

**Internal Revenue Service**

**Advancing *E-file* Study  
Phase 2 Report  
Executive Summary**

**An Examination of Options to Increase  
Electronic Filing of Individual Returns**

**December 15, 2010**

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**Prepared by the MITRE Corporation**

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*This report examines the costs, impacts, and projected adoption of selected Options to increase the e-file rate, reports the latest research on taxpayer and preparer motivations to e-file or not, and summarizes the latest findings that could influence the IRS e-file strategy.*

## 1. Introduction

This document provides an executive summary of the Advancing *E-file* Study Phase 2 (AES2) report. AES2 assesses the feasibility of Options for increasing the electronic filing (*e-filing*) of individual tax returns that were identified in Phase 1 and provides additional insight from new survey research into taxpayer and preparer motivations for and barriers to *e-filing*.

This study was conducted in two phases. The Advancing *E-file* Study Phase 1 (AES1) report, published September 30, 2008, represented a major effort to collect, synthesize, and analyze data on the IRS *e-file* program. Among other achievements, AES1 provided high-level descriptions of 10 possible initiatives to increase *e-file* levels.

For Phase 2, or AES2, each of these initiatives — referred to in this report as Options — were explored in detail. The AES2 report does not include recommendations on selecting or implementing specific Options for advancing *e-file* but lays the foundation for doing so in the future. During this phase, the following themes were identified and merit keeping in mind as the reader progresses through the AES2 report:

- **Few of the AES2 Options will produce a significant gain in *e-file* adoption.** Further, given the length of time required for implementation, many of the Options will not accelerate the timeline for achieving the 80% *e-file* goal. The *e-file* level has been steadily increasing and, without any new government interventions, is projected to reach the 80% goal in 2016.
- **Substantial investments in technology, management, and organizational capability are required for the IRS to assume new roles in tax preparation and submission.** The development and maintenance of new, advanced capabilities for providing software or services comparable with those available from the commercial sector would be costly and time-consuming.
- **Efforts to advance *e-file* must consider the entire tax return preparation and submission experience and evaluate changes in the tax landscape.** Increasing *e-file* levels, and the costs thereof, must be weighed against impacts on issues such as taxpayer compliance and satisfaction and third party partnerships.

### *Purpose of the AES2 Report*

With this report, the IRS is taking the second step toward defining a comprehensive strategy and set of actions to achieve the 80% *e-file* goal.<sup>1</sup> The purpose of this report is to further the IRS's understanding of Options to increase *e-filing* identified in AES1 by delivering a full and even examination of each and help the IRS make decisions about pursuing any particular Option or set of Options.

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<sup>1</sup>The 80% *e-file* goal derives from Title II, Section 2001 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98):

- (a) IN GENERAL.—It is the policy of Congress that—
- (1) paperless filing should be the preferred and most convenient means of filing Federal tax and information returns,
  - (2) it should be the goal of the Internal Revenue Service to have at least 80% of all such returns filed electronically by the year 2007, and
  - (3) the Internal Revenue Service should cooperate with and encourage the private sector by encouraging competition to increase electronic filing of such returns.

Specifically, this report is designed to:

- **Identify at a conceptual or very rough order of magnitude (VROM) level the costs, impacts, and adoption of each Option** — AES2 employs a structured process to create a preliminary definition of each Option and assess each Option separately without any comparison or analysis of trade-offs among Options.<sup>2</sup>
- **Clarify the motivations for taxpayers and preparers to e-file** — AES2 includes original research in the form of a taxpayer survey, preparer survey, and conjoint survey to better determine which issues are most salient for which groups.
- **Summarize key reports that could influence IRS strategies to increase e-filing** — AES2 summarizes key reports that could influence IRS strategies for increasing e-filing.

The focus of this report is on exploring multiple Options to reach the 80% *e-file* goal for individual taxpayer returns and finding new ways to reach the remaining 33% of taxpayers who still submit their returns on paper. By design, this report:

- Does not address the appropriate role of the IRS in the tax landscape (i.e., whether the IRS should be both tax collector and tax preparer).
- Does not address political or reputational risks associated with an Option, such as the impact on the public trust should it fail.
- Does not recommend which Options the IRS should implement.
- Does not define or recommend an overall strategy for increasing *e-filing*, but lays the foundation for the IRS to do so in the future.

Both the AES1 and AES2 reports were prepared by The MITRE Corporation, a not-for-profit organization that operates four Federally Funded Research and Development Centers (FFRDC), including the Center for Enterprise Modernization (CEM), which serves the IRS.<sup>3</sup>

## 2. Changes in the Tax Landscape Since AES1

The 2009 *e-file* rate of 67% represents a 5.9% increase from the previous year.<sup>4</sup> Several factors likely contributed to the higher levels of *e-filing*:

- More Americans prepared their own taxes using home computers and then *e-filed*, foregoing the services of paid preparers.<sup>5</sup>
- For the first time, the two largest tax software vendors — Intuit and H&R Block, which together have the majority of the Federal tax software market — offered bundled pricing for user-installable products, with both Federal tax return preparation and Federal *e-filing* included. Previously, vendors levied separate fees for *e-filing* on these products.<sup>6</sup>

For the purposes of this report, the 80% *e-file* goal refers to the electronic filing of Federal individual income tax returns using the 1040 family of forms and schedules.

