

MSP #4 **FREE FILE: The IRS's Free File Offerings Are Underutilized, and the IRS Has Failed to Set Standards for Improvement**

RESPONSIBLE OFFICIAL

Ken Corbin, Commissioner, Wage and Investment Division

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*

DEFINITION OF PROBLEM

To fulfill its statutory duty to increase electronic filing (e-filing), the IRS partners with Free File, Inc. (FFI), a group of private-sector tax return preparation software providers.² The 12 members of FFI offer free federal tax preparation software products, accessible at IRS.gov, to eligible taxpayers. The participants in the program must ensure that their products in the aggregate are available to 70 percent of all taxpayers, or about 105 million taxpayers, particularly focusing on economically disadvantaged and underserved communities.³ Currently, taxpayers that have adjusted gross incomes (AGIs) of less than \$66,000 are eligible to use Free File software, while taxpayers with AGIs greater than that amount can use Free File Fillable Forms, the electronic version of IRS paper forms.⁴

Since 2002, the year the Free File program began, the number of individual tax returns increased by 15 percent and e-filing has increased by 180 percent.⁵ While electronic filing has increased greatly since 2002, the goals of the Free File program have stagnated and use of the program has steadily declined.⁶ Only about 2.5 million people filed returns using FFI software in fiscal year (FY) 2017 compared to over three million in FY 2014, and the peak of about 5 million taxpayers in tax year (TY) 2004.⁷ The IRS has not committed funding to advertise FFI and raise awareness of the services offered. It no longer produces a demographics report or satisfaction survey to help identify why the number of Free File users is decreasing or what other types of services would best attract new users.⁸

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).
- 2 See IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105–206, 112 Stat. 685.
- 3 Eighth Memorandum of Understanding on Service Standards and Disputes Between the Internal Revenue Service and Free File, Inc. (effective as of Oct. 31, 2018), <https://www.irs.gov/pub/irs-utl/Eight%20Free%20File%20MOU.pdf> (Hereinafter 2018 Free File MOU).
- 4 See *Free File Software Offers*, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited on Oct. 10, 2018).
- 5 In fiscal year (FY) 2002, the IRS received 130,905,000 individual income tax returns, and received 150,690,787 in FY 2017. In FY 2002, the IRS received 46,890,813 e-filed individual income tax returns, and 131,641,943 in FY 2017. See IRS Data Book (FY 2002, 2017).
- 6 See IRS Data Book (FY 2017, FY 2016, FY 2015, FY 2014) (showing Free File software usage has declined from 3,261,248 returns filed in FY 2014 to 2,536,183 returns in FY 2017).
- 7 See IRS Data Book (FY 2017, FY 2016, FY 2015, FY 2014); Michelle S. Chu and Melissa M. Kovalick, IRS, *An Analysis of the Free File Program*, presented at 99th Annual Conference on Taxation at 117 (Nov. 16-18, 2006).
- 8 IRS response to TAS information request (Sept. 7, 2018). Due to the lapse in appropriations, IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

While some taxpayers may be unaware of FFI services, others are unable to use the program due to its eligibility restrictions and language limitations. Taxpayers that do use the program have little guidance about the strengths and weaknesses of each software package's offering prior to selection, and may begin a return only to find the program lacks the capability to prepare the return or to fully capture the deductions and credits available to the taxpayer. As a result of these shortcomings, the services provided by FFI do not meet the needs and preferences of eligible taxpayers, particularly within underserved populations, undermining taxpayers' rights to *quality service* and to *pay no more than the correct amount of tax*. Specifically, the National Taxpayer Advocate is concerned that:

- In TY 2016, 2.3 percent of eligible taxpayers used Free File software, and only 0.2 percent of eligible taxpayers used Free File Fillable Forms;⁹
- Age restrictions sharply curtail the number of FFI options available to elderly taxpayers, as only three of the 12 FFI providers offer services to taxpayers of all ages and five have age limitations that start before the age of 60;¹⁰
- No Free File options were available for English as a Second Language (ESL) taxpayers in filing season 2018; and
- Testing by TAS shows several software providers have limitations in their navigational features and ability to help taxpayers correctly complete their returns, resulting in poor service quality.¹¹

ANALYSIS OF PROBLEM

Background

The IRS Restructuring and Reform Act of 1998 (RRA 98) required the IRS to work with the private industry to increase e-filing, and set the goal of having 80 percent of all federal tax returns filed online by 2008.¹² Similarly, the George W. Bush administration's EZ Tax Filing Initiative directed the IRS to create "a single point of access to free on-line preparation and electronic tax filing services provided by Industry Partners to reduce burden and costs to taxpayers."¹³ Initially, the Administration wanted the IRS to develop its own digital Form 1040, *U.S. Individual Income Tax Return*, accessed through WhiteHouse.gov, but IRS leadership determined the IRS did not have the capacity or resources to develop that product. Instead, the IRS partnered with a consortium of private tax preparation software companies, then known as the Free File Alliance, after the Office of Chief Counsel determined this consortium did not violate anti-trust provisions.¹⁴

In an agreement signed on October 30, 2002, members of the consortium agreed to provide free online return preparation services on an IRS.gov webpage to 60 percent of taxpayers during the tax filing

9 IRS response to TAS information request (Sept. 7, 2018).

10 See *Free File Software Offers*, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited Oct. 10, 2018).

11 Note: the information included in this report reflects observations from the Free File offerings available for the 2018 filing season.

