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

The Internal Revenue Service first allowed individual income tax returns to be filed electronically (e-filed) through a pilot program that began in 1986 and involved five tax preparers. Since then, e-filing has grown to the point that 92% of individual tax returns for the 2021 tax year were e-filed.

E-filing has advantages for both tax administrators and taxpayers. For the former, e-filing substantially lowers the cost of processing returns and entails lower error rates, relative to paper returns. For the latter, e-filing allows individuals to receive a tax refund sooner than they would with a paper return.

The IRS has been promoting e-filing by individuals, businesses, and tax practitioners since the late 1990s. A key part of this effort is the Free File Program (FFP). The FFP makes it possible for individuals, regardless of their filing status, with adjusted gross incomes (AGIs) at or below a specified amount (\$79,000 in the 2023 tax year) to e-file their federal income tax returns, free of charge, using software provided by participating tax preparation companies. There are seven such companies at the start of the 2024 filing season. The IRS provides a secure portal on its website for eligible taxpayers to access the FFP. Taxpayers with AGIs above the FFP limit may e-file their returns, free of charge, through the same portal, using the Free File Fillable Forms, which are electronic versions of tax forms and schedules that offer no filing assistance.

Origin of the FFP

The FFP originated through two sources. One was the IRS Restructuring and Reform Act of 1998 (RRA, P.L. 105-206). The act directed the IRS to increase the share of e-filed individual returns to 80% by 2007 from 23% in 1998 with assistance from the private sector.

A second source was a 2001 directive issued by the Office of Management and Budget's (OMB's) Quicksilver Task Force implementing President George W. Bush's E-Government Initiative. One of the 24 projects chosen by the task force was the EZ Tax Filing Initiative. It was intended to increase the probability of the IRS achieving an 80% individual e-filing rate by 2007 by allowing paper filers to e-file their returns free of charge through a partnership between the IRS and tax software companies.

Initially, the IRS tried achieving the aims of the Initiative by developing digitized versions of Form 1040 (and its schedules and instructions) that could be accessed at no cost through WhiteHouse.gov. When it became apparent that the IRS would be unable to complete such a project anytime soon, Treasury Secretary Paul O'Neill asked IRS

Commissioner Charles Rossetti in January 2002 to establish a partnership with tax software companies to develop a free online filing system that would be managed by the IRS for low-income taxpayers, who were most likely to file paper returns. The resulting private-public partnership was initially called the Free File Alliance (FFA); it is now known as Free File, Inc. (FFI).

The IRS did not achieve its 2007 e-filing goal until 2012, when 83% of individual returns were e-filed.

Structure and Evolution of the FFP

The FFP began when the IRS signed an agreement with the 17 original FFI member companies on October 30, 2002.

The agreement laid down a clear division of authority and responsibility between the IRS and the member companies. It required the companies to provide their tax preparation and filing services through IRS.gov at no cost to 60% or more of individual taxpayers, ranked by AGI. The companies set the eligibility requirements for free filing, based on age, income, and state residence. To join the FFP, each company had to prove that it was capable of providing such a service to at least 10% of individual filers.

The agreement made the IRS responsible for enforcing member company compliance with the terms of the agreement. The agency had the authority to cancel the agreement with one year's advance notice, if it determined that most member companies were providing too little coverage.

A controversial element of the agreement was a commitment by the IRS to not compete in the market for tax filing and preparation. Preventing the IRS from becoming a competitor was a major incentive for tax software companies to create and participate in the FFP.

The IRS and FFI have extended and revised the original agreement five times. These subsequent agreements are linked to nine memoranda of understanding (MOU), which serve to implement the revised agreements.

The second agreement (2005) reduced the range of free services a company could offer to eligible taxpayers; this meant that member companies could no longer offer refund anticipation loans to FFP taxpayers. In addition, the agreement stipulated that no member company could serve more than 50% of such taxpayers, 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 making free fillable individual income tax forms available to any taxpayer, regardless of income, via the IRS's Free File portal. The agreement also required FFI companies to embed a link to IRS.gov in their landing pages for the FFP.