*Stakeholders working together — including States and industry — have made possible the substantial progress on e-file to date.*

<sup>2</sup> The Options were originally identified in the Advancing *E-file* Study Phase 1 (AES1) report, and are addressed in chapters 5–15 of the AES2 report.

<sup>3</sup> The CEM FFRDC is part of MITRE’s Center for Connected Government Operating Center.

<sup>4</sup> IRS (2009) *Calendar Year Projections of Individual Returns by Major Processing Categories*; IRS (2009) *E-file Hits Record 90 Million; 30 Million Filed From Home Computers*

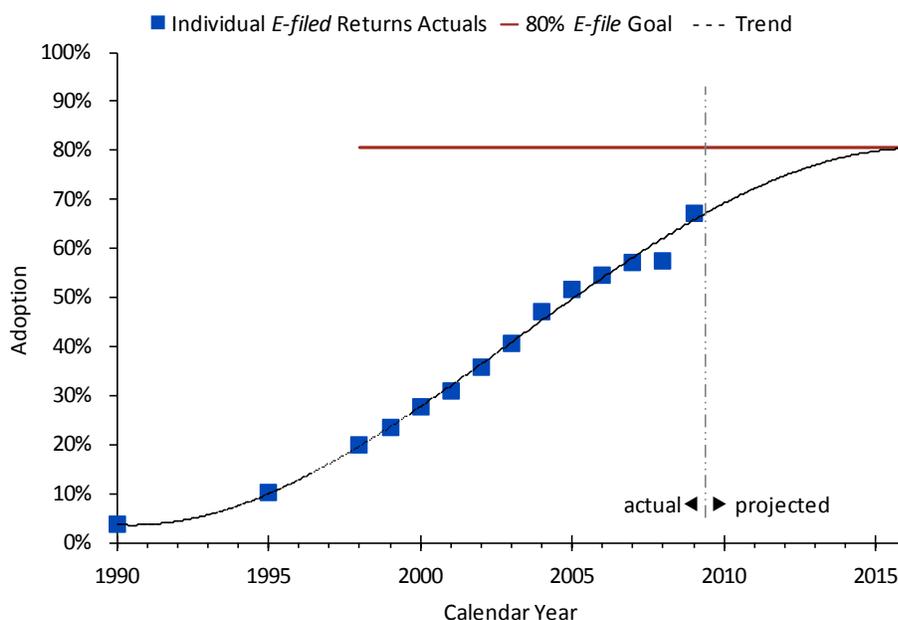
<sup>5</sup> IRS (2009) *Filing Tax Returns from Home Computers Up 20 Percent in 2009*

<sup>6</sup> Government Accountability Office (2009) *Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risks*

Figure 2-1 depicts the actual and projected increase in *e-filing* relative to the 80% *e-file* goal. Based on current trends and IRS projections, the 80% *e-file* goal will be achieved in 2016. This represents a baseline projection, which assumes that none of the Options described in this report is implemented and that no significant changes occur in the tax landscape.

Figure 2-1: Actual and Projected *E-file* Adoption, 1990–2016

*Based on current trends, the 80% e-file goal will be achieved in 2016. This baseline assumes that none of the Policy or Technology Options described in this report is implemented and that there are no significant changes in the tax landscape.*



Source: IRS (2006) *SOI Bulletin Historical Table 22: Selected Returns and Forms Filed or To Be Filed by Type During Specified Calendar Years, 1990-2007*; IRS (2008) *2008 Filing Season Statistics - Cumulative through the weeks ending Dec. 28, 2007 and Dec. 31, 2008*; IRS (2009) *Calendar Year Projections of Individual Returns by Major Processing Categories*; IRS (2009) *Two Out of Three Individuals Now Using IRS e-File*

For a summary of guidance and recommendations from ETAAC, IRS Oversight Board, TIGTA, GAO, and others pertinent to *e-filing*, see Chapter 2 of the AES2 report.

The IRS regularly receives guidance and recommendations from Federal and third party organizations with a vested interest in electronic tax administration. Since AES1, the Electronic Tax Administration Advisory Committee (ETAAC), IRS Oversight Board, US Department of the Treasury, Treasury Inspector General for Tax Administration (TIGTA), and Government Accountability Office (GAO) have issued recommendations related to *e-filing*.

### 3. New Research on *E-file* Motivators

Holdouts are individuals or preparers who continue to submit their returns on paper for any reason, including those who prepare their return on a computer but print and mail it.

This study focuses on key research findings that are reasonably actionable by the IRS.<sup>7</sup> The taxpayer survey results show that many taxpayers are satisfied with *e-file*'s speed, convenience, and accuracy. But Holdouts do not know enough about *e-file* to use it and

<sup>7</sup> For instance, the IRS is unable to directly remediate the lack of technology required to *e-file* cited by some survey respondents as a reason they did not *e-file*.

have concerns with the security and privacy of the Internet as well as *e-file*. The following conclusions were made based on taxpayer survey results:

- **The security and privacy of *e-file* — and the Internet — remains a concern for Holdouts.** Holdouts believe *e-file* does not provide the security and privacy of their data equivalent to that provided by submitting their returns on paper.
- **Understanding how *e-file* works informs the filing decisions taxpayers make.** The IRS could do more to educate taxpayers about *e-file*'s capabilities to help them see that *e-file* is compatible with their needs, skills, and technology.<sup>8</sup>
- **Lack of support for all forms, schedules, and attachments causes some to not *e-file*.** Some taxpayers and preparers submit returns on paper because they cannot — or perceive that they cannot — submit all necessary forms, schedules, or attachments with returns when they *e-file*.
- **Paid preparers have significant influence on taxpayers' decisions to *e-file*.** Most taxpayers trust their preparers' guidance on tax matters. When preparers make the suggestion, taxpayers tend to *e-file*.

