E-PARCC
COLLABORATIVE GOVERNANCE INITIATIVE
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Implementing the Earned Income Tax Credit at AccountAbility Minnesota

Part A

Bonnie Esposito looked out the window of her office, wondering what on earth to do next. A recent report by the state's Children's Defense Fund office revealed private tax preparers were diverting benefits targeted to low-income working families. They were marketing costly tax preparation services and the recently developed refund anticipation loans (RALs) to low-income families; a typical low-income filer was paying roughly $175 a year for these tax-filing services and high-fee loans were disproportionally concentrated in low-income zip codes. In one year alone, the report's authors estimated $7.3 million public funds in Minnesota were diverted from worker's to pay for such fees.

As the executive director of AccountAbility Minnesota, a small nonprofit focused on assisting people with tax preparation, Bonnie found these findings sobering. The state report echoed evidence coming to light nationally. The National Consumer Law Center, the Consumer Federation of America, and the Brookings Institution also were documenting an explosion in high-interest financial services directed to low-income tax filers. While people eligible for the federal Earned Income Tax Credit had the potential to secure significant refunds, thanks to public policy designed to reward work and respond to inequities in the tax system, conditions created circumstances where the market could exploit people's desires for quick access to their refunds and misunderstandings of hidden fees. How could a small nonprofit, powered largely by volunteers, hope to intervene, facing large national for-profit corporations intent on selling the benefits of 'fast refunds'?

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POLICY CONTEXT

Created by Congress in 1975, the Earned Income Tax Credit (or EITC) is designed to benefit low and moderate wage working people, especially those raising children. Starting in the late 1980s, the credit expanded in both scope and reach with bipartisan legislative support.

Those who claim the Earned Income Tax Credit often do not benefit from other parts of the tax code. Most tax deductions, such as those for home mortgage interest or state and local property taxes, only benefit tax filers with liabilities. However, tax credits— particularly those that are refundable, such as the EITC—can benefit those who don't have sufficient tax liability. Because these workers actually pay a greater percentage of their total income in payroll, sales, and other federal and local taxes, refundable tax credits help reduce disparities in current tax policy.

Eligibility for federal EITC, 2010*

Family Size	Maximum Income**	Maximum Credit
2 children	$40,363	$5,036
1 child	$35,535	$3,050
No children	$13,460	$457

*As part of federal stimulus, families with three or more children are temporarily eligible for slightly larger benefits.

**Married couples filing jointly can earn $5,000 more.

In fact, the EITC is now the most significant anti-poverty program in the country, helping to lift an estimated 50 million people out of poverty each year by providing sizable tax refunds. Research documents that the EITC is particularly helpful in providing income to African-Americans and immigrants families, particularly women raising children. The specific value of EITC depends upon the number of children in a family and level of earned income; recently, married couples filing jointly were allowed to have a slightly higher income level. A tax refund comes as a lump sum after income tax returns are filed, and research shows it is particularly valuable for paying off expenses or making investments to improve social mobility. A refund of several thousand dollars can be used to buy new clothes for the family, pay medical bills, or clean up bad credit. It can enable purchases typically out of reach, such as buying a car or making a down payment on a new home. It can also be directed towards improving a longer term economic goal, such as savings, improving housing, or investing in higher education.

The EITC brings significant benefits to state and local economies. In 2005, over 260,000 Minnesotans claimed the EITC, bringing more than $430 million into the state. According to the IRS, the average federal tax refund in Minnesota was $1,640. For many, the benefit was a significant supplement to their direct earnings; a staggering 75% of the Minnesota households filing for the federal tax credit had an adjusted annual gross income of less than $25,000.

In addition to addressing concerns about equity, the continued expansion of the tax credit occurred because it creates incentives for and rewards paid work. It also has few administrative requirements, as it is implemented through the federal tax code. However, historically, it has not always been easy for people to know they are eligible. About one in five eligible workers nationwide did not claim the EITC credit, leaving millions of people without much-needed payments.

