has not implemented effective access controls related to user identification and authentication, authorization, cryptography, audit and monitoring, physical security, and other information security controls. These weaknesses could impair IRS’s ability to perform vital functions and increase the risk of unauthorized disclosure, modification, or destruction of financial and sensitive taxpayer information.... A primary reason for the new and old weaknesses is that IRS has not yet fully implemented its information security program.Until IRS fully implements an agencywide information security program...the financial and sensitive taxpayer information on its systems will remain vulnerable.”)

of a more recent (January 2008) report sums up its findings well: “Information Security: IRS Needs to Address Pervasive Weaknesses.”⁷²

The TIGTA has also identified security weaknesses in IRS electronic systems, and has repeatedly identified unauthorized wireless networks which could be used to gain unauthorized entry into IRS computers.⁷³ More recently, the TIGTA concluded that “[u]ntil security control weaknesses are corrected, the [IRS] Criminal Investigation Division is jeopardizing the confidentiality, integrity, and availability of the System and the taxpayer data residing on it.”⁷⁴ Still more recently, the TIGTA released a report concluding that the IRS had failed to protect its routers and switches sufficiently, and may have compromised the security of sensitive taxpayer information, risking access by hackers or unauthorized workers.⁷⁵

In summary, when evaluating I-File proposals, it would be unwise to ignore the IRS’s history of chronic difficulties in safeguarding sensitive taxpayer data. There is every reason to expect that a mandate to implement an I-File system would expose taxpayer data to similar risks.

3. Government Agencies Face Inherent Disadvantages in Implementing Complex IT Systems

⁷² The GAO found in January 2008 that the IRS had corrected or mitigated only “29 of the 98 information security weaknesses that GAO reported as unresolved at the time of its last review.” See United States Government Accountability Office, *Information Security: IRS Needs to Address Pervasive Weaknesses*. (GAO-08-211, January 2008) at “Highlights.”

⁷³ See United States Treasury Inspector General for Tax Administration, *Use of Unapproved Wireless Technology Puts Sensitive Data at Risk* (Ref. No. 2003-20-056, February 2003). Following this report, the IRS took corrective action to rectify those security vulnerabilities and reportedly adopted a “comprehensive wireless security policy.” Yet a subsequent TIGTA report identified new instances of unauthorized and vulnerable wireless connections to IRS systems in March 2007. See United States Treasury Inspector General for Tax Administration, *Sensitive Data Remain at Risk From the Use of Unauthorized Wireless Technology* (Ref. No. 2007-20-60, March 28, 2007) at 2.

⁷⁴ See United States Treasury Inspector General for Tax Administration, *Sufficient Emphasis Was Not Placed on Resolving Security Vulnerabilities When Restoring the Electronic Fraud Detection System* (Ref. No. 2007-20-108, June 14, 2007), at introductory letter. The TIGTA reported that testing had revealed significant security vulnerabilities in the IRS Electronic Fraud Detection System (EFDS), which is used by the IRS Criminal Investigation Division to detect fraudulent returns, and constitutes the second largest IRS taxpayer database.

⁷⁵ See United States Treasury Inspector General for Tax Administration, *Inadequate Security Controls Over Routers and Switches Jeopardize Sensitive Taxpayer Information* (Ref. No. 2008-20-071, March 2008).

Although the IRS' track record in implementing complex IT systems is not encouraging, we want to make clear that we do not believe the difficulties the agency has encountered are in any way unique, or that the efforts made by IRS personnel are somehow deficient. The simple fact is that the procurement and operation of complex IT systems pose daunting challenges for government agencies in general.

The GAO has reported shortcomings in IT projects in many agencies, including the Department of Veteran's Affairs,⁷⁶ the Department of Homeland Security,⁷⁷ the Department of Justice,⁷⁸ and the Postal Service,⁷⁹ among others. Concern over Federal agencies' ability to effectively manage IT investments prompted the Office of Management and Budget (OMB) to establish its "High Risk List" for federal IT projects in August 2005, with the goal of ensuring

⁷⁶ After spending over \$6 billion over a six year period on IT programs, the Department of Veteran's Affairs (VA) continued to experience difficulty managing its IT resources effectively. As the GAO noted in its 2002 report, "VA has encountered persistent challenges in managing IT to produce results and improve performance." See United States Government Accountability Office, *Progress Made, but Continued Management Attention Is Key to Achieving Results, Statement Of David L. McClure Before The House Subcommittee On Oversight And Investigations, Committee On Veterans' Affairs*, March 13, 2002, at 1, available at: <http://www.gao.gov/new.items/d02369t.pdf>.

⁷⁷ See United States Government Accountability Office, *Management and Programmatic Challenges Facing the Department of Homeland Security, Statement of David M. Walker Before the Senate Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia* (GAO-07-833T, May 10, 2007), at 12, available at: <http://www.gao.gov/new.items/d07833t.pdf> ("Until DHS fully establishes and consistently implements the full range of IT management disciplines embodied in its framework and related to federal guidance and best practices, it will be challenged in its ability to effectively manage and deliver programs.").

⁷⁸ See United States Government Accountability Office, *Executive Office of U.S. Attorneys Needs to Institutionalize Key IT Management Disciplines* (GAO-03-751, July 2003), available at: <http://www.gao.gov/new.items/d03751.pdf> ("Institutionalization of these IT management disciplines has not been an agency priority and is not being guided by plans of action or sufficient resources. Until each discipline is given the priority it deserves, EOUSA will not have the IT management capabilities it needs to effectively achieve the department's strategic goal of improving the integrity, security, and efficiency of its IT systems.").

⁷⁹ See United States Government Accountability Office, *Opportunities to Strengthen IT Investment Management Capabilities* (GAO-03-3, October 2002), available at: <http://www.gao.gov/new.items/d033.pdf> ("The Postal Service has not yet attained the key attributes associated with the most capable organizations, such as evaluating the performance of investments as a whole, capturing "lessons learned," and institutionalizing these lessons to benefit the organization. Until it addresses areas such as these, the Postal Service will not be in a position to continually improve its investment process and leverage its IT capabilities for strategic outcomes.").

that agencies and programs meet intended goals and generate results.⁸⁰ Moreover, the U.S. government is not alone in encountering difficulties in implementing e-government efforts.⁸¹

There are several inherent aspects of government that help explain why so many agencies have had difficulties with their IT modernization efforts. One problem is that many Federal agencies have difficulty recruiting and retaining sufficiently qualified information technology personnel, who have ample high-earning employment opportunities in the private sector.⁸² It is also possible that Federal agencies such as the IRS are less able to adapt to rapid advances in IT than their private sector counterparts.⁸³

Further, the GAO has found that Federal Chief Information Officers (CIOs) face challenges that private sector CIOs generally do not, including special contracting requirements and an exceptionally complicated and uncertain funding process.⁸⁴ In addition, the GAO has

⁸⁰ See, e.g., Office of Management and Budget, *High Risk IT Project List As of February 1, 2007*.

