

MAY 2026

# The Future of Tax Filing

## Part 3: Beyond Direct File: A Vision for the Future of Tax System Access

### Chapter 11: Real-time taxes (estimated payments, withholding, advance payments, and the gig economy)

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<sup>1</sup> This chapter is significantly informed by user research led by Allison Abbott.

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## Summary

- Even in our fast-paced world, the tax system operates on a fundamentally yearly cadence, with taxpayers paying in throughout the year, and potentially due for a rude surprise if their payments turn out at filing time to have been wrong. Making the tax system more real-time would be a tall order, and we do not necessarily argue it deserves to be prioritized given the immense effort involved. But, this chapter contends it would be a positive project, and lays out what it would entail.
- At present the systems to manage and track payments throughout the tax year are antiquated and leave the IRS without clear data on a taxpayer’s status before filing time. Some taxpayers — especially gig economy workers — also must navigate complex processes to stay in compliance. Advance payments of tax credits, if implemented, add another layer to the real-time tax system, requiring some taxpayers to adjust their withholding or estimated payments to stay in compliance. (11.1)
- Many taxpayers are very uncomfortable when it comes to withholding and estimated payments, especially in the gig economy (11.2.1). Most taxpayers also have a strong interest in ensuring they are paying in the right amount. Owing the IRS at filing time is seen as a very bad outcome to be avoided at all costs; paying in far too much and receiving a large refund is preferable but still far from ideal (11.2.2).
- Taxpayers would find it very useful if the IRS helped them track and fulfill their tax obligations throughout the year, especially for gig economy income (11.2.3). But they would not want such a service to automatically make changes on their behalf, and they would be concerned about overreach (11.2.4).
- Next steps and recommendations:
  - The IRS should introduce withholding for gig economy workers. Step one is probably a pilot with a few large gig economy employers. If the pilot goes well, scaling it further may require statute. (11.3.1)
  - The IRS should create a new product that helps taxpayers track and fulfill their tax obligations throughout the tax year (11.3.2). Using status quo data, there is a limited amount this product could do (11.3.3); to make the product more useful, the IRS needs more real-time data during the year, a reporting reform that may be achievable in the context of H.R. 1 implementation (11.3.4). With this additional data in hand, the real-time product would become immeasurably more powerful and useful (11.3.5).
  - Advance payments of tax credits represent a complex real-time taxes challenge that we believe policymakers should approach thoughtfully. (11.3.6)

- Taken together, these piecemeal reforms would move the United States closer to a pay-as-you-earn (PAYE) system. Some reformers may advocate a more thorough and holistic PAYE reform than the a la carte measures laid out here; but we believe such smaller iterative measures are the most viable route to larger reforms. (11.3.7)

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The overall structure of the income tax system in the United States has a curious shape. Throughout the year, taxpayers earn money and pay into the system. Exactly once a year, taxpayers do a wholesale reconciliation between what they paid and what they ought to have paid. If they paid too much, they receive the excess as a refund, with the government essentially having held that excess as an interest-free loan throughout the year. Still worse, if they did not pay enough, they pay the excess, sometimes with fees and interest.

In a world where information moves so quickly that even the idea of a daily-published newspaper seems like a hopeless anachronism, **shouldn't taxes be administered at something better than a yearly cadence, with this yearly crashout reconciliation process relegated to the past?** Indeed, other countries have regimes commonly called pay-as-you-earn, in which taxes are effectively calculated in real time and the yearly reconciliation is nearly nonexistent for most taxpayers, or at least a minor event.

That said, there are important differences between the U.S. tax system and that of countries with true pay-as-you-earn systems. Notably, the U.S. tax code is based deeply on family structure in a way that makes taxes extremely dependent on family events that the tax agency cannot perceive, at least in real time. The U.S. tax code is also more laden with tax benefits that alter taxpayers' bills in perhaps unpredictable ways. And, the U.S. taxes more forms of income than, for example, the United Kingdom. Finally there are existing taxpayer expectations from familiarity with the status quo: whether or not pay-as-you-earn makes more sense, there is the question of whether taxpayers accustomed to the current model would react well to its hypothetical implementation.

**This chapter explores how tax administration works throughout the year, in terms of withholding, quarterly estimated payments, and advance payments of credits, including what data is available to tax agencies, what changes taxpayers would like to see, and what solutions might improve the taxpayer experience.** Although getting all the way to a true pay-as-you-earn system is probably impossible under current law, the evidence suggests taxpayers would appreciate measures that move the overall system in that direction. Collectively, we refer to this set of issues and recommendations as the real-time tax system.

We offer this entire chapter with an important caveat: some of the impactful reforms detailed below would be monumental implementation challenges, whose pursuit would necessarily distract from other worthy reforms. **We think the information below speaks for itself in making the case that the real-time tax system is one worth building on its own**

**terms. But whether it is worth the trade-offs required to prioritize it is a question policymakers will have to answer in context.**

## 11.1 Background: the status quo

This section briefly reviews the basic legal and administrative structure of the tax system during the tax year.

### 11.1.1 Requirements and infrastructure

Legally, taxpayers owe tax to the government in real time throughout the tax year, as they earn their income. Taxpayers are required to make these payments into the system throughout the year, or else pay interest on the late payment of tax.

