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The Future of Tax Filing

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

Chapter 15: IRS and private providers

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Contents

- [15.1 Direct File as a default, and preferred, option](#)
 - [15.2 Direct File as enforcement of tax software accuracy](#)
 - [15.3 Privacy and security standards for software providers](#)
 - [15.3.1 Conditions for data sharing](#)
 - [15.4 Rules and oversight for paid preparers](#)
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Summary

- The IRS has historically played a limited oversight role regarding the private tax software providers and paid preparers who comprise the broader tax filing ecosystem — in large part a function of the IRS’s limited capacity and leverage. In a world with a resurgent Direct File, we believe it would be time for this posture to self-consciously change, to ensure better outcomes for taxpayers.
- While taxpayers should of course be allowed to use other services, the IRS should — unlike in 2024 and 2025 — unapologetically promote Direct File as a default, and even preferred, option for tax filing. (15.1)
- The IRS should more rigorously enforce accuracy standards for private tax preparation software — a task that would be made immeasurably easier by the existence of Direct File tax logic. This comprises both *hard accuracy* (given a set of inputs, does the software determine the correct eligibilities and amounts) and *soft*

accuracy (given a certain taxpayer situation, how likely is it that they are successfully guided to claim all the provisions available to them). A dedicated team would probably be necessary to enforce these standards. (15.2)

- The IRS should also enforce rigorous privacy and security standards for software providers, holding them to the same standards it would impose on its own products — at the price of noncompliant providers losing access to IRS systems (15.3). This is especially critical as the IRS gives private providers access to ever more taxpayer data (15.3.1).
- The IRS should also regulate paid preparers, which will require statutory change. (15.4)

For decades, the IRS has played a very limited oversight role over private tax software providers and paid preparers. Preparers can be penalized for fraudulent returns, and software providers have to pass a limited set of accuracy tests to be authorized for e-file. Preparers are also legally bound by taxpayer data private protections in 26 USC 7216. But in practice, IRS enforcements or penalties are few and far between, even in cases of [systematic inaccuracy](#), likely [violations of taxpayer data privacy rules](#), [high-profile outages](#), or [misleading advertising](#). We are not aware of any precedent for the IRS imposing penalties on private tax preparation software for inaccuracies, much less for misleading or subpar functionality.

Meanwhile, in non-punitive cases, **the IRS has universally positioned itself as something of a neutral party with regards to the functioning of the tax ecosystem.** IRS communications about Direct File, for example, were at pains to present the new project as simply another choice for taxpayers, one that is only for some taxpayers, and one that the IRS would not dream of promoting over other options. During the 2025 tax filing season, as noted in [Chapter 7: Direct File promotion and outreach](#), the IRS web page about free tax filing switched back and forth every minute between whether Free File or Direct File were listed first on the page.

This is all despite the fact that there is ample and serious evidence that some private actors regularly [mislead](#) or [take advantage](#) of taxpayers.

To a meaningful degree, this hands-off approach has been a function of power, leverage, and capacity. In a world where the IRS did not offer its own tax filing options, what leverage did it really have to nitpick about those that third parties were offering? And in a world where nearly all of these solutions were private, how could the IRS legally and ethically draw any distinction between the options available to taxpayers? Today, in a world at least for now again without Direct File, many of these constraints still apply.

But in a future world with a resurgent Direct File, the IRS would be empowered to play a more strident and active role shaping the broader tax filing ecosystem. This chapter explores what this may look like.

In general, while taxpayers should have the choice and freedom to interact with the tax system as they see fit, we believe the IRS should be willing to take a firm stand on private providers in the ecosystem. The IRS should control and regulate the role private providers play in the tax system, and hold them unambiguously to as high a standard as the government. While private providers will of course identify opportunities to differentiate their offerings and provide value to customers, this should not come at the expense of the integrity of the filing system or risk to taxpayers who avail themselves of these options. The role of private providers should be contingent on operating in taxpayers' best interest. And in conducting this oversight and regulation, the IRS should take candidly into account the track records of private actors, to assess whether they promote accurate and secure tax administration, and the IRS should impose consequences on those who do not.