⁸¹ *The Economist*, in a recent special report on e-government efforts around the world, noted that many efforts never reach completion, and that those that do often “work badly” and distract agencies from their core missions. See “The Good, the Bad and the Inevitable,” *The Economist* (February 14, 2008) (“More often, though, big government projects stagger into operation but work badly. Surprised that they work at all, few people ask whether the money was well spent. Only rarely do the promised benefits materialise. Some of those who have studied e-government call it a “dangerous enthusiasm”: a technological quick fix that distracts from the real tasks—hard and slow—of reforming government and running public services properly.”).

⁸² As the Comptroller General of the United States observed to Congress, “[I]n the information technology area...widespread shortfalls in human capital have contributed to demonstrable shortfalls in agency and program performance.” Compensation for computer specialists, computer engineers, and computer scientists has been found to “lag far behind non-federal salaries.” See *Building the Information Technology Workforce to Achieve Results, Statement of David M. Walker Before the House Subcommittee on Technology and Procurement Policy, Committee on Government Reform*, July 31, 2001 [hereafter *IT Workforce Statement*], at 1, and at 14.

⁸³ As noted previously, although the IRS’s original installed computer base was considered to be relatively advanced during the 1950s and 1960s, the Service experienced considerable difficulty keeping pace with advances in computerization throughout subsequent decades. In observing this outcome, ETAAC has recommended that the IRS alter its approach to systems development to anticipate future updates and to avoid obsolescence. See *ETAAC Report, supra*, at 15 (“[T]he IRS needs to take a different approach to system development, support and management. As each new system is scoped and implemented, the IRS must plan for the long term support, operation, improvements and continued funding on that system. The Filing Information Returns Electronically (FIRE) project is an example of a critical system that was built, put into place and then allowed to fall significantly behind architecturally as the information technology world moved forward.”).

⁸⁴ See United States General Accounting Office, *Maximizing the Success of Chief Information Officers* (GAO-01-376G, February 2001) [hereafter *GAO CIO Success*], at 12 (“The federal CIO faces an environment that includes many of the elements encountered by CIOs interviewed for this guide. At the same time, the federal CIO faces additional challenges as a result of specific legislative responsibilities (e.g., records management and defined

noted that staffing protocols and organizational structures in federal agencies are less flexible than in the private sector, that Federal CIOs tend to be less involved in business decisions at the executive level, and that Federal agencies generally have less flexibility in “reassigning staff and structuring capabilities across business and technology lines.”⁸⁵

Ultimately, the biggest difference between government agencies and the private sector when it comes to innovation is in the simple fact that private sector firms experience the discipline of the marketplace, while government agencies do not. As a consequence, government agencies that have entered markets already occupied by private sector firms have tended to fare badly. The Postal Service’s forays into non-postal markets, for example, have frequently entailed substantial risk, and have produced significant financial losses.⁸⁶ If anything, these challenges are likely greater at the IRS than at other agencies, which has little if any experience providing services in competition with the private sector and is burdened with extensive oversight requirements.⁸⁷

C. Implementing I-File Would be Expensive and the Risk of Failure is High

Given the size and complexity of an I-File system, the history of difficulties the IRS has had (and continues to have) in implementing such projects, and the inherent obstacles faced by all government agencies in implementing IT initiatives, we conclude that an IRS I-File initiative

contracting requirements). The federal CIO is also subject to a funding process that is more complex and uncertain than in most other organizations.”).

⁸⁵ *Id.* at 13.

⁸⁶ The General Accounting Office found that the Postal Service lost more than \$84 million on development and marketing of non-postal products from 1995 through 1997. These money-losing non-postal products include prepaid telephone calling card and electronic commerce services, as well as a remittance service. The substantial losses incurred in non-postal markets suggest an overriding concern with expanded scale and scope, as opposed to profitability. United States General Accounting Office, *U.S. Postal Service: Development and Inventory of New Products* (GAO/GGD-99-15, November 1998).

⁸⁷ Although the burdens placed on the IRS by Congress in reaction to the TSM debacle may, at one level, be a rational response to the problems of the past, the additional procedural hurdles are also expensive and time-consuming, and limit the ability of agency managers to exercise the sort of discretion, leadership, and entrepreneurship necessary to successfully implement a complex technological undertaking such as I-File.

would be fraught with risk, and unlikely to be implemented successfully at any reasonable cost. Indeed, it is difficult to conclude otherwise in light of factors such as (1) longstanding reliance on outdated systems; (2) chronic information security weaknesses; (3) the ten-year, three billion dollar TSM debacle (along with the resulting oversight and compliance apparatus governing the ongoing BSM initiative); and (4) the GAO's "high risk" designation for systems development that, after over a decade, has yet to be removed, and was cited explicitly by the GAO as an impediment to I-File implementation.⁸⁸

We concur with the GAO's observation that numerous deficiencies in the IRS's management of its IT assets such as "underestimation of project complexity," and "increases in project scope," have consistently led to cost overruns and schedule delays.⁸⁹ We further concur that the existence of such fundamental weaknesses dictates that the IRS should not embark on new, technologically intensive projects,⁹⁰ and conclude that I-File represents precisely the type of "modernization activity" that the IRS should avoid. In short, we believe the costs of I-File are likely to be high and that, in any case, there is a substantial probability that whatever funds are spent would not produce an acceptable result.⁹¹

⁸⁸ As the GAO concluded in the *GAO I-File Report, supra*, "developing an I-file system could further stretch IRS's capability to manage systems development, an area we have designated high risk since 1995."

⁸⁹ See United States Government Accountability Office, *Internal Revenue Service Needs to Further Strengthen Program Management* (GAO-04-438T, February 2004), available at <http://www.gao.gov/new.items/d04438t.pdf>, at "Highlights."

⁹⁰ *Id.* ("GAO has made a series of recommendations focusing on stronger program management—and *limiting modernization activities* until such management practices were in place.") [emphasis added]. More recently, the GAO concluded that although "IRS has made significant progress in implementing GAO's recommendations and improving its modernization management controls and capabilities," many of GAO's recommendations remain unimplemented, and the IRS still lacks a cohesive strategy for BSM: "...controls and capabilities related to requirements development and management and post-implementation reviews have not yet been fully implemented. In addition, more work remains to be done to fully develop a long-term vision and strategy for completing the BSM program." See *GAO BSM February 2007, supra*, at "Highlights."

⁹¹ In this regard, and to its credit, there is good reason to believe the IRS has learned from experience. As noted previously, in the case of I-File, the agency has repeatedly indicated its concerns about the size and complexity of the undertaking, and its preference for the current Free File arrangement. See, e.g., *GAO I-File Report, supra*, at Appendix IV; see also *Everson 2006 Statement, supra*.

