

# Chapter 1

## EITC BACKGROUND AND DOCUMENTS

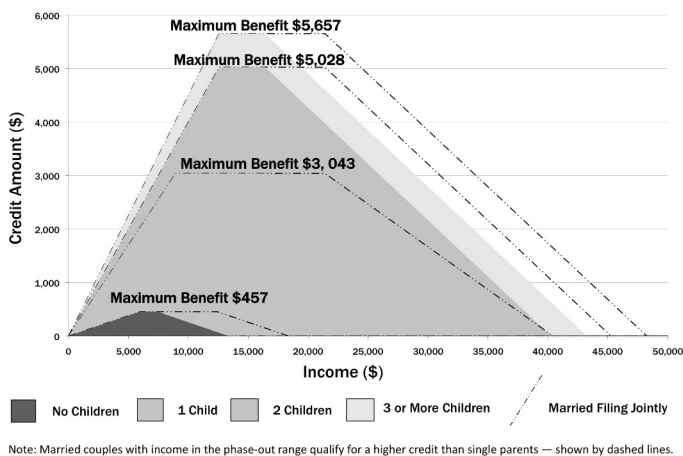
- About the Federal EITC
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- EITC Q&A

# ABOUT THE FEDERAL EARNED INCOME TAX CREDIT

The Earned Income Tax Credit (EITC) is a federal tax credit for low-income working individuals and families. It is intended to reduce the tax burden on low-income workers, supplement their wages, and help families make ends meet. Even workers whose income is too small to pay taxes can receive a refund through the EITC. In tax year 2006, the EITC provided \$43.7 billion in reduced or eliminated tax liability and cash refunds to more than 22 million low-income families.

The EITC is one of the most successful federal anti-poverty programs ever developed. The impact of the EITC on a working family's income can be considerable. For example, in 2010, a single parent raising two children and earning between \$12,550 and \$16,450 is eligible for the maximum EITC of \$5,028—a full 30 to 40 percent increase in the family's income. Taxpayers with one child can claim a maximum EITC of \$3,043. Claiming the Child Tax Credit in addition can provide up to \$1,000 per child to eligible families.

## The Federal EITC in Tax Year 2009



## Who is eligible?

Working families with children that have annual incomes below approximately \$35,000 to \$48,000 (depending on marital status and the number of children in the family) are eligible for the EITC. Also, low-income workers without children who have incomes below approximately \$13,000 (\$18,000 for a married couple) can receive a very small EITC<sup>1</sup>

More than four million people – roughly half of them children – escape poverty each year as a result of the EITC. A study by The Brookings Institution found the EITC reduces poverty among young children by nearly one-fourth.<sup>2</sup>

The EITC significantly increases the number of single parents who join the workforce. One study found the proportion of single mothers who worked increased dramatically between 1984 and 1996 due to legislative increases in federal EITC benefits.<sup>3</sup>

<sup>1</sup> Eligibility description and chart provided by Center on Budget and Policy Priorities, "Policy Basics: The Earned Income Tax Credit" (<http://www.cbpp.org/cms/index.cfm?fa=view&id=2505>)

<sup>2</sup> Sawhill, I. & Thomas, A. (2001). A hand up for the bottom third: Toward a new agenda for low-income working families. Washington, DC: The Brookings Institution.

<sup>3</sup> Meyer, B. D. & Rosenbaum, D. T. (2001). Welfare, the Earned Income Tax Credit, and the labor supply of single mothers. *Quarterly Journal of Economics*, 116(3), pp. 1063–1114.

Interviews with EITC recipients find that they use their refunds to pay off debt, invest in education, and secure decent housing, thus enhancing economic well-being and promoting community revitalization in their neighborhoods.

## AMERICAN RECOVERY AND REINVESTMENT ACT

In the 2009 American Recovery and Reinvestment Act (ARRA), the Earned Income Tax Credit was temporarily expanded for two specific groups: families with three or more children and married couples. Effective for the 2010 and 2011 filing seasons, the EITC will support these taxpayers by:

- Creating a new “third tier” of the EITC for families with three or more children. In this tier, the credit would phase in at 45 percent of income (up from 40 percent under current law), effectively increasing the maximum credit for these families by almost \$600.
- Increasing marriage penalty relief by raising the income threshold at which the EITC begins to phase out for married couples to \$5,000 above the amount for unmarried filers (an increase of \$2,000).