When taxpayers earn salaries or wages on W-2s, the employer generally takes money out of the taxpayer's paycheck, and remits it to the tax agency, as payment of the taxpayer's tax; this process is *withholding*. W-2s are basically unique in this regard — while withholding is technically permissible for other income sources reported on other forms, it is not standard, and generally withholding is only paid via W-2s.

To determine the amount of withholding paid from W-2 wages, taxpayers send their employers Form W-4, which provides relevant information on their tax situation (principally family structure). The W-4 notably changed drastically after the enactment of the Tax Cuts and Jobs Act (TCJA) in 2017, and some taxpayers still refer to older versions of the form. While the W-4 is properly speaking just a document designed to calculate correct withholding for a specific W-2 job, the W-4 does also ask about *other* income. This accounts for the math of graduated taxation, and enables taxpayers to use their W-2 withholding from a job to also pay their tax on income from non-withheld sources, like interest. For example, a taxpayer with \$30,000 in W-2 income and \$10,000 in interest income would have their W-2 withholding increased to account for the additional \$10,000.

If a taxpayer's withholding is less than their total tax liability, usually because of significant non-W-2 income (including gig economy income), they are required to proactively make estimated tax payments quarterly. These payments are generally made directly on the IRS and state tax department websites; as far as we know, there are not significant third-party tools for this process. In the case of the IRS, notably, the estimated tax payment infrastructure is included in IRS.gov/pay functionality, which is separated from the rest of the IRS online account.

### 11.1.2 Data systems

For W-2 employment, the IRS<sup>2</sup> receives *total* withholding payments from employers on a quarterly basis, via Form 941. But Form 941 payments are aggregated across all employees; the report does not actually identify which employees this withholding belongs to, much less the corresponding income of those employees. The IRS does not receive W-2 income information, or any individual-level information at all, until it receives W-2s in January.

This set-up has a few implications. First of all, information is currently received at *best* quarterly; the IRS knows nothing at a cadence less than 90 days. Second, and more important, even the quarterly data is aggregated. The IRS has no information about the income or withholding of an individual person until early the following year.

Most W-2 payroll is managed by a handful of large payroll processor companies (such as ADP, Paychex, and Intuit QuickBooks Payroll). Note that these companies have an incentive to maintain key portions of the status quo: the providers often collect withholding from small- and medium-sized employers biweekly, and earn interest on the money in the interim before it is paid to the IRS at the end of the quarter.

For all other forms of income (including gig economy income), the IRS receives no data whatsoever until information returns are filed early the following year, at which point the IRS learns how much income each taxpayer earned (plus, in the very rare case the other income sources are withheld, the withholding amounts).

### 11.1.3 Advance payments

To help ensure taxpayers do not have their money locked up until tax time in April, policymakers have often proposed or implemented advance payment programs, by which tax credits (usually the CTC, sometimes the EITC) are issued in periodic payments throughout the tax year, in *advance* of their full claim at tax time. Most prominently, the IRS implemented a half year of CTC advance payments in tax year 2021. Currently, Minnesota has advance payments for its state CTC. By changing tax system cash flows during the tax year, these payments are properly understood as components of a real-time tax system.

For some low-income taxpayers, such schemes are the only way to prevent a large refund in April, because these taxpayers have negative net tax liability — that is, rather than owing any tax, the tax system owes them money, thanks to refundable credits. If a taxpayer is eligible for \$2,500 in EITC and their total tax liability (including the credit) is *negative* \$2,000, even zeroing out withholding will not prevent a \$2,000 lump sum in the spring; only issuing the EITC in advance will do so.

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<sup>2</sup> Throughout this section, when we say IRS, we mean by extension state tax departments as well, although some state equivalents of Form 941 include individual-level withholding data. States also have access to quarterly individual-level earnings via unemployment insurance programs, but these would not include individual-level withholding.

For other taxpayers though, advance payments are, in accounting terms, substitutes for adjusting withholding. Suppose a taxpayer has \$2,500 in gross tax liability, and they have their withholding set up correctly to pay \$2,500 into the system over the course of the year; their refund is \$0. The taxpayer suddenly becomes eligible for \$2,000 in CTC. (Suppose for simplicity there are no other credits in the picture.) If this taxpayer does not change their withholding and does not receive advance payments, they will receive a large \$2,000 lump-sum credit. But they can also simply adjust their withholding to spread the credit across the year; instead of paying in \$2,500, they can simply pay in less, totaling \$500. This is mathematically equivalent to keeping their withholding unchanged and receiving \$2,000 in advance payments.

This dynamic can actually introduce a challenge for advance payments in the case of taxpayers who, like this one, receive a credit non-refundably. Suppose the taxpayer does adjust their withholding downward in light of the \$2,000 credit; they now pay in \$500 throughout the year and receive a \$0 refund ( $\$2,500$  tax liability -  $\$2,000$  credit -  $\$500$  withholding). Then, the tax department starts issuing the \$2,000 credit wholly in advance payments. At tax time, the taxpayer has \$2,500 in tax liability, against which they have paid \$500 withholding. But they can no longer claim \$2,000 in credit; they've already received that money during the year. So they now owe \$2,000 ( $\$2,500$  tax liability -  $\$500$  withholding).<sup>3</sup> If they do not want to owe at tax time, they will need to edit their withholding back up \$2,000; the advance payments and the withholding are, in arithmetic terms, simply canceling each other out. (Of course, they may not be perfect substitutes in terms of politics and perceptions; advance payment advocates argue that the payments increase the salience of a credit, making the credit more tangible in the eyes of recipients/voters.)