V. I-FILE WOULD NOT SIGNIFICANTLY INCREASE ELECTRONIC FILING OR GENERATE NET SAVINGS

While the costs of attempting to implement an I-File program would certainly be large, it is difficult to see what benefits the program would create, either to taxpayers or to the IRS.

There are at least three reasons to believe I-File would have little if any effect on taxpayer behavior: (a) most taxpayers use paid tax preparers to file their returns, and would not be affected by I-File; (b) most taxpayers who prepare their own returns and use tax preparation software can already obtain the software at no charge and are unlikely to switch to I-File (or to begin filing electronically as a result of I-File); and, (c) many taxpayers do not use the Internet, and thus could not use I-File. In summary, it is not clear that there is any significant group of taxpayers who would benefit from (and, thus, choose to use) an I-File program.

The ability of I-File to generate net savings for the IRS depends on the program's effectiveness in increasing the proportion of taxpayers who file electronic returns. Since few taxpayers are likely to use I-File in the first place, its impact on electronic filing is likely to be very small. However, we show below that, even under generous assumptions about taxpayer participation, the program will not generate savings sufficient to cover its costs.

A. I-File is Not Likely to Increase the Use of Electronic Filing

As shown in Table One below, approximately 58 percent of tax returns are filed electronically.⁹² In order to increase the proportion of electronic returns, I-File would need to affect the filing behavior of taxpayers who use paid tax preparers (who already have the ability to

⁹² As indicated below, data in Table One are derived from the latest available publication of the IRS *Tax Year 2006 Taxpayer Usage Study*. Note that data from the most recently available IRS *2007 Filing Season Statistics* (which also provide information on the 2006 Tax Year) imply a slightly lower electronic filing rate of approximately 57%. To maintain consistency between Tables One and Two, data from the *Taxpayer Usage Study* are displayed in both tables. Finally, note that recently released data from the IRS *Filing Season Statistics* for March 2008 indicate that the electronic filing rate increased by approximately 2 percentage points relative to rates of electronic filing in March 2007.

file electronically, though many do not), taxpayers who self-prepare, or both. It is unlikely to affect the behavior of either group.

As shown in Table One, in the 2006 tax year, about 63 percent of all returns were prepared by paid tax preparers: Nearly 87 million returns were prepared by paid tax preparers, compared with just 51 million self-prepared by taxpayers. However, I-File would have no effect on taxpayers who utilize paid tax preparers. There are several reasons for this, the most fundamental of which is the simple fact that an I-File system would constitute a *self-preparation* service: I-File would not even attempt to duplicate the personalized income tax return preparation services that paid preparers offer. There is simply no reason to believe that even an effectively implemented I-File system would induce those who prefer paid preparers to switch to self preparation.

This reasoning is confirmed by the data. As noted below, the cost of paid preparation exceeds that of electronic self-preparation substantially. Nevertheless, the majority of taxpayers continue to rely on paid preparers, and the proportion is actually increasing over time,⁹³ even as the cost of electronic self-preparation has decreased substantially, and as rates of electronic self-preparation have increased steadily.⁹⁴ This trend holds with respect to both electronic self-preparation in general and Free File in particular: As noted previously, 19.3 million tax returns have been filed through Free File since 2003, and the out-of-pocket cost of electronic self-

⁹³ Since the 1998 tax year, the proportion of taxpayers using paid preparers has increased by about seven percentage points (from about 56 percent). See Internal Revenue Service, *Tax Year 1998 Taxpayer Usage Study* (Report No. 13), available at: <http://www.irs.gov/taxstats/article/0,,id=96629,00.html>

⁹⁴ As shown in Table One, in the 2006 tax year, individuals who self-prepared filed about 23 million returns electronically, representing about 46 percent of all self-prepared returns, and about 17 percent of all returns filed. These figures represent a marked change from just a few years ago. As of the 1999 filing season, computer-generated electronically filed returns prepared by individuals comprised less than two percent of all returns filed. See Internal Revenue Service, *2000 Filing Season Statistics*, available at: <http://www.irs.gov/taxstats/article/0,,id=96629,00.html> (containing information on the 1999 and 2000 filing seasons, and showing, for the 1999 season, approximately 125 million individual tax returns, less than 2.5 million of which were self-prepared, computer-generated, and electronically filed).

preparation has fallen to zero for the 70 percent of taxpayers who qualify for Free File. Nevertheless, the rate of taxpayer reliance on paid preparers has continued to increase over this time period.⁹⁵

In other words, overall reliance on paid professionals has increased over time, even as self-preparation of electronic returns has become less costly (often free), more user-friendly, and more common. We conclude that taxpayers' persistent and increasing reliance on paid professionals is driven not by a lack of electronic self-preparation options, but rather by other factors, such as the increasing complexity of the tax code.⁹⁶ Even if it were implemented successfully, I-File would offer nothing fundamentally distinct from the electronic self-preparation options currently available through Free File in particular and private industry in general.⁹⁷ Hence, I-File would not affect consumers' propensities to use paid tax preparers.

Table One:
Filed Returns, by Preparation and Filing Method, 2006 Tax Year (thousands)

	Electronic Returns	Paper Returns	Total Returns
Paid Preparer	56,391	30,498	86,890
Self Preparer	23,488	27,995	51,482
TOTAL	79,879	58,493	138,372

Source: IRS, Tax Year 2006 Taxpayer Usage Study (Report No. 16).

⁹⁵ Since 2003, when Free File was implemented, the proportion of taxpayers using paid preparers has risen by roughly 3 percentage points (up from approximately 60 percent). See Internal Revenue Service, *Tax Year 2002 Taxpayer Usage Study* (Report No. 14), available at: <http://www.irs.gov/taxstats/article/0,,id=96629,00.html> (containing information for the 2002 tax year, corresponding to returns filed during 2003).

⁹⁶ As indicated above, there are an average of 700 changes to the tax code annually. See *President's Advisory Panel, supra*, at 16.

⁹⁷ Indeed, I-File's distinguishing characteristic when compared with other electronic self-preparation options is the fact that I-File would be an IRS-implemented program. From the standpoint of taxpayer participation, this may well represent an additional liability: as noted above, the IRS has experienced a series of significant setbacks in safeguarding electronic taxpayer information; in addition, survey evidence indicates that taxpayers tend to distrust increased IRS involvement in tax preparation. See U.S. Department of the Treasury, *Report to the Congress on Return-Free Tax Systems: Tax Simplification Is a Prerequisite*, (December 2003), available at: <http://www.ustreas.gov/offices/tax-policy/library/noreturn.pdf>, at 28 (containing survey results in which roughly half of respondents indicated distrust of IRS involvement in so-called "Return-Free" filing systems).

Two additional points are worth noting here. First, while nearly all paid tax preparers use tax software to prepare their clients' returns, and thus have the ability to file those returns electronically, many do not. As shown in Table Two, of the 85.7 million returns prepared by paid preparers using computer tax software (representing 98.7 percent of all paid-preparer returns), more than 29 million (34 percent) were printed out and filed by mail. These returns represent a rich opportunity for the IRS to increase the rate of electronic filing – but would be completely unaffected by I-File.

