



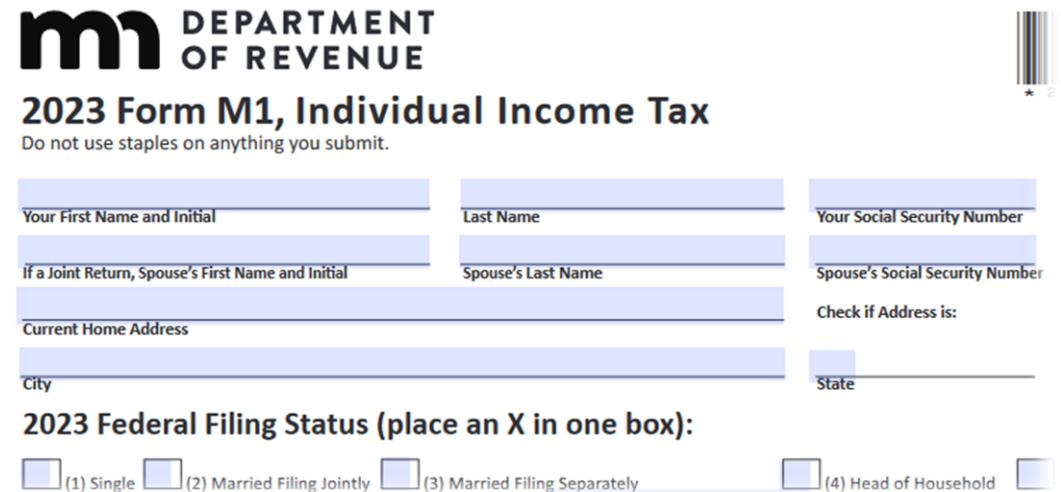
# Free File Options for Minnesota Legislative Report Summary

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# Discussion Goals

- Free File report introduction
- Taxpayer filing practices
- IRS Free File program
- Survey and responses of tax software providers
- Alternative options information
- Other state information
- Conclusions



**mn** DEPARTMENT OF REVENUE

**2023 Form M1, Individual Income Tax**

Do not use staples on anything you submit.

Your First Name and Initial \_\_\_\_\_ Last Name \_\_\_\_\_ Your Social Security Number \_\_\_\_\_

If a Joint Return, Spouse's First Name and Initial \_\_\_\_\_ Spouse's Last Name \_\_\_\_\_ Spouse's Social Security Number \_\_\_\_\_

Current Home Address \_\_\_\_\_ Check if Address is:

City \_\_\_\_\_ State \_\_\_\_\_

**2023 Federal Filing Status (place an X in one box):**

(1) Single  (2) Married Filing Jointly  (3) Married Filing Separately  (4) Head of Household

# Free File Report Information

- Goal is to provide information on free electronic filing options for preparing and filing Minnesota individual tax returns
- Information gathered through surveys of tax preparation software vendors for information on free electronic preparation and filing options for taxpayers, including:
  - System development, capability, security, and costs
  - Costs per return that would be charged to the state to provide the services
  - Information on providing customer service and issue resolution
  - Providing and maintaining a link between Revenue and the IRS E-File program
  - Ensuring that taxpayer information is maintained and protected
  - Current availability of products for free filing and submitting of Minnesota and federal returns

