

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION



Inflation Reduction Act: Interim Results of the Direct File Pilot

June 25, 2024

Report Number: 2024-408-031

HIGHLIGHTS: Inflation Reduction Act: Interim Results of the Direct File Pilot

Final Audit Report issued on June 25, 2024

Report Number 2024-408-031

Why TIGTA Did This Audit

The Inflation Reduction Act of 2022 (IRA) was signed into law on August 16, 2022. Section 10301(1)(B) of the IRA provided the IRS with \$15 million to establish a task force to design an IRS-run, free direct electronic filing system and prepare a report for Congress by May 16, 2023, containing information on the cost of developing and running a system, surveys of taxpayer opinions/expectations and trust in such a system as well as the opinions of an independent third party. On May 16, 2023, the IRS provided its required report to Congress. That same day, the Deputy Secretary of the Treasury issued a letter to the IRS requesting that it pilot a Direct File option for the 2024 Filing Season.

This audit was initiated to provide interim information related to Phase A of the Direct File Pilot. TIGTA will issue a subsequent report later in the calendar year based upon our review of all pilot phases.

Impact on Tax Administration

Direct File is a new, free Federal tax preparation tool piloted by the IRS for the 2024 Filing Season. Once a taxpayer submits their Federal tax return in Direct File, their return is transmitted and processed just like all other electronically filed returns received by the IRS. The IRS estimated that the annual costs of Direct File may range from \$64 million to \$249 million.

On May 30, 2024, the IRS announced that Direct File would be a permanent option for filing tax returns starting in the 2025 Filing Season.

What TIGTA Found

The IRS developed a phased approach to the Direct File Pilot during the 2024 Filing Season to allow it to test Direct File in a limited and controlled environment prior to any potential large-scale launch. Phase A of the pilot was conducted between February 1 and February 21, 2024, with IRS employees who volunteered to use Direct File. Approximately 1,850 IRS employees volunteered. However, during Phase A, only 369 (20 percent) of the 1,850 volunteers created an online account, and the IRS received 165 tax return submissions from 159 taxpayers.

TIGTA's review of the eligibility checker and tax returns filed through Direct File during Phase A identified two opportunities for the IRS to update the eligibility checker to clarify eligibility requirements and potentially reduce taxpayer confusion and burden. Specifically, TIGTA identified concerns with taxpayers purchasing insurance through a health insurance marketplace and inconsistent text between the Spanish and English translations for the Direct File eligibility checker.

Also, the IRS met three of seven firm criteria established for exiting Phase A of the pilot. Two of the seven criteria were not met. Specifically, Spanish translation was not available for Phase A of the pilot and there were known issues with accuracy of tax returns. For the remaining two criteria, TIGTA has been unable to determine whether these criteria were met before exiting Phase A. For example, TIGTA could not assess whether the Customer Support Chat was functioning within specific level of service parameters because the IRS did not define what it considered as an acceptable level of service.

The IRS trained 161 IRS employees who were ready to support Direct File taxpayers as of February 21, 2024. As of this same date, the IRS reported responding to 297 Direct File live chats answering over 600 questions.

What TIGTA Recommended

TIGTA made three recommendations to the IRS including to update the eligibility checker to clarify eligibility criteria and include text that was missing from the Spanish-translated version. In addition, TIGTA recommended that the IRS establish numerical benchmarks for those items that lend themselves to being measured.

The IRS agreed with two recommendations and partially agreed with the third recommendation. Although management agreed with the importance of quantitative metrics to assist in evaluating the Direct File pilot, management did not establish numerical benchmarks as TIGTA recommended.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

U.S. DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20024

June 25, 2024

MEMORANDUM FOR: COMMISSIONER OF INTERNAL REVENUE

FROM: Matthew A. Weir
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Inflation Reduction Act: Interim Results of the
Direct File Pilot (Audit No.: 2024408011)

This report presents the results of our review to provide interim results of our assessment of the Internal Revenue Service's (IRS) plans to develop and pilot an IRS-run Direct File System in the 2024 Filing Season. This review is part of our Fiscal Year 2024 Annual Audit Plan and addresses the major management and performance challenge of *Managing Inflation Reduction Act Transformation Efforts*.

Management's complete response to the draft report is included as Appendix III. If you have any questions, please contact me or Diana Tengesdal, Assistant Inspector General for Audit (Returns Processing and Account Services).

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Background

The Inflation Reduction Act of 2022 (IRA) was signed into law on August 16, 2022.¹ Section 10301(1)(B) of the IRA provided the Internal Revenue Service (IRS) with \$15 million to establish a task force to design an IRS-run, free direct electronic filing system, referred to as "Direct File," and prepare a report for Congress by May 16, 2023, containing the following information:²

- Cost of developing and running a free direct electronic file tax return system with a focus on multilingual and mobile friendly features and safeguards for taxpayer data.
- Taxpayer opinions, expectations, and level of trust, based on surveys, for such a free direct electronic file system.
- The opinions of an independent third party of the overall feasibility, approach, schedule, cost, organizational design, and IRS capacity to deliver such a direct electronic file tax return system.

On May 16, 2023, the IRS provided its required report to Congress. The report's executive summary noted that the IRS's study investigated the costs the IRS would incur to develop and operate a Direct File tool, noting that the estimates were subject to considerable uncertainty. Under varying scenarios relating to the scope and usage of Direct File, the study estimated that annual costs of Direct File may range from \$64 million to \$249 million. On this same day, the Deputy Secretary of the Treasury issued a letter to the IRS requesting that it pilot a Direct File option for the 2024 Filing Season. The Deputy Secretary's letter acknowledged that the best way to be successful is to "begin with a limited scope pilot that allows the IRS to test the functionality for some taxpayers, evaluate success, and use lessons learned to inform the growth of the tool." Further, the letter noted there are certain principles that the IRS needs to consider, such as taxpayer feedback and earning taxpayer trust, when carrying out the pilot.