The current MOU is due to expire on October 31, 2025. 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. In a significant shift, the MOU no longer specifies that the IRS should refrain from developing its own electronic direct filing system through its website.

FFI's membership has shrunk since 2020. The two largest providers of tax preparation and filing services in the United States withdrew from the FFA: H&R Block in 2020 and Intuit in 2021. Together they handled about 70% of returns filed through the FFP for the 2019 tax year.

Use of the FFP

An ongoing concern with the FFP (which goes back to its early years) has been 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. From 2003 to 2019, an average of 2.8% of eligible taxpayers filed using the FFP. Usage rose to 4.0% of eligible taxpayers for the 2020 tax year. Part of this increase was due to claims for the economic impact payments the IRS issued in 2020 to individuals who normally do not file a tax return.

Policy Issues

Congress focused on the FFP's future in 2019. In April of that year, the House passed a bill (Taxpayer First Act, H.R. 1957) to reform some of the ways in which the IRS interacts with taxpayers. One provision would have permanently extended the FFP, which would have meant permanently barring the IRS from creating its own direct e-file service through a secure portal on its website. The provision triggered opposition from some interest groups and lawmakers and led to a congressional debate on whether to codify the FFP or to direct the IRS to abandon it and provide its own online filing and preparation service. Contributing to this opposition were media reports (mainly from ProPublica) that some FFA companies had steered FFP-eligible taxpayers to using the firms' paid services. The 116th Congress passed a similar bill, but without the FFP provision (P.L. 116-25).

Pros and Cons of Retaining the FFP

The FFP still operates, but its future remains uncertain. FFP proponents, including FFI companies, say it should be kept because it saves low- and middle-income taxpayers and the IRS considerable money each year. According to the FFI, taxpayers saved an estimated \$1.5 billion from 2003 to 2018 as a result of e-filing through the FFP, and the IRS saved hundreds of millions of dollars in processing costs.

FFP critics say the current program is too flawed to retain. They say member companies' websites for FFP filing are too complicated and in some cases deceiving; the program's take-up rate remains too low; and the IRS still invests little in promoting the program, assessing taxpayers' experiences with it, and monitoring member company compliance with the current MOU. Critics are also concerned that FFI companies may continue to use the FFP as a means of promoting their paid filing services to FFP-eligible taxpayers. In a 2020 report, the Treasury Inspector General for Tax Administration found that over 34.5 million FFP-eligible taxpayers e-filed their returns using member company commercial services in FY2019.

Reforming the FFP

Some argue that the FFP should be retained, but only if certain changes are made in its operation. These changes would require the IRS to invest more in promoting the FFP among eligible taxpayers and monitoring member company compliance with the MOU. In addition, these proponents say that the MOU should be revised to require member companies to disclose to the IRS any revenue they receive from marketing their paid services to FFP-eligible taxpayers.

Return-Free Filing

Some FFP critics support replacing the program with an IRS e-filing service that simplifies the process, especially for taxpayers with uncomplicated tax situations. One option would involve the IRS electronically sending prefilled returns to individuals whose entire income is reported to the IRS by third parties for their approval or disapproval. Another option would be for the IRS to adopt a return-free filing system based on methods such as exact withholding or tax-agency reconciliation.

Free Direct E-Filing with the IRS

Some FFP critics advocate replacing or supplementing it with a free, direct e-filing system managed by the IRS. P.L. 117-169, commonly known as the Inflation Reduction Act (IRA), provided the IRS with \$15 million to study the feasibility and cost of developing and operating a direct e-filing system that includes "multi-lingual and mobile-friendly features and safeguards for taxpayer data." As mandated by the IRA, the IRS and an independent third party issued reports in May 2023 addressing these issues. The IRS found that 72% of a survey group had an interest in using an IRS direct-e-file system; the IRS also estimated that the annualized cost of developing and operating such a system could range from \$64 million to \$249 million, depending on the number of users and the scope of services.

During the 2024 filing season, the IRS plans to operate a pilot program to allow taxpayers in 12 states to e-file their returns directly with the IRS. Participants must take the standard deduction, receive income from wages reported on W-2 Forms and Social Security and unemployment benefits only, and have no more than \$1,500 in interest income.

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