Bonnie Esposito felt proud that the Minnesota numbers were stronger; 75–80% of those eligible claimed the federal credit. In her state, families also benefited from state tax policy that supplemented the federal credits. The state's Working Family Credit (WFC) mirrors the federal credit, rewarding earned income with state-level refundable tax credits. That effort—combined with other education and child care credits—made Minnesota the most generous of all 50 states in its provision of refundable tax credits. Combined federal and state refunds can add up to 50% of an individual's total annual income in Minnesota. Yet, the potential benefits of these policies created an even larger mandate for having an effective and efficient way for low-income workers to file their taxes. AccountAbility Minnesota was one entity focused on that goal.

NONPROFIT INFRASTRUCTURE FOR TAX PREPARATION ASSISTANCE

To access tax credits such as the EITC and WFC, people must complete both federal and state tax returns. Yet, for many people, tax filing process is confusing and complex, even more so for people with low education levels, recent immigrants, or those who don't speak English as a first language.

There are numerous ways low or moderate-income customers can get their tax refunds. They can use a paid preparer, who often charges significant fees (between $75 to $350); they can seek assistance using computer software, a family member, or friend; they can attempt to do the return themselves; or they can utilize free tax assistance at a Voluntary Income Tax Assistance (or VITA) site. The Internal Revenue Service created the VITA program to reduce barriers to tax preparation. It provides small contracts to nonprofits that leverage volunteer preparers. Minnesota's Department of Revenue also provides similar contracts to support implementation of the state-level credits. The tax sites—approximately 350 in Minnesota—provide free tax preparation to low-income families. The nonprofits involved recruit, train, support, and coordinate volunteers who work long hours to assure that quality tax preparation is done. Yet, this supply is not adequate to meet the demand. Of the Minnesota households who claimed the EITC, approximately two-thirds used a paid preparer for their taxes, even though the average cost of preparation and electronic filing was $120.

Started in 1971 by accounting professionals inspired by the model of pro-bono legal assistance, AccountAbility Minnesota used the modest contracts from federal and state government to stabilize their operations. Their approach placed volunteers in community-based organizations throughout the Twin Cities metro area during tax season. They raised modest private funds that allowed them to expand the number of community tax sites, some operating a few hours a week, others operating a number of days throughout the week. Year after year they expanded the number of volunteers, most of whom were professional accountants, although some college students were also recruited. By the late 1990s, although tax sites operated at 27 different locations, the formal organization was modest, with two or three staff and an annual budget of less than $150,000. Its strength came from the nearly 390 volunteers who both did taxes and served on the organizations' board of directors.

In the past decade, AccountAbility's customers had become increasingly diverse, mirroring the rise in immigrant populations in the state, particularly Hmong, Vietnamese, Latino, Russian, and Somali. This created new pressures to recruit volunteers from these communities to increase comfort among those seeking competent tax preparation assistance. The board wanted to continue to expand and grow. A local foundation, interested in increasing family economic stability, expressed interest in this goal and provided a modest grant for strategic planning and organizational assessment. This process gave the board an opportunity to step back and really consider how to chart a more ambitious future for the organization. Given the changes in federal and state policy, they realized the organization was no longer merely providing access to pro-bono accounting services; the organization was really an anti-poverty organization, focused on implementing significant federal and state tax benefits to low- and moderate-income workers.

In 2002, the board decided to hire Bonnie Esposito as a new Executive Director. She brought a very different skill set than previous directors, all of whom had been accountants. Bonnie had run the state's volunteer office and had a passion for anti-poverty work. She also believed that, through strategic partnerships, the organization could grow to fulfill its mission at a totally new scale. The organization was fundamentally solid, although some changes could be made (See Appendix A). Some changes were fairly operational—training more volunteers to prepare returns with electronic filing, hiring more diverse staff, improving communication with and recognition of volunteers. Yet, other strategies could be developed to broaden the agencies' core work.