These changes will benefit an estimated 7.7 million families nationwide by increasing the amount of EITC for which they are eligible and make 900,000 families newly eligible for the credit. The amount of EITC dollars going to American families will increase by \$4 billion – an 8.8 percent increase from current law. President Obama’s budget includes a proposal to make these temporary changes to the EITC permanent, and U.S. Senator Max Baucus recently introduced legislation that would make these improvements permanent.

## HOW TO IMPROVE THE EARNED INCOME TAX CREDIT

By reducing poverty and encouraging work, the EITC is viewed as one of the most successful policies enacted in recent history. Yet the EITC could do more to close the gap between what families earn and what they need to make ends meet. While the American Recovery and Reinvestment Act made significant improvements to the federal EITC, those changes are temporary and additional changes could be made to improve the EITC even further. A few options have been developed by legislators, think tanks and public policy organizations, including:

### Expand the credit for childless workers

The EITC is available to childless workers, but only for individuals with incomes of up to \$13,000 (\$18,000 for married couples). However, these low-income workers still face a high federal tax burden and many of these tax filers are non-custodial parents that provide child support to their children’s custodial parent.

Further, labor force participation among lesser-skilled men is declining and an expansion to the

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<sup>4</sup>See The Brookings Institution. 2008. “The Scouting Report: Decrease Poverty and Increase Opportunity.” November 26, 2008 Interview with Rebecca Blank, [http://www.brookings.edu/events/2008/1126\\_poverty\\_chat\\_transition](http://www.brookings.edu/events/2008/1126_poverty_chat_transition).

EITC could provide an additional incentive to work.<sup>4</sup> The EITC could be expanded for these low-income workers by increasing the income limits for which they are eligible for the credit, increasing the maximum credit amount, and reducing the age at which they can claim the credit (currently an individual must be 25 to be eligible for the EITC).

#### Further reducing the “marriage penalty”

The American Recovery and Reinvestment Act slightly reduced the “marriage penalty” built into the EITC. Currently, families with two earners must report both incomes – a policy which results in lower EITC benefits for married couples. However, there remains a significant marriage penalty even after the ARRA adjustment. Proposals include allowing the couple to disregard half of the earnings of the lower earning spouse if that would provide a larger EITC<sup>5</sup> or allowing the primary worker to claim the child-based EITC and the secondary earner to claim a smaller credit for low-earning spouses.<sup>6</sup>

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<sup>5</sup> Center for American Progress. 2007. “From Poverty to Prosperity: A National Strategy to Cut Poverty in Half.” Washington, D.C. (April, 2007), [http://www.americanprogress.org/issues/2007/04/pdf/poverty\\_report.pdf](http://www.americanprogress.org/issues/2007/04/pdf/poverty_report.pdf), accessed March 25, 2009; Berube, Alan, David Park, and Elizabeth Kneebone. 2008. “Metro Raise: Boosting the Earned Income Tax Credit to Help Metropolitan Workers and Families.” Washington, D.C.: Policy Program, Brookings Institution (June).

<sup>6</sup> Berlin, Gordon. 2009. “Transforming the EITC to Reduce Poverty and Inequality.” *Pathways* (Winter): 28–32.

Table 1. EITC-Eligible Tax Units and Credit Amounts Pre-Recovery Act Expansions and Post-Recovery Act Expansions