12 RRA 98, Pub. L. No. 105–206, 112 Stat. 685.

13 Presidential Initiatives: *IRS Free File*, <https://georgewbush-whitehouse.archives.gov/omb/egov/c-1-3-IRS.html>.

14 Treasury Department, *Treasury, IRS Announce New Efforts to Expand E-Filing* (Jan. 30, 2002), <https://www.treasury.gov/press-center/press-releases/Pages/po964.aspx>; see Letter from Charles James, Assistant Attorney General, Antitrust Division, Department of Justice, to Stephen Ryan, Manatt, Phelps, & Phillips, LLP (representing Free File Consortium) (Oct. 7, 2002) (Hereinafter DOJ Antitrust Letter 1).

season.¹⁵ The agreement allowed the software providers to determine the scope of their offerings, but obligated the IRS to take oversight action, such as implementing usability performance measures and notifying the consortium if services are not being properly performed.¹⁶ The IRS also had authority to terminate the agreement if the consortium failed to provide appropriate coverage, taking into account “the extent to which actual usage of Free Services has increased.”¹⁷

The IRS intended the Free File partnership to be the “best method” to “promote higher quality Free Services by utilizing the existing expertise of the private sector, maximize consumer choice, promote competition for such Free Services, and thereby meet the objectives in the least costly manner.”¹⁸ In the Free File Memorandum of Understanding, the IRS “pledged to not enter the tax preparation software and e-filing services marketplace.”¹⁹ As a result, the IRS has not followed other countries’ tax administrations in developing its own innovative offerings, such as pre-populated returns, to reduce taxpayer burden.²⁰ While the complexity and structure of the U.S. tax system make it difficult to compare to other countries, the National Taxpayer Advocate does believe that following some innovations, such as an expanded “Pay-As-You-Earn (PAYE)” system, would allow for more accurate and efficient collection of tax liabilities.²¹

While the initial agreement required the Free File Alliance to provide free software services to only 60 percent of taxpayers, several members made their offerings available to all taxpayers without restrictions.²² Members were ranked in “tiers” on the IRS webpage, with the highest-tier members listed first.²³ As a result, use of Free File expanded greatly, as 5.1 million taxpayers filed Free File returns in tax year 2004, a 46 percent increase from the previous year.²⁴ In reviewing the Free File program for anticompetitive effects, the Department of Justice found that the providers’ expansion of services,

15 Free On-Line Electronic Tax Filing Agreement entered into between the IRS and the Free File Alliance, LLC (effective as of Oct. 30, 2002), <https://www.irs.gov/pub/irs-utl/2002-free-online-electronic-tax-filing-agreement.pdf> (Hereinafter 2002 Free File Agreement).

16 *Id.* at 3-4.

17 *Id.* at 2.

18 *Id.* at 1. Describing this decision, Treasury Secretary Paul O’Neil stated, “I don’t intend for the IRS to get into the software business, but rather to open a constructive dialogue with those who already have established expertise in this field.” Department of the Treasury, *Treasury, IRS Announce New Efforts to Expand E-Filing* (Jan. 30, 2002), <https://www.treasury.gov/press-center/press-releases/Pages/po964.aspx>.

19 2018 Free File MOU.

20 See Brookings Institute, Tax Policy Center, *Briefing Book*, 447, https://www.taxpolicycenter.org/sites/default/files/briefing-book/tpc-briefing-book_0.pdf (“At last count, 36 countries, including Germany, Japan, and the United Kingdom, permit return-free filing for some taxpayers.”). The National Taxpayer Advocate notes that many of these countries don’t deliver refundable credits through the tax code, and tax by the individual unit, rather than by the family, making for a more simplified tax system.

21 The IRS should analyze and report on the feasibility of and steps necessary for furnishing information return (e.g., Form W-2, 1099) data to taxpayers electronically for direct importation into Free Fillable Forms and software or for provision to authorized tax return preparers. See also Legislative Recommendation: *Tax Withholding And Reporting: Improve the Processes and Tools for Determining the Proper Amount of Withholding and Reporting of Tax Liabilities*, *infra*; Research Study: *A Conceptual Analysis of Pay-As-You-Earn (PAYE) Withholding Systems As a Mechanism for Simplifying and Improving U.S. Tax Administration*, vol. 2, *infra*.

22 Michelle S. Chu and Melissa M. Kovalick, IRS, *An Analysis of the Free File Program*, presented at 99th Annual Conference on Taxation at 117 (Nov. 16-18, 2006), <https://www.irs.gov/pub/irs-soi/06rpppchu.pdf>.

23 Letter from Renata Hesse, Chief, Networks and Technology section, Department of Justice Antitrust Division, to Lori Larson, Chief, Public Contracts and Technology Branch, General Legal Services (May 9, 2005) at 2 (Hereinafter DOJ Antitrust Letter 2).