**Table Two:
Computer-Prepared Returns, by Filing Method, 2006 Tax Year (thousands)**

	Computer-Prepared Returns	Computer Prepared Returns Filed by Mail	Proportion of Computer Returns Filed by Mail
Paid Preparer Returns	85,746	29,354	34%
Self Preparer Returns	37,433	13,945	37%
Total	123,179	43,300	35%

Source: IRS, Tax Year 2006 Taxpayer Usage Study (Report No. 16).

Second, by ignoring paid preparers, I-File would have no effect on the group of taxpayers who bear the highest out-of-pocket compliance costs. According to the Individual Taxpayer Burden Model (ITBM), developed by IBM Business Consulting Services in conjunction with the IRS,⁹⁸ the average taxpayer in 2003 spent roughly 23.3 hours and \$179 in the filing process. However, these figures vary considerably with preparation method: Self-preparers making use of tax software spent an average of 27.9 hours and \$44 to file their returns, while taxpayers relying on paid preparers spent an average of 22.9 hours and incurred average expenses of about \$268

⁹⁸ The ITBM derives compliance burden estimates based on taxpayer reports of the time spent and costs incurred preparing and filing income tax returns. According to the US Treasury, the new model offers “improved technology and modeling sophistication” that provide “a more comprehensive understanding of the current levels of taxpayer burden.” The ITBM defines the compliance burden as the time and monetary costs that taxpayers must incur to comply with Federal tax regulations. Unlike previous estimates, the ITBM allows the IRS to obtain separate

per return.⁹⁹ Hence, although the time investment associated with electronic self-preparation exceeds that associated with paid preparation by roughly 22 percent, the average cost of paid preparation exceeds that of self-preparation by over 500 percent.

In short, I-File proposals simply ignore the 63 percent of taxpayers who rely on paid preparers, despite the fact that these taxpayers (a) already possess the ability to file online (but often do not), and (b) incur the highest compliance costs.

What about the other 37 percent of filers, those who prepare their own returns either manually or using tax preparation software? First, Tables One and Two show that of about 51.5 million self-prepared returns in 2006, 37.4 million – or *about 73 percent* – were prepared using tax preparation software, and that figure is continuing to rise. It seems highly unlikely that a Federal I-File program would accelerate this trend, for at least three reasons: First, it seems unlikely that I-File would be more attractive to consumers than the array of software programs already available. Second, the companies that provide tax preparation software currently spend millions annually on marketing their products to consumers, making their offerings widely available both via the Internet and through large retailers such as Circuit City and Wal-Mart. Third, as noted above, customer satisfaction with current programs is extremely high: 95 percent of those who used tax preparation services through the Free File program in 2006 said they planned to do so again in 2007.

Another possibility is that I-File would increase the rate of electronic filing among those using tax preparation software. As noted above, many self-prepared returns using tax preparation software are filed electronically. However, as shown in Table Two, taxpayers who self-prepared using tax preparation software filed about 13.9 million returns by mail in 2006.

estimates of time costs and out-of-pocket expenses. See Federal Register Notice (FR Doc 05-13593) July 8, 2005

We do not believe, however, that an I-File program would persuade these filers to switch to electronic filing. In fact, the proportion of self-preparers who mail in computer-prepared returns (37 percent) is about the same as the proportion of those using paid preparers who do the same thing (34 percent). Thus, it appears that about a third of consumers simply prefer to submit paper returns, even though they have the option of filing electronically. This conclusion is supported by the results of an IRS Oversight Board survey indicating that about 30 percent of respondents did not feel comfortable filing taxes electronically.¹⁰⁰ This proportion may well shrink over time as computer literacy continues to grow. However, I-File would not be expected to have any effect on this trend.

In sum, despite the fact that paid tax preparation services are more expensive than tax preparation software, most taxpayers continue to use paid tax preparers, and the proportion is growing. There is simply no reason to believe that I-File would have any impact on this trend. As for those who self-prepare, the vast majority (nearly three-quarters), already use tax preparation software. In addition, as noted above, it is very unlikely that I-File would increase the rate of electronic filing among self-preparers. Finally, about 29 percent of adults do not use the Internet, even occasionally. I-File would clearly have no impact on this “off-line” population.¹⁰¹

B. I-File Would Not Pay for Itself

The only way I-File could pay for itself would be to increase the proportion of taxpayers filing their returns electronically. The potential savings from increased electronic filing are

(Volume 70, Number 130) pp. 39550–39555 [hereafter *ITBM Notice*].

⁹⁹ *Id.* at Table 1.

¹⁰⁰ See IRS Oversight Board, *Taxpayer Customer Service and Channel Preference Survey*, November 2006, available at http://www.treas.gov/irsob/reports/2006_channel_survey_report.pdf, at 19.

¹⁰¹ See Pew Internet & American Life Project, *Home Broadband Adoption 2007*, June 2007, at 2-3, available at http://www.pewinternet.org/pdfs/PIP_Broadband%202007.pdf [hereafter *Pew Internet Survey*].

indeed significant: the IRS estimates that the net cost savings from electronic filing are roughly \$2.36 per return.¹⁰² In other words, if the 58 million paper returns filed in 2006 had instead been filed electronically, the IRS would have saved nearly \$140 million in that year alone. On the face of it, the potential for achieving such savings would appear to be a powerful argument in favor of I-File.

Our analysis, however, shows just the opposite. Indeed, even using highly favorable assumptions, I-File is unlikely generate a positive return on investment over any reasonable time horizon.

As noted above, a very conservative estimate of the development costs of I-File, based on the IRS budget request for adapting its Modernized e-File system for use with individual returns, is approximately \$105 million. We also noted that experience from state efforts suggests operating costs of between 24 percent and 48 percent of development costs, or – at a very minimum—\$25.2 million per year.

We calculated the net present value of I-File based on a variety of assumptions.¹⁰³ The most favorable (to I-File) were as follows: (a) I-File is completed on time, on budget, costing \$105 million over three years, and is fully implemented for the 2011 tax year; (b) annual operating costs are \$25.2 million and do not increase over time; (c) the IRS saves \$2.36 on each return filed electronically; (d) the proportion of filers who would (in the absence of I-File) self-prepare and submit paper returns remains constant, but the number increases at the historical rate

¹⁰² See *GAO I-File Report, supra*, at 4.