Such a stance does not sacrifice taxpayer choice or private enterprise; it simply increases the probability that taxpayers are able to successfully and safely navigate the tax system. The health of the tax ecosystem relies on a vigorous and empowered IRS willing to take this stance.

15.1 Direct File as a default, and preferred, option

As a pilot program with meaningfully limited scope, the IRS was limited in how prominently and forthrightly it could promote Direct File — a filing option that genuinely would not work for many taxpayers.

Once Direct File's scope is larger — once it reaches its *baseline maturity*, as described above — we believe the IRS's stance should change: it should promote and talk about Direct File as the IRS's default filing option (see [Chapter 7: Direct File promotion and outreach](#).)

This is not to say that the IRS would force any taxpayers to use Direct File, or that it would privilege Direct File returns over others. As in other contexts (e.g., Medicare Advantage), private third-party services remain available and supported. But there is no reason the IRS cannot take the position that Direct File is its recommended filing option for taxpayers. It is the option for which the IRS can have the most confidence in return accuracy, having designed and reviewed it in-house and due to pre-population of taxpayer data. It is the option for which the IRS can have the highest confidence in fraud controls. It is the option that doesn't require taxpayers to expose their data to third parties. For all these reasons, the IRS should take the view that, while taxpayers may do whatever they wish, the IRS can unequivocally recommend Direct File, and the IRS should act as if this is, generally speaking, the default for most taxpayers.

Such a measure, as discussed, would be an inflection point for Direct File uptake, though it would not likely result in Direct File becoming even the majority filing option in the United States. (Australia has a robust ecosystem of commercial options, with its government-provided MyTax serving a little more than a third of all taxpayers; we think it is unlikely on any reasonable timeframe that the U.S. would exceed this rate with Direct File.)

But Direct File also serves as a much-needed rebalancing of power between the IRS and private actors in the tax industry. In a world with Direct File, private tax preparation services need to outcompete the public option to earn business. If they can do so, they are certainly entitled to. But their role in the ecosystem should be a function of such competition, not a function of their ability to rent-seek off the back of government services in disrepair.

15.2 Direct File as enforcement of tax software accuracy

A more robust Direct File would also empower the IRS to audit and enforce the accuracy of third-party tax software packages.

At present, IRS oversight of software accuracy is very limited. MeF — via its XML schemas, business rules, and reject codes — effectively oversees tax software’s arithmetic (do the lines add up correctly) and XML formatting (are the appropriate lines in the electronic submission in the right order). But none of this confirms whether the tax situations reported by the taxpayer in the interview-based software map correctly to the generated return. Does the software, for example, correctly disallow the EITC if a taxpayer’s SSN is not valid for employment? The IRS does not systematically oversee this.

For one thing, this is a question of capacity. In a world without Direct File, auditing the accuracy of software would be a highly time-intensive brute force process, with hundreds of IRS employees creating test returns and manually confirming their accuracy. **With Direct File, the IRS can easily generate a correct return for any given scenario, using it as the answer key against which other software’s output (given the same user inputs) can be checked for accuracy.**¹ Direct File’s own testing regime, with its own carefully-curated mutually-exhaustive suite of test cases, could be applied to the external vendors as well.

Moreover, Direct File’s existence ensures that the IRS has a view on what is correct in any given case. During the course of Direct File’s first two years, despite the product’s limited scope, IRS counsel had to issue new opinions on the interpretation of a number of statutory questions that it had never authoritatively resolved before. Direct File’s expansion will ensure that counsel has an opinion, in all covered cases, of what an accurate return is.

In addition to auditing and enforcing what we might call the ‘hard accuracy’ or ‘validity’ of a return (given a set of inputs, does the software generate the right eligibilities and amounts), **the IRS should also use the same processes to audit the ‘soft accuracy’ or ‘soundness’ of a return — that is, how likely is it that a taxpayer using the software correctly claims everything they are eligible for?** In filing season 2021, for example, taxpayers who had not received an Economic Impact Payment in 2020 were eligible to claim the funds as the Recovery Rebate Credit (RRC) on their return. But in many private filing products, the RRC option was quite hidden, and taxpayers could easily pass through the software without

¹ MeF e-file testing requires software providers to correctly submit a small handful of tax returns, which do not come close to probing all components of the software.

claiming this money. A filing season 2021 return that did not claim the RRC was not *inaccurate* in the sense of *hard accuracy*, but we would consider it inaccurate in the sense of *soft accuracy*. Of course, *soft accuracy* gets into design decisions that are judgment calls; not everything can be explicit, or the filing experience would be interminable and untenable. But the IRS ought to be able to define and enforce a standard that ensures most taxpayers claim most tax benefits most of the time.