For more information on findings from the taxpayer and preparer surveys, see Chapter 3 and Appendix A of the AES2 report.

## 4. Guide to AES2 Options

The Options described in detail in the AES2 report (chapters 6–15) were analyzed in terms of the following:

- **Definition** — A conceptual description of the Option. The description includes the current environment, the Option's envisioned capabilities, assumptions and constraints, and areas for further investigation. Definitions do not include detailed business requirements or system design specifications.
- **Projected Net Adoption** — An estimate of the net number and percentage of taxpayers who would switch to *e-filing* from paper filing as a result of the availability of the Option. Those who already *e-file* and would switch to the Option are not included, as this does not increase the overall *e-file* level.
- **Impacts** — The effects on or disruption to the current environment resulting from implementation of the Option.
- **Estimated Costs** — Very rough order of magnitude (VROM) estimates of the Federal budgetary costs for the IRS to implement and sustain operation of the Option (chapters 6–12). For the More Filing Time for *E-filers* Option (chapter 13), costs are estimated in terms of the cost of money due to changes in the timing of tax receipts and refunds. For the Monetary Incentive Option (chapter 14), costs are estimated in terms of the amount of associated tax credits. The estimated costs of each Option exclude costs experienced by stakeholders outside the government and are based on the Option's early stage definition, which reflects significant uncertainty about the Option scope and design. Due to the variability in approaches used to estimate Option costs and the level of uncertainty associated with each Option definition, cost estimates cannot be readily compared across Options.

*Cost estimates cannot be compared across Options due to the variability in approaches used to estimate Option costs and the level of uncertainty associated with each Option definition.*

<sup>8</sup> For example, for taxpayers who do not *e-file* because they owe money, the IRS could emphasize that with *e-file*, they can submit their returns now and pay later (up to the deadline). The increasing availability of tax preparation software products with free or bundled *e-filing* may also encourage these taxpayers to *e-file*.

*Each Option was examined separately without any comparison or analysis of trade-offs among Options. Implementing more than one Option would result in overlap and duplication with existing and future IRS services.*

The Option analyses are presented in summary form in the Fact Sheets (collected here and in chapter 5 of the AES2 report) and in full detail in chapters 6–15 of the AES2 report.

While there may be similar capabilities among Options, each Option was examined separately without any comparison or analysis of trade-offs among Options. Implementing more than one Option would result in overlap and duplication with existing and future IRS services.

The Option definitions, projected net adoption, impacts, and estimated costs provide an idea of what each Option for advancing *e-file* might look like if implemented. Before moving forward with implementation of any Option, the IRS needs to develop more complete Option definitions and assess alternative approaches to acquire envisioned capabilities of each Option, which will enable accurate evaluation of the Option’s cost savings and other benefits.<sup>9</sup>

## 5. Summary of Options

This section describes the Options and their categorization, the technical Options’ dependency on MeF 1040 and taxpayer e-authentication, and the comparability of the Options.

### 5.1 Option Types

Options were categorized as shown in Table 5-1.

Table 5-1: Options by Type and Chapter

Type	Option Title (Chapter)
Technology	Free IRS Direct <i>E-file</i> (Chapter 6)
	Free IRS Online Forms (Chapter 7)
	Free IRS Tax Preparation Software (Chapter 8)
	Modernized Paper Filing (Chapter 9)
Policy	Federal <i>E-file</i> Mandate on Paid Preparers (Chapter 10) <sup>*</sup>
	Targeted Marketing of <i>E-file</i> (Chapter 11)
	Expanded Free File (Chapter 12)
	More Filing Time for <i>E-filers</i> (Chapter 13)
	Monetary Incentive (Chapter 14)
Emerging Technology	Research on Mobile <i>E-file</i> (Chapter 15)

#### *Technology Options*

Three of Technology Options offer the taxpayer a free, direct electronic interface with the IRS: Free IRS Direct *E-file*, Free IRS Online Forms, and Free IRS Tax Preparation Software. The fourth Technology Option, Modernized Paper Filing, addresses how the IRS can achieve efficiencies comparable to those of *e-file* through improved handling of returns submitted on paper, given the long-term need to process paper submissions.

<sup>9</sup> Among the benefits not assessed for each AES2 Option is the presumed cost savings associated with the lesser cost for processing an *e-filed* return versus a paper return.

<sup>\*</sup> MITRE began work on examining a Federal *E-file* Mandate on Paid Preparers Option. Since Congress passed such a mandate before this analysis could be finalized, MITRE set aside its work on this Option.

## ***Policy Options***

The Policy Options — Federal *E-file* Mandate on Paid Preparers, Targeted Marketing of *E-file*, Expanded Free File, More Filing Time for *E-filers*, and Monetary Incentive — address the top motivators (incentives and mandates) driving *e-filing* behavior. Note that Expanded Free File is categorized as a Policy Option even though it offers taxpayers free tax preparation and *e-filing*, because it accomplishes this solely through an IRS partnership with third parties and does not involve a technology investment by the IRS.

## ***Emerging Technology Option***

Following up on the AES1 report discussion of phone-based *e-filing* options, AES2 examines emerging mobile phone technology in the Research on Mobile *E-file* chapter. Unlike the other Option chapters, this chapter provides no analysis of a specific Option implementation.