State	Pre-Recovery Act Expansions				Post-Recovery Act Expansions			
	EITC-Eligible Tax Units	EITC-Eligible Tax Units (%)	EITC Sum (\$1000s)	Average EITC (\$)	Tax Units Benefiting From Proposal*	Newly EITC-Eligible Tax Units	Additional EITC Amount (\$1000s)	% Increase in EITC Amount
Alabama	463,636	22.8%	864,551	1,865	145,335	17,599	67,962	7.9%
Alaska	59,167	18.0%	100,666	1,701	16,104	1,571	8,078	8.0%
Arizona	500,123	17.4%	957,273	1,914	184,556	21,357	100,441	10.5%
Arkansas	284,165	23.4%	553,302	1,947	98,128	10,736	45,243	8.2%
California	2,759,162	16.8%	5,561,291	2,016	1,062,709	117,043	588,403	10.6%
Colorado	347,907	15.2%	620,598	1,784	109,517	12,034	59,717	9.6%
Connecticut	206,087	12.4%	367,388	1,783	53,809	7,589	26,741	7.3%
Delaware	64,363	16.1%	119,963	1,864	19,220	2,918	9,718	8.1%
District of Columbia	41,302	12.9%	65,547	1,587	7,450	743	3,982	6.1%
Florida	1,433,629	16.6%	2,670,844	1,863	434,257	54,316	217,202	8.1%
Georgia	817,040	19.6%	1,587,836	1,943	269,558	29,314	133,699	8.4%
Hawaii	96,802	15.4%	175,339	1,811	29,996	4,450	15,707	9.0%
Idaho	126,819	19.5%	245,035	1,932	54,954	7,757	29,558	12.1%
Illinois	970,985	16.7%	1,882,262	1,939	322,413	37,312	171,884	9.1%
Indiana	515,385	18.2%	938,116	1,820	159,169	18,997	83,429	8.9%
Iowa	218,225	16.0%	373,798	1,713	63,007	9,873	33,649	9.0%
Kansas	205,956	16.8%	379,559	1,843	70,901	9,465	37,984	10.0%
Kentucky	405,672	22.0%	742,291	1,830	114,749	14,372	58,389	7.9%
Louisiana	450,028	24.1%	864,241	1,920	130,131	13,293	59,572	6.9%
Maine	106,538	17.2%	190,305	1,786	32,700	4,797	15,359	8.1%
Maryland	332,594	12.6%	603,499	1,815	85,616	13,768	42,331	7.0%
Massachusetts	381,797	12.3%	684,086	1,792	90,116	12,304	42,248	6.2%
Michigan	857,590	19.0%	1,578,230	1,840	238,707	27,669	126,423	8.0%
Minnesota	347,122	14.3%	596,494	1,718	102,648	16,122	55,049	9.2%
Mississippi	318,757	26.2%	621,784	1,951	99,620	9,917	47,675	7.7%
Missouri	519,440	19.4%	941,069	1,812	154,608	17,987	78,102	8.3%
Montana	86,493	19.8%	161,183	1,864	23,807	2,777	12,473	7.7%
Nebraska	133,784	16.6%	258,132	1,929	49,999	5,048	26,766	10.4%
Nevada	180,663	14.9%	331,458	1,835	66,194	7,668	35,511	10.7%
New Hampshire	76,515	12.4%	134,159	1,753	20,062	2,512	9,055	6.7%
New Jersey	503,322	12.5%	967,244	1,922	145,758	19,163	73,032	7.6%
New Mexico	211,900	24.1%	391,777	1,849	62,627	5,482	32,221	8.2%
New York	1,388,714	15.6%	2,653,481	1,911	424,293	49,447	216,425	8.2%
North Carolina	796,537	19.6%	1,485,543	1,865	250,511	31,901	123,655	8.3%
North Dakota	46,190	15.8%	76,827	1,663	13,069	1,245	6,115	8.0%
Ohio	962,715	18.4%	1,781,718	1,851	264,930	34,424	134,023	7.5%
Oklahoma	347,572	21.7%	677,211	1,948	129,410	15,073	66,298	9.8%
Oregon	298,261	16.9%	511,155	1,714	93,662	12,607	48,504	9.5%
Pennsylvania	951,997	16.5%	1,726,267	1,813	270,381	35,596	139,967	8.1%
Rhode Island	69,592	14.0%	133,070	1,912	20,567	1,887	10,253	7.7%
South Carolina	403,048	20.6%	748,879	1,858	111,784	15,840	55,478	7.4%
South Dakota	67,902	18.7%	113,473	1,671	19,791	2,548	9,002	7.9%
Tennessee	587,439	21.2%	1,075,600	1,831	174,891	21,035	84,511	7.9%
Texas	2,167,278	21.5%	4,480,302	2,067	858,983	80,446	463,129	10.3%
Utah	190,419	17.7%	386,608	2,030	88,628	14,242	48,981	12.7%
Vermont	53,965	17.7%	96,208	1,783	12,464	1,294	6,726	7.0%
Virginia	519,578	14.5%	968,004	1,863	142,961	20,112	68,741	7.1%
Washington	468,405	15.4%	810,532	1,730	137,400	16,687	70,258	8.7%
West Virginia	173,651	21.7%	306,160	1,763	50,186	7,914	24,981	8.2%
Wisconsin	422,324	16.0%	770,174	1,824	116,765	16,431	61,877	8.0%
Wyoming	36,132	14.4%	60,063	1,662	9,941	1,252	5,845	9.7%
<b>U.S. Total</b>	<b>23,974,687</b>	<b>17.5%</b>	<b>45,390,595</b>	<b>1,893</b>	<b>7,709,042</b>	<b>915,934</b>	<b>3,992,374</b>	<b>8.8%</b>