This second audit should solve the problem of what are sometimes called ‘non-claimant filers’ — taxpayers who file a return but fail to claim a credit (like the EITC) that they are eligible for. If taxpayers all use filing tools with high ‘soft accuracy,’ such a population would not exist.

Direct File’s maturity makes all this enforcement possible, but it doesn’t make it inevitable. The IRS should set up a team dedicated to the task of overseeing tax software providers, significantly more robust than the MeF approvals team that currently controls software providers’ access to the e-file system. Their mission would be to ensure that software packages’ hard and soft accuracy measure up to that of Direct File, and they would be empowered to demand improvement or else turn off the e-file access of any software program that demonstrably and persistently causes taxpayers harm.

15.3 Privacy and security standards for software providers

As discussed at further length in [Chapter 5: Direct File and identity verification](#), when it came to identity verification standards for Direct File, the IRS effectively opted to hold Direct File to a higher standard than private software providers, requiring Direct File users to verify their identities at IAL2 to receive MeF reject codes, while users of private software faced no such requirement.

This episode is emblematic of a broader dynamic, in which the IRS enforces incredibly high privacy and data security standards on its own systems, while largely letting private software self-police. This dynamic is due for an overhaul. Not only does it perpetuate the misaligned power dynamic between the IRS and private providers, but it is also incoherent from a privacy and security perspective, since the tax ecosystem is only as secure as its weakest link. In the case of MeF reject codes, for example, it does not matter how secure Direct File is if threat actors can access the reject codes via private software. They will simply continue to attack the system via the private software.

There should be serious privacy and data security rules for accessing the IRS e-file system, with rigorous enforcement and oversight, and consequences for failure to comply. This doesn’t mean private software should be subject to overzealous and impractical standards; as always, it is important to balance access and security. But they should be analogous to the standards the IRS would impose on itself, and its own systems.

This enforcement should be overseen by the same new software oversight team discussed in Section 16.2.

15.3.1 Conditions for data sharing

As we write this in 2026, it is an especially risky moment with regards to the oversight of tax software's data security and privacy standards, because the IRS, through the DATS program, has given private software companies direct access to an API that allows them (with the taxpayer's consent) automated access to data from the taxpayer account. This could eventually give the companies access to Direct File functionality like One-Step Signature.

The principles of taxpayer choice militate in favor of allowing this access, but advocates and policymakers should recognize this is a dangerous moment. The Free File experience shows what can happen when too much is given away to private interests without strings attached. Privacy and security standards should be applied to any software provider, as a price of their access to MeF. But **the standards should apply even more stringently to software providers retrieving sensitive taxpayer data from the IRS via DATS, to ensure this trust is not abused.** Again, the software oversight team should be responsible for policing access to this data.

15.4 Rules and oversight for paid preparers

The above sections deal with standards for private tax software packages.

The same issues, though, apply to paid preparers — businesses that prepare taxpayers' returns. The [Center for Taxpayer Rights has reported in detail](#) on the vast scale of these services, and in particular *non-credentialed preparers* among them, who prepare a large fraction of low-income tax returns. As CTR documents, issues with accuracy and data security at such providers appear widespread, and egregious abuses at smaller scales are [regularly reported](#). And yet the IRS imposes few penalties on these preparers, and collects only a small fraction of the assessed penalties: “While the IRS has identified 87,000 ‘high risk return preparers’ since 2005, and those preparers are disproportionately involved in improper claims for the EITC and other refundable credits, it rarely assesses preparer penalties and even more rarely collects on those penalties.”

The need to improve regulation of paid preparers has been widely covered over the years across the government, including, for example, [by the Taxpayer Advocate](#), [GAO](#), and [TIGTA](#). Congressional action is needed to make some of this regulation possible.