## **5.2 MeF 1040 and Taxpayer E-Authentication**

Two other technology systems — MeF 1040 and Taxpayer E-Authentication — merit brief discussion, as they comprise the foundational infrastructure on which three of the technology options would be built.

MeF 1040 is the IRS system that receives and does initial processing on *e-filed* returns. Benefits of MeF 1040 include: faster confirmation of return acceptance or rejection, more specific explanations of errors, ability to *e-file* attachments, and ability to *e-file* amended and prior year returns. MeF 1040 is an approved project and is currently being implemented in phases. MeF 1040 is assumed to be the platform that will be modified to accept *e-file* submissions from individual taxpayers under the Free IRS Direct *E-file*, Free IRS Online Forms, and Free IRS Tax Preparation Software Options. MeF will also support the policy options through its more robust and efficient processing.

These three Options also assume that the IRS will develop and successfully implement an e-authentication system to enable taxpayers to securely interact with the IRS over the Internet. This taxpayer e-authentication system must be able to scale to support millions of taxpayers, provide strong authentication and security, and be supported by policies and procedures to address: registration/enrollment, credential issuance, registration authentication (identity verification), authorization (role verification), revocation, and audit logging. An IRS taxpayer e-authentication system is in the concept stage, with no planned implementation timeline. There are few, if any, models in government or industry that match the scale of deployment needed to provide a user authentication system to the entire US taxpayer population.

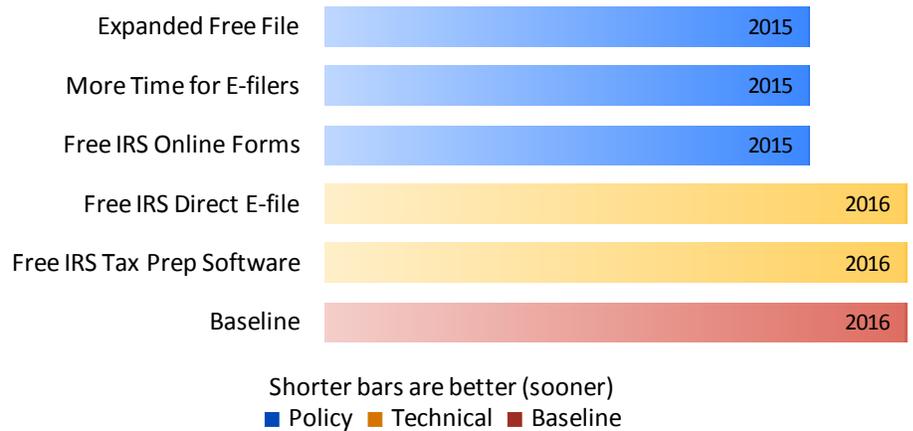
The cost of MeF 1040 and taxpayer e-authentication are not included in the Options' estimated costs.

*The cost of MeF 1040 and taxpayer e-authentication are not included in the Options' estimated costs.*

## **5.3 Comparing Options**

Several factors — noted previously — make it impossible to directly compare the Options. That said, Figure 5-1 illustrates the year when selected AES2 Options are projected to help the IRS meet the 80% *e-file* goal for Federal individual income tax returns. These net adoption projections are based on the latest baseline estimate from the IRS, indicating that without implementing any of the Options or other changes occurring in the tax landscape, the 80% *e-file* goal will be met in 2016.

Figure 5-1: Projected Year that Selected AES2 Options Achieve 80% E-file Goal



Source: IRS (2009) *Advancing e-File Study Phase II Final Net Adoption Estimates*

Note that four options are not displayed in Figure 5-1: Modernized Paper Filing (adoption is not relevant for this option; see chapter 10), Targeted Marketing of E-file (adoption not feasible to estimate; see chapter 12), Monetary Incentive (adoption estimate not currently available; see chapter 15), and Mobile E-file (adoption not appropriate to estimate given early stage of research on emerging technology; see chapter 16).

## 6. Fact Sheets

The remainder of this document summarizes each Option in a single-page fact sheet that includes the definition, impacts, projected adoption above the baseline, and VROM cost estimates.

# Free IRS Direct E-file

## Definition

The Free IRS Direct *E-file* Option will allow individual taxpayers who prepare their tax returns with commercial tax preparation software to electronically submit (*e-file*) their returns directly to the IRS for free.

The IRS will provide the taxpayer with an immediate online confirmation of receipt when the return is submitted. The taxpayer will be able to log into a secure IRS web site to retrieve an acknowledgment of return acceptance or rejection, which is available within 5 minutes of *e-filing*. The IRS will provide customer support to help with submission problems, rejected returns, or the Free IRS Direct *E-file* Option itself.

This Option will be available for use by all individual taxpayers but not by preparers. This Option is intended to address concerns with cost or third party involvement with the current *e-file* system, in which returns are submitted electronically to the IRS through a transmitter (often the same company that provided the tax preparation software).

