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**Isaac M. O'Bannon** • Feb. 05, 2013

When is “free” tax filing not really free?

People wanting “free tax preparation” often find that state taxes, program upgrades, add-on charges, bank products and other fees can add up quickly.

In fact, many do-it-yourself filers could pay about the same to have a credentialed tax expert do them, and still get their refund in about the same time, and with the peace of mind of real professional guidance.

From January to April 15 of each year, Americans are bombarded with advertising for tax preparation software, online programs and stores.

The most common word in those commercials: Free. Of course, there are a few disclaimers on these commercials, far too many to list at the end, which even used car dealers seem to be able to do. Check out the websites of these “free file” tax advertisers, however, and that’s another story.

So, what does “Free” really mean to a taxpayer at using one of the most popular “do-it-yourself” tax programs? Well, that depends on what a taxpayer hopes or expects it to mean.

However, unless a person lives in one of the seven states with no income tax, rarely does “free” mean that a person can complete *and e-file* both their federal and state tax returns for free.

Those states are Alaska, Florida, Nevada, South Dakota, Texas, Washington and

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Since it is a voluntary partnership, the companies are not required to participate, and have quite a bit of leeway in designing their own pricing structures, as long as they meet a minimum threshold of preparing and e-filing free *federal* returns for most people in that income range, but with exceptions for some types of forms.

One of the goals behind the the IRS's Free File system was to spur electronic filing, which has certainly done. More than 75% of individuals now do so for their 1040 returns, either through a software program or a professional.

### **What "Free" Includes**

As a result, qualifying for the free federal versions of these systems varies somewhat, but most of them are designed for preparing and filing very basic returns for Americans without a need for itemizing deductions or with business income and expenses. So, most of the systems do not include a Schedule C unless you upgrade, and many won't provide even the Earned Income Tax Credit or Child Tax Credit, either.

Some other taxation issues that are almost never included in the free versions include multi-state incomes, capital gains taxes, extensive home-business office expenses, business asset depreciation, moderate investment income or those with household employees.

In no cases that I could find, do the free software programs include preparation of partnership, corporation, non-profit, trust or estate taxes. These definitely require an upgrade, but really, you should be using a true tax professional.

### **What "Free" Doesn't Include**

After use of the word free in their advertisements, probably the most emphasized feature has been customer support, access to tax professionals, guidance and other expert advice.

While one of the companies has been vocal in noting that their experts are made up

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Let's start with two specific words left out of the partnership between the IRS and those companies: "state taxes." The IRS program is designed for preparation and filing of federal individual income taxes, not for state income taxes.

That's where most of the do-it-yourself tax preparation systems start to ask for money. A taxpayer can still use the federal part for free, then prepare their state return on paper, but most seem to opt for the additional cost of continuing within the program to complete this filing electronically.

In the past month, several advertisements for the big tax preparation companies have promoted the "free" federal filing aspects of their services.

Here's what TurboTax, H&R Block, TaxAct and TaxSlayer charge for state returns prepared and e-filed in conjunction with the "free" federal version, if the taxpayer qualifies for the free version.

Once again, each of these programs varies in exactly how much you can do with the free version. But for those who qualify, these are the extra costs that most will be encouraged to add on. )The information below is based on their websites' product information and disclaimer pages on Feb. 5, 2013.)

- **TurboTax Online Free Edition**

State preparation fee: \$27.99 per state, includes e-filing.

Tech support and tax support from CPAs, EAs, tax lawyers via email and chat only.

- **H&R Block at Home Free Online Version**

State preparation fee: \$27.95 per state, includes e-filing.

Email tech support; one-time email or chat tax support session.

- **TaxAct Online Free Edition**

State preparation fee: \$14.95 for any number of states, w/e-filing.

Tax and tech support by email only.

- **TaxSlayer Free Tax Edition**

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experienced tax professional.

### **The Other Costs Add Up**

Many taxpayers end up upgrading to a higher (non-free) version of the software, which can cost from \$40 to \$90 more in addition to often higher (\$10 or so) state filing costs. This puts them in the range of \$80 to \$130.

Then, the tax programs often recommend users have their preparation fees deducted from their tax software. This costs about \$30 for many of the programs. Taxpayers can also use a credit card to pay immediately at no extra cost, but there seems to be an encouragement.

### **Then Come the Bank Products, aka Refund Loans or Advances**

Promoted as a faster way for a taxpayer to receive their refunds, these are actually loans offered through the tax software that are issued against the anticipated refund amount.

As loans, they have a cost, because the bank backing the “anticipated” refund has a risk: What if the taxpayer has debts that intercept their refunds or if the taxpayer files false information. As of 2011, the IRS stopped warning preparers and financial institutions if there was such a debt, so the risk increased. With an assortment of various fees and high short-term interest rates, bank loan products can easily add another \$60 to \$170 to the total cost of a taxpayer's return.

Without one of the refund advance loans, a taxpayer who e-files their return to the IRS and asks for direct deposit, can get their refund in as little as 10 days, and often faster from their state. That shouldn't be worth the cost to most taxpayers.

### **The Cost Now:**

Free + State + Upgrade + Deduct Fees + Loan = \$\$\$ ?

So the previously somewhat simple return that was upgraded from a free version of a

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properly prepared and submitted to the IRS and states. If the cost is the same, it's more than a value. And the odds are, the professional will be able to see and know things that the designers of the software forgot.

“At the end of the day, you'll get a higher quality product with much better detail and depth,” said Steven Phelan, a CPA in Oklahoma City. “I wouldn't recommend a person do their own taxes just as I wouldn't recommend someone do their own dental work. When you are not a professional, and you're relying on your own expertise to keep you out of trouble, you're inviting it in.”

For those with very simple tax situations who do still qualify for the free version of do-it-yourself tax software and don't mind paying for the additional cost of the state preparation, the programs do offer a good value. As long as the taxpayers can avoid the add-on surcharges and fees.

### **Last Words of Advice**

Whether a person does their own taxes online or using software, or has a professional help them, don't fall for guarantees that promise a refund. (A promise of the “best/max refund possible” doesn't cross that line, because if you're not due a refund, you won't get one.)

Lastly, if anyone promises a specific amount of refund before they've even talked about your tax information, or tells you they will charge based on a percentage of your refund ... run, don't walk, away from them. There's a good chance they're going to break the law, and they're going to pull you down with them.

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Note: Some community non-profits and IRS-partner organizations like VITA do provide reputable, in-person, free services for certain individuals, often seniors and those receiving other forms of assistance.

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