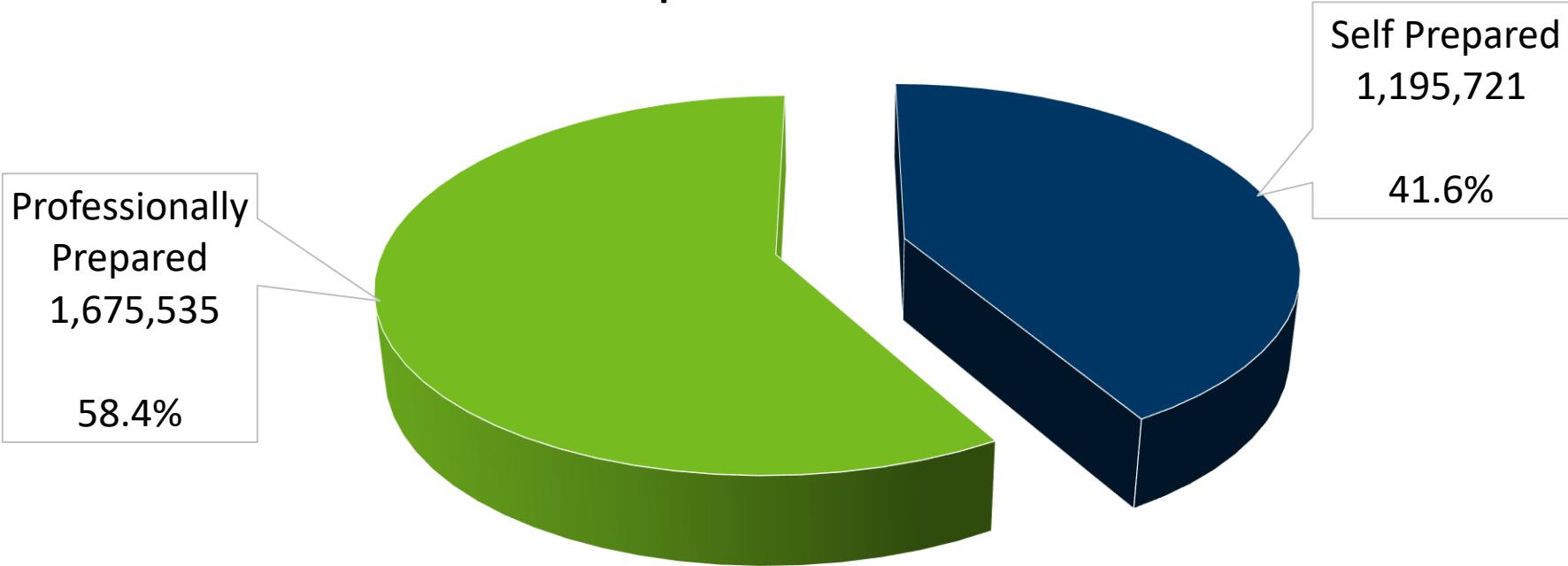
# Free File Report Information

- The final report must also include:
  - A review of options that other states use for state electronic filing
  - An assessment of taxpayer needs for electronic filing, including current filing practices
  - An analysis of alternative options to provide free filing, such as tax credits, vendor incentives, and other benefits, and
  - An analysis of the Internal Revenue Service Free File Program usage



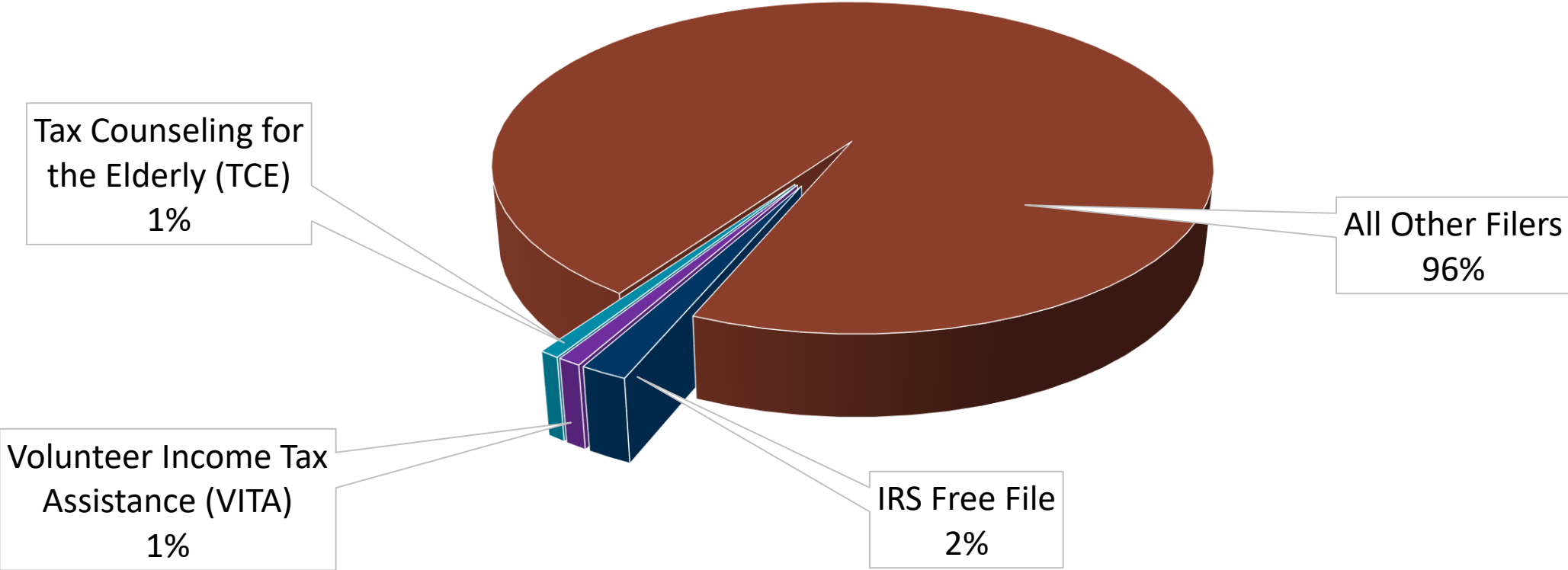
# Minnesota Individual Filing Information

