Privatizing the IRS: Rethinking Tax Collection

Haider Dar

Mark McAllister

BWFA Summer 2025 Interns

White Paper

Abstract

This paper argues that it's time to seriously consider privatization of the Internal Revenue Service (IRS) to increase efficiency, reduce costs, improve service delivery, and innovate the tax administration system. It starts by analyzing the IRS's current structure and the challenges it faces, then builds the case for privatization by using successful international examples and private-sector models. Finally, it suggests practical ways to make privatization work while keeping strong oversight and protecting the public. As taxes become more complex and everything moves digitally, we need a faster, smarter, and more reliable system—and privatization could be the key to getting there.

Privatizing the IRS: Rethinking Tax Collection

The IRS has long faced criticism for slow processing, outdated technology, and poor customer service. One potential solution is partial privatization: allowing private companies, under strict government oversight, to handle specific functions like customer support, digital infrastructure, and return processing. Tech firms such as Amazon or Google could modernize these services while the government retains control over core responsibilities like tax law enforcement and audits. This approach wouldn't change how much people pay in taxes, but it could make the system more efficient, transparent, and user-friendly.

Each year the Internal Revenue Service is tasked with the most critical responsibilities of the federal government, collecting trillions of dollars of taxes to fund everything from public education to national defense. Despite its essential role, the IRS has struggled with inefficiencies, outdated technology and poor service for decades. In 2022 alone, the agency was processing 21 million tax returns from previous years, causing massive delays, refunds and frustrations among taxpayers. Calls to the IRS went unanswered at alarming rates, with customer service representatives only able to respond to a fraction of the inquiries received. Outdated technology and understaffing have made the IRS increasingly incapable of meeting the demands of a 21st-century economy.

The private sector has demonstrated an ability to deliver more efficient, innovative and customer-friendly solutions in sectors that were once controlled by the federal government. The transformation of telecommunications – from a single government regulated agency to a competitive industry populated by T-Mobile, Verizon, and others –

has led to lower prices, better service, and innovative products. The Telecom Act of 1996 encouraged private investment and allowed competition in the cable and internet service industry. Prior to the breakup of AT&T, it was a government-regulated natural monopoly, and essentially the only provider in the industry. Although AT&T was an example of a private company, this is the idea of privatizing the IRS. Similarly, mail and package delivery, once dominated by the U.S. Postal Service, has been changed by private firms like FedEx, UPS, and Amazon. These examples raise a big question: if privatization has worked for other public services, why not apply the same principle to the IRS?

Current Structure and Challenges

The Internal Revenue Service is primarily responsible for administering and enforcing tax laws of United States. Created in 1862, during the Civil War to fund the Union's war effort, IRS has evolved into collecting federal taxes, processing tax returns, issuing refunds, and enforcing tax laws. The IRS is headed by a commissioner, who is appointed by the President and confirmed by the Senate. The Commissioner oversees the agency's entire operation and reports to the Secretary of the Treasury. IRS is divided into multiple specialized divisions:

The IRS is organized into specialized divisions to better serve the diverse needs of American taxpayers. The Wage and Investment (W&I) Division supports individuals with straightforward tax situations or people who file basic returns. The Small Business/Self-Employed (SB/SE) Division focuses on small businesses, sole proprietors, and independent contractors, offering guidance and oversight tailored to their unique tax obligations. The Large Business and International (LB&I) Division handles complex tax matters for corporations, large partnerships, and international taxpayers, ensuring compliance across global operations. The Tax Exempt and Government Entities (TE/GE) Division oversees non-profit organizations, retirement plans, and government bodies, helping them navigate specialized tax rules. Together, these divisions are structured to deliver more efficient, targeted service across the full spectrum of taxpayer needs. While these divisions are structured to address the specific needs of different taxpayer groups, they often struggle to operate during tax preparation season due to some challenges they face. Issues like limited funding, staffing shortages, outdated technology, and growing workloads can hinder their ability to deliver timely and effective service. These obstacles contribute to delays in processing returns, backlogs in correspondence, and frustration among taxpayers seeking support.

In terms of funding and staffing, between 2010 and 2020, the IRS experienced a significant reduction in its budget, leading to challenges in staffing and innovation efforts. *Figure 1* illustrates the decline in IRS appropriations during this period. This budgetary constraint resulted in a decrease in the agency's workforce, impacting on its ability to efficiently process returns and provide customer service. As noted in the 2023 Annual Report to Congress, approximately 18 percent of IRS employees are currently eligible to retire, and around 37 percent of all IRS employees are going to become retirement eligible within the next 5 years. Most recently, under President Trump’s administration, it is estimated that the IRS employee’s headcount dropped by more that 25,000. We are also expecting a 20 percent reduction in the IRS budget. This majorly raises concerns about the

IRS’s efficiency in the 2026 filing season, despite some saying that 2025 was a quite successful filing season.