24 Michelle S. Chu and Melissa M. Kovalick, IRS, *An Analysis of the Free File Program*, presented at 99th Annual Conference on Taxation at 117 (Nov. 16-18, 2006), <https://www.irs.gov/pub/irs-soi/06rpppchu.pdf>; see also Treasury Inspector General for Tax Administration (TIGTA), *Use of the Free File Program Declined After Income Restrictions Were Applied*, Report 2006-40-171 (Sept. 29, 2006).

even as a method of cross-selling their paid goods and services, was “precisely the sort of activit[y] the antitrust laws were designed to protect” and “should be encouraged” by the IRS.²⁵ However, the next Free File agreement ended the tiered structure and significantly curtailed the scope of free services that could be offered by each provider, specifying that no provider could cover over 50 percent of taxpayers.²⁶

The National Taxpayer Advocate continued to criticize the limitations of the Free File program, and advocated that the IRS provide all taxpayers, regardless of income, with a bare-bones digital version of the paper Form 1040 complete with fillable fields, links to instructions, and math and numeric transfer capacity, along with free electronic filing.²⁷ To meet this need, the 2009 Free Memorandum of Understanding (MOU) created “Free File Fillable Forms,” a forms-based product designed by the members to make electronic versions of IRS forms and schedules available to all taxpayers.²⁸

The IRS has renewed its agreement with the Free File Alliance, now called Free File, Inc. (FFI), multiple times, including the most recent agreement signed on October 31, 2018.²⁹ Amendments to the agreement have included broadening the scope of eligibility for the Free File program to 70 percent of all taxpayers, heightening security and privacy requirements, and requiring for members to provide an electronic Free File indicator.³⁰ However, the Free File program still falls short in addressing key areas in need of reform to better serve taxpayers, as discussed below.

The Goals for Free File, Inc., Have Not Evolved Since Its Creation and Its IRS Budget Has Decreased to Zero

Despite surpassing the e-filing goal of 80 percent set by RRA 98, the goals of the Free File program remain stagnant.³¹ The 2018 Free File MOU lists four objectives:

1. “Make tax return preparation and filing easier and reduce the burden on individual taxpayers, particularly the economically disadvantaged and underserved populations;
2. Support the IRS’s statutory goals of increased electronic filing, pursuant to the IRS Restructuring and Reform Act of 1998;
3. Provide greater service and access to the Services to taxpayers; and

25 DOJ Antitrust Letter 2 at 3-4.

26 Free On-Line Electronic Tax Filing Agreement entered into between the IRS and the Free File Alliance, LLC (effective as of Oct. 30, 2005), <https://www.irs.gov/pub/irs-utl/2005-free-online-electronic-tax-filing-agreement.pdf> (hereinafter 2005 Free File Agreement).

27 See, *IRS National Taxpayer Advocate Annual Report and IRS Oversight Board Annual Report: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 107th Cong. 23 (2002) (transcript of testimony); *Tax Return Preparation Options for Taxpayers: Hearing Before the S. Finance Comm.*, 109th Cong. (2006) (transcript of testimony); *Tax Return Filing Season, Internal Revenue Service Operations, Fiscal Year 2009 Budget Proposals*, and the *IRS National Taxpayer Advocates Annual Report: Hearing Before the H. Subcomm. on Oversight of the H. Comm. on Ways and Means*, 110th Cong. 82 (Mar. 13, 2008) (transcript of testimony); see also, National Taxpayer Advocate 2004 Annual Report to Congress 89-102 (Most Serious Problem: *Electronic Return Preparation and Filing*); National Taxpayer Advocate 2004 Annual Report to Congress 471-477 (Legislative Recommendation: *Free Electronic Filing For All Taxpayers*); S. 1321, 109th Cong. § 310 (2005).

28 Fifth Memorandum of Understanding on Service Standards and Disputes Between the Internal Revenue Service and Free File Alliance, LLC (effective as of Oct. 20, 2009), <https://www.irs.gov/pub/irs-utl/2009-fourth-ff-mou.pdf> (hereinafter 2009 Free File MOU).

29 2018 Free File MOU.

30 *Id.*

31 Nearly 130 million tax returns or about 88 percent of all individual income tax returns were e-filed in FY 2018. IRS, *Filing Season Statistics for Week Ending August 31, 2018*. Only about 40 million, or approximately 31 percent, were e-filed in FY 2001, prior to the creation of Free File. IRS Data Book (FY 2001).

4. Implement one of the proposals in the President's Fiscal Year 2003 budget, specifically to encourage further growth in electronic filing by providing taxpayers the option to file their tax return online without charge using cooperation with, and encouraging competition within, the private sector."³²

The objectives have remained substantively unchanged since the program's inception. They continue to reference statutory e-filing goals from 1998 and the President's 2003 budget, rather than identifying new areas for focus and ways to expand the program.

Furthermore, the program formerly had a minimal budget of about \$6 million, but that budget was reduced and ultimately eliminated over the years.³³ The current IRS marketing budget for the Free File program is zero.³⁴ Failing to set new goals for the Free File program or allocate sufficient money towards it reveals how the IRS prioritizes the Free File program and hinders the program from improving the e-filing services the IRS endorses for taxpayers.

The objectives have remained substantively unchanged since the Free File program's inception. They continue to reference statutory e-filing goals from 1998 and the President's 2003 budget, rather than identifying new areas for focus and ways to expand the program.

The IRS Has Not Provided Effective Oversight and Evaluation of the Free File Program

The IRS has not taken steps to evaluate whether the Free File program is even meeting the existing goals described above. To ensure program standards are being met, the 2018 Free File MOU emphasizes the "in-place review process" for the program rather than adding any new initiatives.³⁵ The current "in-place review process" occurs once prior to filing season and once during filing season. This review is mainly to ensure the software providers' technical compliance with the Free File MOU, and does not evaluate the quality of the offerings from Free File software providers.³⁶ Thus, the National Taxpayer Advocate is concerned that merely reemphasizing the limited reviews currently in place, without adding resources or creating new measures, will not adequately evaluate the experiences of taxpayers using the program.