The Treasury Inspector General for Tax Administration (TIGTA) previously reported that the IRS met the legislative requirements set by Section 10301(1)(B) of the IRA.³ However, our review found that the surveying of taxpayers was potentially overstated due to there being no 'neutral' option for a taxpayer to choose from. In addition, we could not determine the reasonableness of the IRS's cost and user estimates because the IRS could not provide us with supporting documentation. As of February 19, 2024, the IRS reported nearly \$10.8 million in obligations related to the Direct File Pilot. This is in addition to the \$11.6 million obligated prior to the start of the pilot. We will evaluate the IRS's actual costs to implement the Direct File tool during the 2024 Filing Season and will report our findings later in the calendar year.⁴

¹ Pub. L. No. 117-169, 136 Stat. 1818.

² See Appendix IV for a glossary of terms.

³ TIGTA, Report No. 2024-408-002, *Inflation Reduction Act: Assessment of a Free and Electronic Direct Filing Tax Return System* (Oct. 2023).

⁴ TIGTA, Audit No. 2024408031, *Review of the Direct File Pilot*.

IRA Strategic Operating Plan

After the IRA was enacted, the Secretary of the Treasury sent a letter to the IRS Commissioner requesting the development of an operating plan that identified specific initiatives and timelines for improving taxpayer service, modernizing technology, and increasing equity in tax enforcement. On April 6, 2023, the IRS published the IRA Strategic Operating Plan (referred to as the “Plan”). The Plan outlines how the IRS will deploy the investments in the IRA to better serve taxpayers, tax professionals, and the broader tax ecosystem, and is organized by five transformation objectives. Each objective is supported by multiple initiatives that the IRS plans to achieve to meet the stated objective.

Initiative 1.5 of the Plan states that the IRS will explore providing taxpayers the option to file certain tax returns directly with the IRS online, *i.e.*, the Direct File Pilot. As of March 7, 2024, the Direct File team, comprised of 32 full-time IRS employees with support from other IRS employees as needed, is responsible for implementing and monitoring the Direct File Pilot. In addition to IRS employees, the Direct File team is supplemented with 29 employees from the Office of Management and Budget’s U.S. Digital Service team. The Direct File team reports directly to the IRS Commissioner.

Basics of Direct File

Direct File is a new, free Federal tax preparation tool offered by the IRS as a pilot for the 2024 Filing Season. Taxpayers walk through seven basic steps to determine eligibility for the pilot, referred to as the eligibility checker.

Taxpayers must create an online account to use Direct File, which requires the taxpayer to authenticate themselves using ID.me. Taxpayers are required to have a current driver’s license, State identification, passport, or passport card. Taxpayers can access Direct File via their smartphone, laptop, tablet, or desktop computer after they create an online account.

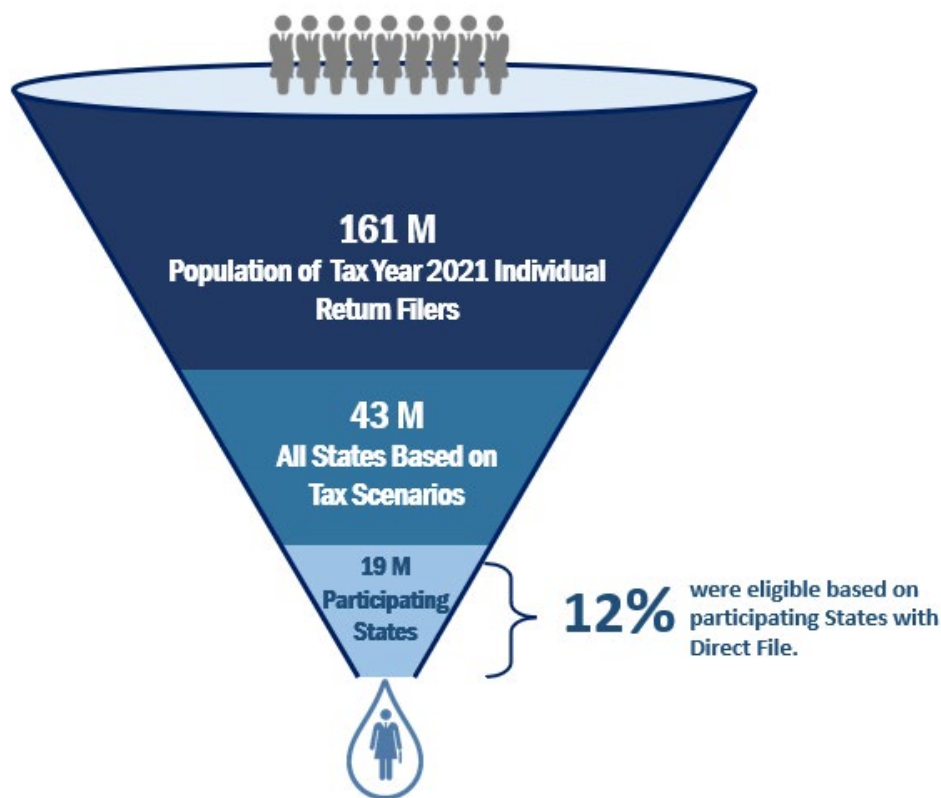
Once a taxpayer submits their Federal tax return in Direct File, their return is transmitted and processed just like all other electronically filed returns received by the IRS. Direct File does not allow for the preparation of an amended or prior year Federal tax return. Direct File also does not allow for the preparation or submission of State tax returns. Instead, the IRS partnered with participating States to systemically allow taxpayers to transfer their Federal tax return information to the State’s online tax tool, on behalf of the taxpayer.⁵

⁵ Direct File partnered with Arizona, Massachusetts, and New York to make it possible for taxpayers to transfer their Federal tax information to their State’s online tax tool. California taxpayers are directed to the CalFile tax application to file their applicable State tax return.