The IRS also struggles with tax return backlogs, particularly during peak filing seasons. As of late September 2022, the agency had approximately 12.4 million returns awaiting processing, leading to delays in refunds for many taxpayers.

The public has major customer service concerns as the IRS fails to provide sufficient customer service. During the 2022 filing season, the IRS received 173 million calls but answered only 22 million (13%), with an average wait time of 29 minutes. This indicates a substantial gap in the agency's capacity to assist taxpayers.

One main concern of the public if we were to privatize the IRS would be cybersecurity of confidential, sensitive information. The IRS has been targeted by cybercriminals seeking to exploit vulnerabilities in its systems. In December 2022, four hackers were indicted for allegedly stealing U.S. tax returns by exploiting weaknesses in IRS data security.

In response to these challenges, the IRS has developed a strategy aimed at improving taxpayer services and efficiency, titled the IRS Modernization Plan. This plan is supposedly developed with the intent for a better future for taxpayers, including enhanced technology upgrades, improved public and political relationships and reactions, improved cybersecurity, and more. While the IRS has these great aspirations to restore public trust and update their systems within the next six years, they have historically struggled with implementing effective technology solutions. Without consistent funding and skilled staffing, even well-designed plans like this risk falling short of their goals.

Case for Privatization

Privatizing the IRS would represent a significant shift in how the government manages its budget and tax collection. Under such a model, private companies would operate under government contracts to manage tax collection in designated regions. These companies would pay a flat fee to the government based on their region and generate profit through the efficiency and services they provide. The fee they pay to the government would be less than the tax revenue they collect, ensuring an opportunity to make a 10-15% profit margin on the revenue. While this wouldn't reduce the amount of taxes owed to the government, it would streamline operations and improve user experience. Private firms often have access to more advanced technologies, including AI, which could enhance processing speed and accuracy. Platforms like TurboTax demonstrate how private-sector innovation can simplify tax filing and promote compliance. Though TurboTax doesn't collect taxes, it shows how user-friendly, tech-driven solutions can make the filing process more accessible and less stressful for individuals.

Privatization Plan

There are 153.8 million taxpayers in the US, so our plan is to divide that by state. Some states may be more valuable than others, based on the income value of the state and how many tax dollars they are paying. See *Figure 2* for a visual layout of the states.

Each state could be managed by a private contractor responsible for collecting federal taxes within a designated region. For example, Maryland, which has approximately 3.2 million taxpayers, could be assigned to a private company under a 5-year contract. With an average annual federal tax liability of $18,044 per taxpayer1, the total tax revenue collected in Maryland over five years would be around $288.7 billion. Under this model, the private contractor would pay the federal government an upfront flat fee to secure the contract. For this example, we'll use $1.5 billion. In return, the company would earn a collection fee of 0.7% of the total taxes collected, amounting to about $2.02 billion, resulting in a net profit of approximately $520 million over the contract period. While this is a hypothetical model, it illustrates how private firms could potentially profit through operational efficiency, not by altering tax rates. It's important to note that current IRS private debt collection programs are limited to overdue accounts and do not involve full-scale tax administration.

This model aims to incentivize efficiency and innovation in tax collection while providing the federal government with predictable revenue from privatization fees. Under our new model for the IRS, government contracted companies would be under strict federal guidelines. While the operational structure of the IRS would shift to the private sector, core elements such as tax codes, rates, eligibility criteria, and exemption standards would remain under the government's control. This would ensure a more trustworthy shift and help the public understand that privatization does not lead to deregulation or inequity, but rather increased efficiency and innovation under the new design.

In addition to streamlining operations, privatizing key IRS functions offers the potential for significant cost savings and improved fiscal efficiency. Currently, the IRS operates with an annual budget of over $14 billion, with a large portion allocated to manual processing, outdated systems maintenance, and administrative overhead. Faster processing and improved customer engagement could lead to higher compliance rates and fewer errors, ultimately increasing the net tax revenue collected without raising rates. The tax rate would remain the same, and these companies would remain under government control. The digital infrastructure would have many opportunities for advancement under contracted companies, including outsourcing private call centers.

Realistically, full privatization of the IRS is quite controversial in the US, and rather than causing more problems, partial privatization would be ideal for tax collection. In our plan, the private companies would be on a government contract, and a portion of the IRS in the government would be a small-scale operation consisting of around 40-60 employees who work to enforce compliance, oversee private contractors, and ensure that taxpayer rights are protected. This team would focus on regulatory oversight, auditing, and legal enforcement, while the contracted firms would handle routine processing, customer service, and data management. This partial privatization model aims to increase efficiency and reduce costs while maintaining the factors of transparency and accountability in the tax system.