32 2018 Free File MOU.

33 Max Cherney, *100 Million Americans Can File Their Taxes for Free, Yet Only 3 Million People Do It*, MARKET WATCH, (Apr. 17, 2018), <https://www.marketwatch.com/story/how-to-file-your-taxes-for-free-online-if-you-make-less-than-66000-a-year-2018-03-28>.

34 IRS response to TAS information request (Sept. 7, 2018).

35 IRS News Release IR-2018-213, IRS, *Free File Alliance Announce Changes to Improve Program; Improved Taxpayer Options Available for 2019 Free File Program* (Nov. 2, 2018), <https://www.irs.gov/newsroom/irs-free-file-alliance-announce-changes-to-improve-program-improved-taxpayer-options-available-for-2019-free-file-program>.

36 These reviews: validate that the software has acquired the appropriate security and privacy certifications; test that a filer can easily prepare, file, print, download and save a tax return using the Free File software; ensure ancillary services/products, Refund Anticipation Checks and Refund Anticipation Loans are not being offered; ensure third party security and privacy certifications have been acquired to assure industry security and privacy standards and practices are being used; and validate a guarantee of calculations is provided by each company. IRS response to TAS information request (Sept. 7, 2018).

In another example of the IRS's limited evaluation of its partnership, even though FFI members are required to provide a use indicator to identify returns filed using Free File, the IRS has not prepared a Free File demographics report since 2015.³⁷ Without conducting a demographics report, the IRS has no way to know which taxpayers are using Free File services. The IRS also no longer conducts Free File satisfaction surveys, which it claims is due to budget constraints.³⁸ However, the most recent Free File MOU from 2018 specifically assigns the members of FFI the responsibility to “provide the necessary support to accomplish a customer satisfaction survey.”³⁹ Thus, the IRS failure to avail itself of that support shows the IRS's failure to exercise oversight to enforce the standards set for the program.

Conducting robust demographics analysis and satisfaction surveys, along with testing of taxpayer scenarios, would help the IRS determine why particular groups use or do not use the Free File offerings, which providers are offering inadequate services, and how it can improve its agreement with FFI to better meet the needs of taxpayers.⁴⁰ There is an old adage that “you get what you measure.” By neglecting to measure and evaluate the Free File program, the IRS is missing a valuable opportunity to fulfill its promises in the 2018 Free File MOU to make the program more taxpayer friendly. The IRS should work with TAS to develop meaningful measures and better oversight, including routine testing, to better ensure the offerings provided on Free File fulfill the *right to quality service*.

Only About 2.5 Million People Filed Returns Using Free File, Inc. in Tax Year 2017, and Use of the Program Continues to Decline

The number of taxpayers filing online has greatly increased since the early 2000s, with almost 130 million or 88 percent of all tax returns being filed electronically in FY 2017. However, less than two percent, or only about 2.5 million of those returns, were filed using Free File.⁴¹ In comparison, paid preparers filed almost 78.6 million tax returns electronically in tax year 2017.⁴² Over 3.5 million returns were prepared through Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs, a higher number than prepared by FFI despite the fact that taxpayers must expend more time and resources to go to one of these sites.⁴³

37 IRS response to TAS information request (Sept. 7, 2018). Due to the lapse in appropriations, IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

38 IRS response to TAS information request (Sept. 7, 2018).

39 2018 Free File MOU at 17.

40 For example, the most recent Free File demographics report from 2015 does not show how many Spanish speaking taxpayers used its services. See *Demographics of TY 2015 Traditional Free Filers, Free File Fillable Form Users, True Paper Filers, V-code Filers, and Form 1040 Series Filers*, included in IRS response to TAS information request (Sept. 7, 2018).

41 IRS Data Book (FY 2017) and IRS, *2017 Filing Season Statistics* (Dec. 29, 2017). In tax year 2016, just under 2.3 percent of all eligible taxpayers submitted returns using the Free File software, and just 0.2 percent of taxpayers used Free File Fillable Forms to submit their returns. IRS response to TAS information request (Sept. 7, 2018).

42 IRS Data Book at 9 (FY 2017).

43 *Id.* at 47 (showing numbers of returns).