¹⁰³ Computing the *present value* of a future stream of revenues and costs involves converting future revenues received (and future costs incurred) into equivalent dollar values in the present day. For example, if the relevant interest rate is 5%, then a payment of \$100 one year in the future is worth approximately \$95.24 ($\approx \$100/(1.05)$) in the present day. See Walter Nicholson, *Microeconomic Theory: Basic Principles and Extensions* (Thompson Learning 2002), at 652-653.

of growth of the total number of tax returns;¹⁰⁴ and, (e) upon implementation, I-File immediately achieves the highest utilization rate achieved by any of the state I-File systems covered in the GAO's 2007 *I-File Report*.¹⁰⁵ Based on these assumptions, which (for the reasons we explained above) are implausibly favorable to I-File, we estimate the net present value of I-File after 10 years to be *negative* \$132 million. In other words, in present dollars, I-File would cost the Federal government \$132 million more than it would save.

More realistic assumptions, of course, generate even less favorable results. As shown in Table Three below, the losses associated with I-File increase substantially when we make reasonable adjustments to just two of the many conservative assumptions underlying the net present value calculation. Specifically, if we assume that I-File achieves the average utilization rate of the states covered in the 2007 *I-File Report* (instead of the maximum rate), the net present value of I-File after 10 years (holding all other assumptions constant) falls to negative \$179 million.¹⁰⁶ Likewise, if we calculate the expected recurring costs of I-File based on the average operating cost/development cost ratio for states covered of in the *I-File Report* (instead of the minimum ratio), the net present value of I-File declines to negative \$200 million (again holding all other assumptions constant).¹⁰⁷ Finally, if we allow both usage rates and operating costs to be

¹⁰⁴ To illustrate, suppose hypothetically that there are 100 taxpayers nationwide, and that 10 of them currently do not file electronically, but would do so under an I-File system. In the first year, the IRS would realize \$23.60 in gross cost savings (equal to 10 times \$2.36 per return). In subsequent years, our methodology assumes that this figure grows at the same rate as the overall number of returns filed. Thus, the number of taxpayers converted to electronic filing by I-File will increase over time, but this figure will remain constant as a percentage of all returns filed.

¹⁰⁵ Pennsylvania achieved the highest usage rate (5.3%) of all states covered by the GAO. Note that usage is calculated as a percentage of total filers. See Table Four, *infra*.

¹⁰⁶ *Id.* Note that the average utilization rate of all states covered by the GAO is approximately 3.0%.

¹⁰⁷ As noted previously, the *GAO I-File Report* provides state I-File cost estimates divided into development and operating expenses. The minimum ratio of operating costs to development costs is 24%, implying recurring costs for I-File of \$25.2 million. The average is approximately 36%, implying annual recurring costs of approximately \$37.5 million for I-File. See *GAO I-File Report, supra*, at 23.

based on averages (that is, if the two aforementioned adjustments are performed simultaneously), the net present value of I-File after 10 years reaches negative \$247 million.

**Table Three:
Net Present Value of I-File As a Function of Two Conservative Assumptions**

	Recurring Costs Based on Minimum of State I-File Systems	Recurring Costs Based on Average of State I-File Systems
Usage Rate Based on Maximum of State I-File Systems	-\$132 million	-\$200 million
Usage Rate Based on Average of State I-File Systems	-\$179 million	-\$247 million

VI. I-FILE EFFORTS IN OTHER JURISDICTIONS HAVE NOT SUCCEEDED

Several jurisdictions have experimented, on a limited basis, with I-File systems. For example, the United Kingdom has attempted to implement an online filing system for taxpayers, as have several states.¹⁰⁸ These systems have ranged in complexity from permitting simple “key and send” returns to providing elaborate return preparation services that very closely resemble commercial tax preparation software. The United Kingdom’s I-File program has been characterized by low participation rates. As a consequence, subsequent evaluations of the program by the British government have pointed to the benefits of public-private partnerships, such as the IRS’s Free File arrangement. At the state level, I-File programs often have failed to deliver net benefits sufficient to justify continuation, and many have suffered from low usage rates.

¹⁰⁸ For summaries of state-specific attempts to implement I-Filing, see *GAO I-File Report, supra*.

As of 2003, four states—Idaho, Massachusetts, Minnesota, and Vermont—had cancelled their I-File programs.¹⁰⁹ More recently, Arkansas, Iowa and South Carolina have also discontinued I-Filing initiatives.¹¹⁰ Many of these states have adopted Free File programs that are companion projects to IRS Free File, and are actually based on the IRS’ agreement with the software industry. This arrangement allows state revenue agencies to leverage these national negotiations for the benefit of the state. In this section, we describe key features of I-File systems as they have been implemented in other jurisdictions, focusing on relatively well-documented, representative examples of I-File experiences at the state level. We also note, when available, relevant user volumes and estimated costs.

A. The United Kingdom’s “Self-Assessment Online” Program Has Not Met Its Objectives

The United Kingdom’s government-provided online filing program, “Self Assessment Online,” has been characterized by substantial technical and operational difficulties and low participation rates, and has failed to meet a 50 percent online filing goal.¹¹¹ The limited success of Self Assessment Online has led some British authorities—citing significantly higher online filing rates in the United States—to consider adopting a system similar to the U.S. Free File arrangement.¹¹² For example, a British government study reviewing tax system modernization efforts within Her Majesty’s Revenue and Customs (HMRC) noted the benefits of the current US arrangement, in which the IRS does not attempt to enter the market for tax software:

¹⁰⁹ See California Franchise Tax Board, *NetFile and e-file Update*, December 2003, Attachment II, at 5 (Table 1).

¹¹⁰ See GAO *I-File Report*, *supra*, at 26; see also South Carolina Department of Revenue, “SC Joins Free File Alliance”, (February 13, 2008) [hereafter *SC Free File Announcement*], available at <http://www.sctax.org/News+Releases/02132008FreeFile.htm>.

¹¹¹ See All Party Parliamentary Taxation Group, *The Future of Income Tax Administration in the UK* (Preliminary Findings), June 2007, at 23, available at: http://www.itif.org/files/UK_Parliamentary_Taxation_Group-Future_of_Income_Tax_Administration.pdf [hereafter *UK Tax Administration Study*].

¹¹² See Lord Carter of Coles, *Review of HMRC Online Services*, March 2006, available at: <http://www.hmrc.gov.uk/budget2006/carter-review.pdf> at 13.

HMRC currently offers free online forms for all its online services. Most other countries take the same approach but the IRS has chosen to stay out of the software market and has negotiated with the software industry for the industry to offer free software to certain groups. In the future, as online filing becomes the norm, we think that HMRC, working with the industry, should consider this approach and whether it might be better to leave software provision to the industry and focus HMRC resources on the infrastructure for exchanging electronic data with customers, agents and other intermediaries.¹¹³

During the 2002 tax season, the British system had to be taken offline for several weeks, due to reported security breaches. In 2005, in the days leading up to the January 31 filing deadline, the system failed to notify approximately 80,000 British taxpayers that their returns had been received. (As a consequence, the filing deadline was extended by two weeks).¹¹⁴ More recently, in 2007, due to reported “production issues” at HMRC, approximately 5 million British taxpayers’ returns were delivered a month behind schedule. Finally, in 2008, the Self Assessment Online interface once again experienced system failure in the hours leading up to the January 31 filing deadline.¹¹⁵

In short, the United Kingdom’s experience with I-File provides evidence that a tax authority’s resources are likely to be better employed in focusing on its core mission, instead of attempting to duplicate the efforts of the software industry. Far from increasing online filing rates, the performance of the British system indicates that an IRS I-File initiative could actually have the opposite effect.