Source: Brookings Institution MetroTax Model

\*Units "benefit" from an expansion proposal if (A) their EITC credit amount increases; or (B) they become eligible for the EITC under the new par

Note: This analysis uses the 2007 American Community Survey PUMS. "Current Law" is based on tax year 2007 eligibility criteria. "House Expansion Proposal" includes a third tier for families with three or more qualifying children that follows the income guidelines for families with two children, but phases in at 45%; it also includes a marriage penalty relief provision that phases out \$2,000 after TY2007 levels for married couples.



with those increases, many low-wage jobs don't provide a sufficient income on which to live. Refundable state EITCs provide low-income workers with a needed income boost.

- REGRESSIVE TAX SYSTEMS

States rely heavily on “regressive” taxes such as sales, excise and property taxes, which hit poorer families harder than wealthier ones when measured as a share of a family's income. Since a state EITC is aimed only at low- and moderate-income families, it helps offset the impact of regressive taxes, making state tax systems more fair.

- EXTENSIVE EVIDENCE THAT EITCS ENCOURAGE WORK

Studies have shown that EITCs encourage families to obtain jobs and remain employed.

- EVIDENCE THAT EITCS ARE USED FOR ASSET-BUILDING EXPENDITURES

Many people use their EITC refunds to make the kinds of investments that enhance economic security and promote economic opportunity, such as paying off debt and investing in education.

- EASE OF ADMINISTRATION

A state EITC requires adding just one line to a state income tax form and the calculation is very simple. States with EITCs report very low additional administrative costs with the credit – typically a fraction of one percent.<sup>7</sup>

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<sup>7</sup> List of reasons for increased interest taken from Center on Budget and Policy Priorities, “Policy Basics: State Earned Income Tax Credits” (<http://www.cbpp.org/cms/index.cfm?fa=view&id=2506>)

<b>State*</b>	<b>Percentage of Federal Credit (Tax Year 2009 Except as Noted)</b>	<b>Refundable?</b>	<b>Workers Without Qualifying Children Eligible?</b>
Delaware	20%	No	Yes
District of Columbia	40%	Yes	Yes
Illinois	5%	Yes	Yes
Indiana	9%	Yes	Yes
Iowa	7%	Yes	Yes
Kansas	17%	Yes	Yes
Louisiana	3.5%	Yes	Yes
Maine	5%	Partially <sup>h</sup>	Yes
Maryland <sup>a</sup>	25%	Yes	Yes
Massachusetts	15%	Yes	Yes
Michigan	20% <sup>f</sup>	Yes	Yes
Minnesota <sup>b</sup>	Average 33%	Yes	Yes
Nebraska	10%	Yes	Yes
New Jersey	25%	Yes	Yes
New Mexico	10%	Yes	Yes
New York <sup>c</sup>	30%	Yes	Yes
North Carolina <sup>e</sup>	5%	Yes	Yes
Oklahoma	5%	Yes	Yes
Oregon <sup>e</sup>	6%	Yes	Yes
Rhode Island	25%	Partially <sup>i</sup>	Yes
Vermont	32%	Yes	Yes
Virginia	20%	No	Yes
Washington	Not yet implemented; scheduled to go from 5% to 10% in 2011 <sup>g</sup>	Yes	Yes
Wisconsin	4% — one child 14% — two children 43% — three children	Yes	No

Notes: From 1999 to 2001, Colorado offered a 10% refundable EITC financed from required rebates under the state's "TABOR" amendment. Those rebates, and hence the EITC, were suspended beginning in 2002 due to lack of funds and again in 2005 as a result of a voter-approved five-year suspension of TABOR. Under current law, the rebates will resume in 2011, but a recent income tax cut that also depends on the rebates is likely to exhaust the funds, leaving the EITC unfunded.

