



# Simplifying the EITC: Automatic filing to increase access

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## OVERVIEW

Simplified or automatic tax filing is a viable policy option that has been demonstrated at the state level, and if properly implemented, could increase the take-up rate of tax credits including the Earned Income Tax Credit (EITC), or the boldly modernized EITC proposal called a Cost-of-Living Refund. A limited automatic tax filing option with the Cost-of-Living Refund would require the IRS or a state revenue agency to send each filer it believes to be eligible for the EITC, based on data it already has in its possession, a return form pre-filled with that data. This outreach would be conducted to two groups of workers:

1. People who have filed tax returns, but did not claim a refund (“Non-claiming filers”).

The first and most basic step is for the IRS to mail a pre-populated form to people who have filed a federal return and who appear eligible for the EITC but have not claimed it on their return. The IRS already sends a simplified worksheet to people in this category, but a pre-populated form would likely boost uptake even more.

2. People who have not filed tax returns (“Non-filers”)

In the second step, the IRS and state revenue agencies should mail a pre-populated form to people who did not file a current-year return but appear eligible for EITC based on their reported income data, encouraging them to claim the credit. Naturally, this group of people who were not required to file a return is much larger than the group who filed an incomplete return that failed to claim their EITC, so this outreach would improve uptake even further.<sup>1</sup>

A key element of this strategy is the pre-populated form, which distinguishes this effort from typical outreach programs. A pre-populated form serves two important purposes: (1) it informs the filer of the actual credit amount he or she may be eligible for (if the provided information is correct), providing a powerful motivation to claim it; and (2) it makes submitting the form easier and less prone to errors. A pre-populated form is a “nudge” (in the behavioral economics sense) at its best.

Previous experiments suggest that this targeted outreach alone could significantly increase federal EITC uptake by as much as 28%.<sup>2</sup> In California, as an example, over 265,000 more California households could receive the federal EITC they have earned.<sup>3</sup> Nationwide, it could mean nearly 2 million additional households claiming the federal credit.

In addition, this same approach by the state agency could prompt a similar number of people (e.g. 265,000 more California households) to claim the state credit. State EITC uptake tends to be somewhat lower than federal, but increases as the state credit increases in value or eligibility expands.

Similar calculations suggest important boosts in uptake in other states too. For example, in Maine, 7,000 families might claim their federal EITC in response to an IRS mailing, and state efforts could yield a similar or greater number of claims for state EITC. In Massachusetts, 25,000 households could claim their federal EITCs, and a similar number might receive their state EITC. In Illinois, approximately 85,600 additional households could claim the federal EITC, and an equal or greater number could claim the state credit.

## **INTRODUCTION**

This idea is straightforward. For workers with relatively simple annual earnings, “the IRS already receives information about each of their sources of income directly from their employers and banks. The IRS then asks these same people to spend time gathering documents and filling out tax forms, or to spend money paying tax preparers to do it. In essence, these taxpayers are just copying into a tax return information that the IRS already receives independently. The [automatic tax return] would have the IRS take the information about income directly from the employers and banks and, if the person’s tax status were simple enough, send that taxpayer a return pre-filled with the information. The program would be voluntary. Anyone who preferred to fill out his own tax form, or to pay a tax preparer to do it, would just throw the [automatic tax return] away and file his taxes the way he does now. For the millions of taxpayers who could use the [automatic tax return], however, filing a tax return would entail nothing more than checking the numbers, signing the return, and then either sending a check or getting a refund.”<sup>4</sup>

While several studies have examined automatic tax returns as a mechanism to reduce compliance costs for taxpayers with relatively simple filing situations, there has been very little academic or other policy work on the feasibility of this system for those who have more complicated tax situations. That said, discussions with tax experts indicate that there could be ways to incorporate EITC/Cost-of-Living Refund into a version of return-free filing, and many advocates point to EITC claimants as among those who would benefit most from automatic filing. This could be implemented through partial pre-filing for Cost-of-Living Refund claimants, discussed below.