Safeguards and Privacy Protections

Data encryption concerns would likely be among the most frequently asked questions from taxpayers regarding IRS privatization. In a system where private entities are involved in tax administration, the protection of sensitive personal and financial data becomes paramount. To address these concerns, the proposed model introduces the use of anonymous identifiers—such as a randomly generated “username” or “code”—that effectively decouple a taxpayer’s identity from their financial records. This separation not only enhances individual privacy but also reduces the potential for misuse of personal data by limiting access to identifying information.

By implementing such a system, the restructured tax framework could significantly bolster encryption protocols and privacy safeguards. Anonymity in taxpayer identification would serve as a foundational layer of protection, making it more difficult for unauthorized parties to correlate financial data with specific individuals. This approach could also help mitigate systemic biases and discriminatory practices that may arise from implicit associations with names, addresses, or demographic information.

Privatization could allow the implementation of cybersecurity technologies that are often more rapidly developed and deployed in the private sector. For instance, blockchain-based identity verification systems could be integrated to ensure that only authorized personnel can access encrypted data. These systems offer immutable audit trails and decentralized control, which can further enhance transparency and accountability in data handling.

In addition to improving security, this model could streamline administrative processes by automating identity verification and reducing the need for manual oversight. The result would be a more efficient, user-friendly tax system that maintains rigorous standards of data protection. Ultimately, by prioritizing privacy and leveraging advanced encryption technologies, the privatized IRS model could foster greater public trust and encourage voluntary compliance among taxpayers.

Conclusion

The Internal Revenue Service plays one of the most essential roles in the federal government, collecting the trillions of dollars needed to fund public services and ensure national stability. Yet for years, it has struggled under the bureaucratic inefficiencies, outdated technology, budget cuts, and growing public dissatisfaction. These issues are no longer minor inconveniences, they undermine public trust, slow the nation's financial operations, and ultimately cost taxpayers time and money. As the global economy becomes more digital, interconnected, and data-driven, the IRS must evolve to meet the needs of a 21st-century tax system. This paper argues that one of the most viable and transformative paths forward is a model of carefully structured, partial privatization.

Privatization does not mean surrendering government control of tax laws or enforcement, nor does it mean opening the door to inequality or deregulation. Rather, it means allowing highly capable private firms with proven track records in digital infrastructure, customer service, and data management to manage the more routine and technical aspects of tax collection. These firms would operate under federal contracts, bound by strict oversight and performance metrics, and would never have the power to influence tax policy. This approach mirrors how other sectors have successfully evolved, such as telecommunications and mail delivery, where privatization introduced competition, innovation, and better service for the public without sacrificing core government oversight.

Evidence from both domestic programs and international tax systems shows that outsourcing certain administrative functions to the private sector can result in faster processing, better compliance, and significant cost savings. Countries like the United Kingdom, Canada, and Australia have embraced private-public partnerships for portions of their tax administration with success. In the U.S., even limited pilot programs involving private debt collection have demonstrated that the private sector can play a role in improving IRS efficiency, albeit on a small scale.

Under the proposed model, private companies would bid for contracts to manage tax collection in specific regions or states, with profit earned through performance-based fees rather than by altering tax rates. The IRS itself would not disappear but would be streamlined into a smaller, centralized oversight body tasked with enforcement, auditing, and contractor supervision. By separating core regulatory functions from administrative ones, the government could maintain transparency, protect taxpayer rights, and ensure legal compliance while still benefiting from the speed and adaptability of the private sector.

Perhaps most importantly, the proposed system is built with safeguards at its core. Recognizing the sensitivity of taxpayer data and the threat of cyberattacks, this model includes robust privacy measures, such as anonymous taxpayer identifiers, encryption, and the use of blockchain technology to minimize the risk of breaches or misuse. By shifting to a modernized, tech-forward infrastructure, the U.S. tax system could become not only more secure, but also more user-friendly and accessible, especially for underserved communities who often face the greatest obstacles when dealing with IRS bureaucracy.

While some may view privatization of tax collection as controversial or risky, the status quo is simply no longer sustainable. A tax system that is slow, confusing, and underfunded ultimately fails its citizens, no matter how fair its laws are on paper. At a time when digital transformation is sweeping every major industry, the IRS cannot afford to remain stuck in the past. Embracing partial privatization, done thoughtfully and with accountability, offers a bold but practical solution to restore public confidence, increase compliance, reduce costs, and make the taxpaying process something that truly works for the American people. As we look to the future, it’s not a question of whether the IRS should change, but how and privatization may be the innovative leap forward that the system urgently needs.