## Impacts

- Taxpayers may not perceive this Option as addressing concerns about cost for two main reasons: taxpayers will still need to purchase tax preparation software to *e-file*; and many software vendors no longer charge a separate fee to *e-file*.
- Taxpayers may not perceive this Option as addressing concerns with third party involvement because they may not be aware of transmitters' current role in *e-filing* and regardless must rely on commercial software to prepare their return.
- Third party transmitters will likely oppose this Option.
- The IRS has little experience providing technical customer support to taxpayers on resolving submission issues.
- Taxpayers may be dissatisfied with the lack of email confirmation provided by this Option, given they are used to automatically being sent real-time emails confirming their other purchases and transactions online.
- This Option requires software vendors to change their products to enable direct transmission of data to the IRS but offers vendors little incentive to do so.
- The IRS will face challenges in marketing this Option to taxpayers, particularly given that the IRS relies on its commercial partners — some of which will be affected by this Option — for much of its taxpayer outreach.
- The IRS must deliver Taxpayer E-Authentication and MeF 1040 before this Option.

## Projected Net Adoption

Number and percentage of Holdouts expected to switch to *e-file* based on Option:

Year	Net <i>E-file</i> #	Net <i>E-file</i> %
2014	274,200	0.19
2015	291,500	0.20
2016	308,300	0.21

With a 2014 deployment, the 80% *e-file* goal will be achieved in 2016 (same as baseline).

## Estimated Cost

**One-time:** \$42 million

**Recurring:** \$27 million/year

Key assumptions & cost drivers:

- Based on 13 million users.
- One-time costs driven by web site portal upgrades.
- Recurring costs driven by increase in IRS Customer Service Representatives.
- Taxpayer E-Authentication system costs are excluded.
- Earliest availability is 2014 if Modernized e-File (MeF) 1040 and Taxpayer E-Authentication are in place.

Please see chapter 6 of the AES2 report for more information on this Option.

## Free IRS Online Forms

### Projected Net Adoption

Number and percentage of Holdouts expected to switch to *e-file* based on Option:

Year	Net <i>E-file</i> #	Net <i>E-file</i> %
2015	604,800	0.42
2016	685,000	0.47

With a 2015 deployment, the 80% *e-file* goal is achieved in 2015 (1 year before baseline).

### Estimated Cost

**One-time:** \$67 million

**Recurring:** \$36 million/year

Key assumptions & cost drivers:

- Based on 3 million users.
- One-time costs driven by development of system.
- Recurring costs driven by increase in IRS Customer Service Representatives.
- Taxpayer E-Authentication system costs are excluded.
- Earliest availability is 2015 if Modernized e-File (MeF) 1040 and Taxpayer E-Authentication are in place.

[Please see chapter 7 of the AES2 report for more information on this Option.](#)

### Definition

The Free IRS Online Forms Option will provide individual taxpayers with a method of preparing their own returns by completing tax forms on a secure IRS web site and electronically submitting (*e-filing*) their completed tax returns directly to the IRS for free. This Option will not provide a question-and-answer approach to simplify the process. This Option will feature automated calculations; hyperlinks to standard IRS instructions; and the ability to save drafts, leave a session, and continue work at a later time. The IRS will provide the taxpayer with an immediate online confirmation of receipt when the return is submitted. The taxpayer will be able to log into a secure IRS web site to retrieve an acknowledgment of return acceptance or rejection, which is available within 5 minutes of *e-filing*. The IRS will provide customer support to help with submission problems, rejected returns, or the Free IRS Online Forms Option itself.

This Option will be available for use by all individual taxpayers but not by preparers. This Option is intended to address concerns with third party involvement or cost with the current *e-file* system.

### Impacts

- Given that the IRS and its partners in the Free File Alliance (FFA) introduced Free File Fillable Forms (FFFF) in 2009, this Option may be perceived as duplicative and unnecessary.
- Taxpayers may not perceive this Option as addressing concerns about cost for two main reasons: other free filing methods from FFA and commercial tax preparation software vendors exist; and many vendors no longer charge a separate fee to *e-file*.
- Taxpayers may not perceive this Option as addressing concerns with third party involvement because they may not be aware of transmitters' current role in *e-filing*.
- This Option will likely adversely affect IRS partnerships with key stakeholders such as tax preparation software vendors and transmitters as well as the IRS-FFA agreement.
- Since this Option will not initially support State returns, taxpayers may be inconvenienced, while States may see a decline in electronically filed returns and see increased expectations that States provide their own similar Option.
- The IRS has little experience providing technical customer support to taxpayers on resolving software and submission issues.
- Taxpayers may be dissatisfied with the lack of email confirmation provided by this Option, given that they are used to automatically being sent real-time emails confirming their other purchases and transactions online.
- The IRS will face challenges in marketing this Option to taxpayers, particularly given that the IRS relies on its commercial partners — some of which will be affected by this Option — for much of its taxpayer outreach.
- The IRS must deliver Taxpayer E-Authentication and MeF 1040 before this Option.

# Free IRS Tax Preparation Software

## Definition

The Free IRS Tax Preparation Software Option will provide individual taxpayers with free web-based software that guides them through the return preparation process and enables them to electronically submit (*e-file*) their returns directly to the IRS. This Option will feature a question-and-answer approach that simplifies the tax preparation process, completes the required forms for the user, and provides explanations of relevant tax law. The Option also will allow taxpayers to save drafts, leave a session, and continue work at a later time. The IRS will provide the taxpayer with an immediate online confirmation of receipt when the return is submitted. The taxpayer will be able to log into a secure IRS web site to retrieve an acknowledgment of return acceptance or rejection, which is available within 5 minutes of *e-filing*. The IRS will provide customer support to help with submission problems, rejected returns, or the Free IRS Tax Preparation Software itself.