<sup>a</sup> Maryland also offers a non-refundable EITC set at 50 percent of the federal credit. Taxpayers in effect may claim either the refundable credit or the non-refundable credit, but not both.

<sup>b</sup> Minnesota's credit for families with children, unlike the other credits shown in this table, is not expressly structured as a percentage of the federal credit. Depending on income level, the credit for families with children may range from 25 percent to 45 percent of the federal credit; taxpayers without children may receive a 25 percent credit.

<sup>c</sup> Should the federal government reduce New York's share of the TANF block grant, the New York credit would be reduced automatically to the 1999 level of 20 percent.

<sup>d</sup> North Carolina's EITC is scheduled to expire in 2013.

<sup>e</sup> Oregon's EITC is scheduled to expire at the end of 2013.

<sup>f</sup> Michigan's EITC is scheduled to increase to 20 percent of the federal credit in 2009. However, as part of budget cuts, the state legislature is considering freezing the credit at 10 percent.

<sup>g</sup> Washington's EITC is worth five percent of the federal EITC or \$25, whichever is greater. When the matching rate rises to 10 percent in 2011, the minimum value will rise to \$50.

<sup>h</sup> In 2009, Maine passed legislation making its EITC partially refundable. The change will take place in TY 2010.

<sup>i</sup> Rhode Island made a very small portion of its EITC refundable effective in TY 2003. In 2006, the refundable portion was increased from 10 percent to 15 percent of the nonrefundable credit (i.e., 3.75 percent of the federal EITC)

# ABOUT THE VOLUNTEER INCOME TAX ASSISTANCE PROGRAM

## BUILDING FINANCIAL SECURITY FOR LOW-INCOME FAMILIES

Community Volunteer Income Tax Assistance (VITA) programs offer free tax help and related financial services to low-income individuals and families. During the 2009 filing season, VITA programs directly served more than **one million underserved taxpayers**, including low-wage workers, persons with disabilities, the elderly, Native Americans, rural populations, and those with limited English-language skills. VITA clients often have the opportunity to open bank accounts and to invest their refunds in safe financial products such as U.S. Savings Bonds, while avoiding the high fees charged by paid preparers and refund anticipation loans (RALs).

Due to high unemployment rates, reduced wages and scaled-back hours, many additional workers will qualify for VITA services over the next two years. For families living on tight budgets, it is now more important than ever to have access to free tax services and the opportunity to take advantage of the new tax benefits enacted as part of the American Recovery and Reinvestment Act.<sup>8</sup> At a time when VITA programs are poised to ramp-up services, sources of local funding have started to dry up. State and local governments are cutting back, while private foundations are beginning to limit grant-making.

Funding from state and local governments, private foundations and individual donors in combination with in-kind contributions from volunteers and community organizations enabled VITA programs to dramatically increase the number of returns prepared over the past five years. Many VITA programs are firmly established in their communities, but struggle to balance the need to meet growing demand with the desire to reach underserved populations where there are no VITA sites or other alternatives to paid preparers. The 2008 Consolidated Appropriations Act<sup>9</sup> created an \$8 million competitive matching grant program to enable grant recipients to assist underserved populations living and working in hard-to-reach rural, Native, urban and suburban communities.

**Congress can help VITA programs meet the tax and financial service needs of underserved communities by continuing to increase the appropriation for the VITA Grant Program.**

Additional funding, beyond the original \$8 million appropriation, would make it possible for VITA programs to effectively serve and reach more working families hit hard by the recession.

## THE IMPACT OF COMMUNITY VITA

Community VITA programs are well worth the additional investment. For underserved workers, the program offers free tax preparation and serves as a gateway to mainstream financial services. To the volunteers who dedicate tens of thousands of hours during tax season, VITA

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<sup>8</sup> Pub. L. 111-5, Sep. 30, 2009.