This is to say nothing of the more commonly-discussed implementation challenge: eligibility can change during the course of a year. If a credit is for a child, for example, the taxpayer may not claim the same children this year as they claimed last year, for any number of reasons. Advance payments are paid based on last year's taxes, on the assumption that nothing has changed. Suppose our taxpayer with \$2,500 in pre-credit gross tax liability knows they are not going to claim the same children as last year, and adjusts their withholding upwards to \$2,500. But if the tax department still issues advance payments based on the prior year eligibility, they will again find themselves owing the \$2,000 back, when it transpires upon filing that the advances were collected in error.

The issue is resolved through a combination of taxpayer responsibility to make real-time updates and safe harbor provisions protecting taxpayers who fail to do so. But of course, the ability to make real-time updates is closely related to the functioning of the real-time tax system in general.

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<sup>3</sup> During the 2021 implementation of the Advance Child Tax Credit, this dynamic would have been muted since, (1) only half the credit was paid out in advances, and (2) the advance payments were paired with an expansion in the size of the credit. This meant that taxpayers' net liability at year end only increased by a maximum of \$500 per older child and \$200 per younger child, instead of \$2,000 in this example.

## 11.2. Taxpayer attitudes

During our user research sessions, we asked taxpayers how they determine their withholding and estimated taxes, we probed whether they prefer to get refunds or pay in the right amount, and we explored what kinds of tools would be helpful to taxpayers in making this process easier. In our user research recruitment we over-sampled for gig economy workers, who are more likely to have complicated experiences in this domain. Moreover, because we were compensating research participants through an online user research platform, all of our participants inherently had *some* gig economy income.

### 11.2.1 Many taxpayers are very uncomfortable when it comes to withholding and estimated payments, especially in the gig economy

**Many participants taxpayers said they were basically shooting in the dark regarding their withholding and estimated payments.**

- *[How confident do you feel on a scale of 1 to 10, that you're withholding the right amount of taxes?] "Absolutely not. Probably zero." — Participant #7*
- *[How do you determine your W-2 withholding?] "Wild, wild, wild guesses" [How confident do you feel on a scale of 1 to 10, that you're withholding the right amount of taxes?] "Negative two...I just feel like it's like a guessing game." — Participant #9*
- *"I mean, the way I'm doing it now is very unconfident. I'm not sure if I'm doing it right" — Participant #14*

This confusion had led to some nightmare stories:

- Last year, Participant #15 set aside \$4,000 in a savings account throughout the year, to cover her expected tax liability, but then learned she owed \$7,000 when she filed. She's now paying off the \$3,000 via a credit card, while also withholding more from her W-2.
- Participant #9 had not made estimated payments herself, but had done so for her mother's taxes — only after things had gone quite wrong. *"The first year that we didn't do it, [the tax bill] was so high that I was like shell shocked."* — Participant #9
- Participant #5, a gig economy worker with highly fluctuating wage income, reported having unintentionally set up his withholding so it was far too high, up to and including sometimes receiving a \$0 paycheck.

Some taxpayers expressed more confidence, though even then, it wasn't 100%:

- *"I mean, the exact right amount, I'm not confident at all. Something in the ballpark that's not going to get me penalties, I feel fairly confident, like an eight or nine."* — Participant #6, the only participant who reported paying regular quarterly estimated taxes
- *"I would probably say it's at like a seven or an eight. And the reason why I say that is just because, I guess since January, there have been so many things that have changed*

*tax-wise, law-wise.... There's so many different ways to earn income now and there's so many different ways they're taxing things.” — Participant #11*

**Partially the lack of confidence came from the difficulty in just keep track of income and payments:**

- *“How much more do I need to save? Especially because it's not just my W-2, where they list it up, and you can see your year to date... But to find year to date with all this other stuff, you'd have to go to every account and your bank accounts. And I have payments through like PayPal, Zelle, and Venmo. So I have to go in and calculate all of that up for each client separately. So that's what makes it really hard to keep track of.” — Participant #15*

**It was also clear that there is no single place where taxpayers regularly learn about these topics — about the need to do quarterly payments, or about when one might update withholding.** Generally, participants told us about learning about their responsibilities from past mistakes, or offhand from friends who had potentially similar situations. There is no “welcome to the gig economy” information that taxpayers receive when they start earning 1099 income.

**Of the participants with gig economy income, only one actually reported making regularly quarterly estimated payments.** Most were not making such payments at all, or at least not making them quarterly.

- Some said they would as their business got bigger, or “more formal” (Participant #12)
- Participant #11 reported saving money throughout the year in a high-yield savings account, and making four estimated tax payments right before the annual deadline.
- Many participants were explicitly or tacitly using their W-2 withholding to cover their gig economy income.

One participant had previously made quarterly payments for a business they no longer had, and reported that learning how to do it was a challenge:

- *“I owned a magazine before and I did have to do quarterly taxes for the magazine and they were ... really scary when I first started doing them. They were extremely overwhelming. ... But in the beginning, I was like, oh my gosh, this is scary. If I do this wrong, I'm going to go to jail.” — Participant #12*

To the degree that participants had a system for figuring their estimated payments, it was almost always simply based on the prior-year return (which is, in some but not all cases, an accurate strategy).