## **FEDERAL EFFORTS**

While automatic tax filing has been a topic of public consideration since at least 1985, when President Reagan proposed a version,<sup>5</sup> there has been little traction on its implementation at the federal level since then.<sup>6</sup>

A number of groups inside and outside the government have performed intermediate feasibility studies, all of which have concluded that there is little to no barrier to providing return-free filing to the 40-60 million Americans with relatively simple tax arrangements.<sup>7</sup> The Internal Revenue Service Restructuring Act of 1998 called for the Secretary of the Treasury to develop procedures for the implementation of a return-free system in the United States for “appropriate” individuals by 2007, and to release a conclusive feasibility study on this issue.<sup>8</sup> However, this feasibility study has never been released, for unknown or unstated reasons.<sup>9</sup>

Since 2007, “eight bills have been introduced in Congress urging the IRS to electronically pre-fill simple returns for taxpayers, including the Bipartisan Tax Fairness and Simplification Acts of 2010 and 2011.” None became law. Most recently, in 2016 (and again in 2017), Sen. Elizabeth Warren proposed legislation to implement return-free filing for a large swath of Americans, mandating that the IRS make available for download “third-party provided return information relating to individual income tax returns” -- or send pre-filled forms utilizing that information to eligible individuals. The legislation would initially restrict eligible individuals to unmarried filers without

dependents, who do not itemize, do not deduct business expenses or file for a sole proprietorship, and have no income other than wage, interest, or dividend income.<sup>10</sup> However, it would grant discretion to expand eligibility to the IRS, including to “taxpayers who are eligible to claim the earned income tax credit under section 32 and have dependents,” and calls for a report on expansion.”

Tax experts believe it would be possible to integrate even the current version of the EITC into return-free filing with language along the following lines: “Here is everything we know about your filing status and wages, and based on this we think you’re eligible for the EITC. Here is the amount you would receive, depending on the number of dependents you have. Below, please fill out the remainder of the eligibility criteria part of the form to verify your eligibility and credit amount.”<sup>11</sup> The structure of the proposed Cost-of-Living Refund mitigates this issue further, as eligibility is based solely on income and marital status. The IRS could send those it believes to be eligible for the credit a pre-filled form with that income and status, state that on that basis it believes the taxpayer to be eligible for the Cost-of-Living Refund, and ask for verification.

The IRS [CP-09 form](#), sent to tax filers who appear eligible for the EITC but have not claimed it on their return, offers an example of the limited information necessary and how to walk taxpayers through the process of providing accurate data. Contacting these people who have already filed tax returns should be seen as the baseline, but the opportunity we highlight is in targeting people for whom IRS has earnings data but who have not filed returns (generally because their income was too low to require filing).

Commentators have noted the particular benefit that EITC claimants would secure from automatic tax filing, if they were eligible to do so. “Twenty percent of people eligible for the EITC don’t get it, and a big fraction of returns contain errors, usually because of the complexity of the credit and due to errors by commercial tax preparers. Automatic filing would provide EITC payments to many of that 20 percent not getting them, and would spare taxpayers from doing complex calculations that sometimes lead to error.”<sup>12</sup>

## **STATE EXPERIMENTS**

While a handful of jurisdictions have investigated versions of return-free filing,<sup>13</sup> the only jurisdiction that has implemented it at any level is California.<sup>14</sup>

In February 2005, the California Franchise Tax Board mailed out (and made available electronically) tax year 2004 returns to nearly 52,000 test group members, filled-in with data already available to the FTB through employer and financial institution filings in a pilot program called “ReadyReturn.” ReadyReturn was initially only made available to a test group of individuals whose income came solely from wages and where the taxpayer claimed no adjustments to income other than the personal exemption and standard deduction.<sup>15</sup>

Some 11,000 test group members actually completed and filed their pre-filled returns. In general, ReadyReturn was received positively by those who participated in the pilot. 90 percent of participants said it saved them time, and only 0.3 percent of ReadyReturn filings contained errors, as opposed to 3.1 percent of non-ReadyReturn filings. The pilot operated again in tax year 2005.

