



Highlights of [GAO-07-570](#), a report to the Committee on Finance, U.S. Senate

TAXPAYER SERVICE

State Experiences Indicate IRS Would Face Challenges Developing an Internet Filing System with Net Benefits

Why GAO Did This Study

Some states and countries allow taxpayers to prepare and file tax returns on their Internet Web sites at no charge, an option not available to federal taxpayers. Such a service might mitigate the concerns taxpayers have about current electronic filing options, which require filing through a third party and may involve fees. Increased electronic filing would reduce IRS's paper processing costs, reduce transcription errors, and speed up refunds.

However, the idea is controversial. IRS already has a Free File program which offers free return preparation and filing by private companies for some people via IRS's Web site. Some are opposed to IRS competing with tax preparation software companies.

GAO was asked to (1) describe IRS's options for on-line preparation and filing (I-file) based on states' experiences; (2) determine the benefits and costs of I-file based on the experiences of the states; and (3) describe the potential for IRS to realize cost savings from I-file. GAO profiled 7 states and the District of Columbia, 2 foreign countries and 3 federal agencies to describe I-file options and determine their benefits and costs.

Commenting on a draft of this report, the IRS Commissioner said he appreciated our observations on the states' experiences.

www.gao.gov/cgi-bin/getrpt?GAO-07-570.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jim White at (202) 512-9110 or whitej@gao.gov.

What GAO Found

The options available to IRS for implementing I-file system vary in technology, features, and eligibility. The states profiled all employed an interactive format on their Web sites for tax return preparation. The systems varied in whether they included features such as the ability to save and return. Systems also varied in eligibility, i.e. limiting income or residency.

For the systems profiled, both reported benefits and costs were relatively modest and it is unclear whether benefits were greater than costs. I-file systems may generate benefits by increasing electronic filing and reducing filing fees for taxpayers. California and Pennsylvania estimated savings of \$1.00 per return and \$3.47 respectively per return converted from paper. However, the benefits were limited by low usage. I-file usage rates were less than 6 percent. Available data on I-file costs, while limited, shows costs are a very small percentage of state tax agencies' budgets. For example, California reported spending \$700,000 to develop and operate CalFile from 2003 to 2005—less than 0.1 percent of the tax agency's annual budget. States kept I-file costs relatively modest by restricting eligibility and features. Several states used contractors to develop and operate their I-file system as well as provide the computer hardware. Low usage also contributed to modest costs. For example, some states said low usage meant they could use existing computer equipment.

IRS's potential to realize net cost savings from an I-file system depends on the costs of developing the system and the number of taxpayers converted from paper to electronic filing. IRS's costs could be higher than the states'. First, the federal tax system is more complex. Second, unlike states which already had Web sites with Internet transaction capabilities, IRS would have to significantly upgrade its Web site and incur new security costs. Finally, developing an I-file system would further stretch IRS's capability to manage systems development, a GAO high risk area since 1995. Converting paper filers to electronic filing generates savings of \$2.36 per return, according to IRS estimates. However, the number of paper filers who would convert is uncertain. The 13 million individual taxpayers who prepared their returns on a computer but then printed and mailed them to IRS are one target for conversion to I-file.

I-file System 2006 Usage Rates for 7 State Agencies and the District of Columbia

	I-file users	Total filers	Percentage of total filers
California	111,436	14.6 million	0.76
District of Columbia	9,285	.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: State tax agencies.

Note: Usage rates are based on the total number of filers, not the number of eligible I-file users.