**We conclude that there is plenty of opportunity space here for a product that eases anxiety and helps taxpayers avoid nightmare scenarios.**

## 11.2.2 Taxpayers very much want to avoid owing money, though they generally don't want big refunds either

We also probed about taxpayers' attitudes about the size of their refund. Did taxpayers prefer to pay in the exact right amount into the system, such that they had a \$0 refund? Did they not really mind getting a bigger refund, because the refund served as a useful savings mechanism? How bad an outcome is it if they owe money? The strength of taxpayers' opinions on these questions determines the importance of a product to precisely manage real-time taxes.

**First, we heard near-universally that taxpayers very much do not want to owe taxes when they file, citing not wanting to be “in trouble” with the IRS.**

- *“You don't want to mess with the IRS. You don't want to owe them.”* — Participant #4

**Beyond this, opinions varied. Most people were interested in paying in as close as possible to the right amount, though they often said they know others who prefer a large refund.**

- *“So from a personal standpoint, I like getting kind of that closer to zero refund at the end of the year. I hate owing, but it's best to just pay in what's due and have more money throughout the year. From what I've been seeing and what I hear, most people seem to like that huge refund.”* — Participant #10
- *“[I prefer paying the exact right amount,] because then I have my money for longer and can use it to invest or spend however I need, rather than having the government have my money and then give it back to me.”* — Participant #6, who later said he'd want to be within 10% of correct
- *“Up to this past year, I didn't mind owing a little bit. [But last year,] the difference was so big, and I'm still paying it... I don't like being in that situation. So I would rather overpay. Definitely.”* — Participant #15
- *“I would want to have it exactly right, but...I'm the type of person, like, I'd rather go a little bit earlier, so I know I'm not late. So it's like, me personally, I probably would still over-withhold just a little bit”* — Participant #7
- *“Yeah, I'd rather have a little bit of a refund than have to owe..... So, I mean, there was one year that I owed and it was when I was unemployed and I forgot to have the taxes withheld from my unemployment. ... And when I filled out my unemployment claim last week, I'm like, yes, hold the taxes, please. I don't want to have to owe next year. ... I like to have it be as close as possible.”* — Participant #1
- *“I'd rather just pretty much break even on my taxes...But sometimes there's people that like to have that, that big chunk savings.”* — Participant #4
- *“I feel kind of slightly overpay to the tune of getting me a refund, if that makes some sense. I don't mind breaking even, but I definitely don't want to overpay to the point where now the IRS is owing me five thousand or more dollars, because that means I really did not do the math right.”* — Participant #11

One participant explicitly preferred overpaying to get a large refund:

- *“I guess I would choose to have more withheld so that I could get the bigger refund...And I know there's people that argue against that and they say you're just loaning the government money interest-free. Why do you want to do that? That's all you're doing. Don't get excited over a big refund. But it's just nice to kind of have that to kind of count on. ... if I don't do that and I rely on myself to set money aside like in a savings account, I'm going to drain that. I can't count on myself not to touch that. But if it's gone, if it's out of my check, it's held and I don't have access to it.... It's like a kind of foolproof savings.” — Participant #13*

Some taxpayers prefer — or at least don't mind — overpaying; but many want to be as close as possible to the right number, and even those who don't mind overpaying seemed to express there was a limit. **There is fairly widespread interest in paying in something near the right amount.**

### 11.2.3 There is space for the IRS to help with gig economy income in particular, and taxpayers would spend a limited amount of time using it

Between the anxiety and bad outcomes discussed in Section 11.2.1, and the moderately prevalent desire for payments throughout the year to be correct in Section 11.2.2, **we can infer there would be space for a product solving the real-time payments problem. Many participants validated this directly:**

- Participant #7 described “a user-friendly IRS website that you can enter in your current situation” and see if she's “in the red, or the green” regarding her withholding.
- *“An app or something that kind of puts all that data together and says, okay, you made this much here, you made this much here...and then if it pulled that tax information and said, this is your estimated tax thus far. I think that would be super useful...I could actually be willing to do quite a lot [to use such a product] because that's a huge time saver compared to going through each account.” — Participant #15*
- Regarding a potential product that would track income and payments throughout the year: *“That'd be a service....And I think the part of that, that I would really like, it would just be the peace of mind.... I don't honestly think it should be a service that we would have to pay for because I feel like the IRS should just tell us, because they know.” — Participant #9*

When taxpayers were wary or, in one case, entirely uninterested, it was usually not because the product would be in principle unhelpful, so much as that they did not trust it would necessarily be correct — a dynamic discussed further in the next section.

**Overall, though, participants felt this was the right role for the IRS** — rather than, for example, an employer who is helping to manage withholding, or another third party. One participant said they thought, of any actor in the ecosystem, the IRS would be likely to be “the most right.”