In 2006, the Legislature voted down the statewide expansion of ReadyReturn. However, the FTB independently revived the program and implemented it for the 2007 tax year, expanding eligibility from the narrowly selected pilot population to a larger group of approximately one million taxpayers -- those who had “single or head of household filing status, no more than five dependents, standard deduction, no credits other than the exemption

credits and the renter's credit, [and] income only from wages," as well as "only one employer" and "total wages no more than \$163,187 for single taxpayers and \$244,785 for head of household filers."<sup>16</sup>

The FTB reported relatively minimal costs to administer the ReadyReturn program. For the pilot program implemented in tax years 2004 and 2005, the administrative cost in the first year was \$222,000, declining to \$161,000 in the second year. Upon expansion of the program to all eligible taxpayers for tax year 2007, the administrative cost rose to \$482,000. In tax year 2008, when the program was expanded to renters, head of household filers, and dependents, the cost nevertheless declined to \$325,000.<sup>17</sup> In 2009, FTB reported that because it did not "anticipate further expansions to the program, [it] anticipate[d] annual costs to be under \$150,000 per year."

By 2016, ReadyReturn was integrated into the CalFile online tax filing system, which "uses a question and answer format to guide taxpayers through completing" their state income tax return, importing data that the FTB already has on file in the process.<sup>18</sup> CalFile remains publicly available, and allows filers to claim certain credits using the question and answer system of return completion, including the EITC (if they have no self-employment income to report).<sup>19</sup>

The California experience demonstrates that return-free filing is possible, in at least some form, for those claiming the EITC, though CalFile involves more input (through the interview-style process) from filers than the initial ReadyReturn program did. Feasibility concerns at the federal level must therefore be grounded in particular federal circumstances.<sup>20</sup>

A pilot project in New York City, called the Earned Income Tax Credit Mailing Project, mailed pre-populated amended federal, state, and local returns to New York City tax filers it believed could have claimed the EITC three years prior, based on IRS data, but had not done so.<sup>21</sup> It successfully increased the credit's take-up rate: In their second mailing in 2008, they worked with the IRS to target the population that was eligible for the EITC in the 2005 tax year and failed to claim it, and sent about 15,000 pre-populated returns. Roughly 5,000 people who got the amended returns filed them, and about 4,200 actually got money back, a rate of about 28% of those who received the pre-populated returns.<sup>22</sup>

However, this program only assisted taxpayers in claiming the credit for prior years; it did not identify those currently eligible for the credit. Though this is a route to help eligible claimants obtain EITC benefits, this program did not solve the crucial problem that the Cost-of-Living Refund aims to address -- getting working- and middle-class family cash when they actually need it -- because of its retroactive nature.

Additionally, a demonstration project was conducted in California in 2010, with support from Los Angeles City Councilmembers Richard Alarcon and Paul Krekorian. The IRS mailed 46,000 households throughout California letters telling them they may have qualified for the Earned Income Tax Credit last year, and that it's not too late to claim their refund (an average of \$1,400). Here is an example of mailing sent in 2010 California outreach to

EITC-eligible tax filers:<sup>23</sup>



Increased state outreach efforts to EITC-eligible people can also improve their access to the federal EITC. A 2018 report estimated that \$1.9 billion in federal EITC refunds go unclaimed in California alone, and notes the economic growth “left on the table” by that missing income: “The foregone economic impact of the unclaimed \$1.9 billion federal EITC dollars totals over \$2.3 billion in business sales losses, over 14,500 additional jobs not generated or supported, more than \$800 million dollars in wages or labor income lost, and more than \$150 million dollars in additional tax revenue losses for state, county and city governments.”<sup>24</sup>

### CONCERNS ABOUT AUTOMATIC TAX FILING

Opponents of automatic tax filing typically include representatives of the interests of private tax preparers as well as a number of conservative groups (including Grover Norquist’s Americans for Tax Reform<sup>25</sup>). These groups have issued a number of reports and studies criticizing automatic tax preparation.

Publicly, they contend that it is a “conflict of interest” for the government to serve as tax preparer, tax collector, and tax enforcer. They also assert arguments relating to costs to third parties and administrability concerns.