¹¹³ *Id.* at 25.

¹¹⁴ See *UK Tax Administration Study* at 27.

¹¹⁵ See Grainne Gilmore, “Tax deadline extended after website crash,” *Times Online* (January 31, 2008) available at: <http://business.timesonline.co.uk/tol/business/money/tax/article3282733.ece>. The Canada Revenue Agency’s online system has experienced similar difficulties. In 2007, the Canadian E-File system experienced a service breakdown lasting more than a week. See Curtis Rush and James Daw, “Kiss Early Tax Return Cash Goodbye,” *Toronto Sun* (March 7, 2007) (available at <http://www.thestar.com/News/article/189175>). See also Canada Revenue Agency, “Canada Revenue Agency Service Interruption” (March 2007) (available at <http://www.cra-arc.gc.ca/newsroom/factsheets/2007/march/fs070307-e.html>).

B. State I-File Programs Have Generated Few Benefits and Many Have Been Abandoned

While state I-File efforts have sometimes been cited by proponents in support of a Federal I-File program, our review of the results of state programs suggests they have been far from successful. Although state I-File programs are by nature less ambitious than the proposed Federal effort (if for no reason other than the fact that state tax laws are much less complex than the Federal tax code), the costs of such efforts have tended to exceed estimates, while the benefits have been small or non-existent. As shown in Table Four below, usage rates of state-level I-File systems surveyed by the GAO ranged from 0.76 percent to 5.32 percent, with an average utilization of just under three percent. Indeed, several states have abandoned their I-File efforts, in some cases choosing instead to participate in the Free File Alliance.

**Table Four:
Usage of State I-File Systems**

	I-file Users	Total Filers	Percentage of Total Filers
California	111,436	14.6 million	0.76
District of Columbia	9,285	0.3 million	3.19
Indiana	83,422	3.0 million	2.74
Kansas	50,999	1.4 million	3.59
Maryland	115,678	2.8 million	4.17
Pennsylvania	300,552	5.6 million	5.32
South Carolina	29,241	2.0 million	1.43
Utah	25,267	1.0 million	2.51

Source: *GAO I-File Report, supra*, at ‘Highlights.’ Note that usage rates are based on the total number of filers, not the number of eligible state I-File users.

1. California

California, through the introduction of its CalFile system, began to offer online tax filing services several years ago. The state says it has been able to do so relatively inexpensively, indicating that it spent approximately \$700,000 (less than 0.1 percent of the state tax agency’s

annual budget), although the completeness of the scope of the reported costs is unknown.¹¹⁶ Such modest development costs, however, may have come at the expense of system functionality. In 2006, only 111,436 Californians used the CalFile program, accounting for 1.74% of eligible California taxpayers and 0.76% of all California taxpayers.¹¹⁷ This figure represents a *decline* of approximately 30% from 2005, when 158,000 returns were processed.¹¹⁸

A 2003 report by California's Franchise Tax Board, which developed and oversees the CalFile program, noted that online e-filing grew more slowly for the CalFile program (19%) than for the IRS Federal e-file program (27%),¹¹⁹ suggesting that the Free File Alliance may outperform CalFile. CalFile's limited utilization, in particular the system's limited ability to convert high-cost paper filers to low-cost Internet filers, suggests that the system may fail to generate net benefits. For example, the GAO has estimated that in 2004 CalFile generated "...a savings of \$67,000 in processing costs," but that "California estimated it spent \$256,000 developing and operating I-File in 2004."¹²⁰ The GAO notes that "[c]onsequently...benefits appear less than costs."¹²¹

2. Pennsylvania

Pennsylvania's *pa.direct.file* is the largest of the state I-File programs in both relative and absolute terms, serving over 300,000 users, or 5.32% of the taxpaying population. The program is also considered to be a financial success, as each taxpayer converted from paper filing to E-Filing saves an estimated \$3.47,¹²² one of the highest cost savings of any state I-File program. It

¹¹⁶ See *GAO I-File Report, supra*, at 4.

¹¹⁷ *Id.* at 18.

¹¹⁸ California State Board of Equalization, *Chiang Says FTB's Free e-file Program Issues Tax Refunds in 5-7 Days*, February 23, 2006, available at: <http://www.boe.ca.gov/members/chiang/pressrel/2006/ftbfileprogram.pdf>.

¹¹⁹ See California Franchise Tax Board, *NetFile Report*, Sept. 2003, at 9. The NetFile program has since been rebranded CalFile.

¹²⁰ See *GAO I-File Report, supra*, at 4.

¹²¹ *Id.* at 26.

¹²² *Id.* at 19.

should be noted, however, that these savings are due in large part due to Pennsylvania's relatively high initial cost of paper return processing, which stands substantially above that of California and many other I-File states.¹²³ Furthermore, what is not clear is the extent to which the growth of Pennsylvania I-File represents customers transitioning from paper filing to electronic filing or merely customers transferring from one electronic filing program to another. The latter provides no net operating cost savings.¹²⁴

The *GAO I-File Report* also notes that “[w]hile Pennsylvania had 20 percent of eligible taxpayers using I-File, GAO nonetheless interpreted this to be a low usage rate given that the state instituted the system in 2000.”¹²⁵ Indeed, Pennsylvania's I-File program has had problems acquiring users; over the past seven years (2000-2006), an average of less than one percent of total taxpayers converted to I-File each year.¹²⁶ It is perhaps indicative of the limited success of the other state I-File programs across the country that *pa.direct.file* is considered a model for I-File development.

3. Arkansas

Arkansas's I-File program, Telefile Online, met with such limited success that the program has been discontinued and replaced with Free File. The *GAO I-File Report*, quoting one Arkansas official, puts total usage over a five-year period at 5,149 returns; the busiest year for Telefile was apparently 2005, when 1,382 returns were processed.¹²⁷ Arkansas taxpayers

¹²³ *Id.* at 24.

¹²⁴ *Id.* at 26 (“Pennsylvania did not provide an estimate of the number of I-file users that converted from paper.”)

¹²⁵ *Id.* at 18.

¹²⁶ Based on the 2006 utilization rate of 5.32%.

¹²⁷ See *GAO I-File Report, supra*, at 26.

interested in filing online via the government are now offered a state version of the Free File Alliance, or simply utilize commercial online filing sites for free or at cost.¹²⁸

4. Iowa

Like Arkansas, Iowa's I-File program met with less success than supporters had hoped and was ultimately abandoned. System usage was extremely limited, peaking at 22,815 in 2004. The program also suffered from high unit costs—perhaps in part due to the limited user volume—which Iowa officials have estimated at about \$7.00 per return.¹²⁹ Iowa has also chosen to leverage the IRS Free File Agreement and is now offering Free File as its online filing program.