Bonnie knew the organization's main strength was its ability to leverage volunteer professionals to help those less fortunate. Volunteers receive many hours of extensive training and, through the process, become certified according to VITA specification at an intermediate level. The training is continually updated because of experience and changes to tax law. Because of this investment of time and development of expertise, many volunteers feel loyalty to the organization, with many engaging for over 10—some even over 20—years. During tax season, from late January through April 15th, they volunteer four to eight hours a week, helping customers file tax returns.

Another key asset for AccountAbility Minnesota was the network of community-based organizations serving as tax sites—over 40 in the metro area by the early 2000s. For these host organizations, the free tax preparation service expanded the services available to their clients at no direct cost. The AccountAbility Minnesota volunteers came to the sites without the host organization needing to fund site coordination, volunteer training, or quality assurance.

Yet, Bonnie saw that the original process was a bit too loose. Some sites didn't understand their responsibilities as partners and miscommunication created stress for volunteers. Operating so many sites also created operational complexity for the staff and often confused customers, for it was hard to remember which sites were open on particular nights. Many sites had extensive waiting time to get tax returns completed. Bonnie decided to formalize the relationships with sites through a memorandum of understanding. After discussions with the board and staff, they also decided to reduce the number of overall sites to 30. Each would operate for longer hours both to reduce unnecessary logistical headaches and improve tax payer services.

Bonnie began to explore the possibility of expanding this nonprofit network beyond the metropolitan area. Building upon a workshop a staff member had created, "To Your Benefit: Understanding Tax Credits and Deductions," she encouraged staff to do training at state-wide social service professional meetings and conferences. She raised some funds from corporate and private foundations. She also learned from an evaluation report that many of the state's

Community Action Agencies were already helping low-income people access tax credits, although without the technical support or volunteer training which AccountAbility could offer.

She also began to cultivate state-level partners. The national anti-poverty advocacy organization, the Children's Defense Fund, was a long-time proponent of Minnesota's state-level tax credits for working families. Staff there was doing research to monitor participation rates and document implementation challenges, such as the increased prevalence of Refund Anticipation Loans. She also met with the Community Action Agencies' state-government funder, the Office of Economic Opportunity in the Department of Human Services, which was interested in securing potential resources to bring AccountAbility's expertise to their state-wide nonprofit network. Likewise, Bonnie followed up with the local foundation that had invested in the agencies' strategic planning and organizations. The McKnight Foundation was interested in investing their resources to leverage public antipoverty programs; tax credit implementation seemed like a viable focus and she made sure foundation program officers knew about her efforts to expand the agency's reach.

Attending to these issues, Bonnie grew the organization significantly in her first 3 years. The overall numbers of tax payers served increased 51%, in part because of her strategic decision to reduce the overall number of metropolitan sites and partner with selected sites in Greater Minnesota. In 2005, the volunteers and community partners helped secure $11.7 million in tax refunds to low-income taxpayers. She also intentionally expanded services to the Latino community by providing information about AccountAbility in Spanish and recruiting and training volunteer preparers fluent in Spanish. Increasingly, a number of particular tax sites served other immigrant populations, and seasonal tax site coordinators from those communities were hired to lower barriers to community access. She also responded to an IRS mandate to increase significantly the electronic filing of tax returns, assisting staff in altering the volunteer training and securing laptop computers to deploy to community sites. Overall, AccountAbility Minnesota was strong and growing. That's why the growing reports of high interest financial services directed at their customers gave her pause. Should the organization try to respond?

POLICY IMPLEMENTATION PROBLEM

Many avenues exist for people to file their taxes. Historically, however, there were considerable wait times for refunds because of the time it took to mail returns, process them, and for the IRS to issue refund checks. With the increased utilization of electronic-filing, both federal and state governments could process refunds more quickly. The increase of electronic transfers among financial institutions also enabled the direct deposits of returns into existing checking or savings accounts.