References

CATO Institute. (11 April 2023). *Transforming the Internal Revenue Service.* *www.cato.org/policy-analysis/transforming-internal-revenue-service#introduction*

Cannon, Matt. (26 Jun 2025). *IRS Warning Issued for 2026 Taxes.* *www.newsweek.com/irs-warning-issued-trump-bill-job-cuts-2026-taxes-2091061*

Internal Revenue Service. (29 May 2025). *IRS Modernization.* *https://www.irs.gov/newsroom/irs-modernization*

Kyle Talks Money. (11 Jun 2020). How Would We Privatize the IRS? - [Video]. YouTube. www.youtube.com/watch?v=eBpWRyTqtuo

Taxpayer Advocate Service. (25 Jun 2025). *Improve Automation and Metrics to Enhance the Taxpayer Experience.* *www.taxpayeradvocate.irs.gov/reports/2026-objectives-report-to-congress/full-report-26/*

U.S. Government Accountability Office. (30 Jan 2025). 2024 Tax Filing: IRS Improved Live Service and Began to Modernize Some Operations, but Timeliness Issues Persist (GAO-25-107375). www.gao.gov/products/gao-25-107375

Figures

Figure 1.

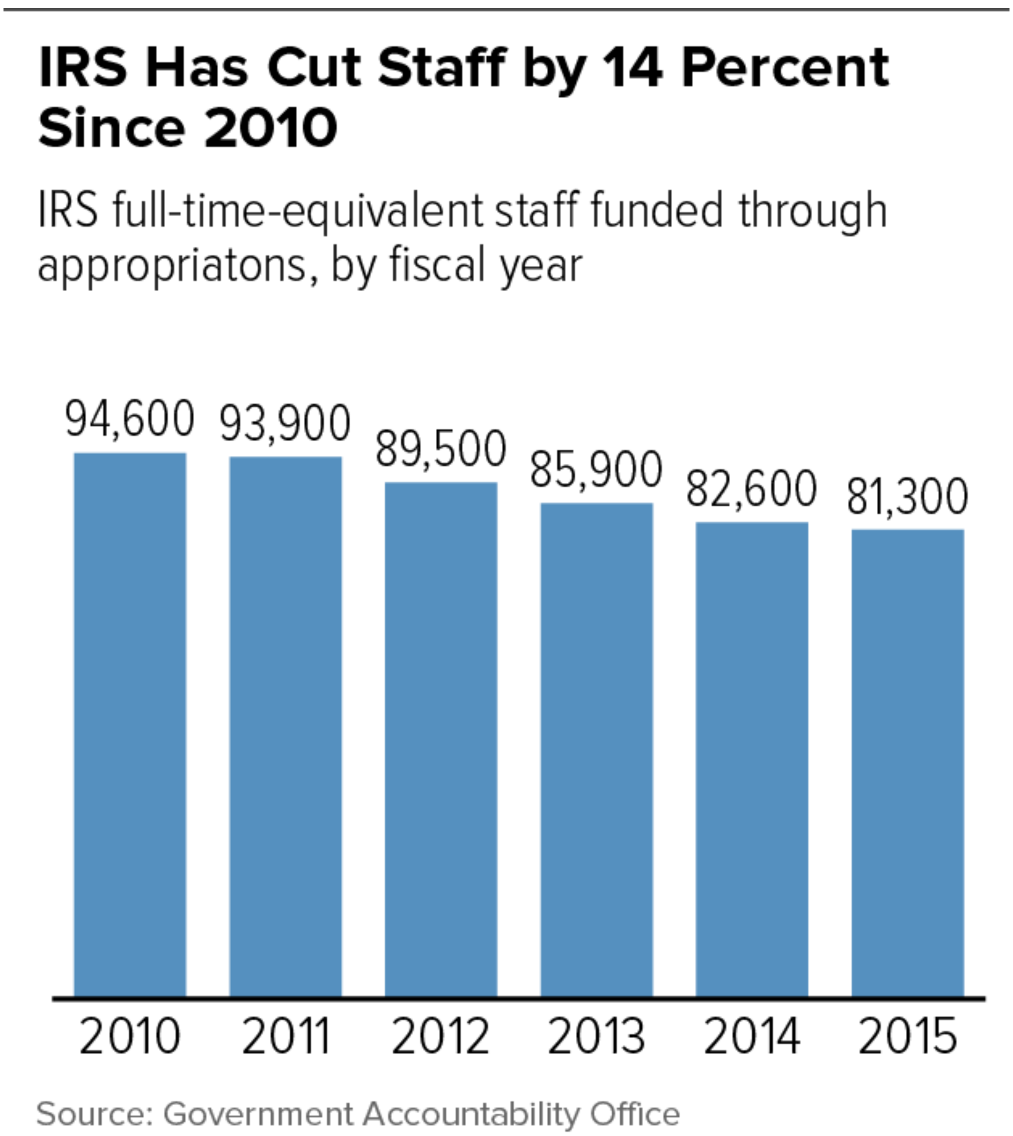

Figure 2.