

Legislative Recommendation #4

Set Goals for Substantially Increasing the Use of the Free File Program by Filing Season 2025 and Replace Free File If Those Goals Are Not Attained

PRESENT LAW

Section 2001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98) directed the IRS to set a goal of increasing the e-file rate to at least 80 percent by 2007.¹

REASONS FOR CHANGE

In response to the RRA 98 directive, the IRS in 2002 contracted with a consortium of tax return preparation software providers known as the Free File Alliance.² Under the agreement, the software companies make their products available for free to taxpayers with adjusted gross income (AGI) at or below \$69,000 – a category that includes 70 percent of all taxpayers, or over 110 million taxpayers during calendar year 2020. All taxpayers, including taxpayers with higher AGIs, may use Free File Fillable Forms, the IRS's electronic version of paper forms.³

As organized and operated, the Free File program provides limited benefits to taxpayers and consumes IRS resources. The program should be substantially improved or replaced.

While the IRS and the software industry often tout Free File as a model public-private partnership, they have somewhat inconsistent objectives. The IRS is (or should be) aiming to make the filing process as painless and inexpensive for taxpayers as possible. Therefore, it should be advertising the Free File program and actively evaluating and improving it regularly to ensure it is taxpayer-friendly and widely used. By contrast, the software companies have a financial incentive to keep the usage rate low, because every taxpayer who uses Free File is not purchasing a paid product.⁴

From a taxpayer perspective, Free File has largely failed. Although 70 percent of taxpayers qualify to use Free File software, less than three percent of taxpayers (approximately 4 million) used Free File software to file their returns during 2020.⁵ Moreover, data on repeat usage suggests that taxpayers who have used Free File have

1 See RRA 98, Pub. L. No. 105-206, § 2001, 112 Stat. 685, 723.

2 In 2014, the Free File Alliance formally changed its name to Free File, Inc. (FFI), and the new name is used on legal documents. However, the IRS and the organization itself continue to use the name "Free File Alliance" on their respective websites.

3 For a description of the program as well as access to all the associated Free File agreements and Memoranda of Understanding, see IRS, Free File: About the Free File Alliance, <https://www.irs.gov/e-file-providers/about-the-free-file-alliance> (last visited Nov. 20, 2020).

4 While the preparation and filing of federal income tax returns is free, Free File companies may charge for the preparation and filing of state tax returns. Taxpayers often pay these fees to avoid the need to re-do their state returns from scratch using another program.

5 IRS Compliance Data Warehouse Electronic Tax Administration Research and Analysis System (ETARAS). This count reflects usage of tax software but excludes usage of Free File Fillable Forms and the "Non-Filer Tool" that individuals without a return filing obligation could use to claim Economic Impact Payments authorized by the Coronavirus Aid, Relief, and Economic Security Act in 2020.

generally been dissatisfied with it. Among taxpayers who used Free File software during the last four years, only 53 percent used Free File software again the following year.⁶

If Free File is discontinued, taxpayers would still have free e-filing options. Leading tax software companies have long offered their products to taxpayers at no charge. The Free File Alliance reported that its members provided free tax software to at least 17.7 million taxpayers outside the Free File program during the 2019 filing season.⁷ It is therefore likely that most, if not substantially all, of the approximately four million taxpayers who used Free File software in 2020 could have filed for free through company websites if Free File did not exist.

From the IRS's perspective, the Free File program is also of questionable value. First, taxpayers enter the Free File program through the IRS's website, IRS.gov, and if they are dissatisfied with the program, it reflects poorly on the agency. Given the low repeat usage rate, it appears many taxpayers are not satisfied with the program. Second, the IRS already incurs costs to administer the program, and numerous oversight and advisory bodies have urged the IRS to make improvements to the program that would increase its costs.⁸ In an environment where IRS resources are tightly constrained, the costs of managing the program can be justified only if more taxpayers participate and are satisfied enough with the program to use it again.

The National Taxpayer Advocate believes the Free File program should be significantly improved or replaced. Before contracting with the Free File Alliance, the IRS should conduct research studies, develop actionable goals, create measures evaluating taxpayer awareness and satisfaction, test each member's software for substantive accuracy and ease of navigation, provide more options for English as a Second Language taxpayers, and conduct more outreach. It should set a goal of increasing the Free File usage rate to a significantly higher yet attainable level, such as ten percent of the taxpayers eligible to use the program, and set a goal of increasing the retention rate to 75 percent of taxpayers who used the program in the preceding year. If these targets are not attained, the IRS should avail itself of another private sector option – entering into a sole-source or multi-source contract with tax software manufacturers to provide software to all taxpayers at no or low cost.

RECOMMENDATION

- Direct the IRS to set a goal of increasing the usage rate of the Free File program to a significantly higher yet attainable level (*e.g.*, ten percent of the 70 percent of taxpayers eligible to use the program) and a goal of increasing the retention rate to 75 percent of taxpayers who used Free File in the preceding year

6 IRS Compliance Data Warehouse, ETARAS MEF 1544 Table (includes returns filed through September 30 of each year). For each year, TAS identified returns submitted through Free File and processed by the end of the fiscal year and then determined whether returns bearing the same taxpayer identification number were submitted through Free File in the following year. Looking at all returns over the four-year period, only about 53 percent of taxpayers who used Free File in one year used it again the following year. For the most recent year, however, the percentage of repeat users (*i.e.*, taxpayers who used Free File software in 2019 and then again in 2020) rose to 62 percent.

7 MITRE, *Independent Assessment of the Free File Program* x (Oct. 3, 2019). To access this report, see IRS, IRS Statement on Free File Program (Oct. 11, 2019), <https://www.irs.gov/newsroom/irs-statement-on-free-file-program>.

8 Oversight and advisory bodies have routinely recommended that the IRS provide more rigorous oversight over the Free File Program and do more to promote the program through marketing. See, *e.g.*, National Taxpayer Advocate 2019 Annual Report to Congress 45-51 (Most Serious Problem: *Free File: Substantial Free File Program Changes Are Necessary to Meet the Needs of Eligible Taxpayers*); Treasury Inspector General for Tax Administration, Ref. No. 2020-40-009, *Complexity and Insufficient Oversight of the Free File Program Result in Low Taxpayer Participation* (Feb. 2020); Internal Revenue Service Advisory Council Public Report 14-18 (Nov. 2018) (concluding the IRS's oversight of the Free File program has been "deficient"); MITRE, *Independent Assessment of the Free File Program* (Oct. 3, 2019); Memorandum from Staff of the Permanent Subcommittee on Investigations to Senate Committee on Homeland Security and Governmental Affairs, *IRS Oversight of the Free File Program* (June 9, 2020).

and, if those goals are not attained by 2025, to replace Free File with an alternative approach to provide tax software to all taxpayers at no or low cost, such as through the use of sole-source or multi-source contracts with tax software companies.