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INSIGHT: Free File—Mend It, Don't End It



BY COURTNEY KAY-DECKER

I've been following the various news articles about the IRS Free File program over the past few months. In a nutshell, the reporting has alleged that some tax software providers—members of the Free File Alliance—were steering unwitting taxpayers away from Free File's services toward paid tax preparation and filing services. Furthermore, they claim that some tax software companies pushing the company's Free File results lower in search engine results, allegedly to lead taxpayers into spending more than necessary.

Those are pretty strong allegations. Certainly, I'm in no position to know others' motives. That being said, a valid, non-nefarious reason exists for Free File Alliance companies to ensure that searchers for the Free File program don't start at their Free File landing pages—taxpayers are supposed to start at the Internal Revenue Service's Free File site at IRS.gov. The IRS has responsibility for overall communication of the Free File program to the public. That approach ensures that taxpayers receive a neutral and consistent presentation of their options. In fact, the IRS has created a tool to help taxpayers determine what level of free services are available to them through the program, including *state* Free File services. The tool is quite helpful, but don't go looking for it now. It is in hibernation until the filing season reopens in January 2020. What I take away from the reporting is that the Free File program has work to do to make sure that eligible taxpayers know that starting at IRS.gov provides the full picture of the options.

In my view, the reporting and other commentary on this issue has fallen into the old stereotypes: Corporations are greedy and inherently evil. Government is either too incompetent, or it's too cozy with the bad private sector. By extension, public-private partnerships take on all the purported evil of the private sector. The narrative suggests that the Free File program is in exis-

tential crisis, and the only solution is to replace it with an IRS-run, return-free filing regime. The return-free system's concept is that the IRS would simply send you a bill to pay, like property taxes. As nice as this may sound, I respectfully disagree that a return-free system is the solution to the challenges facing the Free File program. The Free File program was not perfect when it began, and it isn't perfect now. But lack of perfection is a bad reason to throw away an innovative program that is providing a beneficial, free service to millions of taxpayers each year.

Others have already written in other outlets about how the Free File program came to be as a result of the 1998 IRS Act and about the Congressional directive to grow electronic filing in the U.S. Others have laid out the case against the return-free system concept, including trouble-plagued experiences of places like the U.K. Furthermore, [the MITRE Corp. report](#) issued last month provides a good analysis of the current issues and recommendations for improvement of the Free File program itself. I won't rehash those discussions. Instead, my focus is on a couple of areas that have not been considered: *States* and, to use a buzzword, *culture*.

The Free File Program Is Available for State Tax Returns, Too.

“What about the states?” or “How will taxpayers deal with X issue at the state level?” These were questions I heard (and asked) often during my tenure as Director of Revenue in the state of Iowa. Issues that arise in the federal tax system tend also to arise in some variation at the state level. States take their sovereignty seriously. Each state revenue agency is its own “mini-IRS,” responsible for administering the state's tax laws. And each state has different budgetary, political, legal, and

philosophical constraints that must be balanced. There are pockets of uniformity across the country, but still many differences exist that need to be managed in any collaborative effort.

Of the 43 states (and the District of Columbia) that have an individual income tax, all of them collaborate significantly with each other (and with the IRS) to create opportunities to make tax administration less expensive and cumbersome for taxpayers. In fact, most electronically filed state income tax returns pass through the IRS before arriving in state systems. This arrangement makes it relatively easy for interested states to piggyback on the Free File program. In fact, the Free File agreements specifically provide states with that option.

Currently, the Free File program provides free software for free state tax preparation and filing in 22 states and the District of Columbia. Of the 2.6 million federal returns prepared and filed for free using the Free File program during the 2018 fiscal year, nearly half that many returns were also prepared and filed for free at the state and D.C. levels using the program. Omission of state free return volumes in the national Free File count artificially masks the true scope and impact of the program. In these states, the availability of Free File allows the participating states to offer a free service to their qualified taxpayers without cost to the state, or the taxpayers who pay that state's bills.