The changes in tax processes and financial services also created a new wrinkle in the implementation of the EITC. While all customers want their tax refund quickly, the relative refund size for low-income families meant that the benefits were particularly significant. In addition, since many low-income families are 'unbanked,' without savings or checking accounts at formal banks, they do not possess an account into which tax returns can be deposited. This demand created an opportunity in the market to which some businesses eagerly responded. Starting in 1999, citizens began to report being charged significant fees for confusing products.

Large tax preparers, such as H&R Block, Jackson Hewitt, and Liberty Tax Service, were offering what they called “Refund Anticipation Loans” (RALs). Although there was limited financial risk for the preparer, this product provided short-term cash advances secured by and repaid through proceeds from a consumer’s federal tax refund. To ease customer access to this loan, tax preparation firms developed a debit-card product for the loan. H&R Block’s “Emerald Card” allows customers to access their refunds, avoid check cashing fees, and even access funds through other temporary loans, if customers are willing to pay significant fees. The rates on these loans are amazingly high, ranging from about 40% to over 700% Annual Percentage Rate (APR).

Operationally, the tax preparer collaborates with a bank and creates a temporary account to which the taxpayer’s refund can be deposited by the IRS. Once that happens, the loan is considered paid off and the bank account is closed, robbing taxpayers of the opportunity to develop an ongoing relationship with a financial institution. If they elect to use the debit card, they also must spend their entire refund, as savings is not an option. Customers aren’t able to build their credit history or grow their wealth, leaving them vulnerable to needing to take out another RAL the following tax season and use additional “fringe” banking options (e.g., check cash stores) in the meantime.

Unintentionally, IRS tools and practices tacitly promoted use of RALs. One metric provided by government’s electronic filing software was the Debt Indicator, which identified customers with past tax liabilities that need to be offset in any new return. These customers are particularly vulnerable to the high-fee products, as salespeople can stress their abilities to settle such a debt instantaneously. The IRS also permitted commercial tax preparers to market their products as an “IRS Free File” program. In reality, this designation simply means that when the commercial tax preparer filed a client’s tax return with the IRS they, as the preparer, do not have to pay a fee. This designation means little to the tax payer who is assessed significant fees in what is marketed as a “free file” program.

From where Bonnie Esposito sat, the consequences of these conditions and practices were significant. Customers were coming into the AccountAbility Minnesota sites with stories of confusion, of instances in which they had clearly not read all of the fine print, where they truly were not aware of the accumulated cost of accessing their tax refunds quickly from paid preparers. Data from national studies documented that federal EITC recipients were particularly targeted for the high interest loans; while EITC recipients only constituted 15% of all taxpayers, more than half of RAL customers received the tax credit. According to a study by the National Consumer Law Center and the Consumer Federation of America, refund anticipation loans siphoned off about $749 million in loan fees and administrative expenses from workers receiving the EITC. This was public money not going into the pockets of the low-income people for which it was intended but, instead, going to large private corporations.

The consequences of these practices also had geographic dimensions. In Minnesota, the highest concentrations of tax payers eligible for the EITC live in north Minneapolis and American Indian reservations. These impoverished communities were particularly targeted as places to promote the Refund Anticipation Loan: more than 75% of EITC claimants on some northern Indian Reservations and 50% of those in north Minneapolis zip codes took out RALs.

OPTIONS FOR ACCOUNTABILITY MINNESOTA TO CONSIDER

Sitting in her office, a few distinct paths of action stretched before Bonnie. The organization was thriving and growing, reaching more people with free tax preparation services and growing the quality and reach of their volunteer base. But free tax preparation alone no longer met the need of the increasingly complex market.

One path was ambitious and involved developing a new financial product to compete with the predatory RALs. Earlier that summer, at the national meeting of other VITA programs (convened by the National Community Tax Coalition), she learned of an approach being piloted. Bill Meyers, from the Alternatives Federal Credit Union in Ithaca, described a product that used existing lines of credit to offer a product they called "Refund Express." As a VITA site, the credit union worked with the same type of customers as AccountAbility. As a credit union, they charged a modest $20 set-up fee and 11.5% APR to secure their risk, thereby offering safe and convenient loans for low-income tax filers who wanted immediate access to their refunds. In the first year, 20% of their tax assistance customers requested the loans. The total average cost for customers was $25 and, after one year, 66% of the new customers still retained their bank account. In the second year, only 10% of customers took the loan; the change was attributed to the availability of the existing accounts and consumer education. The credit union also experienced no financial losses through the Refund Express program in the first two years.