As part of this broader potential product experience, we asked taxpayers to reflect on a potential world in which the IRS saw that their withholding or estimated payments appeared to be wrong and **sent a notification recommending they update their withholding or make a payment. Again, with the caveats discussed further below, taxpayers were very enthusiastic about such a program.**

We asked taxpayers how much time they would be willing to spend using such a product, to improve the accuracy of their withholding/estimation. Most said they would be willing to spend around 15 minutes to an hour — which is, admittedly, not necessarily a lot of time. In some cases they acknowledged that they would trade off spending less time for less precision:

- *“Less work for more of a ballpark, just because people's lives are busy.” — Participant #4*

#### 11.2.4 But taxpayers really want to be in control, and were concerned about overreach

**The interest in such a product, though, came with several important caveats, all of them generally reflective of the notion that participants had limited faith in even the IRS’s ability to get it exactly right.** Taxpayers were wary of anyone but themselves being in the driver’s seat. They emphatically did not want any actor, including the IRS and especially their employer, to *automatically* make withholding changes on their behalf.

- *“I need to know what's going on....I would want anyone to communicate with me first, and then I make the decision on what I want to do... Like, you don't know what is going on with me. So don't make those decisions for me.” — Participant #8*
- *“I want to be kind of the director of that ship. I'm an adult, I'm independent of the government, I want that choice... it's my right to have that control over that.” — Participant #15*
- *“I need the transparency and the communication. Just like I wouldn't want a bank to do anything automatically or any other financial institution to do anything automatically without me knowing that would affect my finances as well as my cashflow. I just want to be in the know so I can be prepared.” — Participant #11*
- *“Them just automatically updating it — I see more harm than good with that.” — Participant #10*

Sometimes this desire for autonomy came in the same breath as the acknowledgment that they might not fully understand the tax system, and there is a lot they don’t know. Even so, taxpayers said, they want to be in control.

- *“You know, I think that people ought to have as much autonomy as possible. But it's so intimidating... the whole tax code is just, it's just like a foreign language to me anytime I'm trying to figure things out on my own with regards to that. And you're so worried about penalties, you just don't want to get it wrong. But you don't want them necessarily*

*just dictating everything too, because that feels wrong. So in a perfect world, it would be me [making the decisions], but there would be some kind of easier way to understand the information so you would feel more confident.” — Participant #13*

Many participants cited specific pieces of data the IRS would not know (unreported income, family changes), which would cause the IRS’s recommendations to be wrong. One taxpayer even said he was explicitly uninterested in the product, precisely because he thought it would be so unreliable:

- *“I don't think I'd be comfortable with that because in order for that to work, they would need to have access to all my finances to know exactly what it is that I'm going to be deducting.” — Participant #6, also the one participant who reported making regular quarterly payments*

**The aversion to automatic changes even spilled over to reluctance to receive recommendations from the IRS, which might be inferred as directive:**

- *“I would feel like they were telling me, ‘you better change it,’ even if they phrased it all like friendly and just trying to be helpful and everything. I would feel like they were instructing me to make that change somehow. So I would get a little nervous and I would feel like I needed to change something. Even if I felt like it was okay, I'd be like, well, if they think so, then I must be doing something wrong.” — Participant #13*

One participant also mentioned concerns about the IRS having *too much* access to data:

- *“I would like something that could kind of monitor my separate accounts. I wouldn't want it, you know, visible to the IRS. I don't like them in my bank accounts.” — Participant #15*

**One noted that **the product could engender more confidence if it showed its work:****

- *“Probably what would make me more confident is just having them showing their notes of — hey, look, we've seen it come through on this 941 from these, investments have the foreign income tax taken out of it, or from what their sources of the information are. Just kind of the proverbial Wizard of Oz from behind the curtain of, hey, from our sources, you're going to owe \$2,000. Well, where are you getting that math? When I do my return, I'm showing I'm a break even. No, you're actually going to owe \$2,000. We'll show you. So having them show their work or see where they're getting their sources from...would be a great help.” — Participant #10, who is also a tax accountant*

It’s important, of course, to take this with a grain of salt: taxpayers’ desire for control may simply be a reflection of the fact that the IRS doesn’t currently have enough information to execute such a product well, and hasn’t proven itself up to the task of similar projects in the past. These are perceptions that could — and, via the program described below, *would* — change over time; changing these perceptions would indeed be part of the point. But, this is

the current state, and it is important to take it seriously as a starting point, and not force people into a world they are uncomfortable with.

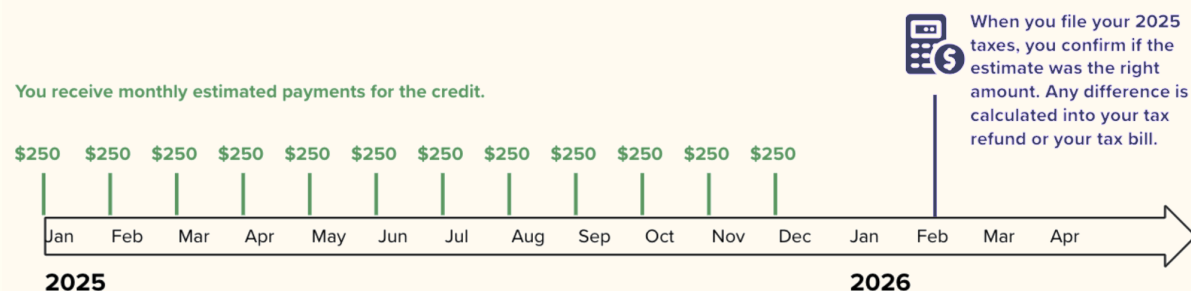
## 11.2.5 Taxpayers are wary of advance payments under the current system

We also asked taxpayers about the prospect of getting their credits in advance payments, using the 2021 Advance CTC regime as our example. The scenarios are shown here.