Elimination of the Free File program at the federal level means 23 state Free File programs would simultaneously disappear, creating in effect a huge 'unfunded liability' in half the income tax states in the country. Would it still be worthwhile for the tax software providers to reconstitute a free return preparation and filing program only with the states? Would there have to be 23 separate state partnership agreements to continue the free services? If the state Free File program disappears, taxpayers will either have no replacement service, or the states will have to scramble to create (*and pay for*) a new system. And who knows whether it would make sense financially, legally, or politically for states to build their own return-free systems at public expense. Though fillable forms and other filing tools exist in many states, I'm not aware of any state that currently operates a true return-free system.

During nearly eight years as a state tax administrator, I had a front row seat to challenges taxpayers face in complying with complex federal and state tax laws. An important part of my job was to identify opportunities to make filing and interacting with our agency easier. When taxpayers understand their obligations, they tend to be more compliant. During my tenure, we had flat and sometimes shrinking appropriations, and a tax code that was more complicated than one might expect. We prioritized our limited resources to find solutions that would resolve challenges for the largest numbers of our taxpayers. We were often faced with a menu of less than ideal choices. Leveraging public-private partnerships like the Free File program helped us minimize resource gaps while still delivering important services to our taxpayers. Our goal was always to get the best information possible to our taxpayers on a given issue, and to make the process as easy as possible, within our budget, legal, technological, and workforce constraints. We certainly weren't perfect. Sometimes we needed Band-Aids, duct tape, and a little pixie dust to get us through. Fortunately, I had a team that was dedi-

cated to serving our taxpayers and wanted to become better every day.

While I was a tax administrator, I learned something interesting—and a bit surprising—about taxpayer behavior. Many taxpayers are afraid when they receive correspondence from their tax agency, state or federal. The worst mistake a taxpayer can make when receiving a letter from their tax agency is to ignore it. Nonetheless, many taxpayers do just that. By ignoring or avoiding correspondence, taxpayers face consequences such as liens, loss of appeal rights, or worse, loss of refunds. Why would taxpayers do something contrary to their interests? Here's what they often said when they finally contacted us: "I was afraid to open it," or "I was afraid it would say I owed money, and I couldn't pay it." Let me bring this home: I recently got an envelope in the mail from the IRS. For a moment, I had butterflies. Then I remembered that I signed up for some e-services, and the letter was a confirmation for fraud prevention purposes. Even I, someone who has a decent sense of how the system works, had a moment of fear.

Knowing that this fear exists, I wonder how a typical taxpayer might feel about a return prepared for them by government. Will the most vulnerable among us know that they can object? Do they know that they won't be audited just for revising the information provided by the government? Will they realize that any response must be timely? I am concerned that a large part of the population who could benefit from the services will end up paying more than they owe out of fear. This is particularly concerning since government, both federal and state, does not have enough information about taxpayers' private lives to ensure that a government-prepared return is fair and accurate.

Why does my experience in Iowa matter? As stated above, any changes to the Free File program need to take into account the impact on taxpayers at the state level. Perhaps more importantly, the challenges faced at the state level aren't that different from the challenges faced by the IRS. Like states, the IRS has a laundry list of constraints that it must manage, not the least of which is budget.

Some think it would be easy for the IRS to develop a return-free system with today's technology. That could be true. But I distinctly remember my IT folks cringing every time I suggested that any technology project should be simple. Every new technology task takes away from some other priority. Should a new initiative be at the top of the IRS's technology priority list when it still runs systems from the Kennedy and Nixon administrations? You put on your own oxygen mask before you help others. The IRS needs to focus on its own technology before adding major new responsibilities to its service offerings. In the meantime, there are plenty of ideas out there to make the Free File program materially better without spending hundreds of millions of taxpayer dollars (or more).