Eligibility for the Direct File Pilot

The Direct File Pilot was designed to support a limited set of tax situations.⁶ In addition, taxpayers must have lived and worked in one of 12 participating States for all of Calendar Year 2023 to be eligible for the Direct File Pilot.⁷ Using Tax Year 2021 tax return data, the IRS estimated that 19 million (12 percent) of the 161 million individual return filers would be potentially eligible for the pilot during the 2024 Filing Season. Figure 1 shows the estimated total number of potentially eligible taxpayers for the pilot during the 2024 Filing Season based on the tax scope offered in the pilot and participating States.

Figure 1: Individual Tax Return Filers Eligible for the Direct File Pilot



Source: TIGTA graphic based upon Publication 1304, *Individual Income Tax Returns (2021) Statistics of Income, Table A* and estimates provided by the IRS's Research, Applied Analytics, and Statistics on behalf of Direct File.

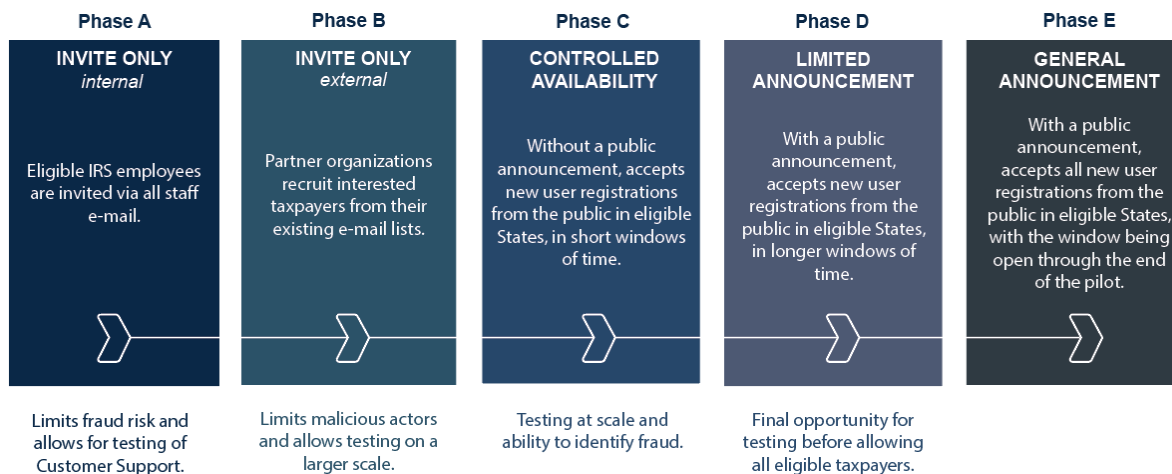
⁶ Appendix II lists the types of income, tax credits, and deductions eligible for the pilot.

⁷ Pilot States include five States with an individual income tax or tax credit that participated in the pilot: Arizona, California, Massachusetts, New York, and Washington. The pilot also included seven States without an individual income tax that were eligible for the pilot: Florida, New Hampshire, Nevada, South Dakota, Tennessee, Texas, and Wyoming.

Pilot phases

The IRS developed a phased approach to the Direct File Pilot during the 2024 Filing Season to allow it to test Direct File in a limited and controlled environment prior to any potential large-scale launch. The pilot was designed to test the technology, customer support, State integration, fraud detection, and overall taxpayer experience. Figure 2 provides a summary of the IRS's originally planned phases of the Direct File Pilot.

Figure 2: Summary of Direct File Pilot Phases



Source: TIGTA graphic based upon IRS Direct File Pilot Design and Rollout dated July 20, 2023.

Customer service

Direct File is designed to allow taxpayers to answer questions about their tax situation to prepare their tax return accurately and confidently. When needed, taxpayers can click on available links for additional information that will explain tax concepts in more detail. However, if a taxpayer decides they need assistance, they can chat live with an IRS assistor from 7:00 a.m. to 10:00 p.m. Eastern time Monday through Friday, except Federal holidays. IRS assistors can provide technical support and answer basic tax law questions related to the pilot's tax scope, in both English and Spanish. IRS assistors do not have access to the taxpayer's IRS account data. Any questions or issues that fall outside of Direct File are routed to other IRS support channels.

The Direct File Customer Support team created training materials, knowledge bases, *etc.* prior to the launch of the pilot. Approximately 400 employees have been identified to support Direct File, as needed, with approximately 200 employees in Caguas, Puerto Rico, serving as the primary site and approximately 200 employees from backup sites in Fresno, California; Jacksonville, Florida; and Brookhaven, New York.

Results of Review

This report presents the interim results of our review to assess the IRS's Direct File Pilot during the 2024 Filing Season. The results in this report are limited to Phase A of the pilot, which was conducted with IRS employees only between February 1, 2024, and February 21, 2024. We will continue our review of the Direct File Pilot and plan to report on our findings later in the calendar year.

On May 30, 2024, the IRS announced that Direct File would be a permanent option for filing tax returns starting in the 2025 Filing Season.



Processing of Direct File Tax Returns

Returns Submitted Through Direct File During First Phase

The Direct File team worked with the Research, Applied Analytics, and Statistics function to identify the population of taxpayers who were eligible for Direct File during the 2024 Filing Season based on the tax scope and State availability. For Phase A, the IRS sent an internal announcement on January 22, 2024, soliciting IRS employees who worked in participating Direct File States to volunteer to use Direct File during Phase A of the pilot. Approximately 1,850 IRS employees volunteered to participate in the pilot.

