

**DEPARTMENT OF TAXATION
2025 Fiscal Impact Statement**

1. **Patron** Jeremy S. McPike

3. **Committee** House Finance

4. **Title** Individual Income Tax: Virginia Free File Program

2. **Bill Number** SB 1306

House of Origin:

Introduced

Substitute

Engrossed

Second House:

In Committee

Substitute

Enrolled

5. Summary/Purpose:

The bill would require Virginia to offer a state-sponsored free electronic filing option for Virginia state individual income tax filers by joining the new federal Internal Revenue Service (“IRS”) Direct File program, which would allow qualified individuals to electronically file their federal individual income tax returns for free. To effectuate this transition, the bill would require that the Department of Taxation (“the Department”):

- Develop and offer a free electronic Virginia state individual income tax filing program that is similar to and compatible with the Direct File program,
- Enter into a memorandum of understanding (“MOU”) with the IRS to join the Direct File program no later than August 1, 2027, and
- Coordinate with the IRS in program development.

This bill would also repeal current Virginia law that prohibits the Department from offering a state-sponsored free electronic filing option for individual income taxpayers and would direct the Department to terminate the current agreement for Virginia to participate in the Free File program.

The Department would be required to phase out the Virginia Free File program no later than December 31, 2028, and enter into an MOU with the IRS to join the Direct File Program no later than August 1, 2027, effective for taxable years beginning on and after January 1, 2028.

If enacted during the regular session of the 2025 General Assembly, the remaining provisions of this bill would become effective July 1, 2025.

6. Budget amendment necessary: No.

7. No Fiscal Impact (See Line 8.)

8. Fiscal implications:

Administrative Costs

The Introduced Budget Bill provides funding for the Department to replace its existing tax processing system, the Integrated Revenue Management System ("IRMS"). Assuming such funding is retained in the 2025 Appropriation Act, no additional funding would be necessary for this bill. A free electronic state filing platform could be developed as part of the Department's overall system replacement at no additional cost provided that the changes align with implementation of the individual income tax system changes that are currently scheduled for Taxable Year 2028.

Revenue Impact

This bill would have no impact on General Fund revenues.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Federal Free Individual Income Tax Electronic Filing Programs:

IRS Free File Agreement

The IRS entered into an agreement on October 30, 2002 with the Free File Alliance, a consortium of companies in the electronic tax preparation and filing industry. The agreement was established to facilitate the offer of free, online tax return preparation and filing services to low-income taxpayers. As part of the agreement, the Free File program offers free services to taxpayers meeting the qualifications for free offerings. Such offerings, when taken in the aggregate, are currently intended to provide free services to be available to 70 percent or more of taxpayers with the lowest adjusted gross incomes.

The agreement requires the IRS to provide taxpayers with links to the free services offered through the Free File program on the IRS's website. In addition, the original federal Free File agreement contained certain restrictions regarding online filing programs that may be offered by the IRS, which prohibit the IRS from competing with the Free File program in providing free, online tax return preparation and filing services to taxpayers.

In 2019, when the IRS extended the Free File program, several reforms were made as part of the extension. These changes included the prohibition of some practices the IRS deemed deceptive as well as the removal of the provision that had prohibited the IRS from competing with the Free File program in providing free online tax return preparation and filing services to federal taxpayers. Shortly after this extension, certain software vendors

announced they would be leaving the Free File Alliance. According to the IRS in 2022, 2 percent of all taxpayers used the Free File program to file their federal income tax returns.

IRS Direct File Program

Partially funded by the Inflation Reduction Act of 2022, the IRS launched the Direct File program for the 2024 filing season in 12 states. As a condition for participating in the program, the IRS requires any states that impose a state income tax to provide a state-level free filing platform that can interface with the federal Direct File platform. Four of the states that participated in the Direct File program during the 2024 filing season had a state individual income tax (Arizona, California, Massachusetts, and New York), while the other eight states do not impose an individual income tax (Florida, New Hampshire, Nevada, Tennessee, Texas, South Dakota, Washington, and Wyoming). The number of participating states increased to 25 for the 2025 filing season, consisting of the 9 states that do not impose an individual income tax and 16 states that impose a state individual income tax. IRS Direct File is a free online tax filing service that is currently available to taxpayers with an income of up to \$200,000 for single filers and up to \$250,000 for those filing jointly.

Virginia Free Individual Income Tax Electronic Filing Programs

Virginia iFile Program

Prior to Taxable Year 2010, the Department provided a free online filing and payment system called iFile. iFile was an application developed by the Department and was available to most Virginia taxpayers, regardless of income. iFile was not available for certain taxpayers that claim credits, which excluded approximately 3 percent of Virginians from using iFile.

Virginia Free File Program

During the 2010 Session, the General Assembly enacted legislation (House Bill 1349, Chapter 535 of the 2010 *Acts of Assembly*) that required the Department to establish a Virginia Free File program based on the IRS Free File program for the Taxable Year 2010 filing season. To implement this program, the Commonwealth was required to enter into an agreement with the Free File Alliance, which would offer online tax return preparation and filing services to 70 percent of Virginia taxpayers with the lowest incomes. The Virginia Free File agreement was required to be established based on the agreement between the IRS and the Free File Alliance that was signed by the IRS Commissioner on October 30, 2002 and that was modified and extended on November 5, 2009.

The 2002 and 2009 IRS agreements specifically prohibited competition with the Free File Alliance. As a result, Virginia's agreement also prohibited the Department from offering any competing electronic free filing system for Virginia state individual income tax filers. Virginia's current agreement maintains this restriction, which is similar to the one included in the original IRS agreement for the federal Free File program but was removed from the federal agreement by the IRS in 2019.

Proposal

The bill would require Virginia to offer a state-sponsored free electronic filing option for Virginia state individual income tax filers by joining the new federal IRS Direct File program, which would allow qualified individuals to electronically file their federal individual income tax returns for free. To effectuate this transition, the bill would require that the Department:

- Develop and offer a free electronic Virginia state individual income tax filing program that is similar to and compatible with the Direct File program. This program would be for taxable years beginning on or after January 1, 2028, and would be offered notwithstanding any federal action regarding the Direct File program.
- Enter into a MOU with the IRS to join the Direct File Program no later than August 1, 2027.
- Coordinate with the IRS in program development to maximize compatibility, security, and integration with the IRS Direct File program, and develop eligibility criteria that are not less restrictive than the criteria established for participation in the IRS Direct File program.

This bill would also repeal Chapter 535 of the 2010 *Acts of Assembly*, which requires the Department to enter into an agreement with the Virginia Fee File program that contains a prohibition on Virginia offering a state-sponsored free electronic filing option for Virginia state individual income taxpayers. The bill would direct the Department to terminate this agreement and phase out of the Virginia Free File program.

The Department would be required to phase out the Virginia Free File program no later than December 31, 2028, and enter into an MOU with the IRS to join the Direct File Program no later than August 1, 2027, effective for taxable years beginning on and after January 1, 2028.

If enacted during the regular session of the 2025 General Assembly, the remaining provisions of this bill would become effective July 1, 2025.

Similar Bills

HB 2264 is identical to this bill.

cc: Secretary of Finance

Date: 02/03/2025 SJH
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