This Option will be available for use by all individual taxpayers but not by preparers. This Option is intended to address concerns with third party involvement or cost with the current *e-file* system. This Option will not offer certain features offered by commercial tax preparation software (sometimes at additional cost), such as: tools to maximize deductions, tools to flag audit risks, customized tax advice, the ability to import prior year return data, the ability to import W-2s and 1099s electronically, State return preparation, software accuracy guarantees, and audit assistance.

## Impacts

- Commercial software vendors and transmitters will likely expend considerable resources opposing this Option.
- Taxpayers may not perceive this Option as addressing concerns about cost for two main reasons: other free filing methods from FFA and commercial tax preparation software vendors exist; and many vendors no longer charge a separate fee to *e-file*.
- Taxpayers may not perceive this Option as addressing concerns with third party involvement because they may not be aware of transmitters' current role in *e-filing*.
- This Option will not compare favorably to the full range of features that commercial tax preparation software vendors bring to the market.
- The IRS has no prior experience delivering user-centric tax preparation software that is frequently updated.
- This Option will likely adversely affect IRS partnerships with key stakeholders such as tax preparation software vendors and transmitters as well as the IRS-FFA agreement.
- Since this Option will not initially support State returns, taxpayers may be inconvenienced, while States may see a decline in electronically filed returns and see increased expectations that States provide their own similar Option.
- The IRS has little experience providing technical customer support to taxpayers on resolving software and submission issues.
- Taxpayers may be dissatisfied with the lack of email confirmation provided by this Option, given they are used to automatically being sent real-time emails confirming their other purchases and transactions online.
- The IRS will face challenges in marketing this Option to taxpayers, particularly given that the IRS relies on its commercial partners — some of which will be affected by this Option — for much of its taxpayer outreach.
- The IRS must deliver Taxpayer E-Authentication and MeF 1040 before this Option.

## Projected Net Adoption

Number and percentage of Holdouts expected to switch to *e-file* based on Option:

Year	Net E-file #	Net E-file %
2016	1,960,300	1.34

With a 2016 deployment, the 80% *e-file* goal will be achieved in 2016 (same as baseline).

## Estimated Costs

### One-time:

\$136 million (3 million users)

\$141 million (24 million users)

\$160 million (46 million users)

### Recurring:

\$50 million/year (3 million users)

\$58 million/year (24 million users)

\$115 million/year (46 million users)

Key assumptions & cost drivers:

- Based on three usage levels: 3, 24, and 46 million users.
- One-time costs driven by development of system.
- Recurring costs driven by increase in IRS Customer Service Representatives and software maintenance.
- Taxpayer E-Authentication system costs are excluded.
- Earliest availability is 2016 if MeF 1040 and Taxpayer E-Authentication are in place.

Please see chapter 8 of the AES2 report for more information on this Option.

## Modernized Paper Filing

### Projected Net Adoption

The Option does not affect *e-file* adoption. It provides similar efficiency and accuracy benefits as *e-file* for paper returns. This study did not find publishable evidence supporting or disproving the hypothesis that a tax authority's acceptance of 2D barcoded paper returns hurts the *e-filing* adoption rate.

### Estimated Costs

**One-time:** \$71 million

**Recurring:** \$10 million/year

Key assumptions & cost drivers:

- IRS cost estimate developed in 2007 for proposed Msp project which was not funded.
- One-time and recurring costs are driven by customization and licensing fees for commercial Optical Character Reader (OCR) scanning technology.
- Recurring costs include electronic records storage.
- Excludes the capability for IRS enterprise-wide electronic access to the imaged return.
- Four years estimated to build and deploy.

Please see chapter 9 of the AES2 report for more information on this Option.

### Definition

Even when the 80% *e-filing* goal is achieved, tens of millions of individual returns will still be submitted to the IRS on paper. For this reason, finding efficiencies and cost savings in the processing of paper returns is an important part of the IRS's overall modernization and *e-filing* strategy.

To handle individual income tax returns submitted on paper, the Modernized Paper Filing Option will include optical scanning, automated data extraction using both character recognition (CR) and two-dimensional (2D) barcodes, data export, and electronic image archiving.

This Option will provide significant flexibility and cost savings over the existing paper return processing solution. Return data will be quickly extracted and exported in formats compatible with *e-filed* returns. Most of the manual transcription of data that occurs at IRS Submission Processing Centers today (rekeying data from paper returns into IRS computer systems) will be eliminated. Optically scanned returns will be electronically retrieved, eliminating the costs and delays associated with retrieving paper returns. Additionally, optically scanned returns will become the official return-of-record, allowing the original paper returns to be destroyed.

This Option will address all paper filers, not as a means to encourage them to *e-file*, but to allow the IRS to achieve efficiencies and cost savings comparable to *e-file*. It also will put all *e-filed* and paper return data into a single modernized data pipeline supporting the retirement of costly legacy processing systems.

### Impacts

- The IRS had been considering the Modernized Submissions Processing (Msp) proposal as a means of meeting its business needs for the last two years. Various proposals preceded the Msp proposal. The IRS is still in need of a solution for modernizing paper filing.
- Only CR can capture data from both V-Coded and manually prepared paper returns. 2D barcodes are limited to the 74% of paper returns that are V-Coded.
- 2D barcodes will require the IRS to redesign its tax forms.
- In the absence of a mandate, tax preparation software vendors may have little incentive to modify their software to support 2D barcodes.
- 2D barcodes may cause confusion or negative reactions among some taxpayers.
- 2D barcodes may have an adverse affect on the *e-file* level.