Their unstated -- but widely understood to be principally motivating -- objections are more self-serving. For private tax preparers, the widespread public adoption of automatic tax filing would pose a significant competitive threat to their business model; for conservative groups, a process that simplifies tax filing could lead taxpayers to be more willing to pay their taxes.<sup>26</sup> As a result, both interest groups have reason to oppose automatic filing systems, and private tax preparers in particular have proved willing to spend at all levels of government to prevent its adoption.<sup>27</sup>

The practical flaws typically pointed out by these groups include:

- **Increased costs to third parties.** “Government preparation of returns would require payers of income—employers, financial institutions, even governments writing benefits checks—to incur costs by significantly moving up reporting deadlines for the IRS to get the information in enough time so that tax refunds are not delayed.”<sup>28</sup> While more research into this issue is warranted, it is unclear whether this issue is significant enough to stymie return-free filing altogether.
- **IRS administrability issues.** A main line of attack is aimed at the complexity of the tax code itself (making pre-filing a complex task) and the IRS’ out of date computer systems. Critics argue (in

part because we have not had an updated feasibility study since 2003) it is unclear whether the IRS has the capacity to move the data provided by employers and other payers into a return-free filing system without significant additional investment.<sup>29</sup> And for taxpayers with more complex situations, the IRS may not have all necessary information to pre-fill forms. However, California's experience suggests that the former concern may be overblown, and the latter could be solved by implementing only a partial automatic return, giving taxpayers the opportunity to provide additional information that the IRS does not possess.

- **Low participation rates in ReadyReturn in California.** “In the first year it was widely available, only 1.5% of those eligible (only those with the simplest returns are eligible) used ReadyReturn and in the second year only 3.2%. In 2012, fewer than 90,000 taxpayers used the system out of roughly one million who were eligible.”<sup>30</sup> Given the difficulty of accessing the system, lack of marketing, and high rate of satisfaction, it is difficult to conclude that this issue was caused by any problem with the system itself.
- **Issues for low-income taxpayers.** Opponents claim that EITC recipients would be particularly disadvantaged, given that “EITC eligibility depends on complex determinations that can be difficult to gauge accurately with return-free filing, especially since low-income filers have more frequent family status changes than do upper-income filers. Low-income taxpayers may also be less likely to correct erroneous pre-populated tax forms or claim tax credits generally for which they are eligible. Recovering erroneous refunds would be particularly burdensome for low-income filers, especially in view of the fact that there is considerable evidence that many taxpayers plan for and count on tax refunds, and seem to like being overwithheld.”<sup>31</sup>

The 2010 study sponsored by the tax preparers quotes Bob Greenstein's testimony to an economic recovery advisory panel in December 2009: “[S]implified filing would need to be implemented carefully in order to avoid large increases in EITC errors or large reductions in take-up rates for refundable credits.”

While care in implementation would be crucial, the Cost-of-Living Refund is simpler than EITC and many of these issues are alleviated by the design of our credit. Given the errors sometimes associated with the EITC, incorporating automatic filing into the Cost-of-Living Refund would help ensure that more people who need it can benefit from their tax credits.

