

## **Electronic Filing: Free File**

The Free File Alliance, a joint effort by the IRS and tax software providers, just kicked off its fourth year. The program was begun in an effort to encourage taxpayers to electronically file tax returns. Last year, around 17 million taxpayers did their taxes using a computer and e-filed them. More than 5 million of those returns came in through the “Free File” program. Last year, however, the option to file for free through the IRS website was open to all taxpayers without restrictions.

On Oct. 29, 2005, the Free File Alliance and the IRS agreed to a memorandum of understanding (the 2005 IRS Agreement) to amend and extend the original free file agreement for an additional 4 years. Under the 2005 IRS Agreement, each member must make its Services available, on a non-discriminatory basis, to not less than 10% and not more than 50% of the individual taxpayer population. For the current tax year, the Alliance provides services only to taxpayers with adjusted gross incomes of \$50,000 or less. A spokeswoman for one of the software providers in the Free File Alliance was quoted as saying that the primary reason to limit eligibility this year “was to restore Free File to its original philanthropic mission and intent.” For the 2005 filing season, the Free File Alliance consists of 20 different software programs. Set forth below are some of the obstacles presented by the current Free File Alliance system.

Eligibility requirements vary greatly among the providers and are dependent on such things as AGI, which state you live in, how old you are, whether you are on active military duty, and whether you are eligible to claim the EIC. The IRS website ([www.irs.gov](http://www.irs.gov)) attempts to guide taxpayers to a service by asking you questions related to the various eligibility criteria.

What is not taken into consideration by the IRS website in determining which free file company a person should use, however, is the type of income, deductions, and credits a person is eligible to claim. Most of the companies have limited forms that are available in their free file system and may not offer all, or any, state returns. For example, one company (EZTaxReturn.com) lists only 12 Federal forms being supported and this includes Forms W-2, W-2G, and 1099-R. It also includes limitations on some of these forms. For instance, even though the site supports the form for the dependent care credit, there is a limitation on that form so that if your spouse earned no income because he or she was a student or was disabled, you may qualify for the dependent care credit, but the site cannot help you claim it. The company offers three solutions for accessing forms that it does not support in its Free File program: (1) the company will sell you software that includes four additional forms and an interview format for \$19.95; (2) the company will connect you via a weblink to “Formsend.com” that will email, download, or fax you a form or instruction for a delivery charge of \$2.99 per form or instruction, or (3) for more complex returns, the company refers you via weblink to H&R Block’s webpage so that H&R Block can prepare and e-file your federal return for a starting cost of \$29.95.

Although the Free File service is marketed as free, the provider often subjects taxpayers to additional charges for very basic services late in the process. These services include resetting of passwords, printing and mailing services, preparing amended returns, and fees for payment by credit card. In addition, the Free File Alliance software providers market additional fee-based services for its users such as state return preparation and filing fees (\$0 to \$24.95), professional tax return review (\$29.95 to \$49.95), audit protection (\$29.88 to \$47.95), live chat help (\$19.95 to \$29.95), telephone technical support (\$29.95 per return or \$15 per call), per question consultation with a tax professional (\$5.95 to \$14.88 per question); vault service (\$9.95 to \$10 for 5 years); and credit chargeback (\$29 to \$35). Free File Alliance providers also offer refund anticipation loans with costs ranging from \$19.95-\$104.95 in addition to proposed finance chargers or interest rates ranging from 31% - 227% APR plus possible late fees. Taxpayers receiving a refund may also get offers to deduct fees from the refund, to receive prepaid debit cards with numerous transactional charges, or to purchase other retail gift cards with shipping and handling fees.

Free File Alliance providers also offer other more tangential services. One website provides a link to an international barter exchange that offers to bring the taxpayer at least \$1,000 in new business during the first 12 months of business with their exchange or the company will refund an initial membership fee (enrollment fee is \$25 + a 3-4% fee on each exchange + a \$15.00 monthly accounting fee). The same Free File provider has another link for tax preparation franchise opportunities in which the taxpayer can be paid between \$40 and \$60 per tax return generated for the vendor. The website advertises that “ONLY THE SKY LIMITS YOUR POTENTIAL”. The company offers to provide banners, signs, start-up kits, and unlimited opportunity. Franchise ownership costs \$15,500; tax operator costs \$495; FaxTax costs as low as \$199.