<sup>9</sup> Pub. L. 110-161, Dec. 26, 2007 (121 Stat. 1975).

programs are an opportunity to give back to their communities. For the federal government, VITA programs are a way to improve taxpayer services and to ensure that workers receive the tax benefits they have earned. A substantial increase in federal funding for the VITA Grant Program will enable community VITA programs to strengthen and expand their role as:

- **One Piece of the Economic Recovery Puzzle:** VITA programs help low-income workers to access tax benefits, such as the Earned Income Tax Credit and Child Tax Credit.
- **A Smart Alternative to Paid Preparers:** VITA program clients keep 100 percent of their tax refunds and avoid high-cost loan products.
- **A Bridge to Financial Security:** Many VITA programs offer clients the opportunity to open bank accounts, invest in U.S. Savings Bonds and access public benefits.

## THE VITA GRANT PROGRAM

While VITA programs have been in existence for 40 years, which is as long as the federally funded Tax Counseling for the Elderly (TCE) and Low-Income Taxpayer Clinic (LITC) programs combined, the program did not receive federal funding until the 2008 Consolidated Appropriations Act<sup>10</sup> authorized an \$8 million competitive matching grant program.

The 2009 Omnibus Appropriations Act<sup>11</sup> extended funding by \$8 million through September 30, 2010. And the President's FY 2010 budget proposes to continue funding by an additional \$8 million through September 30, 2011.

**Congress created the matching grant program to help VITA programs achieve the following objectives:**

- Enable the VITA programs to extend services to underserved populations in hardest-to-reach areas, both urban and non-urban
- Increase the capacity to file returns electronically
- Heighten quality control
- Enhance training of volunteers
- Significantly improve the accuracy rate of returns prepared at VITA sites.

## FIRST-YEAR RESULTS

From July to September 2008, 379 VITA programs applied for \$30 million in funding with 111 first-year applicants receiving a grant. Grant amounts ranged from \$731 to \$600,000 with a median grant of \$56,000. Of the \$8 million available in FY 2008, the IRS allocated \$7.4 million

<sup>10</sup> Pub. L. 110-161, Dec. 26, 2007 (121 Stat. 1975).

<sup>11</sup> Pub. L. 111-8, Mar. 11, 2009 (123 Stat. 634).

for grants and retained the remaining \$600,000 to cover a portion of the \$2.1 million it cost to administer the program in its first year.<sup>12</sup>

Diverse organizations received funding, including community-based organizations, local United Ways, asset-building coalitions, national nonprofits, AARP, community action agencies, local and tribal governments and public universities. Programs serving rural populations received one-fourth of the grant funding, while organizations serving Native American communities and disabled persons received 5 and 3 percent of the funding, respectively.

During the 2009 filing season, the IRS conducted its first rigorous evaluation of VITA tax preparation accuracy.<sup>13</sup> The study, which will serve as a baseline for future evaluations, is expected to be released in late 2009.

VITA programs file more than 90 percent of tax returns electronically. During filing season 2009, approximately half of all VITA clients requested direct deposit with nearly 3,000 choosing the split refund option (a substantial increase from the 2008 filing season) that enables taxpayers to direct refunds toward multiple accounts. VITA programs view direct deposit and split refunds as a way to promote asset-building at tax sites. For example, in 2009, numerous programs allowed clients to direct a portion of their refund toward the purchase of U.S. Savings Bonds.

## THE COST OF PAID TAX PREPARATION AND REFUND ANTICIPATION LOANS

Low-income workers and their families have benefited from the creation and expansion of refundable tax credits, such as the EITC and the Child Tax Credit. However, these and other tax credits continue to increase tax code complexity, making it nearly impossible for low-income workers to complete their tax returns unassisted. The majority of Americans need help preparing their tax returns. In 2007, paid tax preparers completed nearly 87 million tax returns – 63 percent of all returns filed. The percent of low-income taxpayers relying on paid tax preparers is even higher: for example, nearly three-fourths of the 23 million EITC recipients rely on a paid preparer.

H&R Block, one of the more competitively-priced tax preparers, charged an average of \$187 per return in 2009. Meanwhile, consumer advocates estimate that in 2007, 5.4 million EITC recipients took out a refund anticipation loan (RAL) at an average cost of \$96 per loan. As VITA programs plan how to help clients take advantage of next filing season's expanded tax benefits, many paid preparers will be looking for ways to profit from expected large tax refunds.

