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# California Can Save Taxpayers Billions of Dollars by Prepopulating Tax Info from IRS Direct File to CalFile

A small investment in CalFile could make state income tax filing virtually automatic and put \$2.2 billion back into the pockets of low- and middle-income taxpayers

## INTRODUCTION

*Direct File is the IRS's revolutionary new project to provide free, simplified, public online tax filing for the first time in American history. The program launched in 2024 with a pilot that was restricted in scope in 12 states – covering a small share of the taxpayers that could ultimately benefit. Direct File has the potential to take the cost and headache out of tax filing. As a public option for tax filing, Direct File can make the tax preparation market more equitable, inclusive, and competitive.*

## IRS DIRECT FILE CAN REVOLUTIONIZE HOW AMERICANS DO THEIR TAXES

**Tax filing in America is expensive and complicated – and it locks low-income people out of valuable tax credits.** Because tax filing is so difficult, many of the lowest-income households and households who are disproportionately Black, Latino, non-English speakers, single moms, and ITIN filers – are barred from valuable tax credits, because of the barriers to tax filing. As a result, more than [one in five eligible families don't receive the federal EITC](#), and the gap is likely larger in most states. For those who do file, they pay for the privilege, even when they qualify for free services. It costs Americans an average of [\\$150 and 9 hours](#) to file taxes each year. Last year, 58% of CalEITC, Young Child Tax Credit, and Foster Youth Tax Credit

recipients paid to file their taxes, even though they qualify for free filing. The result is that an estimated [\\$763 million of would-be tax refunds](#) are diverted from low- and moderate-income families to tax prep companies every year.

The current system isn't built to meet the needs of taxpayers. Americans shouldn't have to pay to meet their legal obligation to file taxes – or to claim credits they qualify for. Until now, the main option has been the 'Free File Alliance,' a concession made by the federal government in response to the paid tax prep industry's lobbying efforts against a government-developed tool. The Free File Alliance requires tax prep companies to offer free tax filing to low- and middle-income taxpayers, but among other shortcomings, it doesn't require free state filing in all cases.

Not surprisingly, this arrangement has failed because the paid tax prep industry's first priority is profiting off the backs of taxpayers. Paid tax prep companies did [the bare minimum required](#) – and even still, [underhandedly steered taxpayers away from the free option](#) – so taxpayers ended up paying anyway. In fact, [fewer than 3% of households eligible for the Free File Alliance actually get free tax filing](#) – while more than 30 million eligible households end up using the company's paid version of the software.

Free tax filing through the Volunteer Income Tax Assistance (VITA) program is a critical resource for the lowest-income taxpayers. For the families that use VITA, it is crucial, but it's only able to serve a very small number of taxpayers – as low as 2% of the population who claim low-income tax credits in some states. The best use of VITA is to continue to concentrate on the households who need significant help filing their taxes. *We need a comprehensive solution.*

**Free, public, simple filing through Direct File is the right solution for all kinds of taxpayers.** The IRS Direct File program is an entirely free, easy, secure, interview-style tool that filers can use on a computer, tablet, or smartphone. It saves time, eliminates filing fees, and takes the stress out of tax filing. This idea resonates with taxpayers. Even before the Direct File tool was launched, the idea was supported by [88% of voters](#) across the country, including majority support across party lines.

**The results of Direct File's first year were overwhelmingly positive.** The IRS's data on user satisfaction showed [90% rated their experience as above average or excellent](#), and 86% said it increased their trust in the IRS.

Code for America, which built the state filing tools and integrations in New York and Arizona, reported that [96% of their users were satisfied or very satisfied with the state tool](#); 95% said the data federal-to-state data transfer was “seamless and quick;” 90% of those who filed with IRS Direct File went on to finish their state return; and **88% completed their state return within 15 minutes.**

**“\$763 million of would-be tax refunds are diverted from low- and moderate-income families to tax prep companies every year.”**

*Assembly Committee on Business and Professions, Legislative Analysis, 2019*

An ESP [survey of Direct File users](#) across all 12 pilot states during the 2024 tax filing season showed high satisfaction and significant time and money savings for tax filers: 74% preferred Direct File to other filing methods, including 79% of users age 45+, and 80% of Trump voters; and 60% said it took less than an hour to file their federal and state taxes.

**Making tax filing easy and free will help Californians claim millions of dollars in untapped tax credits.** Every year in California, hundreds of millions of dollars in tax credits like the EITC and CTC are left on the table because filing taxes is too hard – disproportionately by the lowest-income households and Black, Latinx, and Indigenous households. Those dollars could be helping families make ends meet and stimulating our local economies. By making tax filing free,

easy, and ultimately automatic through Direct File, [California families could get up to \\$1.4 billion per year](#) in currently unclaimed federal tax credits.

**Direct File is a smart investment with an enormous return on investment.** This year under the limited scope of the pilot, 5.2 million California taxpayers were eligible for Direct File. If all of them had used it, they would have saved [\\$832 million in filing fees](#) alone. When Direct File is at scale in a few years, it will deliver \$2.2 billion in total value to California taxpayers, between filing fees, time cost of filing, and additional federal EITC and Child Tax Credits claimed. That's \$2.2 billion in local California economies that would have otherwise been siphoned off by tax prep companies or gone unclaimed as federal tax credits.

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## **CALFILE CAN WORK WITH IRS DIRECT FILE TO OFFER SEAMLESS TAX FILING**

**Full integration would allow Californians to get the full benefits of Direct File and cut down on costly errors.** Research shows that one of the things taxpayers value most when it comes to filing their taxes is the ability to do their federal and state taxes together at

the same time. In this year's pilot, three states – Arizona, Massachusetts, and New York – fully integrated their state tools with IRS Direct File, meaning taxpayers' information was automatically transferred from the federal Direct File tool to the taxpayer's state tax return without them having to type their information again.

California was different in a critical way: Direct File and CalFile were not fully integrated. This meant that – for California taxpayers only – after typing all of their information into the federal tool, they were directed to CalFile where they had to effectively start from the beginning, re-verify their identity and enter their information again (with a few exceptions like address). This increases the time it takes to file, not to mention increases the risk of costly errors.

Even given these challenges, 33,328 Californians used the Direct File tool to file their taxes during the four-week pilot, saving millions of dollars in filing fees alone.

Integrating Direct File and CalFile would open the door wide for millions more Californians to file for free next year, and would translate to hundreds of millions of dollars that Californians could spend on anything besides tax prep. It would advance important goals shared by forward-thinking state agencies like the Franchise Tax Board, Governor Newsom, and legislative leaders who have championed expansions of the CalEITC, Young Child Tax Credit, and Foster Youth Credit: that these programs must reach their full potential and promise by being truly accessible to the families who need them most, and that our state can be a model for a government that works better for working families in California.