On February 1, 2024, the Direct File team officially kicked off the pilot with five IRS employees who worked in one of the non-income tax States participating in Direct File. These employees volunteered to be the first filers and were selected by the Direct File team to be the first taxpayers to use Direct File. These employees agreed to allow members of the Direct File team to observe the preparation of their tax return from beginning to end. After successful filing with these employees, the IRS proceeded with Phase A as follows:

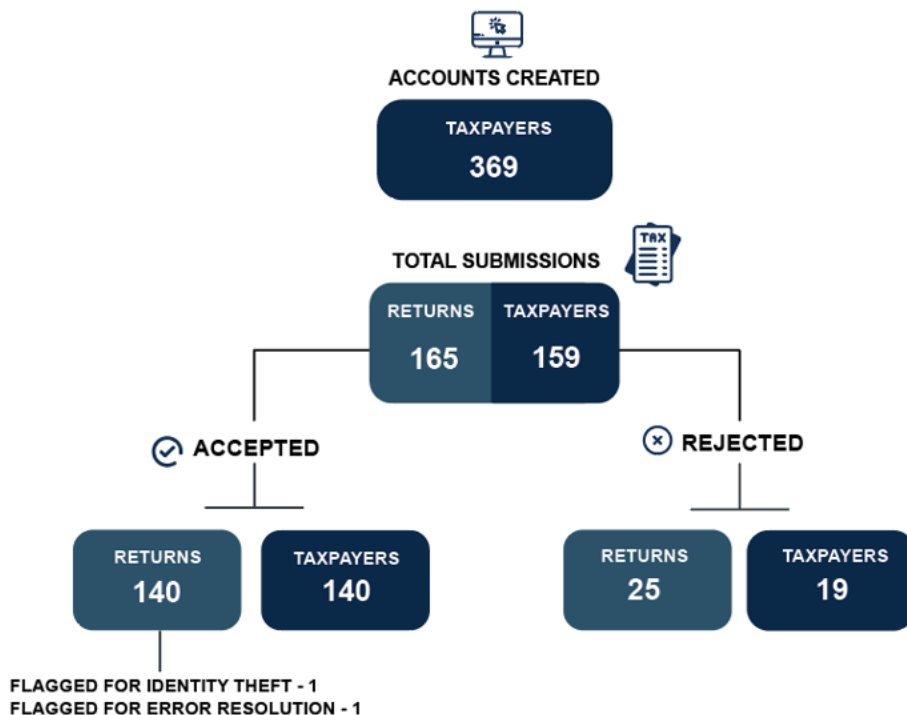
- On February 9, 2024, an e-mail was sent to 1,200 IRS employees from non-income tax States who volunteered to participate in the Direct File Pilot informing them that the pilot was open.
- On February 15, 2024, an e-mail was sent to the remaining 650 IRS employees from income tax States who volunteered to participate in the Direct File Pilot informing them that the pilot was open.

During Phase A of the pilot, 369 (20 percent) of the 1,850 total volunteers created an online account. The IRS received 165 tax return submissions from 159 taxpayers during Phase A of the pilot.⁸ While the Direct File team encouraged IRS employees to file during Phase A, employees may continue to file at any time during the pilot.

⁸ A taxpayer can submit a tax return more than once. For example, a taxpayer may submit a return that is rejected and subsequently correct the return, resubmit the return, and the return be accepted – counting as two submissions.

Figure 3 provides the status of Direct File tax return processing during Phase A of the pilot *i.e.*, between February 1, 2024, and February 21, 2024.

Figure 3: Status of Direct File Tax Returns as of February 21, 2024



Source: Phase A Dashboard as of February 22, 2024, at 8:00 a.m. Eastern time; TIGTA's analysis of Processing Year 2024 Modernized Tax Return Database returns submitted; and IRS Direct File Identity Theft Selection reports and Error Resolution data between February 1, 2024, and February 21, 2024.

We will continue to monitor the number of tax returns submitted via Direct File throughout the pilot, including from IRS employees who volunteered. We also plan to survey taxpayers who were eligible for the pilot or who created an account but did not submit a tax return using Direct File. In addition, we will monitor the business rules and fraud filters and report on their accuracy.⁹ We plan to report on these results later in the calendar year.

Eligibility checker

The IRS offers an informational eligibility checker that allows taxpayers to determine their eligibility to participate in Direct File based on the following requirements:

- State. Direct File is only available for people who live and work in one of the 12 participating States.
- Identification. Direct File requires taxpayers to have certain types of identification to prevent fraud, such as a driver's license, State identification, passport, or passport card.

⁹ The IRS uses business rules to identify errors on tax returns at the time the returns are filed.

- Income. Direct File only works for people with certain types of income, such as Form W-2, *Wage and Tax Statement*.
- Deductions. Direct File only allows taxpayers to take the standard deduction.
- Health Insurance. Direct File only works for people with certain kinds of health insurance and for people without health insurance. It does not include health insurance purchased through a marketplace like Healthcare.gov.
- Credits. Direct File only supports common credits that reduce taxes, such as the Child Tax Credit, the Earned Income Tax Credit, and the Credit for Other Dependents.
- ID.me. Direct File requires taxpayers to create an ID.me account to prevent tax fraud and keep tax information secure.

Our reviews of the eligibility checker and tax returns filed through Direct File during Phase A identified two opportunities for the IRS to update the eligibility checker to clarify eligibility requirements and potentially reduce taxpayer confusion and burden.

