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The IRS Technology Modernization Program: An Overview

The Internal Revenue Service (IRS) collects 95% of the funds needed to operate federal government programs and agencies. In FY2023, the agency collected \$4.7 trillion in gross revenues, processed 272 million tax returns and other forms, and issued \$659 billion in refunds. The IRS's information technology (IT) systems are critical to this output.

The capabilities of those systems have long been a concern to taxpayers, tax professionals, and lawmakers, among others. Critics regard key elements of the IRS's information systems as outdated, inefficient, and ill-suited to achieving the service's current strategic goals. These systems rely on core legacy computer systems installed in the 1960s that operate on computer programming languages such as Common Business Oriented Language (COBOL) and Assembly Language Code. The Government Accountability Office (GAO) maintains that legacy systems like the IRS's "contribute to security risks, unmet mission needs, staffing concerns, and increased costs."

The IRS has pursued several major technology modernization initiatives since the 1970s. It has spent billions of dollars on its current effort, the Business Systems Modernization (BSM) program, which started in the late 1990s. In recent years, the program has emphasized projects intended to expand and digitize taxpayer services (e.g., creating online taxpayer accounts for expedited case management). Central to such projects is the replacement of the IRS's COBOL-based Individual and Business Master Files, which are still used in the processing of individual and business returns.

This In Focus briefly reviews the evolution of the BSM program and discusses some of the policy issues it raises.

Evolution of the BSM Program

The BSM program focused on several technology development initiatives in its early years. Foremost among them was the Customer Account Data Engine (CADE 1), which was intended to replace the Individual Master File with a faster, more efficient, and more secure taxpayer data management system. In 2004 congressional testimony, GAO's Robert F. Dacey referred to CADE as the "linchpin modernization project" because most IRS information systems depended directly and indirectly on the file's data.

IRS officials initially estimated that CADE 1 would cost \$66 million and would be ready for deployment by late 2001. In 2009, after a string of delivery delays and cost overruns, the IRS stopped working on the project.

In 2010, the IRS began to develop a successor to CADE 1 known as CADE 2. The project was slated to be finished in three phases, the first two of which were to be completed by

January 2014. The GAO reported that only the first phase was completed by January 2014. According to the IRS's latest projection, CADE 2 should be fully deployed by FY2028.

The IRS made significant changes in the BSM program when it launched a six-year plan (called the IRS Integrated Modernization Business Plan or IMBP) in April 2019 to make major improvements in taxpayers' interactions with the IRS. The plan revolved around projects intended to (1) expand online access to taxpayer information and other IRS services, (2) reduce call-wait and case-resolution times, (3) accelerate the processing of tax returns and refunds, (4) simplify the verification of taxpayer identities, and (5) retire millions of lines of legacy IT code. The IRS initially projected that these projects would be completed by FY2024 at a cost between \$2.3 billion and \$2.7 billion.

An infusion of multiyear funding for the IRS under the Inflation Reduction Act (P.L. 117-115, IRA, see below for more details) seemingly has imparted new momentum to the IRS's long-standing technology modernization efforts. In April 2023, the IRS issued a "Strategic Operating Plan" (SOP) for using the \$79 billion in mandatory IRA funding the agency was to receive between FY2022 and FY2031, including \$4.8 billion in BSM funds. This funding is in addition to IRS discretionary funding in that period. One of the SOP's five objectives was to "deliver cutting-edge technology, data, and analytics to operate more effectively."

In a 2024 update of the SOP, the IRS stated that it is planning to undertake 18 technology modernization projects between FY2023 and FY2025, at a total cost in IRA funds of \$3.3 billion. Three projects are expected to account for a significant portion of that expenditure: Enterprise Case Management, Individual Master File Modernization, and Identity and Access Management.

Funding

Congress set up a special appropriations account in FY1997 (the Information Technology Investment Account) for the BSM program. Since FY1998, BSM funds have been available only for the acquisition, development, and implementation of products and services related to modernization projects; they may not be used for the maintenance and operation of the IRS's existing IT systems, the cost of which is covered by a different appropriations account.

Initial BSM funding was \$295 million in FY1998. This amount has fluctuated ever since. Funding peaked in FY2002 (in current dollars) at \$406 million and remained above \$300 million until FY2005, when it fell to \$203 million. BSM appropriations remained below \$300 million until FY2012, when they rose to \$330 million. Funding

then stayed near that amount until Congress lowered it to \$110 million in FY2018. It steadily rose from FY2019 to FY2022, but Congress approved no BSM funding in FY2023 and FY2024. Enacted BSM funding totaled nearly \$6 billion from FY1998 to FY2024.