### Receiving Credits: Version L



### Receiving Credits: Version E



First, and perhaps surprisingly, although many of the participants had eligible children during the 2021 CTC experience, almost **none of the participants appeared to remember that the 2021 Advance CTC had occurred**. Participants treated it as a novel idea, one that they would be surprised to come across in real life.

- “So they’re actually thinking about doing that?” — Participant #3, who already had three children in 2021

**Second, taxpayers’ reactions in our user research were generally negative.** The reaction appeared to be driven by the uncertainty in the advance payments, engendered by the fact we described the advances as “estimated” payments — the idea the advances could be deemed wrong was what most upset participants. At least one cited a personal experience of Advance Premium Tax Credit payments having later been determined overgenerous due to mid-year income changes. In this sense, the presumptive eligibility regime and the high

phaseout included in the final Build Back Better language could have assuaged taxpayers' concerns. But, for the most part, taxpayers did not express that they liked the idea if it could be finagled to work; they just thought it sounded like a problem waiting to happen, and not worth it — or, at the very least, not a priority.

- *“Nope. Give it to me afterwards.” — Participant #4*
- *“I don't know if I like that [advance payments]. But I think it would be good to get an extra \$250, but not, you know, then not being aware if you're going to owe or not. Yeah, I don't like that.” — Participant #3, who said he would opt out of such a system*
- *“Now you owe all that money back because something happened in your tax situation, like with my child, that I wasn't expecting... Yeah, I mean, it kind of stinks waiting for it, but I'd rather be sure. I guess I'm not one of those risk takers, especially, you know, having to pay bills. I'd rather get a surprise at the end of like a Christmas present instead of a bad surprise, like, oh, no, never mind.” — Participant #15*

**There is of course countervailing [research](#) showing that taxpayers' opinions about periodic payments in the abstract are generally more negative than what they report after having actually received them.** A July 2022 [survey](#) by the Urban Institute, for example, studying the same 2021 Advance CTC payments, researchers found that 45% of nonelderly adults living with children preferred having received the advance CTC payments, while 27% preferred a single payment as part of a tax refund and 28% had no preference. Similarly, a 2015 [Chicago pilot](#) studying the impacts of periodically paid EITC found that 90% of those who received periodic payments preferred them to a lump sum. It is certainly possible taxpayers would be happy to receive advance payments, despite what they report.

Still, it is worth considering taxpayers' comments in the larger context. When looking at the functioning of the tax system and timing of payments throughout the year, lots of things currently don't work well for taxpayers. **There are many specific reforms they would find helpful, that would strongly reinforce their faith in the tax system. It seems that advance payments would only do so if designed in a way that gave taxpayers a high level of certainty about their accuracy. Otherwise, they risk presenting a variety of implementation challenges that resemble the same themes that taxpayers are most concerned about.** While our research shows a clear preference among taxpayers for staying roughly 'square' with the IRS throughout the year — avoiding large refunds or unexpected bills — that preference does not necessarily translate into a desire for advance payments, at least among these participants, and at least in the hypothetical.

## 11.3 Solutions

Even our limited user research is more than enough to conclude there is very likely a useful product here — something tax agencies could provide that would make a meaningful improvement in the lives of taxpayers, who struggle with making the right payments throughout the year and do not currently have good solutions.

### 11.3.1 Withholding for gig workers

Before we get to the details of such a product, we must first address the biggest gap in the real-time system: gig economy income generally has no withholding. Given taxpayers are so uncomfortable with estimated tax payments, this sets up many of them to owe money — unless they simultaneously have a W-2 job lucrative enough to cover withholding for both income streams.

**The solution is fairly obvious: there should be at least the *option* of withholding in the gig economy.**

Conveniently, the basic plumbing for gig economy withholding already exists, as 1099-NEC accommodates withholding; it is just only used at present for backup withholding and various special cases.

**Step one is probably a pilot**, possibly at the state level, with a few of the larger gig economy companies, to more broadly implement 1099-NEC withholding. Such a pilot should not require statutory authorization. The companies have an incentive to participate even without statute because (1) it would be a fairly inexpensive way to improve workers' satisfaction, not to mention a P.R. win, and (2) the companies would get to play a major role in implementing and designing a reporting system that might eventually become mandated, and they could engineer a solution that works well for them rather than later be subjected to a more burdensome process that doesn't take their needs into account.

Eventually, scaling this process to more gig economy businesses may require statute. It probably won't be possible to enforce or implement in every case, given the range of 1099 employers, but it could reach a large majority of gig economy workers. If the withholding were mandated via statute, the mandate may depend on the size of the employer.

At least in the early stages, the withholding should be opt-in rather than opt-out for payees, allowing taxpayers to decide what works best for them. Assuming the initial implementation works well, the long-term goal should be to make such withholding mandatory, for at least the vast majority of cases.