- Taxpayers purchasing insurance through a health insurance marketplace. We identified Direct File returns rejected by the IRS because the IRS had data that indicated that the taxpayers purchased health insurance directly from a marketplace during Calendar Year 2023 and the taxpayers did not file a Form 8962, *Premium Tax Credit*, as required.

Recommendation 1 (E-Mail Alert): On February 14, 2024, we alerted the Chief, Direct File, of our concern that the eligibility checker was not clear for individuals who needed to file a Form 8962. Specifically, taxpayers would not understand that they were not eligible to use Direct File based on the information in the eligibility checker related to health insurance coverage. We recommended that the IRS take steps to reduce taxpayer confusion by updating the eligibility checker to clarify eligibility for taxpayers who may have purchased insurance through a marketplace anytime during Tax Year 2023.

Management's Response to E-Mail Alert: IRS management agreed with the recommendation and updated the eligibility checker on March 27, 2024, to provide clarification to taxpayers who purchased health insurance through a marketplace.

- Inconsistent text found between eligibility checker translations. Our review of the Spanish translation for the Direct File eligibility checker found that three of the seven eligibility steps were missing information that was available in the English version. For example, this included text that explained a taxpayer will need an Adoption Taxpayer Identification Number for any dependents claimed, if applicable.

Recommendation 2 (E-Mail Alert): On February 16, 2024, we notified the Chief, Direct File, of our concern that the Spanish translation for the Direct File eligibility checker was missing information. We recommended that the IRS update the eligibility checker to include the missing text identified for the Spanish version and ensure that any future changes made to the Direct File eligibility checker are also updated for all available languages.

Management's Response to E-Mail Alert: IRS management agreed with the recommendation and deployed the Spanish language version of Direct File to the public on March 12, 2024.

Criteria established to evaluate pilot phases

The IRS originally planned to complete five different phases for the Direct File Pilot (see Figure 2). However, prior to the launch of the pilot, IRS management removed the second phase, *i.e.*, Phase B, due to limitations, complexity, and taxpayer privacy concerns with obtaining e-mail addresses for volunteers. Thus, they moved directly to Phase C after completing the rollout of Phase A.

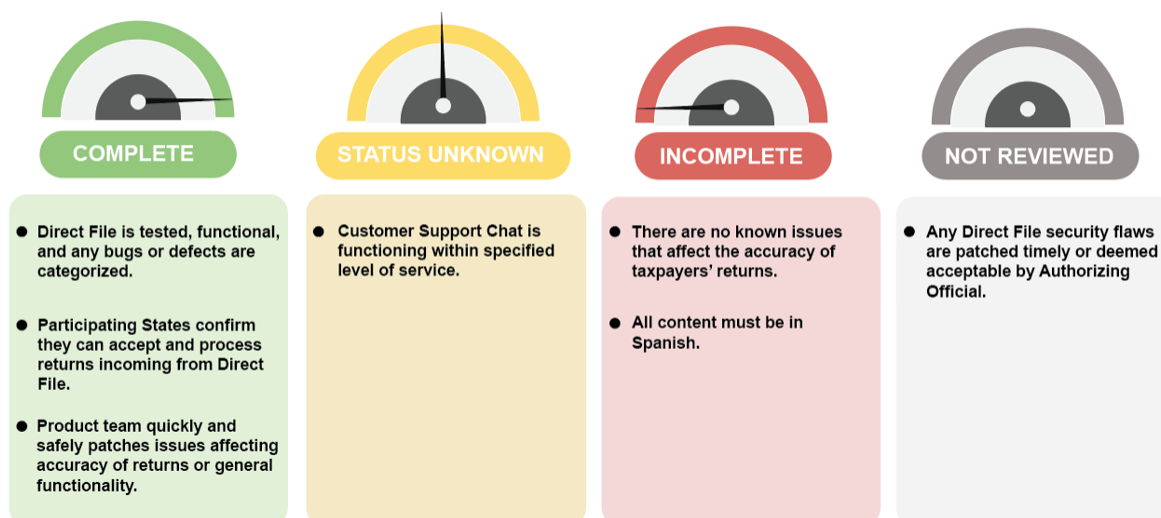
Our review of the seven firm criteria for Phase A identified that the IRS proceeded to Phase C of the pilot even though it did not meet two of its firm criteria, as follows:

- **Spanish translation.** Although translating all Direct File content into Spanish was a firm criterion for completing Phase A, IRS management decided to delay the completion of this requirement to Phase C. Management stated that they needed to begin testing the ability to scale, identify fraud, and see the impact on customer support while providing the Direct File team sufficient time to perfect the translations and load them into the Direct File application.
- **Known issues with accuracy of tax returns.** Our review of the Direct File Pilot ticketing system as of February 21, 2024, identified unresolved tickets that could affect the accuracy of returns. For example, we identified an open ticket showing a known issue with Direct File allowing biological dependents to be older than the parent(s) listed on the tax return. We also identified an open ticket showing an issue with Direct File not prompting taxpayers who changed their filing status to Widowed to re-answer questions about their spouse. At this time, it is unknown to what extent these issues affect the accuracy of tax returns; however, we will continue to monitor these issues throughout the remainder of the pilot.

Office of Audit Comment: In their response, management noted that these examples do not align with the IRS's definition of a tax accuracy issue. However, as we stated, these issues were identified by the IRS's own ticketing system as known issues with Direct File and it was unknown to what extent these issues affected the accuracy of the tax returns. We plan to continue to monitor this throughout the remainder of the pilot.

Figure 4 provides our assessment of whether the IRS met each of the seven firm criteria for Phase A before moving to the next pilot phase.