In 2008, the average VITA client earned \$18,800 before taxes or about \$9 per hour. At this hourly rate, a person must work 21 hours just to cover the average cost of tax preparation at H&R Block. This same person needs to work nearly 6.5 additional hours to purchase an H&R Block refund anticipation loan.

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<sup>12</sup> During a May 20, 2009 meeting at the Center for Economic Progress's office in Chicago, IL, the Internal Revenue Service's Stakeholders, Partnerships, Education, and Communication office provided information on the fiscal year 2008 administrative expenses and indicated that the IRS would increase the allocation of grant funds toward administrative expenses in fiscal year 2009.

<sup>13</sup> The Treasury Inspector General for Tax Administration (TIGTA) conducts an evaluation each year. Although the study includes a statistically valid sample of tax sites and tax returns, it is limited to a small number of tax sites. Further, the 2008 audit examined only 36 returns between VITA and the Tax Counseling for the Elderly programs.

## REFUND ANTICIPATION LOANS<sup>14</sup>

Refund Anticipation Loans (RALs) are one- to two-week loans secured by a taxpayer's expected tax refund. For a steep price, RALs provide taxpayers near-instant access to their tax refunds. Unfortunately, many taxpayers do not understand the true cost of RALs or know that by choosing direct deposit they can receive their tax refund in as little as 10 days. Paid tax preparation and RALs are an enormous drain on federal programs like the EITC and Child Tax Credit. Every dollar spent on high-cost services and products is one less dollar hard-working taxpayers have available to spend or save.

- 8.7 million taxpayers purchased a RAL during the 2007 filing season
- Taxpayers paid an estimated \$833 million in RAL fees
- The cost of a \$3,000 RAL ranges from \$62 to \$110
- 63 percent of RAL customers receive the EITC
- RAL fees drain \$523 million from the EITC program

## COST OF PAID TAX PREPARATION AND RALS TO THE EITC PROGRAM<sup>15</sup>

Type of fee	Cost to taxpayer	Drain on EITC Program
Tax preparation fee	\$183	\$996 million
RAL loan fee (including dummy account fee)	\$58 or \$107.50	\$523 million
Add-on RAL Fee (for 20%)	\$40	\$44 million
<b>Total Cost</b>	<b>\$281 or \$330.50</b>	<b>\$1.56 billion</b>

Source: Fox, Jean Ann and Chi Chi Wu, Big Business, Big Bucks: Quickie Tax Loans Generate Profits for Banks and Tax Preparers While Putting Low-Income Taxpayers At Risk, National Consumer Law Center and Consumer Federation of America, Washington, DC: Feb. 2009 [http://www.consumerlaw.org/issues/refund\\_anticipation/content/2009\\_RAL\\_Report.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/2009_RAL_Report.pdf).

## COMMUNITY VITA AND ASSET-BUILDING SERVICES

Tax preparation remains the cornerstone of VITA programs. But in recent years, more VITA programs have offered financial services and products to help clients save and invest their tax refunds. **Total federal tax refunds** returned to VITA clients reached **\$1.4 billion** in 2009, making tax season the time for workers to take account of their family's finances and invest in their children's futures.

A recent survey of National Community Tax Coalition member organizations found that two out of three programs offer clients the opportunity to open checking and saving accounts at tax

<sup>14</sup> Fox, Jean Ann and Chi Chi Wu, Big Business, Big Bucks: Quickie Tax Loans Generate Profits for Banks and Tax Preparers While Putting Low-Income Taxpayers At Risk, National Consumer Law Center and Consumer Federation of America, Washington, DC: Feb. 2009, [http://www.consumerlaw.org/issues/refund\\_anticipation/content/2009\\_RAL\\_Report.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/2009_RAL_Report.pdf).

<sup>15</sup> Fox, Jean Ann and Chi Chi Wu, Big Business, Big Bucks: Quickie Tax Loans Generate Profits for Banks and Tax Preparers While Putting Low-Income Taxpayers At Risk, National Consumer Law Center and Consumer Federation of America, Washington, DC: Feb. 2009, [http://www.consumerlaw.org/issues/refund\\_anticipation/content/2009\\_RAL\\_Report.pdf](http://www.consumerlaw.org/issues/refund_anticipation/content/2009_RAL_Report.pdf).

time. In addition, one-quarter of programs offer clients the opportunity to invest a portion of their refund in U.S. Savings Bonds or Certificates of Deposit (CDs). Each tax season, VITA programs offer new, innovative financial products to connect their clients to the financial mainstream. For example, during the 2009 filing season, several programs piloted low-fee prepaid debit cards that allow unbanked clients to take advantage of direct deposit, electronic bill pay, and ATM access. VITA programs not only open doors to working-family tax credits, but also act as a gateway to financial opportunity.