### 11.3.2 A real-time taxes product — and connections to existing infrastructure

As outlined above, our user research makes clear there is **taxpayer interest in a tax agency product that allows taxpayers to see what they are earning and paying throughout the year, and whether they are on track to have paid the right amount into the system**. It would facilitate adjusting withholding or estimated payments if taxpayers are on the wrong track. This section discusses the broad outlines of the product; the details of its data sources and the actionable recommendations it could present to taxpayers are discussed in the following sections.

Some key aspects of the product:

- Eventually, **such functionality would need to exist at both the federal and state level**, since withholding and estimated payments are made separately at each level. That said, much of the basic infrastructure for such a product would be common to both levels, and as in the case of Direct File, there is a **strong case for having state versions somehow integrate with a central federal version**.
- Federally, **the product would be connected to — and perhaps the central component of — the IRS online account**. Integration with the online account would allow the real-time functionality to use information already saved within the taxpayer’s account. And it would be sensible for taxpayers to find this functionality in the same place as functionality for other non-tax-time account management or updates.
- It could in principle be plausible for the IRS to liaise directly with employers to update withholding. But we heard clearly from taxpayers that they don’t want such updates made silently or automatically; they want to be involved. As such, **employers do not need to be directly involved with any such functionality**.
- Relatedly, **taxpayers should make the final call on any changes**. The IRS should not be making silent updates based on background data. Taxpayers need to be aware and participate in changes — at least in the early years as the IRS builds up trust.
- **All functionality in the product, especially any notifications recommending changes, must be carefully phrased not to project overconfidence**. We heard that taxpayers will feel wary contradicting an IRS suggestion, even if it is just a suggestion. The functionality needs to thoroughly communicate the level of certainty inherent in any information provided.
- **The functionality should, wherever possible, “show its work,”** explaining the sources and nature of any calculations to better inspire confidence and help taxpayers understand their situations.
- **Taxpayers would be recruited to take up use of the product through the filing process**. This is an easier proposition in a world with Direct File — but there are other ways. Taxpayers could receive messages about the new product when their refund is posted, using the mechanisms discussed in [Chapter 10: IRS communications](#). These messages could also be customized according to the types of benefits the particular taxpayer might see, based on their tax situation. Software providers could provide prominent links to and information about the product in their products — either voluntarily because it is a useful service to taxpayers, or as a requirement documented in [Publication 1345](#) and state Letters of Intent. Such communications would help taxpayers ensure they are fixing their withholding and payments for the current year while they are filing for the prior year.

### 11.3.3 Real-time taxes functionality using status quo data

Remember that, under the status quo, tax departments have no access to real-time data about withholding or earnings throughout the year.

**As such, the simplest status quo version of the functionality would be based on prior year data, plus any estimated tax payments made to date.** Upon logging in, the functionality would tell you that, if your current year ultimately looks like last year, you should make a given quarterly payment.<sup>4</sup> There could also be functions for editing basic parameters and yielding new quarterly payment amounts. For example, the product might show calculations in terms of (a) expected total income, (b) expected total withholding, (c) expected filing status and household composition (with attendant estimates for EITC and CTC) — but then allow the user to edit each of these and see accordingly updated estimates. In a world with updated dependency rules (see [Chapter 12](#)), the functionality might also help taxpayers to remember who is claiming a given child this year, and proactively amend withholding information accordingly.

The IRS could also set up pilot programs to import year-round data from certain large gig economy employers or large payroll processors, on a pilot basis, to begin exploring expanded functionality.

**There are two key calls to action in the product: either to make an estimated payment, or to adjust withholding** (for W-2 income; or, in a world with gig economy holding, for gig economy income). In the simplest version of the product, the withholding adjustment would generate a new W-4, which would be submitted to the taxpayer's employer.<sup>5</sup>

#### 11.3.4 Getting better data — and connection to H.R. 1 implementation

**Regarding W-2 income, tax agencies need to receive withholding and earnings data, by person, more frequently throughout the year.** More precisely, this implies a few changes:

- When payroll processors make quarterly aggregate withholding payments on Form 941, they would also report *by person* the withholding *and income* that correspond to each individual taxpayer.
- The payroll processors should make these reports (and, possibly, payments) biweekly or even weekly, rather than quarterly.

This second change is less critical for this particular use case — tax agencies could still make a lot of progress with quarterly data. Moreover, payroll processors might object to the second change, because they earn interest on the withholding until the end of the quarter (though that opposition could be muted by changing the reporting cadence and keeping the payment cadence). As such, the first change would be the priority.

**Regarding 1099 gig economy income, tax agencies need some measure of advance reporting: income (and, if applicable, per Section 11.3.1, withholding) on an individual level, at least quarterly, if not per payout.** As with the idea of requiring 1099 withholding, as

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<sup>4</sup> Today, some commercial software encourages taxpayers to make such payments, following this logic.

<sup>5</sup> In the longer term, a more sophisticated version of this functionality might run via a real-time-taxes API, that employers query while running payroll for the latest updates from their employees.

discussed in Section 11.3.1, this reporting won't be possible in every case; there are too many small gig economy employers and sometimes money really does arrive highly inconsistently throughout the year. But, again, enrolling even the large gig economy employers in an advance reporting system would be a big deal. And again, the requirement could be based on the size of the employer.