Figure 4: Assessment of the IRS's Phase A Criteria Being Met



Source: TIGTA graphic based upon Direct File gating criteria as of January 17, 2024.

As noted in Figure 4, the status of one of the seven criteria is currently unknown. We were unable to assess whether the Customer Support Chat was functioning within specific level of service parameters because the IRS did not define what level of service needed to be met before moving to the next phase. However, IRS reports show that 97 percent of chats during Phase A were answered by an IRS assistor within two minutes.

In addition, we did not review the status of one of the seven criteria. A separate TIGTA review is assessing the security of Direct File, and a report will be issued later in the calendar year.¹⁰

Recommendation 3 (E-Mail Alert): On February 7, 2024, we notified the Chief, Direct File, of our concerns that the IRS did not identify quantifiable metrics that would allow the Direct File team and IRS leadership to determine when to move forward between phases and demonstrate continuous improvement. We recommended that the IRS establish numerical benchmarks for the targets and indicators that lend themselves to being measured.

Management's Response to E-Mail Alert: IRS management partially agreed with the recommendation. Management agreed with the importance of quantitative metrics to assist in evaluating the Direct File pilot. However, management did not establish numerical benchmarks as we recommended. Management stated that because this is the first time the Government has deployed a product of this kind, there is insufficient historical data and context to pre-subscribe specific outcomes that would dictate the path to be taken with respect to the product roll out. Instead, a pilot of this kind should be evaluated in a flexible manner, using both quantitative and qualitative factors, which management stated is consistent with their understanding of best practices for product launches in both the private and public sectors. Management also noted their commitment to providing relevant data for public consumption at the end of the pilot and conducting stakeholder outreach to help with the evaluation of the results. Management stated that the IRS has spent several weeks engaging a wide range of stakeholders, including current and future

¹⁰ TIGTA, Audit No. 202320024, *IRS Direct File System Security*.

“customers” and noted that this information has been invaluable and may not have been obtained if the pilot was curtailed by a pre-subscribed gating criteria.

Office of Audit Comment: We agree that this is the first time the Government has deployed a product of this kind. However, creating numerical benchmarks for Direct File would allow for evaluating growth and improvement with quantitative metrics instead of relying on the subjective nature of the Direct File team’s subject matter expertise. As noted, we could not evaluate if the IRS met its firm target for Customer Support Chat prior to exiting Phase A because the IRS did not define what the level of service needed to be before moving to the next phase. Further, we disagree with management’s assertion that having pre-subscribed gating criteria would have curtailed the pilot and their efforts to conduct stakeholder outreach and obtain information about the pilot. Instead, this kind of quantitative data could have been used to inform IRS management and help the IRS objectively decide how it planned to move forward with the pilot phases.



Providing Customer Service

Direct File Live Chats

The Direct File team began training IRS assistors to support Direct File in January 2024. According to IRS management, training encompassed two in-person days and two virtual days of instruction. As of February 21, 2024, 161 IRS employees were trained and ready to support Direct File; the remaining employees were finishing their training.¹¹ As of this same date, as shown in Figure 5, the IRS reported responding to 297 Direct File live chats answering over 600 questions.

¹¹ Direct File assistors will perform other work when not assisting Direct File customers.

Figure 5: Summary of IRS-Reported Live Chat Reasons for Phase A¹²

The IRS had **297 Live Chats** including over **600 questions** regarding the Direct File Program.



Reason for Chat	Count	Percentage
Eligibility for Pilot	150	24%
About Direct File	99	16%
Personal Tax Account Info	95	15%
Tech Troubleshooting	92	15%
Other	77	12%
Rejections or Return Status	64	10%
Tax Law Clarification	43	7%
ID.me and Account Creation	12	2%

Source: Phase A Dashboard as of February 22, 2024, at 8:00 a.m. Eastern time.

The number of questions may exceed the number of live chats for multiple reasons. For example, taxpayers may leave a single chat open while filing their tax return using Direct File and ask multiple questions in a single chat. Taxpayers may also close the chat after each question and initiate a new chat each time they have a question. Further, the reasons for the chat are manually categorized and the IRS employee may feel that the reason for a single chat encompasses multiple categories. For example, a taxpayer may initiate a chat because their tax return rejected and the IRS identifies a technical issue with Direct File that caused the rejection of the tax return during the chat session. As such, this chat would be categorized in two different categories.

We will continue to monitor the number of chats, the chat reasons, and the assistance provided to taxpayers. This includes surveying taxpayers and IRS assistors, reviewing chat logs, identifying the number of hours IRS employees report providing Direct File customer support, *etc.* We plan to report on our findings later in the calendar year.

¹² Percentages do not total to 100 percent due to rounding.

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to provide interim results of our assessment of the IRS's plans to develop and pilot an IRS-run Direct File System in the 2024 Filing Season. To accomplish our objective, we:

- Met with IRS management and reviewed documentation to determine the scope of the pilot, eligibility requirements for participating in the pilot, Customer Support plans, and the IRS's phased approach for implementing/testing the pilot.
- Monitored the IRS's implementation of Phase A of the pilot, including:
 - How the IRS solicited employee volunteers and the number of employees who volunteered.
 - The number of Direct File accounts created, returns submitted, returns accepted or rejected by the IRS, and returns flagged for error resolution and/or identity theft.
 - The number of live chats requesting assistance with Direct File and the reasons for the chat.
- Reviewed the Direct File eligibility checker to determine if any updates were warranted.
- Determined if the IRS met all firm criteria established for Phase A before proceeding with subsequent phases.

