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## The Internal Revenue Service's Free File Program (FFP): Current Status and Policy Issues

The option to electronically file (e-filing) federal individual income tax returns began in 1986. Since then its usage has grown considerably. By the end of December 2020, 89% of returns for the 2019 tax year were e-filed. Nonetheless, 17.6 million paper returns were filed for that year.

As a policy objective, the IRS would like to achieve an e-filing rate of 100% because of its advantages over paper filing. Generally, e-filing has a lower cost for processing returns and reduced error rates. E-filing also speeds up the processing of tax refunds for individuals who had too much income tax withheld or overpaid their tax during a year.

An element of the IRS's strategy to promote universal individual income tax e-filing is the Free File Program (FFP). The program permits individuals with adjusted gross incomes (AGIs) at or below a specified amount (\$73,000 for the 2021 tax year) to electronically prepare and file their federal income tax returns, free of charge, using software provided by participating tax software companies, which totaled eight companies at the start of the 2022 filing season. The IRS provides a direct portal on its website for qualified persons to file through the FFP. Taxpayers with AGIs above \$73,000 can e-file their returns free of charge through the same portal using Free File Fillable Forms.

Since its creation in 2002, the FFP has had three goals:

- Simplify tax preparation and filing for “economically disadvantaged and underserved” taxpayers;
- Provide more services to taxpayers who normally file paper returns; and
- Encourage further growth in e-filing by giving lower-income taxpayers the opportunity to file their returns free online through software provided by tax software companies.

### Origin of the FFP

The FFP has its origin in two sources. One was the IRS Restructuring and Reform Act of 1998 (RRA, P.L. 105-206). Among other things, the RRA directed the IRS to increase the share of e-filed individual returns to 80% by 2007, with assistance from the private sector. Achieving this goal posed a significant challenge for the IRS, as the e-filing rate was 23.5% in the 1998 tax year.

The second source was a directive issued in 2001 by the Office of Management and Budget's (OMB's) Quicksilver Task Force to implement President George W. Bush's E-Government Initiative. One of the 24 initiatives chosen by the task force was the EZ Tax Filing Initiative. Its main

purpose was to help the IRS reach its 80% e-filing goal by 2007 by making electronic tax preparation and filing more accessible to paper return filers without requiring them or the federal government to pay for commercial tax services. The key to success, senior Treasury officials thought at the time, was for the IRS to establish a “single point of access” for lower-income taxpayers to free online tax preparation and filing services provided by tax software companies. (The IRS did not achieve its 2007 e-filing goal until 2012, when 83% of individual returns were e-filed.)

As a first step in implementing the EZ Tax Filing Initiative, the IRS tried to develop a digitized version of Form 1040 and accompanying schedules and instructions that could be accessed at no cost through [WhiteHouse.gov](http://WhiteHouse.gov). It soon became apparent that the IRS lacked the resources and experience needed to efficiently launch such a project. To circumvent these obstacles, in January 2002, Treasury Secretary Paul O'Neill asked IRS Commissioner Charles Rossetti to form a partnership with tax software companies to develop a system for providing free online tax preparation and filing services for lower-income taxpayers. The resulting private-public partnership was (and still is) called the Free File Alliance (FFA).

### Structure and Evolution of the FFP

The FFP began when the IRS signed an agreement with the 17 original FFA member companies on October 30, 2002. There was a clear division of authority and responsibility between the IRS and the participating companies.

The initial agreement required the companies to make available at no cost their tax preparation and filing software through [IRS.gov](http://IRS.gov) to at least 60% of taxpayers ranked by AGI. The companies retained complete control over the scope of their free-file services and eligibility requirements, with one exception: each member company had to be capable of providing free filing services to cover at least 10% of individual tax returns filed for a year.

The IRS was responsible for enforcing member company compliance with the terms of the agreement. As a result, the agency was authorized to cancel the agreement with one year's advance notice, if it determined that the companies, over an extended period, were failing to provide adequate or required coverage.

A key component of the agreement arguably involved a trade-off between access to e-filing for paper filers and the potential benefits of the IRS creating a direct filing option for all taxpayers. The IRS pledged not to compete in the market for tax software. In return, member companies agreed to offer free electronic tax preparation and filing

services to low- to middle-income taxpayers. This meant that the IRS could not develop prefiled tax forms and make them available at no cost to taxpayers through a secure portal on its website.

The IRS and the FFA have extended and revised the original agreement five times. These subsequent agreements are linked to nine memoranda of understanding (MOU), which apply to specific tax filing seasons.

