



Prefilled Individual Income Tax Return Filing: What It Is and Policy Issues

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Filing federal income taxes imposes costs on taxpayers, the Internal Revenue Service (IRS), and employers and other payers. According to the [IRS](#), the average individual taxpayer with business and nonbusiness income in 2021 spent a total of 13 hours to prepare and file their income tax return. For those who purchased tax software or paid someone to prepare and file their returns, the average out-of-pocket cost was \$240. There is considerable variation among taxpayers in these compliance costs.

U.S. policymakers have been looking for feasible ways to reduce filing costs for some time. The IRS Restructuring and Reform Act of 1998 (P.L. 105-206) directed the IRS to develop a return-free filing system that eligible taxpayers could use to file their returns, starting in 2008. The IRS never produced such a system. There is still interest in Congress to implement a cheaper alternative to the current filing system. S. 4508 and H.R. 8368 in the 117th Congress would require the IRS to create a prefilled return filing system that eligible taxpayers could use to file their returns, beginning in 2024, among other things.

This Insight briefly explains how prefilled return filing would work and discusses some of the policy issues raised by proposals to use such a system in the United States.

What Is Return-Free Filing?

In general, return-free tax filing allows taxpayers to meet their income tax obligations without filing a return with their tax agency. In 2020, at least [36 countries](#) (including the United Kingdom, Germany, Japan, Denmark, and Sweden) employed such a system. In general, return-free filing is accomplished in one of two ways: an [exact withholding system \(EWS\)](#) or a [tax agency reconciliation system \(TARS\)](#).

In an EWS, a tax agency attempts to ensure that the exact amount of a taxpayer's tax liability is withheld over the course of a year. The main goal of such a system is to keep eligible taxpayers from having to file returns at the end of the year to obtain refunds or pay balances due. An EWS typically requires taxpayers to report the information needed to calculate accurate withholding allowances to their employers or a tax agency at the start of a year.

Under a TARS, taxpayers have the option of having their tax returns prepared by a tax agency and sent to them for review. The tax agency calculates tax liabilities based on information it has received from

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taxpayers, employers, banks, and other third parties. Taxpayers can accept the assessments and pay any tax owed or receive any refund due, or contest the assessments by filing their own return. Withholding does not have to be exact under a TARS because withholding and payments are reconciled at the end of the year.

Policy Considerations

The question of whether the IRS should prefill tax returns for certain taxpayers raises a number of policy considerations. These include the potential cost savings from using such a system; the number of taxpayers who might benefit and their tax situations; and its implications for taxpayer compliance and the federal tax gap.

Potential Cost Savings

A primary incentive for adopting prefilled return filing is the reduction in taxpayers' compliance costs it might generate. This reduction would stem from decreases in the time and money eligible taxpayers spend to file their returns. In a 2006 study, [Austan Goolsbee](#) found that a fully implemented federal TARS could reduce eligible taxpayers' total compliance burden by \$44 billion over 10 years, assuming 100% of eligible taxpayers participate.

[Some argue](#), however, that prefilled return filing would not necessarily reduce the overall income tax filing cost. In their view, such a system would shift much of this cost from taxpayers to the IRS and employers, banks, and other payers. Employers and other payers presumably would have to upgrade their information technology (IT) systems to accelerate the transfer of data to the IRS to allow it to prepare prefilled returns without significant delays within the current filing schedules. The IRS presumably would have to modify its IT systems to accommodate the timely preparation of these returns.

Still, the IRS might have lower processing costs overall under a prefilled return filing system, as it may result in fewer math errors and fewer paper returns. It is unclear how much cost savings the IRS could realize with prefilled return filing.

Taxpayers Who Might Benefit

According to a recent study, prefilled return filing [might benefit up to 41% to 48% of individual taxpayers](#). The exact number would depend on their tax situation and the scope and accuracy of the income reported by third parties to the IRS. The [experiences of other countries](#) with a TARS suggest that the success rate might be highest for [single filers with relatively simple tax situations](#). [An example is someone with wage income](#) only who has no dependents and claims the standard deduction and no other deductions, exemptions, or credits. A lower success rate would be likely for taxpayers who itemize their deductions and derive significant shares of their income from sources currently not subject to information reporting, such as self-employment income. Boosting the success rate for this group of taxpayers may require a broad simplification of the federal income tax.

Prefilled return filing may also benefit taxpayers who are not required to file but must file to receive refunds they are due.

Implications for Taxpayer Compliance and the Federal Tax Gap

It is unclear whether prefilled return filing would improve taxpayer compliance, and thus reduce the federal tax gap, which is the difference between total federal taxes owed and total taxes paid in full and on time. The gross tax gap is estimated to be [about \\$600 billion](#).

Most likely beneficiaries would be taxpayers with predominantly wage and interest income, both of which have high compliance rates because they are subject to employer (W-2) and third-party (Forms 1099) reporting to the IRS. Prefilled return filing may have little effect on the compliance of some of the biggest individual contributors to the tax gap, which include self-employed persons and partners from partnerships; their income is subject to little or no information reporting, which makes it difficult for the IRS to track their true income.

Prefilled return filing may also distort the incentives for tax compliance for some individuals. Such a system may incentivize taxpayers to contest what they consider an IRS overestimate of their tax liability but to quietly accept an underestimate, increasing the tax gap. Any revenue loss from this distortion, however, might be partially offset by the collection of revenue from nonfilers who owe taxes and are issued prefilled returns.

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