Performance of This Review

This review was performed with information obtained from the Office of the Chief, Direct File, located in Washington, D.C., during the period October 2023 through February 2024. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Major contributors to the report were Diana M. Tengesdal, Assistant Inspector General for Audit (Returns Processing and Account Services); Linna K. Hung, Director; Jeffrey D. Cullum, Audit Manager; Dylan C. Altobelli, Lead Auditor; and Edgar M. Moon, Auditor.

Data Validation Methodology

We performed tests to assess the reliability of data from the Modernized Tax Return Database and the Error Resolution file. We evaluated the data by 1) performing electronic testing of required data elements, and 2) reviewing existing information about the data and the system that produced them. We determined that the data were sufficiently reliable for purposes of this report.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: planning documents identifying the IRS's plans for implementing, monitoring, and reviewing the pilot. We evaluated these controls by reviewing the planning documents for reasonableness and discussing with IRS management, as applicable.

Appendix II

Direct File Pilot Tax Eligibility Criteria

⊖ Types of income, tax credits and deductions

You may be eligible to join the pilot if you live in a pilot state and report these items on your 2023 federal tax return:

Income

You may be eligible to join the pilot if you report these income types on your 2023 federal tax return:

- [W-2 wage income](#)
- [SSA-1099 Social Security income](#)
- [1099-G unemployment compensation](#)
- [1099-INT interest income of \\$1,500 or less](#)

You can't use Direct File if you have other types of income, such as [gig economy](#) or [business income](#).

Credits

- [Earned Income Tax Credit](#)
- [Child Tax Credit](#)
- [Credit for Other Dependents](#)

You can't use Direct File if you claim other credits like the [Child and Dependent Care Credit](#), [Saver's Credit](#) or the [Premium Tax Credit](#).

Deductions

- [Standard deduction](#)
- [Student loan interest](#)
- [Educator expenses](#)

You can't use Direct File if you [itemize deductions](#).

Source: <https://www.irs.gov/about-irs/strategic-plan/direct-file#income>, as of March 19, 2024.

Appendix III

Management's Response to the Draft Report



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, DC 20224

May 28, 2024

MEMORANDUM FOR: MATTHEW A. WEIR
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Daniel I. Werfel
Commissioner, Internal Revenue Service

SUBJECT: Draft Audit Report – Inflation Reduction Act: Interim Results of
the Direct File Pilot (Audit #2024408011)

Thank you for the opportunity to review and provide comments on the subject draft audit report. We appreciate the Treasury Inspector General for Tax Administration's (TIGTA) input, analysis, and collaborative efforts thus far to improve the taxpayer experience during the Direct File pilot. Direct File is a completely new service offered by the Internal Revenue Service (IRS) and, in terms of technology and customer support, is unlike anything the IRS or other federal agencies have offered before. While this interim report focuses solely on Phase A of the Direct File pilot, we have learned an incredible amount from both Phase A and the entire Direct File pilot that will help inform the future of Direct File.

The Direct File pilot was intentionally built with a limited scope. During the 2024 Filing Season, our primary goals centered on assessing the viability of our approach while providing an immediate value to a significant number of low- to middle-income taxpayers residing in one of the twelve pilot states. To design the pilot, we engaged in extensive research and usability testing, engaging directly with diverse groups of taxpayers to learn the preferences of Direct File users first-hand. Customer support was integrated within the operations of the service itself. The support employed a test, learn, and iterate approach, focused on agile and human-centered practices.

We thank TIGTA for raising their concern regarding our Eligibility Checker for individuals who needed to file a Form 8962, *Premium Tax Credit (PTC)*. The Direct File team monitored this issue as we wanted to observe opportunities to improve the service while working to prevent potential issues from impacting the taxpayer experience. This included determining the most common reasons why returns were rejected and identifying how to avoid rejected returns in the future. As TIGTA notes, after this issue was identified as an area where taxpayers continued to experience confusion, we

deployed changes to our Eligibility Checker to provide clarification to taxpayers who purchased health insurance through a marketplace.

We also thank TIGTA for raising their concern with the Spanish translation. While our team worked extensively to ensure the accuracy of all translations, we appreciate the additional review TIGTA provided. As noted, we made the necessary changes to the screener language to include the missing information. As changes are made to the Direct File screener, those changes will be made to the Spanish translation as well.

As TIGTA notes, the IRS made the decision to delay implementation of translating all Direct File content into Spanish to Phase C of the pilot. This gating criterion was originally added to support Phase B, which was subsequently removed from the plan due to operational concerns. On March 12, 2024, we deployed the Spanish language version of Direct File to the public.

Regarding tax return accuracy, TIGTA identified two examples that do not align to the IRS's definition of a tax accuracy issue. Both examples would require the taxpayer to provide answers that are known to the taxpayer to be false. If these examples are to be categorized as tax accuracy issues, the IRS would be holding Direct File to an impractical standard of accuracy, requiring the tool to prevent a taxpayer from providing false information on their tax return. Regardless of what filing method taxpayers use, they are ultimately responsible for what information is provided on their return and ensure it is complete and accurate.

We agree with TIGTA it is important for the IRS to demonstrate continuous improvement during the pilot, including the review and evaluation of our gating criteria. The Direct File team collected significant quantitative and qualitative data such as length of hold time for customer support chat as well as the customer experience with support chat. This combined data allows the Direct File team to understand whether the level of service provided to taxpayers is acceptable. Based on prior observations, we did not create pre-defined precise thresholds that would lead to a go vs. a no-go decision. Instead, we used the information to develop options and will engage with stakeholders on the best path forward. This approach is consistent with industry best practices on a potential new product. The goal of a pilot like this is to test against unknowns and determine if there is an acceptable baseline of evidence to continue the program and build future metrics.