FIGURE 1.4.1⁴⁴

Individual Return Filings by Filing Type, FY 2017

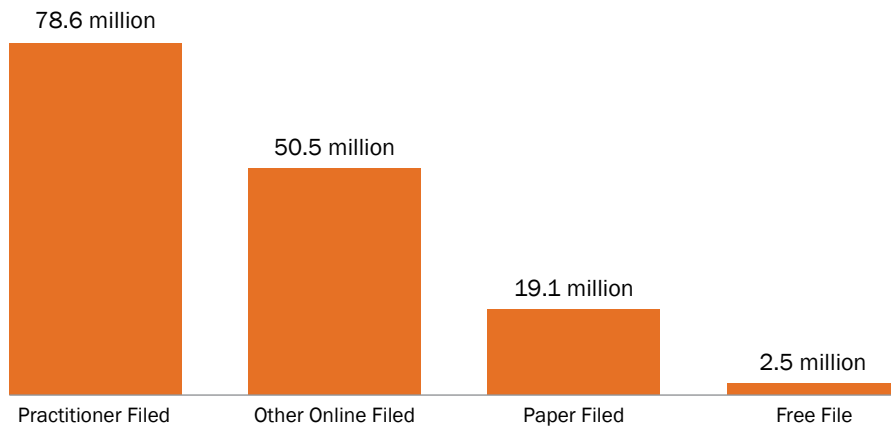
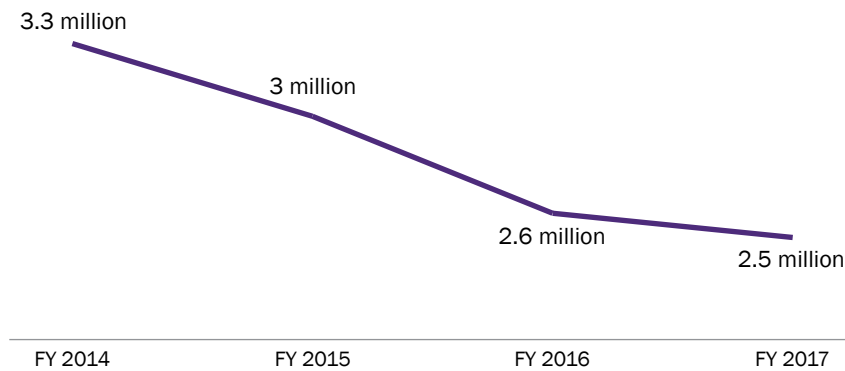


FIGURE 1.4.2⁴⁵

Free File Returns by Fiscal Year



44 IRS Data Book at 9 (FY 2017).

45 IRS Data Book (FY 2017, FY 2016, FY 2015, FY 2014).

Conducting robust demographics analysis and satisfaction surveys, along with testing of taxpayer scenarios, would help the IRS determine why particular groups use or do not use the Free File offerings, which providers are offering inadequate services, and how it can improve its agreement with Free File, Inc. (FFI) to better meet the needs of taxpayers.

As Figure 1.4.2 illustrates, use of Free File software has continued to decrease since 2014. This declining usage also shows the program's low retention rate, as only 44 percent of taxpayers that used Free File in FY 2014 and were eligible to use the program again in FY 2015 did so.⁴⁶ FFI usage was at its greatest when software providers could offer unrestricted services to more than 50 percent of taxpayers, as over 5 million taxpayers used FFI software in TY 2004.⁴⁷ While the 2005 restriction preventing each software provider from covering more than 50 percent of individual taxpayers was intended to make it easier for software providers to enter the Free File program, the number of participating providers has decreased from 20 providers in the program's early years to just 12 in FY 2018.⁴⁸ Thus, this restriction has failed to achieve its goal and, instead, has limited the options available to taxpayers.

The elimination of any marketing budget for the Free File program has made it difficult for the IRS to make taxpayers aware of the services available, as advertising for the program is limited to a few filing season press releases. There is virtually no marketing or promotion of Free File Fillable Forms on the IRS.gov homepage, even though this service is available for everyone. The IRS has mainly focused its efforts to increase awareness of the Free File program on making it easy to locate Free File on IRS.gov and IRS2Go, but these efforts do not show taxpayers the value of Free File or why they should use FFI instead of a paid return preparer. As stated above, because the IRS no longer conducts FFI customer satisfaction surveys, it does not have a way to know why the number of Free File users is decreasing or what other types of services would best attract new users. These questions must be answered to determine whether the program is worth continuing.

The Services Provided by Free File, Inc. Fail to Meet the Needs of Taxpayers, Particularly Within Underserved Populations

Free File Does Not Effectively Serve Its Targeted Demographics

The latest FFI operating agreement specifically highlights economically disadvantaged and underserved populations as the targeted groups for Free File services.⁴⁹ Taxpayers in vulnerable groups typically have limited disposable income and free time to spend on tax return preparation. However, FFI is failing to serve taxpayers within these populations, particularly low income taxpayers, elderly taxpayers, and ESL taxpayers.⁵⁰

46 Jacob Goldin, *Participation in the IRS Free File Program*, TAX NOTES (Oct. 23, 2017).

47 Michelle S. Chu and Melissa M. Kovalick, IRS, *An Analysis of the Free File Program*, presented at 99th Annual Conference on Taxation at 117 (Nov. 16-18, 2006).

48 See *Free File Software Offers*, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited on Oct. 10, 2018).

49 2018 Free File MOU.

50 Stakeholders raised concerns that the Free File program would not serve its target audience adequately in comments to the Federal Register Notice on Free Internet Filing Agreement. Specifically, these comments noted that the program would not protect the interests of low income taxpayers and risked excluding English as a Second Language taxpayers. See IRS Electronic Tax Administration, *Responses to Federal Register Notice on Free Internet Filing Agreement* (Sept. 17, 2002).

First, while a high percentage of taxpayers using FFI software are low income, this number still constitutes a small proportion of low income taxpayers as a whole. Figure 1.4.3 illustrates the breakdown of income levels of Free File users in 2015, the last year the IRS prepared a demographics analysis report.

