

## #7 DIRECT THE IRS TO SET GOALS OF SUBSTANTIALLY INCREASING THE USAGE RATE AND THE RETENTION RATE OF THE FREE FILE PROGRAM BY FILING SEASON 2025 AND TO REPLACE FREE FILE WITH AN ALTERNATIVE APPROACH 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.<sup>48</sup>

### Reasons for Change

In response to the RRA 98 directive, the IRS in 2002 entered into an agreement with a consortium of tax return preparation software providers known as the Free File Alliance.<sup>49</sup> Under the agreement, the software companies make their products available for free to, in the aggregate, 70 percent of all taxpayers, or about 105 million taxpayers in tax year (TY) 2018. In exchange, the IRS refrains from competing with these companies; therefore, the IRS does not develop or make its own software available to taxpayers. Eligibility for Free File software is based on adjusted gross income (AGI). Taxpayers with incomes currently below about \$66,000 qualify. All taxpayers, including taxpayers with higher AGIs, may use Free File Fillable Forms, the electronic version of IRS paper forms.<sup>50</sup>

As presently organized and operated, the Free File program provides limited benefits to taxpayers and consumes IRS resources to administer. 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, the reality is the parties to this transaction have opposite objectives in key respects. 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 more actively evaluating and improving it on a regular basis 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 a taxpayer who is not purchasing a paid product.<sup>51</sup>

From a taxpayer perspective, Free File has largely failed to achieve its objectives. Despite the fact that 70 percent of taxpayers qualify to use Free File software, less than two percent of taxpayers (2.5 million) used Free File software to file their returns during 2019.<sup>52</sup> Moreover, data on repeat usage suggests that taxpayers

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

49 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.

50 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. 11, 2019).

51 As noted below, software companies make their tax software products available for free to many taxpayers on their companies’ websites. However, they can cross-sell ancillary products on their companies’ websites and generally may not do so when taxpayers access tax software through Free File.

52 IRS response to TAS fact check (Dec. 20, 2019).

who have used Free File have generally been dissatisfied with it. Among taxpayers who used Free File software during the last four years, the majority did not use Free File software again in the following year.<sup>53</sup>

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 reports that its members provided free tax software to at least 17.7 million taxpayers outside the Free File program during the 2019 filing season.<sup>54</sup> It is therefore likely that most, if not substantially all, of the 2.5 million taxpayers who used Free File software last year would have been able to file for free through company websites if Free File did not exist.

The Free File program is also of questionable value to the IRS for two reasons. 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 incurs costs to administer the program. Particularly in an environment where IRS resources are tightly constrained, the costs of maintaining the program can only be justified if the usage rates and taxpayer satisfaction rates are increased.

While the Free File program provides only limited benefits to taxpayers and drains IRS resources, it is providing a valuable insurance policy for the software industry. Leading software companies understandably are concerned that their businesses could be adversely affected if taxpayers could e-file their returns directly with the IRS without going through a software company. For the tax software industry, the key provision in the Free File agreement provides: “[T]he federal government has pledged not to enter the tax [return] preparation software and e-filing services marketplace.”<sup>55</sup>

Over the past decade, certain software companies have lobbied heavily for legislation that would make the Free File agreement permanent, effectively locking into place the current arrangement under which fewer than two percent of taxpayers are using free tax software that most could get from the members' websites directly, while permanently barring the IRS from allowing taxpayers to file returns directly with the government. A provision to codify Free File was included in a House-passed version of the Taxpayer First Act,<sup>56</sup> but was removed before enactment after a series of articles published in 2019 suggested that some members of the Free File Alliance had not acted in the best interests of taxpayers by steering them away from Free File software options.<sup>57</sup> Under congressional pressure, the IRS requested an independent assessment of the program from

53 IRS Compliance Data Warehouse, Electronic Tax Administration Research and Analysis System (ETARAS) MEF 1544 Table. 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 (TIN) were submitted through Free File in the following year. Looking at all returns over the four-year period, only about 46 percent of taxpayers who used Free File in one year used it again the following year. However, for the most recent year (taxpayers who used Free File software in 2018 and then again in 2019), the percentage of repeat users rose to 54 percent.

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

55 Eighth Memorandum of Understanding on Service Standards and Disputes Between the Internal Revenue Service and Free File, Incorporated, Art. 2, at 5 (signed on Oct. 31, 2018 for a three-year term), <https://www.irs.gov/pub/irs-utl/Eight%20Free%20File%20MOU.pdf>.

56 Taxpayer First Act, H.R. 1957, 116th Cong. § 1102 (2019).

57 See, e.g., ProPublica, *The TurboTax Trap: How Tax Prep Industry Makes You Pay*, <https://www.propublica.org/series/the-turbotax-trap> (last visited Nov. 11, 2019).

MITRE.<sup>58</sup> The MITRE 2019 Free File Report found that five companies used a coding device to exclude their Free File landing page from organic searches on search engines such as Google or Bing.<sup>59</sup>

The National Taxpayer Advocate believes the Free File program should be significantly improved to meet taxpayer needs or should be replaced. Before entering into a new agreement 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, provide options for English as a second language taxpayers, and conduct more outreach.<sup>60</sup> 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 70 percent of taxpayers eligible to use the program, and 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; namely, entering into a sole-source or multi-source contract with tax software manufacturers to make tax software available to all taxpayers at no or low cost.

### Recommendations

- Mandate that the IRS, in consultation with the National Taxpayer Advocate, submit a report to Congress by June 30, 2020, summarizing the actions it has taken to address the recommendations in the MITRE 2019 Free File report as well as recommendations made in the National Taxpayer Advocate's 2019 Annual Report to Congress to improve the Free File program by filing season 2021.
- 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.*, 10 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 and, if those goals are not attained by 2025, to replace Free File with an alternative approach to make tax software available to taxpayers at no or low cost, such as through the use of sole-source or multi-source contracts with tax software companies.

58 To access the MITRE 2019 Free File Report, see IRS, IRS Statement on Free File Program (Oct. 11, 2019), <https://www.irs.gov/newsroom/irs-statement-on-free-file-program>.

59 MITRE 2019 Free File Report, at vi-vii, 46. The members took the position that such practice keeps them in compliance with their agreement with the IRS to require the program software to be accessible only through IRS.gov. Despite the industry's stated rationale, the resulting practice of steering taxpayers away from program software appears deceptive in nature. To eliminate this seemingly deceptive practice, the IRS should consider proposing to change the next MOU so that IRS.gov is just one way to access program software.

60 For additional background, see FREE FILE: The Free File Program Is Failing to Achieve Its Objectives and Should be Substantially Improved or Eliminated, NATIONAL TAXPAYER ADVOCATE BLOG (Mar. 15, 2019), [https://taxpayeradvocate.irs.gov/Free\\_File\\_Program\\_Is\\_Failing\\_to\\_Achieve\\_Its\\_Objectives?category=Tax%20News](https://taxpayeradvocate.irs.gov/Free_File_Program_Is_Failing_to_Achieve_Its_Objectives?category=Tax%20News); National Taxpayer Advocate 2019 Annual Report to Congress 46-54 (Most Serious Problem: *Free File: Substantial Free File Program Changes Are Necessary to Meet the Needs of Eligible Taxpayers*); Naomi Jagoda, Warren, Brown, Press IRS on Study Reviewing Free File Program, THE HILL (Nov. 15, 2019), <https://thehill.com/policy/finance/470601-warren-brown-press-irs-on-study-reviewing-free-file-program>.