The National Taxpayer Advocate proposed that BSM be funded on a multiyear basis in her *FY2018 Report to Congress*. In her view, a longer funding horizon would greatly lower the project interruptions, cancellations, and cost overruns associated with single-year funding. Congress may have taken a step in that direction when it allowed the IRS two years (from FY2022 to FY2024) to spend the \$275 million in enacted BSM appropriations for FY2022.

According to the GAO, the IRS invested \$3.3 billion in IT in FY2022, of which \$0.9 billion went to development and modernization and \$2.4 billion to operations and maintenance. The IRS's IT spending rose to \$4.4 billion in FY2023, nearly half of which (\$2.0 billion) came from mandatory IRS funding provided by the Inflation Reduction Act (see below for more details).

Congress provided no appropriations for BSM in FY2023 and FY2024, and the Biden Administration is requesting no discretionary funds for BSM in FY2025.

Recent Developments

According to the GAO, the IRS was working on 21 IMBP projects in August 2022. Of these, 9 were intended to retire core legacy computer systems, and the other 12 sought to develop new digital options for assisting taxpayers. By the end of September 2022, the IRS had suspended work on 6 of the 21 projects; among the suspended projects were CADE 2 Target State (TS) and Individual Master File Retirement Acceleration (IMFRA). These projects were still suspended as of May 2024.

The Treasury Inspector General for Tax Administration (TIGTA) noted in a 2022 report that the project suspensions allowed the IRS to transfer \$400 million of the \$1 billion it received for technology modernization projects in the American Rescue Plan Act (P.L. 117-2) to the taxpayer services account. The additional funds were used to defray the cost of shrinking large backlogs of paper tax returns and taxpayer correspondence from FY2021 and FY2022.

In August 2022, Congress passed the Inflation Reduction Act (P.L. 117-115, IRA). Among other things, the act provided the IRS with nearly \$79 billion in mandatory funding, to be used for a variety of purposes from FY2022 to FY2031. Of that amount, \$4.8 billion was designated for BSM projects. These funds were in addition to any discretionary BSM funding in that period. TIGTA has reported that the IRS had used nearly \$1 billion of the IRA BSM funds by the end of 2023.

The Fiscal Responsibility Act of 2023 (P.L. 118-5) rescinded \$1.4 billion of the IRA funding. The Further Consolidated Appropriations Act, 2024 (P.L. 118-47) rescinded another \$20.2 billion in IRA funds. It is unclear how these reductions might affect the IRA's BSM funding

In April 2023, the IRS issued a "strategic operating plan" for use of the \$79 billion in IRA funding. The plan offered some details on how the agency intends to invest the \$4.8 billion for BSM projects, without providing specific cost estimates. One of the plan's priorities is the retirement of the Business Master File by FY2027 and the Individual Master File by FY2028. Another priority is to invest IRA funds in consolidating the IRS's multiple case management systems on a single digital platform.

In a March 2024 report, the GAO asserted that the IRS's technology modernization efforts were at "the risk of cost overruns, schedule delays, and overall project failure" unless the agency clarifies how it plans to use IRA funding to achieve its IT modernization goals.

In a May 2024 update to the SOP, the IRS asserted that if Congress were to continue providing no BSM discretionary funds, the \$4.8 billion in the IRA's BSM funds may be exhausted by FY2026.

Congressional Oversight

Fluctuations in BSM funding since the late 1990s partly reflect congressional concerns about the IRS's ability to manage and complete complicated and risky IT modernization projects without costly delays.

Congress has established several ways of overseeing BSM program management. To obtain funding for a project, the IRS first must submit a request to the House and Senate Appropriations Committees for approval. Before a request is submitted, it has to be reviewed by TIGTA, the Office of Management and Budget, and the GAO. The IRS is also required to submit quarterly reports to the House and Senate Appropriations Committees on the cost, status, and projected delivery dates for BSM projects.

Policy Issues

A recurring, preeminent concern about the BSM program is the IRS's ability to deliver significant technology improvements on schedule and within budget, and to set feasible strategies for achieving program goals.

A notable driver of this concern is the IRS's ongoing effort to replace the Individual Master File. Two projects critical to the success of that effort (i.e., CADE 2 TS and IMFRA) are currently suspended, and according to a 2024 TIGTA report, it is unclear when work on them will resume. In early 2023, the GAO reported that as of June 30, 2022, 33% of IRS IT applications, 22% of software, and 8% of hardware were considered legacy.

The GAO noted in the same report that the absence of a feasible timeline for replacing the Individual Master File raises the concern that the IRS is likely to face growing challenges as it continues to rely on software "written in an archaic language requiring specialized skills that are increasingly difficult to find."

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