5. Minnesota

The state of Minnesota sought to develop a relatively uncomplicated I-File system. After declaring that return preparation services comparable to those offered by commercial software companies were too costly to build and maintain, the Minnesota Department of Revenue (MnDOR) settled on the simpler “Key and Send” web service.¹³⁰ This service, dubbed “Web Telefile”, was offered to taxpayers who had previously used telephone-based Telefile.¹³¹ Introduced in 2001, the service was discontinued the following year due to low volume usage.¹³² MnDOR subsequently partnered with the Free File Alliance and enjoyed relatively robust growth in electronic filing.¹³³

6. South Carolina

¹²⁸ Arkansas Department of Finance & Administration, Office of Income Tax Administration, *E-File Your Taxes on the Web*, accessed June 25, 2007, available at: http://www.arkansas.gov/dfa/income_tax/tax_efile_providers.html.

¹²⁹ See *GAO I-File Report*, *supra*, at 25.

¹³⁰ See Cynthia Rowley and Greg Tschida, *Individual Income Tax Web Filing – Our Experience and Why We Killed It*. Minnesota Department of Revenue, prepared for the Federal Tax Administrator's 2004 Annual Meeting, available at: http://www.taxadmin.org/FTA/meet/04tech_pres/tschida.pdf, at 7.

¹³¹ *Id.* at 10.

¹³² *Id.* at 17, 20.

South Carolina initiated its SCnetFile online filing program in 1999, but usage never exceeded 32,000 returns out of more than two million filed, and by 2008 was declining. In February 2008, the state Department of Revenue announced that it was discontinuing SCnetFile and joining the Free File Alliance instead. Ray Stevens, Director of the South Carolina Department of Revenue, explained the state's decision as follows:

SCnetFile, while it certainly served its purpose at the outset, is simply no longer able to meet the needs of our citizens. We wanted to offer taxpayers a quality, up-to-date, user-friendly medium for electronically filing their tax returns.... Free File does that and does it while allowing our taxpayers to file both their federal and state returns.¹³⁴

VII. THE GOALS OF I-FILE CAN BE BETTER ACHIEVED THROUGH OTHER APPROACHES

Given the high costs and large risks associated with I-File, and the extremely limited potential benefits, it makes a great deal of sense to examine alternative approaches to achieving its stated goals. In this section we examine alternatives, and conclude that they are far superior to I-File from every perspective. In particular, we conclude that, rather than competing with Free File, the policymakers should seek to strengthen it.

A. Further Improve the Free File Program

A recent TIGTA audit found that some of the tax software programs provided through the Free File Alliance computed the amount of taxes due incorrectly in a small percentage of cases. The audit also concluded that a feature on the Free File web site designed to guide taxpayers in choosing among the various Free File providers was found in some instances to be incomplete and inaccurate.¹³⁵ As a consequence, TIGTA recommended that the IRS “establish a process to

¹³³ *Id.* at 28.

¹³⁴ *See SC Free File Announcement, supra.*

¹³⁵ The TIGTA also found that Free File Alliance members erroneously indicated that roughly 37,000 returns were prepared via Free File, when in fact taxpayers had been charged for preparation and filing. *See TIGTA Free File Report, supra*, at 2.

test the software used in the [Free File] Program before the filing season, to ensure common tax scenarios are handled accurately.”¹³⁶ The IRS disagreed with this particular recommendation, on the grounds that “testing of commercial tax preparation software to determine its accuracy in applying the tax law would be a monumental challenge for the IRS.”¹³⁷

Although the complexity of the tax laws makes it virtually impossible to eliminate 100 percent of errors in tax returns (regardless of whether they are prepared electronically or on paper),¹³⁸ and while we are sympathetic to IRS’ concerns regarding the burden of testing commercial software programs, we do believe the IRS can and should seek to ensure that the products offered by Free File providers meet minimum standards of accuracy.

There are several alternative approaches that the IRS could adopt to minimize error rates in Free File software. In responding to TIGTA’s recommendation that IRS conduct tests on Free File software, the IRS indicated that it lacked the contractual authority to “require that software developers place their products under the IRS configuration management process.”¹³⁹ Clearly, any sensible contract between the IRS and third party software providers should address the issue of minimum acceptable software performance standards. As with other significant program improvements that have been adopted by the IRS and the Free File Alliance over the course of the program’s five year history, it is well within IRS authority to govern the program according to the agreed upon terms.

¹³⁶ *Id.* at 3.

¹³⁷ *Id.* at 4.

¹³⁸ For example, data collected by the IRS itself indicates that telephone assistors have provided incorrect answers to tax law questions to between approximately 10 and 24 percent of taxpayers seeking assistance between 2004 and 2006. See United States Government Accountability Office, *Testimony Before the Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, IRS Assessment of the Interim Results of the 2006 Filing Season and Fiscal Year 2007 Budget Request, Statements of James R. White and of David A. Powner*, (GAO-06-615T, April 2006), available at <http://www.gao.gov/new.items/d06615t.pdf>, at 10.

¹³⁹ See TIGTA *Free File Report*, *supra*, at 13.

Hence, one obvious mechanism for reducing software error rates is simply to ensure that Free File contracts stipulate that software error rates must meet appropriate performance thresholds. The Free File agreement already requires that participating companies meet the commercial best practices standard of guaranteeing the accuracy of their calculations. Although it may not be feasible or practical for the IRS to engage in extensive software testing, it may be possible to delegate to private third parties the management of a seal review program not unlike those now successfully employed in the privacy field, such as TrustE. To qualify as a Free File participant, the IRS could require verification that each company meet all of the minimum requirements stipulated in the Free File agreements that the IRS has previously established with the software industry, as well as additional requirements as necessary.

A further measure for public assurance, already proposed in the current Free File Enhancement Act legislation in Congress, HR 3457, would involve applying government procurement standards (i.e., long-established Federal Acquisition Regulations) for validating product commerciality and corporate responsibility as an IRS clearance review process for any company wishing to participate in the Free File program. This type of safeguard would utilize the same strictures that the federal government itself would require of commercial products, services and companies that it would consider for its own end use.

B. Include “Fillable Forms” Capability In Free File Offerings

Recently introduced legislation proposes that free “fillable forms” technology be made available to all taxpayers through the Free File program. Fillable forms are electronic versions of

the familiar paper forms that allow for online entry and submission of taxpayer data. The GAO previously identified this filing method in its 2007 *I-File Report*.¹⁴⁰

Specifically, H.R. 3457 would direct the Secretary of the Treasury to “enter into an agreement with the Free File Alliance to provide a forms-based software service for all individual taxpayers...”¹⁴¹ Under this proposal, all taxpayers would have free access to electronic versions of standard 1040 and 1040EZ forms, as well as commonly used schedules.¹⁴² Moreover, the proposed legislation could be implemented simply by renegotiating agreements with Free File participants, who would be responsible for any implementation costs.