Free File Has Been a Catalyst for Culture Change Within the Tax Ecosystem

I am a big fan of bold thinking to improve the status quo. The process of imagining even impractical ideas can give rise to workable solutions that make the world a better place. From time to time, it is even valuable to

consider whether an entire system should be thrown out. But we want our government to be careful with taxpayer dollars. Return-free filing is a big, bold idea. It probably sounds like heaven to those who hate doing their taxes. But it also means acquiring a lot more information about the personal lives of our taxpayers as we throw out the whole tax administration system as we know it. And, by the way, it would require massively simplifying the tax code.

The Free File program itself was actually a pretty revolutionary idea in the tax world. It was, to my knowledge, the first modern attempt to create a true partnership between the tax software industry, the IRS, and the states. Industry and government didn't like each other one little bit. Each assumed the other had a secret agenda.

Through Free File, the sectors began to realize that they were serving the same taxpayer, and that a more collaborative approach might make sense. They found a common purpose: encouraging electronic filing, driven by Congress enacting the 1998 IRS Restructuring and Reform Act. Both sectors knew that electronic filing of tax returns offered savings to taxpayers through increased accuracy, faster refunds, and lower costs to process. Over time, for different reasons, both saw value in making electronic filing free for some segment of the population. And importantly, over the years the Free File agreement was modified and improved to reflect a changing world and to ensure that taxpayers could reap the benefits of competitive tax software innovation. One change worth highlighting was the addition of electronic fill-in-the blank income tax forms that can be filed electronically, courtesy of enhancements the IRS and the Free File Alliance agreed to a decade ago. Now, both a paper and an electronic Form 1040 with the major schedules can be filed for free by anyone, because the fillable forms tool has no economic means test.

Even though I disagree with the conclusion that a government-run, return-free system is the solution to Free File's problems, I firmly believe that the advocates of a return-free system have valuable substantive insights about the Free File's shortcomings. I wish its advocates would skip the politicized hyperbole and ad hominem attacks against industry and the IRS. Those are unhelpful, and frankly don't serve the larger public interest. Demonizing the "other" is an easy way to stir outrage, but it makes it more difficult to actually meet public interest needs, and to form the essential relationships necessary to get to the heart of an issue and en-

sure the continuous process improvement the public does deserve.

Solving big problems requires diversity of thought and experience, and a deep understanding and respect of others' perspectives and constraints. It also requires a willingness to move forward on areas of consensus, even if the result is less than perfect. For all its faults, Free File has changed for the better the way the private sector, the IRS, and the states, interact with each other in furtherance of a common cause. Free File built the foundation for other critically important collaborations in the national interest. A notable example is the IRS's Cyber Security Summit. The collaborative efforts of the IRS, the states and industry have made a very significant impact on preventing and detecting identity theft tax refund fraud in an era of intense global cyber threats.

The IRS, the states, and the Free File Alliance should always be open to understanding challenges taxpayers are facing with the program and seek appropriate solutions. From what I understand, they are doing just that. In my view, the recent controversy creates an enormous opportunity for a fresh look at the program. The MITRE report offers the roadmap to guide the improvements. New goals need to be established. The guardrails and rules of the road need to be reevaluated. Methods and content of communications with taxpayers need be revisited. What the Free File program needs is recalibration and fine-tuning, not elimination. All of the humans I know in the IRS, the states, and industry are reasonable, thoughtful, and hard-working people. In the end, I have no doubt that they will find ways to solve today's challenges, just as they should, without jeopardizing services available to constituencies in need or the progress made in electronic filing for the nation as a whole. As with so many things in public service, mend it, don't end it.

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Author Information

Courtney M. Kay-Decker is the former Director of Revenue for the state of Iowa, and the former state co-chair of the Identity Theft Tax Refund Fraud Information Sharing and Analysis Center Partnership (the IDTTRF-ISAC Partnership). She recently completed a term serving on the Electronic Tax Administration Advisory Committee to the IRS. Courtney practices law with Lane & Waterman LLP in Davenport, Iowa.