FIGURE 1.4.3, Percentage of Free File Users by Income Demographics (TY 2015)⁵¹

Adjusted Gross Income	Traditional Free File	Free File Fillable Forms
Negative AGI	1.00%	0.30%
\$0 to \$17,000	47.75%	13.10%
\$17,001 to \$25,000	15.91%	4.77%
\$25,001 to \$35,000	15.35%	5.58%
\$35,001 to \$50,000	14.13%	7.95%
\$50,001 to \$75,000	5.79%	20.56%
\$75,001 to \$100,000	0.03%	20.98%
\$100,001 or More	0.04%	26.75%
Total	100.00%	100.00%

Figure 1.4.3 shows the majority of all Free File software users had adjusted gross income of \$25,000 or less.⁵² However, this represents only about 1.5 million taxpayers, or just under 3 percent of all taxpayers in this demographic.⁵³ This shows that a substantial number of low income taxpayers are using other methods to file their returns or are not filing at all. If low income taxpayers pay for tax return preparation services instead of using the free ones offered by FFI, they would have less resources available to cover other basic living expenses. Although there may be legitimate reasons for using for-fee services—lack of tax knowledge, fear of making mistakes, desire for refund anticipation loans—the IRS has not conducted research to determine why low income taxpayer prefer for-fee services over free filing.

Second, elderly taxpayers are limited in the Free File software options available to them. While the IRS does offer the Tax Counseling for the Elderly program to assist taxpayers age 60 or older with return preparation, this program is only available during the filing season and is not designed to serve every taxpayer in this age range. Free on-demand electronic tax preparation service is still a valuable resource for taxpayers in this demographic. However, only three of the 12 FFI providers offer services to taxpayers of all ages, and even these have use restrictions based on the taxpayer's state of residence, income, or eligibility for the Earned Income Tax Credit.⁵⁴ Five of the 12 FFI providers have age limitations that start before the age of 60, with some even excluding taxpayers over the age of 50.⁵⁵ Age

51 See *Demographics of TY 2015 Traditional Free Filers, Free File Fillable Form Users, True Paper Filers, V-code Filers, and Form 1040 Series Filers*, included in IRS response to TAS information request (Sept. 7, 2018).

52 *Id.* Due to the lapse in appropriations, IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

53 Only 1,513,295 taxpayers out of 56.9 million total taxpayers with income \$25,000 or less used Free File software. *Id.*

54 For example, one Free File, Inc. (FFI) software provider makes its services available to all ages, but the taxpayer must have adjusted gross income of less than \$33,000 or be eligible for the Earned Income Tax Credit. See *Free File Software Offers*, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> (last visited on Oct. 10, 2018).

55 *Id.*

restrictions like these sharply curtail the number of FFI options available to taxpayers, making it more difficult for them to choose a return package suited to their needs and preferences.

Third, ESL taxpayers face extreme difficulty navigating and using the Free File software, as no options were available in languages other than English in filing season 2018. The Hispanic community in the United States typically has a lower rate of electronic filing than other demographic groups.⁵⁶ A recent TAS study showed that because of language barriers and less education, Spanish-speaking taxpayers may be especially vulnerable to unscrupulous return preparers who promote high-interest loans and charge high fees.⁵⁷ Thus, there is a great need for free tax return preparation assistance, vetted by the IRS, to be made available to Spanish-speaking taxpayers. However, this need is not being met by FFI. While the IRS does provide some guidance to Spanish-speaking taxpayers on IRS.gov, the description and display for using Free File is only available in English.

FIGURE 1.4.4

IRS Free File Guidance in Spanish



Even if an ESL taxpayer can navigate through this screen, none of the return preparation software options available have a Spanish language option.⁵⁸ In its most recent Free File Memorandums of Understanding, the IRS made making tax filing easier for underserved populations a key objective, and even required members to provide a Spanish Free File indicator to show how many taxpayers took advantage of such services.⁵⁹ However, in another example of the IRS's lack of oversight and evaluation of the Free File program, there were zero providers offering such a Spanish-language version in filing season 2018. Because the IRS itself has not translated the Form 1040 into Spanish, Free File Fillable Forms are also only available in English.⁶⁰ These limitations in service can drive Spanish-speaking taxpayers to costly paid preparer options.

56 Sonja Pippin and Mehmet Tosun, *Electronic Tax Filing in the United States: An Analysis of Possible Success Factors* 12 ELECTRONIC JOURNAL OF E-GOVERNMENT, ISSUE 1, 22-38 (2014).

57 National Taxpayer Advocate 2015 Annual Report to Congress vol. 2, 102 (Research Study: *Understanding the Underserved Hispanic Population*) ("Hispanics who use unregulated preparers run the risk of having their returns prepared incorrectly, either as a result of incompetency or willful misconduct."). TAS research has shown that only six percent of Hispanic taxpayers used a free tax preparation service by a trained volunteer, while 60 percent used a paid tax return preparer other than an attorney, CPA, or enrolled agent. *Id.*

58 Due to the lapse in appropriations, IRS did not provide a timely response to our request to verify these figures during the TAS Fact Check process.

59 2018 Free File MOU at 16; 2015 Free File MOU at 16.

60 In tax year 2017, TAS translated Form 1040 into Spanish, the first time ever this form has been available in a language other than English. TAS will update this form with changes for the 2018 Form 1040. The form is available at TAS's tax reform website, <https://taxchanges.us/es/>.