## EITC Q & A

### BASIC FACTS ABOUT THE EITC:

Q. What is the Earned Income Tax Credit?

A. The Earned Income Tax Credit (EITC) is a federal tax credit for low-income working individuals and families. It is intended to reduce the tax burden on low-income workers, supplement their wages and help families make ends meet. Even workers whose income is too small to pay taxes can receive a refund through the EITC. In tax year 2006, the EITC provided \$43.7 billion in reduced or eliminated tax liability and cash refunds to 22.4 million low-income families.

Q. What does it mean to be a refundable tax credit?

A. This means that the family gets a refund check even when the credit is greater than the amount they owe in taxes. Due to the refundable nature of the EITC, it has become the largest federal income support program for low-income working families.

Q. Who qualifies for the EITC?

A. Working families with children that have annual incomes below approximately \$35,000 to \$48,000 (depending on marital status and the number of children in the family) generally are eligible for the EITC. Also, poor workers without children who have incomes below approximately \$13,000 (\$18,000 for a married couple) can receive a very small EITC.

Q. How do people claim the EITC?

A. To claim the EITC, you must file a tax return. Families making below \$42,000 can get their taxes done for free at a Volunteer Income Tax Assistance (VITA) site. These trained volunteers can help families complete their taxes and ensure they claim valuable credits including the EITC and the Child Tax Credit. You can find a VITA site by calling the IRS toll-free number at 1-800-906-9887 or visiting the National Community Tax Coalition website at [www.tax-coalition.org](http://www.tax-coalition.org).

### MISCONCEPTIONS ABOUT THE EITC:

Q. Isn't the EITC just welfare?

A. No, the EITC is not welfare. You must work to claim the EITC. The refundable nature of the EITC is what makes it such a powerful tool to help hard-working families keep more of their hard-earned dollars. Each year EITC refunds lift more than 4.4 million people – roughly half of them children – out of poverty. The families who would receive a refund do pay taxes.

Low-income families pay sales tax, property tax, excise tax and other taxes. A refundable EITC helps offset these other taxes, thereby making the tax system more fair. Extensive research has shown that the EITC increases workforce participation among low-income families, but refundability is key to this effect.

Q. What about the fraud and overpayment rates? I've heard that many people who claim the EITC don't qualify.

A. The rates you may have heard about are based on studies completed by the IRS in 1999 and 2001. These studies are seriously compromised by major methodological problems that likely caused the estimate to overstate the actual error rate.

Overpayment is not the same as "fraud." To the extent these studies found actual overpayment, it was largely the result of families with few resources attempting to understand and comply with fairly complicated rules — not intentional abuse of the tax system.

Since then, Congress and the IRS have worked toward simplifying the rules and increasing oversight in order to reduce confusion and reduce potential rates of fraud and overpayment. Among the changes:

- Congress passed a new Uniform Definition of Qualifying Child, which simplified the definition and helped clear up confusion that had previously been a significant source of errors.
- The IRS developed a powerful database to help identify cases in which an EITC claimant may be wrongly claiming a child.
- Since 2001, the IRS has improved its methods for identifying EITC filers who appear to be under-reporting their income.
- The IRS has launched an initiative to identify commercial tax preparers who have submitted a significant volume of erroneous EITC claims and to target the preparers for more intensive enforcement and education activities.
- The IRS holds extensive oversight with the VITA program to ensure quality preparation. The IRS requires volunteers to be IRS-certified by passing a competency exam. Additionally, the VITA sites have no profit motive to inflate refunds.

By comparison, noncompliance in other parts of the tax system results in a much higher loss of income for the IRS than any EITC overpayments. The 2001 IRS "tax gap" study, which assessed noncompliance throughout the tax code, found that 51 percent of rent and royalty income, 57 percent of small business income and 72 percent of farm income went unreported. This misreporting of business income is at least 10 to 12 times the size of total EITC overpayments.