## 2022 Electronic Individual Income Tax Preparation Method

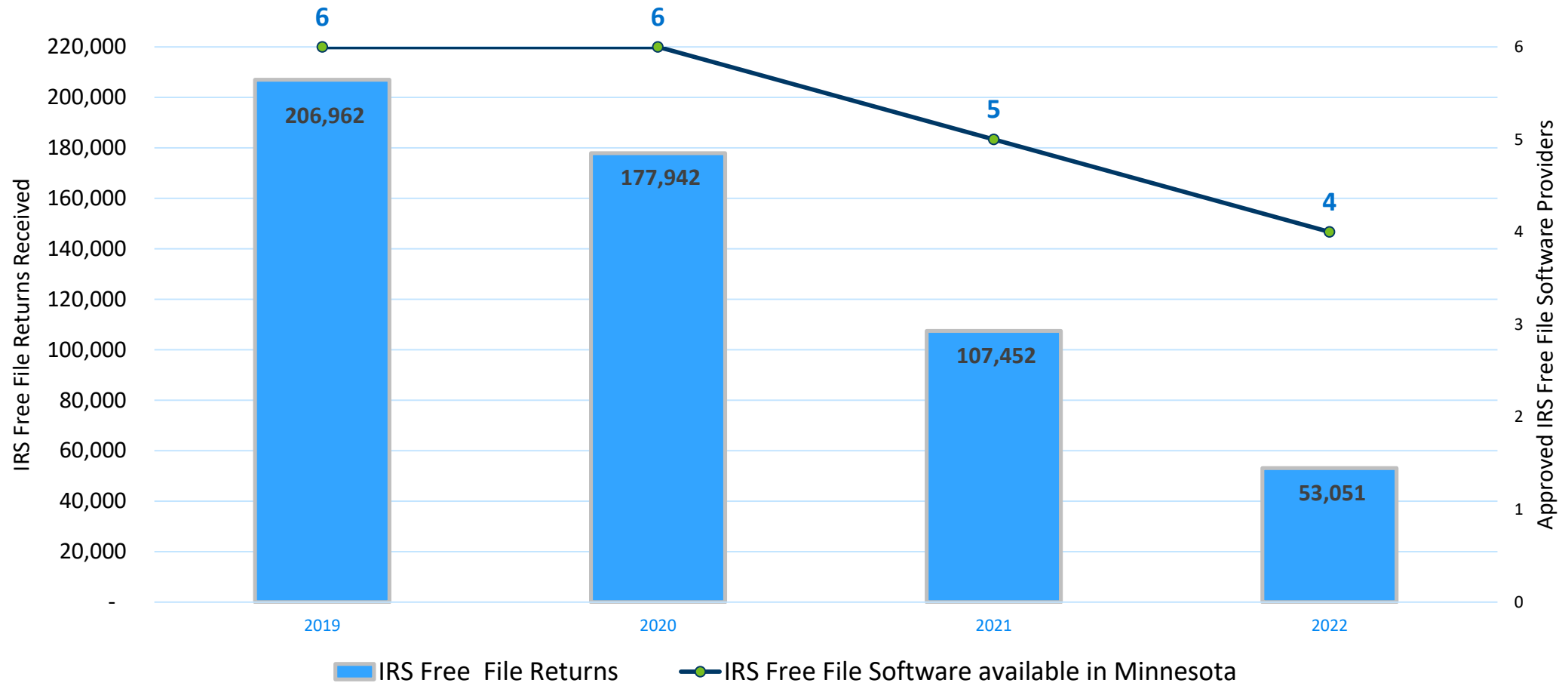


# Minnesota Individual Filing Information

## 2022 Summary of Minnesotan Filing Methods



## Minnesotans' Use of IRS Free File



# IRS Direct File – What is it?



- Pilot test for completing 2023 federal tax returns online for free, directly with the IRS
- Provides step-by-step guidance for adding tax information
- Available in English and Spanish languages
- Real-time support from IRS customer service representatives
- Accessible from smartphones, laptops, tablets, and desktop computers
- No income limit but it is intended for basic tax returns (not self-employed, standard deduction, etc.)



# 12 States Participating in 2024 Pilot

## No State Income Tax

- Florida
- New Hampshire
- Nevada
- South Dakota
- Tennessee
- Texas
- Washington
- Wyoming

## Other States Participating

- Arizona
- California
- Massachusetts (FAST/GenTax)
- New York

\*IRS will route tax filers to a state-supported tool once their federal return is completed

# Software Vendor Survey



- Twenty-seven software providers capable of modern electronic filing (“MeF”) were sent surveys to gather information for this report
  - Thirteen providers offer products for self-preparation of individual taxes
  - Fourteen providers serve tax professionals
- Nine providers responded
  - Four expressed interest in providing a state-based solution
  - None of the respondents are currently offering a similar solution to other states

# Cost Information



- Information from respondents indicates a cost range of \$2.4M to \$19.5M per year
  - Based on only two of the four interested vendors providing cost information
  - Estimates were provided without a firm set of requirements
  - Confidence in cost estimates should be low
  - Revenue and MNIT costs are not included in these estimates and would need further evaluation

# Additional Cost Factors

- Mid-year and federal conformity law changes would increase costs
- Costs could change yearly or per contract, depending on agreement
- Minimum fee or fixed cost contract likely needed to support vendor development and support
- Add-on services could be included or optional at additional individual costs, such as
  - Speaking to a tax expert by phone, video or text
  - Additional return reviews by a tax expert
  - Audit protection
  - Refund transfer products
- A request for proposal with defined requirements likely needed for more precise cost information