**“Given the near-term realities of H.R. 1, this entire topic of real-time income and withholding reporting is a good candidate for exploring at the state level before scaling any solutions federally, particularly in states where individual-level withholding data is already reported quarterly.”**

In principle, tax agencies should be getting these advance reports for other 1099s as well, including interest income (1099-INT), unemployment income (1099-G), Social Security (SSA-1099), etc. In practice, agencies can probably get much of the way there without these additional reports; taxpayers with large amounts of interest, for example, are probably higher-income taxpayers with complex situations, who may well already be hiring accountants to help them manage payments throughout the year. Agencies can at least get started without this additional 1099 reporting, though they should keep it on the road map for the longer term.

**Getting better data pipelines connected at a huge scale is often a prohibitively difficult proposition. But right now, in 2026, there is a possible angle for tax agencies: the implementation of H.R. 1.** Employers may have a stake in building seamless income reporting processes so they don't have to handle confirming employees' income ad hoc, as state agencies enforce Medicaid work requirements.

Given the near-term realities of H.R. 1, **this entire topic of real-time income and withholding reporting is a good candidate for exploring at the state level before scaling any solutions federally, particularly in states where individual-level withholding data is already reported quarterly.**

Another option to enforce the construction of these better reporting pipelines would of course be via statute: Congress could mandate W-2 income and withholding reported to the IRS quarterly or more, and mandate something analogous for at least the largest gig economy workers. We are hopeful, though, that much of this could be done administratively.

### 11.3.5 Second-generation real-time taxes functionality

With the expanded data discussed in Section 11.3.4, the functionality of the real-time tax product can become much more robust. **Rather than using prior-year earnings and withholding as loose estimates for current-year earnings and withholding, the product can use the current-year data, and detect with considerable precision whether a taxpayer is on track.** Of course, some reliance on the prior-year data is still valuable. Prior-year income data could help the IRS predict, for example, if there is likely an additional income source that is not currently reporting in real time.

Changes in family structure would continue to be the major data point that relies on taxpayers' own data entry. Because the IRS does not and still will not directly detect family structure changes, it would still be on taxpayers to make these edits themselves. The real-time functionality would need to be very forthright about this need — much as it needs to communicate, in general, that these are just estimates based on current information, and could be incorrect.

**With better reporting, tax agencies should also send proactive alerts to taxpayers when they detect that taxpayers are likely off-base with their payments — not only inviting them to use the product to check their status, but letting them know it is likely they need to make a change.**

### 11.3.6 Advance payments of tax credits

Based on the structural issues discussed in Section 11.1.3 and the user research discussed in Section 11.2.5, we recommend that lawmakers and advocates be thoughtful about reintroducing advance payments of refundable tax credits.

- **Implementing advance payments requires solving a variety of challenging administrative issues in a high-stakes time-pressing context.** Because monthly or quarterly payments would likely need to change in response to real-time family (and, depending on policy details, income) changes in taxpayers' lives, accuracy would require quick and easy access to online tools that permit updating real-time tax information, and quick and easy resolutions to conflicting dependent claims — all in a world where even the less time-sensitive retrospective versions of these issues are not entirely solved. It also, as discussed in Section 11.1.3, requires taxpayers who receive the credits non-refundably to amend their withholding to ensure they don't find themselves suddenly owing — an easier problem than the issue of unexpected family changes, but still one that requires taxpayers to have a clear real-time picture of their taxes that they currently do not have. It involves, in other words, conquering some of the thorniest real-time taxes issues.
- Advocates and policymakers may not like the fact that taxpayers' fear of owing money to the IRS is so substantial. **But that fear currently exists, and we believe they have to take it seriously.** Policymakers should be attempting to build trust and

reduce anxiety. A program that creates unexpected tax liability for even a small population of taxpayers could do damage in this regard.

- Finally, to the degree that one of the goals of advance payments is the visibility of the program, and thereby of the support provided by tax credits, **policymakers should consider that this visibility might be achieved via other means** — for example, through a transparent and well-messaged year-round taxes product, or a filing product.

If policymakers continue with an advance payments program, we recommend they take seriously the learning that taxpayers want to be in control of their destiny on such topics. Advance payments should in most cases be an option that taxpayers proactively elect on their W-4 or on their prior-year return, so that they know what’s coming and can plan around it. A product like the one discussed in the previous sections would also go a long way toward facilitating the transparency, understanding, and control taxpayers want.

### 11.3.7 A glide path to pay-as-you-earn (PAYE)

Many advocates in the tax space are interested less in piecemeal reforms like the ones discussed here than in a wholesale pay-as-you-earn (PAYE) tax system, like, for example, the one in the U.K.<sup>6</sup> Our view is that, taken together, implementing the various reforms in this chapter constitutes the first several steps towards PAYE.

The Direct File experience offers a useful analogy. Many advocates were interested not in a “public TurboTax” but in a “return-free filing” system, in which tax returns became a thing of the past. But Direct File was showing that we have to go through the first to get to the second. The piecemeal reforms of Direct File and of a highly-manual real-time product, respectively, are the first steps toward return-free filing and toward PAYE. Given the current infrastructure, the current levels of trust in the IRS, and the complexity of the U.S. tax code, jumping to a further point in the development would likely only backfire for taxpayers and for tax administration.

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<sup>6</sup> PAYE is also sometimes referred to as pay-as-you-go, or PAYG. PAYE should not be confused with the student loan repayment plan of the same name.