Over the course of the pilot, more than 3.3 million taxpayers started the Eligibility Checker to see if they could use Direct File; 423,450 taxpayers logged into Direct File; and 140,803 taxpayers submitted accepted returns. Direct File issued more than \$90 million in tax refunds and collected \$35 million in tax balances due. This data, along with

other input from stakeholders,¹ demonstrates a material demand for Direct File as a filing option.

The IRS takes seriously its need to fully evaluate the Direct File pilot to understand its impacts. Establishing specific goals for a variety of metrics for a new product without sufficient context and relevant data on which to set the baseline is not a best practice and can undermine the goal of a product pilot effort. In particular, there are a number of factors that would make it impractical to have pre-defined performance targets, including:

1. Never before has the Federal Government created free tax filing software for the general public.
2. No tax software, for which we have any data, has been rolled out with a similar phased pilot strategy.
3. The potential impact of pending tax legislation on future filing seasons.
4. Never before has the IRS piloted an exclusively chat-first based customer support program.

The data gathered and lessons learned throughout the pilot will inform a decision on the future of Direct File and establish future metrics.

The IRS appreciates TIGTA's role in helping improve the Federal Government.

Our responses to your specific recommendations are enclosed. If you have any questions, please contact me, or a member of your staff may contact Direct File, Director, Bridget Roberts at 202-317-4212.

Sincerely,
Daniel I.
Werfel
Danny I. Werfel
Commissioner
Internal Revenue Service

Digitally signed by Daniel
I. Werfel
Date: 2024.05.28
13:10:02 -04'00'

Attachment

¹ See e.g., letter dated May 14, 2024, from 256 separate organizations around the country to the Treasury Secretary and IRS Commissioner urging the government to make Direct File permanent and citing several independent research studies indicating robust taxpayer demand for a Direct File option.

Recommendations

RECOMMENDATION 1 (E-Mail Alert)

On February 14, 2024, we alerted the Chief, Direct File of our concern that the eligibility checker was not clear for individuals who needed to file a Form 8962. Specifically, taxpayers would not understand that they were not eligible to use Direct File based on the information in the eligibility checker related to health insurance coverage. We recommended that the IRS take steps to reduce taxpayer confusion by updating the eligibility checker to clarify eligibility for taxpayers who may have purchased insurance through a marketplace anytime during Tax Year 2023.

CORRECTIVE ACTION

The IRS agrees with this recommendation. We updated the Eligibility Checker on March 27, 2024, to provide clarification to taxpayers who purchased health insurance through a marketplace.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

Director, Direct File

CORRECTIVE ACTION MONITORING PLAN

NA

RECOMMENDATION 2 (E-Mail Alert)

On February 16, 2024, we notified the Chief, Direct File of our concern that the Spanish translation for the Direct File eligibility checker was missing information. We recommended that the IRS update the eligibility checker to include the missing text identified for the Spanish version and ensure that any future changes made to the Direct File eligibility checker are also updated for all available languages.

CORRECTIVE ACTION

The IRS agrees with this recommendation. On March 12, 2024, we deployed the Spanish language version of Direct File to the public.

IMPLEMENTATION DATE

Implemented

RESPONSIBLE OFFICIAL

Director, Direct File

CORRECTIVE ACTION MONITORING PLAN

NA

RECOMMENDATION 3 (E-Mail Alert)

On February 7, 2024, we notified the Chief, Direct File of our concerns that the IRS did not identify quantifiable metrics that would allow the Direct File team and IRS leadership to determine when to move forward between phases and demonstrate continuous improvement. We recommended that the IRS establish numerical benchmarks for the targets and indicators that lend themselves to being measured.

CORRECTIVE ACTION

The IRS agrees with the importance of quantitative metrics to assist in evaluating the Direct File pilot. However, given this is the first time the government has deployed a product of this kind, there is insufficient historical data and context to pre-subscribe specific outcomes that would dictate the path to be taken with respect to the product roll out. Instead, a pilot of this kind should be evaluated in a flexible manner, using both quantitative and qualitative factors. This is consistent with our understanding of best practices for product launches in both the private and public sectors.

Of particular note, the IRS committed to providing relevant data for public consumption at the end of the pilot and then to conduct stakeholder outreach to help with the evaluation of the results. The IRS has spent the last several weeks engaging a wide range of stakeholders, including current and future “customers.” This information has been invaluable and may not have been obtained if the pilot was curtailed by a pre-subscribed gating criteria.

IMPLEMENTATION DATE

NA

RESPONSIBLE OFFICIAL

NA

CORRECTIVE ACTION MONITORING PLAN

NA

Appendix IV

Glossary of Terms

Term	Definition
Electronic Filing	The transmission of tax information directly to the IRS using mobile devices or computers. Electronic filing options include (1) online self-prepared using a mobile device or personal computer and tax preparation software, or (2) using a tax professional.
Filing Season	The period from January 1 through mid-April when most individual income tax returns are filed.
Health Insurance Marketplace	The place for people without health insurance to find information about health insurance options and to purchase health insurance. It is also known as the Health Insurance Marketplace or Health Insurance Exchange.
ID.me	Provides secure identity proofing, authentication, and group affiliation verification for government and businesses.
Obligation	A definite commitment that creates a legal liability for the payment of goods or services ordered or received. Obligations reduce the amount of funds available.

Appendix V

Abbreviations

IRA	Inflation Reduction Act of 2022
IRS	Internal Revenue Service
TIGTA	Treasury Inspector General for Tax Administration



**To report fraud, waste, or abuse,
contact our hotline on the web at www.tigta.gov or via e-mail at
oi.govreports@tigta.treas.gov.**

**To make suggestions to improve IRS policies, processes, or systems
affecting taxpayers, contact us at www.tigta.gov/form/suggestions.**

Information you provide is confidential, and you may remain anonymous.