C. Create Incentives for Electronic Filing

In addition to enhancing the Free File program, we believe the IRS should consider providing direct incentives for taxpayers to file their returns electronically. As noted above in Table Two, in the 2006 tax year, more than 43 million tax returns were prepared on a computer and then *printed out and mailed to the IRS*. About two-thirds of these were prepared by paid tax preparers, with the remainder prepared by individuals (self-prepared). As noted above, each paper return submitted to the IRS costs taxpayers about \$2.36 compared with the cost of processing the same return electronically.

A number of proposals have been advanced to encourage higher rates of electronic filing. For example, ETAAC has recommended that Congress give the IRS authority to require all tax professionals filing more than 50 returns per year to file electronically.¹⁴³ Thirteen states already have mandates requiring professional tax preparers that prepare more than a specified number of

¹⁴⁰ See *GAO I-File Report, supra*, at 3 (“Two main technologies are used to collect data from taxpayers: PDF fillable form technology often looks like the paper version of a form and Web page technology is interactive and prompts the user to respond to preformatted questions.”) [Emphasis added].

¹⁴¹ H.R. 3457, 110th Cong. § I.A.1 (2007).

¹⁴² *Id.* at § I.A.1.

¹⁴³ See *ETAAC Report, supra*, at 6-7.

tax returns to do so through e-file.¹⁴⁴ Another alternative is to provide direct incentives to all taxpayers who file electronically.

D. Consider Additional Reforms

ETAAC also recommends that the IRS implement a variety of commonsense practices to improve the delivery of electronic taxpayer services. For example, ETAAC notes that many taxpayers would benefit from interactive account resolution services, such as the ability to receive or view notices online and resolve these matters electronically. ETAAC endorses the provision of such services, assuming that online authentication and registration can be efficiently developed. In addition to suggestions for individual filers, ETAAC recommends that the IRS extend comparable online filing options to other taxpaying segments (such as businesses).¹⁴⁵

Also, as we noted above, I-File would generate no benefits with respect to the 29 percent of adults, comprised disproportionately of low income taxpayers, who lack computer and/or Internet access.¹⁴⁶ These taxpayers would be better served through other means, such as increased funding for IRS Taxpayer Assistance Centers (TACs) or Low Income Taxpayer Clinics (LITCs), and expansions of such programs into low income neighborhoods and rural communities. Today there are several hundred TACs nationwide tasked with providing taxpayers with in-person tax assistance. TAC employees provide several services designed to minimize taxpayer compliance burdens, such as interpretation of tax laws and regulations and preparation

¹⁴⁴ Specifically, Alabama, California, Connecticut, Massachusetts, Michigan, Minnesota, New Jersey, New York, Oklahoma, Utah, Virginia, West Virginia, and Wisconsin currently have such mandates. See Intuit Inc., Tax Resource Center: State and Federal E-File Mandates, available at http://accountant.intuit.com/practice_resources/tax/efile/efile_statemandates.aspx. In addition, Louisiana has adopted similar mandates that will take effect in 2008. See Louisiana Department of Revenue, Electronic Filing Mandate for Tax Preparers, accessed Oct. 22, 2007, available at [http://www.rev.louisiana.gov/forms/vndrforms/eFAQ\(092607\).pdf](http://www.rev.louisiana.gov/forms/vndrforms/eFAQ(092607).pdf).

¹⁴⁵ See *ETAAC Report, supra*, at 14.

¹⁴⁶ See *Pew Internet Study, supra*, at 2-4 (showing that 29% of adults do not use the Internet at least occasionally, and that broadband adoption is negatively correlated with income).

of certain individual tax returns.¹⁴⁷ TAC services are potentially quite valuable to the millions of lower income taxpayers lacking access to the IRS website, as well as those lacking the resources to seek paid advice from tax professionals. Increasing investment in such services would provide taxpayers meaningful relief from compliance burdens, and would target the population arguably most in need of such relief more effectively than I-File.

LITCs provide representation to low income taxpayers for audit, appeals, and collection issues, and federal tax litigation services either for free or for a nominal charge. While operated by nonprofit organizations, law schools, or business schools, LITCs receive partial funding from the IRS through a grant-matching program.¹⁴⁸ Given that low income taxpayers are among the least likely to own computers and have Internet access, these individuals would clearly derive far more benefit from increases in TAC and/or LITC funding than from any proposed I-File program.

VIII. CONCLUSIONS

Our review of the evidence suggests that any effort by the IRS to implement an I-File program would generate costs far in excess of any possible benefits. Accordingly, we recommend against pursuing such an effort. Our conclusion is based on the following facts.

First, the marketplace is already making available to taxpayers the ability to file their taxes online, and the Free File Alliance makes that capability available to most taxpayers at no charge. Consumer satisfaction with the existing system is high, and there is simply no reason to believe that a federally-operated I-File program would be superior to the choices already available in the marketplace. If anything, I-File might chill investment and slow innovation in

¹⁴⁷ See, e.g., <http://www.irs.gov/localcontacts/index.html>.

¹⁴⁸ See Internal Revenue Service, *IRS Accepting Applications for Low Income Taxpayer Clinic Matching Grants!*, available at: <http://www.irs.gov/advocate/article/0,,id=106991,00.html>.

the existing private market for tax preparation software, thus actually slowing the adoption of these cost-saving technologies.

Second, the costs of implementing I-File would be substantial, and the risks of failure would be high. The IRS has a long and difficult history when it comes to implementing major IT projects, and, like other government agencies, suffers from a variety of handicaps (relative to the private sector) in acquiring and maintaining information technology systems. The fact that the IRS itself has repeatedly expressed doubts about the wisdom of I-File is a credit to the Service's ability to learn from its past difficulties in implementing large information technology projects.

Third, even under the most favorable assumptions, the likelihood that I-File would generate savings commensurate with its costs is extremely low. Even under very favorable assumptions with respect to implementation, costs, and utilization rates, I-File is unlikely to generate a positive return on investment over any reasonable time horizon. Indeed, we estimate that in its first decade, I-File would cost at least \$132 million more, in present dollars, than it would save.

Fourth, and finally, there are a number of alternatives to I-File which could be implemented at far lower (or even zero) cost, and which would be far more cost-effective in increasing the rate of electronic filing and reducing taxpayer compliance costs. Rather than embarking upon a costly and risky project like I-File, for which the benefits are likely to be small or non-existent, policymakers should pursue the available alternatives.

At the end of the day, I-File is a solution in search of a problem. The private marketplace is already providing taxpayers with electronic tax filing capabilities. Each filing season, those capabilities are improving, and being used by more taxpayers. Rather than attempting to supplant the existing system, policymakers should focus on further improving it.