# Endnotes

1. The IRS currently sends CP-09 forms to existing filers who appear to be eligible for federal EITC credit. The CP-09 is a simplified form, but it is not pre-populated with personal information or estimated credit amount to be claimed. A pre-populated form would very likely increase responses. A pilot project in New York that targeted households that had filed but not claimed the federal EITC yielded claims by an additional 28% of that population. We have assumed that a similar percentage yield of 28% could obtain from state efforts, as an approximation. However, because of differences between federal and state eligibility, not all households will receive forms from both the IRS and their state tax agency. As well, some of those who respond and claim federal credits may not respond or claim state credits while some will respond and claim both.
2. This program was carried out in New York City at least in 2006-2008 for tax years 2003-05. The program partnered with the IRS to correctly identify the eligible population for at least one mailing, in February 2008. In 2009, the program was transferred to Albany and expanded statewide. Testimony of Sam Miller, Assistant Commissioner, New York City Department of Finance, November 17, 2009, [http://clkrep.lacity.org/onlinedocs/2009/09-2750\\_misc\\_11-17-09.pdf](http://clkrep.lacity.org/onlinedocs/2009/09-2750_misc_11-17-09.pdf). It is unclear if it continues to operate.
3. Calculations below at footnote 22.
4. Austan Goolsbee, The 'Simple Return': Reducing America's Tax Burden Through Return-Free Filing, Discussion Paper 2006-04, The Brookings Institution (July 2006) (online at <http://www.brookings.edu/~media/Research/Files/Papers/2006/7/useconomics-goolsbee/200607goolsbee.PDF>). This is the description commonly used by proponents of return-free filing. A more complex return-free filing option could be implemented through more precise withholding.
5. Reagan said: "We envision a system where more than half of us would not even have to fill out a return. We call it the return-free system, and it would be totally voluntary. If you decided to participate, you would automatically receive your refund or a letter explaining any additional tax you owe. Should you disagree with this figure, you would be free to fill out your taxes using the regular form. We believe most Americans would go from the long form or the short form to no form." <https://www.vox.com/2016/4/13/11417676/elizabeth-warren-tax-return-free-filing-tax-day-intuit-hr-block-turbotax-automatic-simple>.
6. And in 2003, the IRS signed the Free File Alliance agreement with a consortium of tax preparers -- permitting these preparers to provide free online tax preparation services to low-income Americans, but also committing the IRS to avoid developing tax preparation services of its own. Internal Revenue Service, "Free File: About the Free File Alliance" (online at <https://www.irs.gov/uac/About-the-Free-File-Alliance>). Warren has called the Free File Alliance "a front for tax prep companies who use it as a gateway to sell expensive products no one would even need if we'd just made it easier for people to pay their taxes." <https://www.propublica.org/article/filing-taxes-could-be-free-simple-hr-block-intuit-lobbying-against-it>.
7. See Goolsbee 2006, IRS 2003, Gale 1997, GAO 1996, GAO 1992 studies.
8. <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Return-Free-2003.pdf>
9. Conversation with Rich Phillips (ITEP), November 13, 2018.
10. <https://www.congress.gov/bill/115th-congress/senate-bill/912/text>. The legislation also states that it does not "absolve the taxpayer from full responsibility for the accuracy or completeness of his return of tax."
11. Conversation with Rich Phillips (ITEP), November 13, 2018. Bill Gale of TPC has also said he believes this system is feasible: "This is not some pie-in-the-sky that's never been done before. It's doable, feasible, implementable, and at a relatively low cost." Liz Day, "How the Makers of TurboTax Fought Free, Simple Tax Filing," ProPublica, (March 26, 2013) (online at <https://www.propublica.org/article/how-the-maker-of-turbotax-fought-free-simple-tax-filing>).
12. <https://www.vox.com/2016/4/13/11417676/elizabeth-warren-tax-return-free-filing-tax-day-intuit-hr-block-turbotax-automatic-simple>.
13. Half a dozen OECD countries employ pre-populated tax returns. <https://www.oecd.org/tax/administration/36280368.pdf>. Others use a "precision withholding" method of return-free filing, deducting precisely the correct amount from individual paychecks. The British government administers a Working Family Tax Credit based on family income and size, but has exempted it from their withholding-based automatic filing system, establishing a separate claims application process. Rather than proactively sending a pre-filled form, however, individuals must order a specific form from the UK Treasury in order to claim the credit.
14. John Rappe, Connecticut Office of Legislative Research, Jan. 24, 2017, <https://www.cga.ct.gov/2017/rpt/pdf/2017-R-0019.pdf> ("California appears to be the only state that implements return-free filing, according to the Federation of Tax Administrators and the National Conference of State Legislatures.")
15. California FTB 2006. Colorado experimented with a similar program sometime between 1998-2003. The state File4Me program allowed individuals with no dependents, claiming no credits or deductions, to enter their W-2 wages and withholdings online, and the state would then automatically complete the remainder of their forms and issue a refund or

balance due notification. <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Return-Free-2003.pdf> at 13. I have not found literature explaining the end of this program.

16. <https://www.ftb.ca.gov/readyReturn/ReadyReturnReport2009.pdf>.

17. Id. at 3.

18. At least one expert believes this integration may have been carried out after pressure by interest groups to make ReadyReturn difficult to locate. Conversation with Rich Phillips (ITEP), November 13, 2018.