## **Federal *E-file* Mandate on Paid Preparers**

MITRE began work on examining a Federal *E-file* Mandate on Paid Preparers Option. Since Congress passed such a mandate before this analysis could be finalized, MITRE set aside its work on this Option.

Please see [chapter 10 of the AES2 report](#) for more information.

## Targeted Marketing of E-file

### Projected Net Adoption

Due to the difficulty in linking marketing to adoption, a measure of the reach of the campaign may be provided instead of an adoption estimate.

### Estimated Costs

**One-time:** There are no one-time start-up costs, and IRS would only incur the estimated recurring costs until it achieves the 80% *e-file* goal

**Recurring:** \$6 million/year

Key assumptions & cost drivers:

- Assumes IRS conducts one 4-year campaign or until the 80% *e-file* goal is attained.
- Costs for contractor support from marketing firms with the expertise to assist the IRS with detailed analysis of target population characteristics, developing campaign strategy, and evaluating campaign effectiveness are not included, but are recognized as an essential element for calculating the overall cost of this Option.

Please see chapter 11 of the AES2 report for more information on this Option.

### Definition

The Targeted Marketing of *E-file* Option will identify specific groups of taxpayers and paid preparers who submit tax returns on paper and will attempt to persuade them to switch to electronic return submission (*e-filing*).

The purpose of the Targeted Marketing of *E-file* Option is to focus marketing and communication efforts on high-opportunity populations (i.e., those with greatest possibility of *e-file* adoption). For example, more analysis about V-Coders — taxpayers and preparers who prepare returns on a computer but print and submit returns on paper — might yield information based on demographics and other characteristics that could help identify potential populations for the targeted marketing of *e-file*. Since members of this group already use computers to prepare their returns, they are likely to be more open to *e-file*. The key will be to understand why these taxpayers and preparers choose not to *e-file* and to develop marketing campaigns to persuade them to do so.

To further define this Option, the IRS will draw on research performed as part of AES2 as well as other relevant sources. The desired outcome of this Option is to provide the framework the IRS needs to develop a data-driven, multi-year targeted marketing strategy aimed at specific segments of the *e-file* Holdout population. This strategy and its execution will identify *e-file* participation goals, marketing tasks, key messages, measures to gauge the effectiveness of targeted marketing campaigns, and resources required to conduct these campaigns.

### Impacts

- The IRS has limited experience and resources available to develop end-to-end targeted marketing campaigns and will need assistance from targeted marketing experts.
- Without collaboration with its stakeholders, the IRS will not have the communications networks and financial and staff resources needed to wage successful *e-file* targeted marketing campaigns.

# Expanded Free File

## Definition

The Free File Program provides free tax preparation and *e-filing* to eligible participants. The program, which has two components, Traditional Free File (TFF) and Free File Fillable Forms (FFFF), is offered through an agreement between the IRS and the Free File Alliance (FFA). The Expanded Free File Option will expand both components of the current program. Specifically, this Option will:

- Remove the Adjusted Gross Income (AGI) limitation for TFF (free online Federal income tax preparation and *e-filing* software) to make it available to all individual taxpayers.
- Enhance the FFFF user experience and number of forms and schedules supported by FFFF.

## Impacts

- This Option may be contrary to the business interests of tax preparation software vendors and may be perceived negatively by the business community.
- This Option will affect the IRS-FFA agreement and may adversely affect IRS partnerships with key stakeholders such as tax preparation software vendors and transmitters.
- Raising or removing the AGI limitation without also expanding the services provided and forms and schedules supported through the Free File Program may not produce the desired effect of increasing *e-file* adoption.

## Projected Net Adoption

Number and percentage of Holdouts expected to switch to *e-file* based on Option:

Year	Net <i>E-file</i> #	Net <i>E-file</i> %
2012	1,143,100	0.81
2013	1,156,300	0.81
2014	1,167,100	0.81
2015	1,176,500	0.81
2016	1,185,600	0.82

With a 2012 deployment, the 80% *e-file* goal is achieved in 2015 (1 year before baseline).

## Estimated Costs

**One-time:** None identified.

**Recurring:** Under \$1 million/year

Key assumptions & cost drivers:

- Cost driven by Free File Program management staff, additional IRS help desk support staff, additional return volume.
- Excludes communications and outreach to promote Option.

Please see chapter 12 of the AES2 report for more information on this Option.

## More Filing Time for E-filers

### Projected Net Adoption

Number and percentage of Holdouts expected to switch to *e-file* based on Option:

Year	Net E-file #	Net E-file %
2011	1,366,000	0.99
2012	1,452,600	1.03
2013	1,536,000	1.08
2014	1,614,500	1.12
2015	1,686,600	1.17
2016	1,751,600	1.21

With a 2011 deployment, the 80% *e-file* goal will be achieved in 2015 (1 year before baseline).

### Estimated Costs\*

\*Includes only the cost of money

**One-time:** Not estimated.

**Recurring:** Savings of:

\$2 million/year at 1% interest,

\$5 million/year at 2% interest,

\$7 million/year at 3% interest, or

\$9 million/year at 4% interest.