- Solution would need to meet Minnesota Statutes, Chapter 13 and Chapter 270B
- Solution would need to meet IRS Publication 1075 requirements
- All providers are anticipated to meet these standards with current software products; basic security functions include:
  - Securing customer data
  - Reporting any data breaches
  - Performing and reporting fraud analysis
  - Sharing information related to keeping customers' data safe

# Software Quality Information

- Two of the four interested vendors provided information on a quality plan
- Responses detailed commitment to developing and maintaining a high-quality product
- Revenue would participate in quality reviews, fielding user feedback and helping address complaints and other improvement opportunities
- Timeframe of up to two years for software development, testing and implementation



# Potential Alternative Options

1. Reimburse taxpayers for Minnesota filing costs
2. Reimburse software providers for Minnesota filing costs
3. Provide a free in-house solution for all Minnesota filers
4. Keep the current system (business as usual)
5. Build capabilities based on the results and recommendations of the IRS Direct File pilot
6. Work towards increasing the use of IRS Free File, VITA, TCE and other existing programs

# Option 1: Reimburse Taxpayers

**Summary:** The state of Minnesota could provide a refundable credit or directly reimburse income tax filers

## Opportunities:

- Refundable credit would reduce tax owed or increase refund for taxpayers who file electronically

## Notable Challenges:

- Could be complex to implement and operate
- Could increase the rate of fraudulent refund claims+
- One-year lag between buying the software and receiving the credit
- Likely federally taxable





# Option 2: Reimburse Software Providers

**Summary:** The state could directly reimburse tax software vendors

**Opportunities:**

- An efficient, easier-to-implement reimbursement method
- No taxpayer behavior change needed

**Challenges:**

- How to address vendor cost increases over time
- A flat fee reimbursement may:
  - Underpay for the service if add-ons are chosen by the customer
  - Over-pay for the actual value of the service with less-complex returns

# Option 3: In-House Solution

**Summary:** The state could work with its current tax administration software vendor to develop its own free file system

**Opportunities:**

- Minnesota has full control over development of its free file solution
- Can be built and customized to fit Minnesota's specific needs and guidelines