19. [https://www.ftb.ca.gov/online/calfile/qualifications2017.shtml?WT.mc\\_id=CalFile\\_Sidebar\\_Qualifications\\_2017](https://www.ftb.ca.gov/online/calfile/qualifications2017.shtml?WT.mc_id=CalFile_Sidebar_Qualifications_2017). Filers may also claim the nonrefundable child and dependent care expenses credit.

20. The Technology Policy Institute (a leading opponent of return-free filing, and an institution funded in part by Intuit) has argued that California's updated computer systems allow it to receive back-end information from employers and financial institutions earlier than the federal government does.

<https://techpolicyinstitute.org/wp-content/uploads/2010/09/should-the-government-prepare-2007495.pdf>. It is unclear how this is the case, and Mr. Phillips dismissed this concern in our November 13 conversation.

21. This program was carried out at least in 2006-2008 for tax years 2003-05. The program partnered with the IRS to correctly identify the eligible population for at least one mailing, in February 2008. In 2009, the program was transferred to Albany and expanded statewide. Testimony of Sam Miller, Assistant Commissioner, New York City Department of Finance, November 17, 2009, [http://clkrep.lacity.org/onlinedocs/2009/09-2750\\_misc\\_11-17-09.pdf](http://clkrep.lacity.org/onlinedocs/2009/09-2750_misc_11-17-09.pdf). It is unclear if it continues to operate.

22. Applying that rate to other states, find the federal EITC uptake rate for a state at <https://www.eitc.irs.gov/eitc-central/participation-rate/eitc-participation-rate-by-states> and the federal EITC claims in a state at <https://www.eitc.irs.gov/eitc-central/statistics-for-tax-returns-with-eitc/statistics-for-tax-returns-with-eitc>. Divide the latter number by the former to find the total EITC-eligible population for a state, and subtract the number of existing claims to find the number of potential new claimants. Multiply by the 28% rate from the New York pilot to conservatively estimate the number who might claim their federal EITC. State EITC claims could be boosted by a similar or larger amount, as state EITC uptake tends to be somewhat lower than federal. Applied nationwide, we could expect to see an increase of about 1.7 million households claiming the federal credit (based on an 80% take-up rate nationally and approximately 24.1 million federal claims in 2015).

23. Maria Sotero, Happy Holidays from the IRS, New America Foundation (November 2010) (online at <https://www.newamerica.org/asset-building/the-ladder/happy-holidays-from-the-irs/>). Additional information at [https://www.sco.ca.gov/PDF-Var/eo\\_pressrel\\_controller\\_encourages\\_federal\\_tax\\_credit\\_claims.pdf](https://www.sco.ca.gov/PDF-Var/eo_pressrel_controller_encourages_federal_tax_credit_claims.pdf).

24. Antonio Avalos, "The Costs of Unclaimed Earned Income Tax Credits to California's Economy: Update and Expansion of

25. Grover Norquist, "Don't Let the IRS Do Your Taxes," Huffington Post (June 3, 2013) (online at [http://www.huffingtonpost.com/grover-norquist/grover-norquist-taxes\\_b\\_3005698.html](http://www.huffingtonpost.com/grover-norquist/grover-norquist-taxes_b_3005698.html)).

26. <https://www.theatlantic.com/business/archive/2016/03/the-10-second-tax-return/475899/>

27. Intuit has spent more than \$2 million per year lobbying Congress every year for the last ten years, including explicitly on this issue, and also lobbied the California legislature aggressively against ReadyReturn.

<https://www.opensecrets.org/lobby/clientsum.php?id=D000026667>

28. <https://www.forbes.com/sites/janetnovack/2013/04/09/five-fallacies-about-return-free-tax-filing/#1e4629ba2e92>

29. <https://techpolicyinstitute.org/wp-content/uploads/2010/09/should-the-government-prepare-2007495.pdf>

30. <https://www.forbes.com/sites/janetnovack/2013/04/09/five-fallacies-about-return-free-tax-filing/#1e4629ba2e92>

31. TPI 2010, <https://techpolicyinstitute.org/wp-content/uploads/2010/09/should-the-government-prepare-2007495.pdf>.