Key assumptions & cost drivers:

- Estimate is based on net cost of money (savings to Treasury) combining the effects of the March 15 paper return filing and payment deadline, and the April 15 deadline for *e-file* returns.
- Net cost of money shows costs (savings) to the Treasury at different interest rates.
- Excludes: Cost of communication and outreach programs, changes to IRS information systems, changes to IRS policies and procedures, changes to IRS publications, and temporary staff to handle changes to peak filing workloads.

Please see chapter 13 of the AES2 report for more information on this Option.

### Definition

The More Filing Time for *E-filers* Option will give *e-filers* more time to file (i.e., prepare and submit their tax returns and pay any money owed) than paper filers. This Option is intended to motivate taxpayers and preparers who now file paper returns to *e-file* instead. To implement this Option, the IRS must determine its features:

- The amount of additional filing time granted to *e-filers* (e.g., 15 days, 1 month).
- The scope of the filing deadline change (i.e., whether the change will apply to the submission of the return, the payment of taxes owed, or both).
- The direction of the filing deadline change (i.e., moving the paper filing deadline before April 15, moving the *e-filing* deadline after April 15, or both).

For purposes of this report, this Option is defined as follows:

- For *e-filers*, the filing deadline remains April 15.
- For paper filers, the filing deadline becomes March 15.

Under this Option, paper filers who currently file after March 15 will be targeted; these taxpayers will be forced to change their filing behavior by *e-filing*, filing paper returns earlier, or requesting an extension (note that even with an extension, any money owed is still due April 15).

### Impacts

Impacts based on a March 15 paper filing deadline include:

- Changing the April 15 filing date may cause a strong negative public reaction.
- Moving the paper filing date to March 15 may burden preparers, particularly those who operate small practices. This is likely to cause an increase in the number of extension requests.
- The current pattern of filing peaks in February and April may change, requiring adjustments to staffing, operations, and peak-related capacities.
- State and local tax authorities whose filing deadlines are tied to the Federal filing date will be affected.
- The availability of W-2s, 1099s, and other information returns to taxpayers limits how early the paper deadline can be.
- IRS business processes, systems, and forms and publications will be affected.

# Monetary Incentive

## Definition

The Monetary Incentive Option will provide a one-time monetary incentive in the form of a tax credit to paper filers to encourage them to switch to *e-file*. The IRS will determine the dollar amount and eligibility criteria for the incentive. For the purposes of this report, incentive amounts of \$2, \$6, and \$15 are used to illustrate the costs and impacts.

## Impacts

- The majority who now *e-file* will not be eligible for a monetary incentive under this Option and thus may be displeased with the Option.
- This Option reduces the risk of taxpayers “gaming the system” (i.e., quitting *e-file* only to resume *e-filing* the next tax season to get the incentive) but poses the risk that those who switch to *e-file* may not continue to do so in the absence of an ongoing incentive.

## Projected Net Adoption

No adoption information is available at this time.

## Estimated Costs\*

\*Includes only the amount of the tax credit taken by taxpayers

**One-time:** \$32 – \$961 million

**Recurring:** None. This Option based on a one-time incentive.

Key assumptions & cost drivers:

- Cost driven by cost of tax credit incentive amounts (\$2, \$6 and \$15) based on adoption rates that range from 25% to 100% of paper filers switching to *e-file* and collecting the tax credit.
- Excludes costs to implement and administer the tax credit such as changes in IRS IT systems, policies, procedures, and publications.
- Excludes cost to develop and implement a marketing strategy and outreach campaign to advertise the incentive.

Please see chapter 14 of the AES2 report for more information on this Option.

## Research on Mobile *E-file*

### Projected Net Adoption

Due to the early stage of this research, adoption estimates for specific Mobile *E-file* Options cannot be provided.

### Estimated Costs

Due to the early stage of this research, cost estimates for specific Mobile *E-file* Options cannot be provided.

Please see chapter 15 of the AES2 report for more information on this Option.

### Definition

AES1 introduced the possibility of a phone-based *e-file* option that could take advantage of the increasing usage of mobile phone devices and the growing technologies that allow these devices to perform more than traditional phone capabilities. Due to the distinct nature of Mobile *E-file* (i.e., emerging technology, new ground for IRS, etc.), it is still in the early stages of investigation. As such, it has a different treatment than the other options discussed in this report. This report considers what Mobile *E-file* might look like based on the current landscape and trends of mobile phone technology. These considerations would apply to any further development of this option.

Mobile *E-file* allows taxpayers to use a mobile phone to electronically submit their Federal individual income tax return to the IRS (and possibly to prepare the return on the mobile phone as well). Based on current technology, Mobile *E-file* would not be a stand-alone solution. Rather, it would provide a front end and user interface to an electronic tax preparation and submission system. Other than these interfaces, the capabilities required for Mobile *E-file* would be similar to those of the web-based filing options discussed in chapter 8 Free IRS Online Forms and chapter 9 Free IRS Tax Preparation Software.

Implementing Mobile *E-file* independently from a web-based application would involve extensive duplication of effort and significant cost. It is therefore likely that any Mobile *E-file* solution will involve adding a mobile front-end to an online forms or tax preparation capability, or developing mobile and web-based capabilities concurrently.

Mobile *E-file* may appeal to two groups: taxpayers who have access to a mobile phone but not necessarily to a computer with Internet access, and taxpayers who have a mobile phone with Internet access but do not currently prepare and submit their return electronically due to cost or third party involvement concerns.

### Impacts

Due to the early stage of this research, assessment of impacts for specific Mobile *E-file* Options cannot be provided.

END OF EXECUTIVE SUMMARY.