Perhaps this type of model might be possible in Minnesota. One of AccountAbility's board members worked in a large, commercial bank. There were others with different connections in the financial service industry, and the metro area had a number of smaller community banks and credit unions. One potential partner would be the US Federal Credit Union, which began operating a voluntary tax assistance site in 2004 with AccountAbility's technical support. It provided financial services to the seven-county metro area and, within two years, had done free tax preparation for 275 customers at two of their locations. Yet it would be difficult for the organization to move in this direction. AccountAbility had never provided actual financial services. The funding environment was uncertain and business model ambiguous. Many stakeholders wanted to stabilize the organization's core tax preparation work given the small portion of the market they still reached.

Another path involved just focused on growing AccountAbility's customer base throughout the state. Leaders at the state Office of Economic Opportunity were inspired by their initial conversations with AccountAbility. The Office's statewide network of nonprofit service providers could benefit from AccountAbility's technical support and volunteer training. The network's mission was solidly antipoverty. Working together, the Office of Economic Opportunity and AccountAbility could decrease the numbers of low-income workers not accessing federal and state tax credits. They could increase attention to electronic filing, which decreases customer wait time and makes products like RALs less appealing. Perhaps some of the state-wide expansion in free tax preparation could concentrate in areas such as American Indian reservations, where there was a high prevalence of RALs.

Still another path focused her attention on enhancing AccountAbility Minnesota's ability to do public policy advocacy. At the National Community Tax Coalition meetings, she always heard presentations emphasizing the importance of linking local voluntary tax preparation to public policy advocacy. Minnesota's Senator Coleman sat on a consumer protection committee and would be receptive to hearing more from a state-based organization about national policy change. There also would be ways to join in advocacy protecting and expanding state-level tax policy that benefits AccountAbility's customers.

Finally, a number of Minnesota's private foundations and United Way agencies were energized about new products to help clients build wealth. The 'tax return moment' provided a unique opportunity for financial education and savings. The idea of matched-savings accounts, called Individual Development Accounts, was gaining traction in the state; Minnesota had recently became the first to have a statewide program where each dollar of individual savings is matched by $3 from a combination of state, federal, and philanthropic sources. To participate, accountholders complete a minimum of 12 hours of financial management classes, an additional 10 hours of asset-specific education, and commit to monthly savings plans. Unlike other subsidized savings accounts, such as Individual Retirement Accounts (IRAs) or 401(k) plans, IDAs target low-wage earners, providing subsidies through matches rather than through tax incentives. Perhaps AccountAbility could develop this type of product as a mechanism to encourage savings among their customers. When combined with the lump sum from tax refunds, IDAs offer significant savings benefits to low-income workers. Like the alternative-RAL program, though, this would require the organization to raise significant amounts of money and develop new core competencies.

All options carried risk. All presented opportunities. One thing was certain; in the future, AccountAbility Minnesota would need to continue to change if it was to carry out its mission on behalf of low- and moderate-income workers. What was the most strategic way forward?

Appendix A: Organizational Snapshot, Late 2002

AccountAbility Minnesota Mission: To provide tax preparation and accounting services to individuals and small businesses with limited means by leveraging volunteer resources.

Eligibility for Services:
Low-income taxpayers with annual incomes of $30,000 or less and families with annual incomes of $40,000 or less

Customer Profile:

- Number served: 7,416 (13% increase from 2001)
- The average annual income for AccountAbility customers was just over $12,000.
- Approximately 40% of all customers are Hmong, Hispanic, Somali, Vietnamese, or Russian.
- English was the second language for 47% of our customers.
- 1,552 disabled clients, a three-fold increase over 2000.