Insight

Return-Free Filing Is Not Free

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Executive Summary

- The Inflation Reduction Act provided the Internal Revenue Service (IRS) with $79 billion in funding—more than 5 times the agency's annual operating budget.
- Tucked into this funding was a $15 million appropriation to study a potential "free direct efile" tax filing system.
- While a return-free tax filing system may sound appealing, it is unclear that such a system administered by the IRS would provide a net benefit for taxpayers.

Introduction

In August of this year, President Biden signed the Inflation Reduction Act (IRA) into law. A key element of the law is a $79 billion slug of funding for the Internal Revenue Service (IRS), largely devoted to operational expenses and enforcement actions. The bill also provided the IRS with $15 million to study options on how to develop a "free direct efile" tax filing system, obscuring, somewhat, the act's big-ticket provisions. Under such a system, the IRS would develop an online portal that would complete a taxpayer's tax return for them. For decades, the idea of a return-free tax filing system has been debated as a way to mitigate the cost of complying with the U.S. tax system. While the notion of easy tax filing has obvious appeal, the practical reality of such a system may be somewhat underwhelming. As belied by the massive funding infusion for the IRS, the operations of federal government's tax authority are hardly "free," as some advocates have advertised. The complexities of the tax system that taxpayers currently navigate will not have changed under such a system. Rather, this proposal would simply pile on more responsibility and grant more authority to the IRS. Such a notional return-free system would shift costs from individual taxpayers to a taxpayer-funded entity. Any discussion of a return-free system must adequately recognize these costs, and in so doing, disabuse observers of this policy debate of the notion that, as ever, nothing's free.

IRS Performance

In successive reports, American Action Forum research has tracked the burden of taxpayer compliance with the federal tax system. Similarly, this research has documented flagging customer service by the IRS. In its most recent report to Congress, the IRS internal watchdog, the Taxpayer Advocate Service (TAS), observed that the IRS answered only about 1 in 10 telephone calls in fiscal year 2021, down from the 24 percent from the prior year. To be sure, this decline in responsiveness corresponded with new responsibilities for COVID-19-related relief programs and, somewhat related, a doubling in taxpayer phone calls. Post-COVID, one would expect the IRS's response rates to improve from virtually unreachable to merely aloof – a sub-optimal baseline for the nation's tax authority.

A fair observation of the IRS's performance would note that IRS funding had been essentially flat in real terms over the last two decades. Over the same time, the number of U.S. taxpayers has grown apace with the population, while the IRS's workforce has declined and the number of tax-filers has grown. There was a legitimate case to be made that poor customer service was somewhat a function of resource constraints. That case has now been obviated by the IRA's infusion of $79 billion – more than five times the agency's annual operating budget. Yet of this amount, only $3 billion has been devoted to "Taxpayer services," while the majority of the funding is being devoted to enforcement – essentially in an effort to wring more revenue out of the existing tax system.

Mission Creep

Over the last decade, the IRS has been asked to do more with less. The administration of the Affordable Care Act subsidies marked a substantial expansion of the agency's purview. More recently, the agency has been tasked with administering economic impact payments during the COVID-19 pandemic, as well as an advanceable child tax credit. That many of these payments went to decedents, and double-digit error rates for refundable tax credits, suggests that the IRS's expanding mission has stretched the agency's capacity. That the agency has failed to discover the source of a conspicuous leak of sensitive taxpayer information does little to inspire confidence that the agency is prepared to see its mission expand again. The $3 billion in funding for improved taxpayer services may be welcome, but relative to a baseline of poor customer service and agency mission creep, it is unclear how substantially the agency can improve its core services to taxpayers. Putting the agency in charge of filling out tax returns would exacerbate this challenge.

The provision in the IRA funding the study of a potential return-free filing system specifies that the study include, among other provisions, "taxpayer opinions, expectations, and level of trust, based on surveys, for such a free direct efile system; and…the opinions of an independent third-party on the overall feasibility, approach, schedule, cost, organizational design, and Internal Revenue Service capacity." Recently, 22 organizations observing this policy debate expressed skepticism that the IRS can capably administer such a system. In forgoing research, AAF will examine the magnitude and direction of the costs associated with such a system.

Conclusion

While a return-free tax filing system has been advertised by advocates as a "free" approach to reducing the burden on taxpayers from compliance with a complex tax system, a closer examination of the IRS recent performance in the face of mission creep, and the prioritization of its (now) ample resources, suggests that a clear win for taxpayers is hardly assured. Rather than piling on additional responsibilities to a supercharged tax authority, policymakers should be grappling with the underlying sources of tax complexity and the burdens they impose on taxpayers.