Testing by TAS Shows That Content Quality Is Not Consistent Among All Free File Software Providers, As Several Have Limitations in Their Navigation and Capabilities

The National Taxpayer Advocate continues to be concerned that the IRS does not sufficiently exercise its authority to set standards for what must be included in each Free File software provider's service offerings. The 2018 Free File MOU sets standards for core forms and schedules that must be offered by Free File software providers, but does not ensure that each offering covers specific deductions, credits, and exemptions.⁶¹ To evaluate each Free File software provider's ability to support items a taxpayer may include on a return, TAS tested several return preparation scenarios including Schedule C deductions, the tuition and fees credit, the Earned Income Tax Credit, casualty loss/disaster relief provisions, and the mortgage insurance premium deduction. Our testers had varying success completing their simulated return, depending on the provider they chose and the complexity of the scenario.⁶²

The perceived benefit of Free File software, as opposed to just Free File Fillable Forms, is that it gives guidance to help taxpayers navigate through the return filing process and alert them of all deductions and credits for which they may be eligible. However, testers noted that the quality of guidance provided during the process varied greatly among the software providers. Some sites had helpful tools like video tutorials, live chat features, explanations of deductions, and review features to help ensure taxpayers hadn't missed any credits or deductions. On others, however, the testers noted confusion in finding a help center, being overwhelmed by lists of unexplained deductions, and difficulty in correcting errors.

Testers of the casualty loss/disaster relief scenario noted that some providers failed to have prompts for how to claim this deduction, and they were left searching for the proper forms on their own. Testers of the Schedule C scenario noted that while all providers supported filing a Schedule C, some did not allow adding in depreciable assets or offer additional guidance on depreciation. Some sites also failed to explain how particular deductions or credits were calculated and selected, making it difficult for taxpayers to ensure they had selected the appropriate ones.⁶³ As a result of these limitations, taxpayers with limited knowledge of tax law depending on the Free File program for guidance may not realize they are eligible for some deductions and credits or claim them improperly, leading them to file incorrect returns.⁶⁴ If the service quality provided by Free File software fails to meet taxpayers' expectations, it can erode trust in the agency given the IRS's seeming endorsement of the Free File software offerings.

61 See 2018 Free File MOU. When TAS has conducted testing on Free File software in the past, our office found significant limitations in the coverage of some software providers. For example, testing by TAS in 2006 showed that a majority of providers did not include tax law benefits provided after Hurricane Katrina. See *Tax Return Preparation Options for Taxpayers: Hearing Before the S. Finance Comm.*, 109th Cong. (2006) (transcript of testimony). Similarly, testing in 2015 showed several Free File packages did not include info about exemptions from the Individual Shared Responsibility Payment of the Affordable Care Act, meaning some taxpayers paid a penalty they didn't owe. See National Taxpayer Advocate 2015 Annual Report to Congress 167-179, fn. 20 (Most Serious Problem: *Affordable Care Act (ACA) – Individuals: The IRS Is Compromising Taxpayer Rights As It Continues to Administer the Premium Tax Credit and Individual Shared Responsibility Payment Provisions*).

62 Please note: TAS's objective was to determine the existence and extent of limitations and problems that a typical user of the Free File sites would encounter. In some instances, the testers found the sites very difficult to navigate and were unable to locate forms or answers that later testers could locate. Therefore, the results described below reflect simply what our testers experienced and not necessarily what a site was capable of accomplishing.

63 For example, when testing the tuition and fees deduction scenario, one tester noted that some of the software providers did not explain the difference between the American Opportunity Credit, Lifetime Learning Credit, and the tuition and fees deduction. These providers would merely provide the credit or deduction determined to be most beneficial, without providing the bottom line value for all three.

64 Some software tested seemed overly focused on refund maximization, which could tempt taxpayers to provide incorrect information in hopes of getting a larger refund.

If the IRS continues to show no appetite for monitoring and overseeing, including testing, the products it gives the appearance of endorsing, the IRS should end its Free File offerings and, instead, focus on improving and promoting free fillable forms, which is the 21st century version of the Form 1040.

Cross-Marketing and Advertising of Other Services on Free File Software Platforms Can Confuse Taxpayers, and Gives the Impression of IRS Endorsement of For-Fee Services

All Free File sites are accessed through the official IRS.gov website, yet cross-marketing of ancillary products and services is common on many of the sites. In the past, the National Taxpayer Advocate has raised concerns that cross-marketing and advertising on Free File software platforms can distract and confuse taxpayers as they complete their returns and undercut the value of the free services provided.⁶⁵

TAS commends the IRS for including important amendments to strengthen taxpayer protections and limit the marketing of paid services by FFI members in the 2018 Free File MOU.⁶⁶ The new MOU includes language requiring software providers to automatically return taxpayers to the IRS Free File page if they don't qualify for an offer, preventing software providers from upselling their other products through "value-add" buttons on landing pages.⁶⁷ The MOU also contains provisions for limiting email solicitations of taxpayers in subsequent years, and requiring Free File software providers to offer returning taxpayers Free File products as a first option in subsequent years.⁶⁸

While these amendments are important, the National Taxpayer Advocate continues to be concerned over the marketing of paid state tax filing services on Free File platforms. Our testing showed some providers required taxpayers to enter in state tax return information, even if the taxpayer did not intend to file a state return, and then advertised the price of the state return at the end of the process. While some states offer free filing independent of FFI, the 2018 Free File MOU prohibits the IRS from making

65 See *Tax Return Preparation Options for Taxpayers: Hearing Before the S. Finance Comm.*, 109th Cong. (2006) (transcript of testimony).

66 For a description of our prior testing, see *Tax Return Preparation Options for Taxpayers: Hearing Before the S. Finance Comm.*, 109th Cong. (2006) (transcript of testimony).