**Challenges:**

- Roll out requires a phased approach to customers over years
- IRS link to federal return information (Form 1040) does not currently exist
- Complex tax filings would be costly to support
- Data entry from federal return (Form 1040) required for customers

# Option 4: Keep the Current System

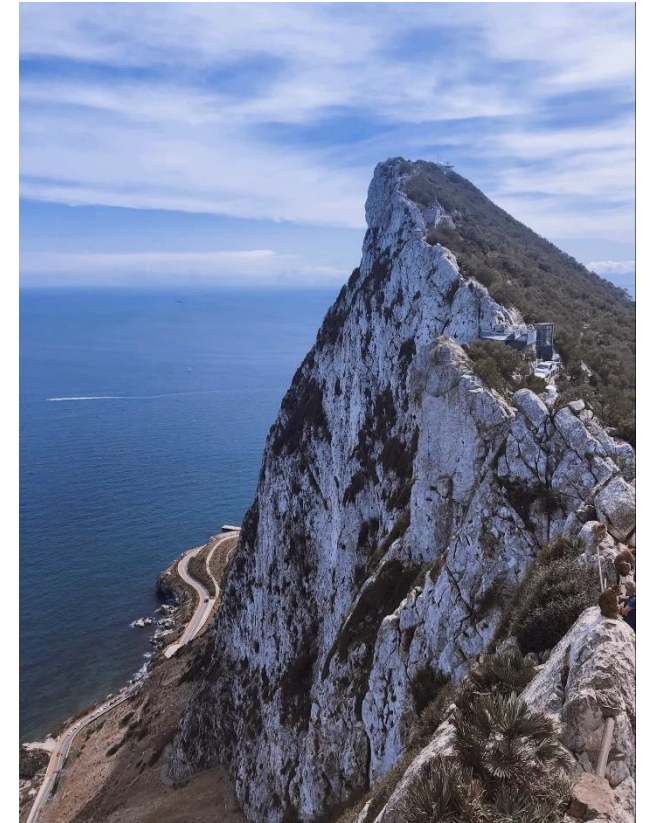
**Summary:** No change - business as usual

**Opportunities:**

- Does not change the scope of Department of Revenue's people, processes, and technology
- Minimizes impact to tax software providers and paid tax professionals

**Challenges:**

- Inaction will not alleviate the burden or cost for Minnesotans to file their taxes



# Option 5: Leverage IRS Direct File Work



**Summary:** The state could be an early adopter of the IRS Direct File system

**Opportunities:**

- Customers can fill out and send a free federal return (Form 1040) and be directed to a state supported tool to file a Minnesota return

**Challenges:**

- Direct File program is in early stages of development and is limited to simple tax filings
- Level of state effort needed to participate is unknown

# Option 6: Work to increase Free Filing Programs

**Summary:** The state could and take a larger role in promoting existing no-cost programs (Free File, VITA, and TCE)

## **Opportunities:**

- Increased promotion would cost less than some other alternatives
- IRS provides tax software to VITA and TCE sites at no cost

## **Challenges:**

- VITA and TCE programs are more income restrictive than Free File, which limits eligibility and usage
- Higher costs to support rural sites
- Revenue promotion of other non-IRS supported free tax services may be seen as a conflict-of-interest by customers

- No respondents are providing a similar service to any other states
- All 50 states and the District of Columbia participate in some form of electronic filing
  - VITA sites in all 50 states and the District of Columbia
  - TCE sites in 22 states and the District of Columbia
  - 22 states and the District of Columbia belong to Free File, Inc.
  - 19 states have some form of direct e-File service for individual income tax filers
  - 12 state are currently participating in the IRS Direct File pilot

# Conclusions

- Partnering with a single software provider to provide Minnesotan's a free filing option is feasible if:
  - The solution is adequately funded for multiple years, and
  - A multi-year rollout period is allowed
- Future legislative direction for any free-file solution must allow for multi-year commitments
- Recent advances in technology and software capabilities could make any of the options in this report feasible



# Other Considerations

Current and future policy discussions and decisions on free filing should be weighed with these key questions:

1. What is the role and scope of government with regards to individual tax filing costs?
2. What is the role of public-private partnerships?
3. Is it worth the continued cost and resources to provide Minnesotans a free or subsidized filing service?







Thank you!

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