The second agreement (2005) reduced the range of free services a company could offer to eligible taxpayers, limited the share of eligible taxpayers a single company could serve to 50%, and increased the share of taxpayers eligible for free filing through the FFP to the bottom 70% of individuals ranked by AGI.

The 2009 agreement expanded the scope of the FFP by adding free fillable individual income tax forms to the services available through the program. Taxpayers of all income levels were eligible to file using these e-forms. The 2009 agreement also required FFA companies to embed a link to IRS.gov in their landing pages for the FFP.

The current agreement is due to expire on October 31, 2023 (see the 2021 addendum to the 2018 MOU). It includes provisions intended to raise taxpayer awareness of the program, encourage eligible taxpayers to regularly use it, and prevent participating companies from excluding their Free File landing pages from internet searches for the FFP. The MOU does not specify that the IRS should refrain from developing its own return filing system.

The structure of the FFA has shifted since 2020, as the program's two largest providers of tax preparation and filing services withdrew from the FFA: H&R Block in 2020 and Intuit in 2021; together they accounted for two-thirds of FFP usage in 2019 and previous years. Eight providers remain in the program, including TaxSlayer and TaxNet.

## Use of the FFP

One concern about the FFP since it began in FY2003 has been its low usage rates. In the first year of the program, 2.8 million individuals filed their tax returns through the FFP, or 3.5% of all eligible taxpayers. Use of the program peaked in FY2005, when 5.1 million individuals (or 6.4% of eligible taxpayers) filed through the FFP. Since then (except for 2009), FFP use has mostly declined. Of the 154.1 million individual tax returns filed in FY2019, 2.8 million were filed through the FFP (2% of eligible taxpayers). Use of Free File increased during the first year of the COVID-19 pandemic. According to the IRS Taxpayer Advocate's 2020 report to Congress, "8 million citizens" received an economic impact payment (i.e., stimulus check) via the FFP in FY2020, and another 4.2 million taxpayers (about 4% of eligible taxpayers) used the FFP to e-file their tax returns.

## Policy Issues

In the 116<sup>th</sup> Congress, discussion of the FFP focused on whether to codify the program and to permit the IRS to develop its own competing software. In April 2019, the

House passed a bill (Taxpayer First Act, H.R. 1957) to reform various aspects of how the IRS interacts with taxpayers; it included a provision that would have permanently extended the FFP. The provision was opposed by several groups, including some Members of Congress, concerned about media reports that some FFA companies earned revenue from FFP-eligible taxpayers who e-filed their returns using the companies' paid services. The 116<sup>th</sup> Congress eventually passed a similar bill, but without the FFP provision (P.L. 116-25).

## Pros and Cons

FFP proponents say it should be retained in its current form because it saves low- and middle-income taxpayers and the IRS considerable money each year. According to the FFA, taxpayers saved an estimated \$1.5 billion from 2003 to 2018 as a result of the option to file free under the FFP. In the same period, the FFA claims that the program has saved the IRS hundreds of millions of dollars in processing costs.

FFP critics contend that the current program is too flawed to achieve its main goals. They say that member companies' websites for FFP filing are too complicated, the program's take-up rate is too low, and the IRS has done too little to promote the program and monitor member companies' adherence to the MOU. Critics are also concerned that some FFA companies (including Intuit and H&R Block) may have benefited in recent years from the FFP by marketing paid services to FFP-eligible taxpayers. In a recent report, the Treasury Inspector General for Tax Administration found that over 34.5 million FFP-eligible taxpayers e-filed their returns by using member companies' commercial software in FY2019.

## Options for Reforming the FFP

Criticism of the FFP has led some to call for significant changes in the program. Two options appear to have attracted considerable interest among policymakers.

One option would retain the FFP but make certain critical changes in how it operates. These changes would require the IRS to invest more in promoting it among eligible taxpayers, and to more closely monitor member companies' compliance with the MOU. In addition, the MOU would be revised to require member companies to disclose to the IRS the revenue they receive from marketing their paid services to FFP-eligible taxpayers.

A second option would replace the FFP with a filing system that simplifies the process, especially for taxpayers with uncomplicated tax situations. This option could be realized in several ways. For instance, taxpayers might prepare and file their returns through a secure portal on the IRS website; or the IRS might prefill returns for individuals whose income and deductions are completely reported to the IRS by third parties, and then send them to taxpayers for their review and acceptance; or the federal government might adopt a return-free filing system based on exact withholding or tax-agency reconciliation.

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