67 IRS News Release IR-2018-213, *IRS, Free File Alliance Announce Changes to Improve Program; Improved Taxpayer Options Available for 2019 Free File Program* (Nov. 2, 2018), <https://www.irs.gov/newsroom/irs-free-file-alliance-announce-changes-to-improve-program-improved-taxpayer-options-available-for-2019-free-file-program>. See also 2018 Free File MOU § 4.32.2 (Requiring Members to "provide, as a first option, a prominent hyperlink for the taxpayer to return to the IRS Free File Landing Page" if the taxpayer "enters a Member's Free File Landing Page and begins to complete a return but ultimately cannot qualify for the Member's free offer."); § 4.32.6 ("Members shall not include a "value-added" button (*i.e.*, an icon, link or any functionality that provides a taxpayer with access to a Member's commercial products or services) on the Member's Free File Landing Page.").

68 See also 2018 Free File MOU § 4.14 (A returning taxpayer must "be given a first option to return to the Member's Free File offer before receiving any other alternative choices for the Member's publicly available commercial tax preparation products or services."); § 4.32.4 ("Free File Members shall communicate not less than once annually via email with their taxpayer customers who used Free File services and completed their returns through Free File in the immediately preceding tax year prior to the opening of the following tax season. The content of this email(s) shall only remind the taxpayer about the availability of the Member's Free File offer and invite them to return to the Member's Free File Landing Page. Free File Members shall not use these communications to communicate with the taxpayer about any non-Free File commercial products or services. No marketing, soliciting, sale or selling activity, or electronic links to such activity, will be permitted in these email(s).").

taxpayers aware of these services.⁶⁹ By providing links to software providers marketing paid state-return options and not advertising the other free state options available, the IRS is in effect endorsing these for-fee products. Thus, rather than providing a service that meets taxpayers' needs, Free File software has the potential to mislead taxpayers and ensnare them in for-fee product offerings.

CONCLUSION

With no effective goals, measures, or budget, the IRS's Free File program in its current format has become an ineffective relic of early efforts to increase e-filing. Rather than being a beneficial program providing free return preparation services to all, it is an inadequate program that provides limited services and is used by only a small percentage of eligible taxpayers. The IRS is devoting zero resources to oversight and testing of this program to understand why taxpayers aren't using it and how the services offered could be improved. When the services provided by FFI fail to meet the needs and preferences of taxpayers, particularly in underserved communities, it reflects poorly on the IRS and can erode taxpayers' trust in fair tax administration.

If the IRS is going to promote the product, then it needs a dedicated budget and staff to set standards for the program, including what provisions products must incorporate in order to participate, to prevent taxpayers from being harmed. This starts with setting actionable goals that address issues currently faced by taxpayers and establishing measures to assess whether those goals are being met. The IRS must monitor and test with scenarios what the products do and present taxpayers with more information so they can make an informed choice about whether to use each product. Focusing on the taxpayer's experience using the Free File program will allow the IRS to identify how to best alter and develop the program to make free tax return preparation a more convenient and viable option for taxpayers.

If the IRS continues to show no appetite for monitoring and overseeing, including testing, the products it gives the appearance of endorsing, the IRS should end its Free File offerings and, instead, focus on improving and promoting free fillable forms, which is the 21st century version of the Form 1040.⁷⁰ This fillable electronic version of the Form 1040 should build on what is offered by Free File Fillable Forms, including linking from IRS form instructions to IRS publications, increased guidance for common areas of taxpayer confusion, creating versions available in other languages like Spanish, and providing a dedicated email where taxpayers can get help when experiencing technology glitches.

69 See 2018 Free File MOU § 4.22. The 2018 Free File MOU specifies that providing links from “the IRS Free File Website to Non-Free File State Department of Revenue websites is grounds for FFI to immediately dissolve its obligations in this MOU.” 2018 Free File MOU § 4.22.

70 For additional description of this recommendation, see Legislative Recommendation: *Tax Withholding And Reporting: Improve the Processes and Tools for Determining the Proper Amount of Withholding and Reporting of Tax Liabilities*, *infra*.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Develop actionable goals for the Free File program, including targeted-use percentages, prior to entering into a new agreement with Free File, Inc.
2. Work with TAS to create measures evaluating taxpayer satisfaction with the Free File program and test each return preparation software's ability to complete various forms, schedules, and deductions.
3. Provide Free File Fillable Forms and Software options for English as a Second Language taxpayers.
4. Prepare an advertising and outreach plan to make taxpayers, particularly in underserved communities, aware of the services available through the Free File program.
5. Allow Free File members to provide services to all taxpayers as a part of its next operating agreement instead of capping the percentage of eligible taxpayers each software provider can cover.
6. Redesign the Free File Software Lookup Tool to better direct taxpayers to software providers that best meet their circumstances.
7. Improve the capabilities offered to taxpayers through Free File Fillable Forms, including:
 - a. Linking from IRS form instructions to related IRS publications;
 - b. Providing increased guidance for common areas of taxpayer confusion;
 - c. Ensuring taxpayer's abilities to download, save, and print all forms with troubleshooting assistance; and
 - d. Creating a dedicated email where taxpayers can get help when experiencing technology glitches.
8. If the above recommendations are not substantially adopted, discontinue the Free File Program and create an improved electronic free fillable forms program including the features described in Recommendation 7.