

A 2004 REPORT ON EARNED INCOME TAX CREDIT, FROM POLICY MATTERS OHIO

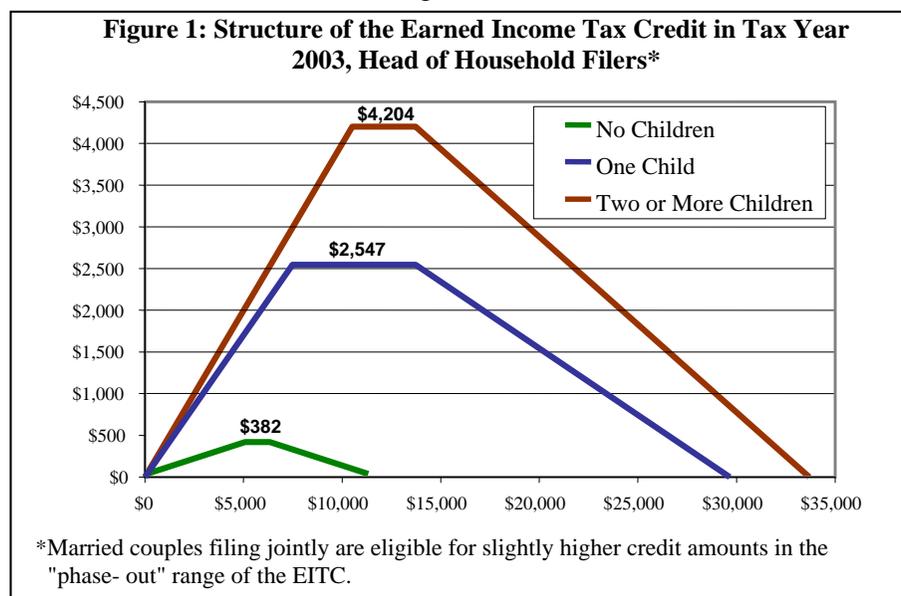
TAKING CREDIT: BOOSTING PARTICIPATION IN THE EARNED INCOME TAX CREDIT IN GREATER CLEVELAND

AMY HANAUER, SEPTEMBER 2004

In a city that was recently recognized for having the nation's highest poverty rate, thousands of Cleveland's poorest workers do not claim a valuable tax credit that yields an average of \$1,700. Each year, the credit lifts nearly 5 million people above the official poverty line, and in 2002, 726,000 Ohio families received \$1.2 billion in federal money by filing for the Earned Income Tax Credit (EITC), a refundable tax credit available to low-income families and single adults. While the EITC provides a considerable boost to earnings, at least 15 percent of those eligible do not claim the credit. This brief discusses current and recommended strategies aimed at increasing participation in the EITC to maximize available means of assisting low-income workers. To download the full 31-page *Taking Credit: Boosting Participation in the Earned Income Tax Credit in Greater Cleveland*, go to www.policymattersohio.org/eitc_04.htm.

ELIGIBILITY

The EITC is targeted towards low- and moderate-income working families and very low income working adults. Income level determines both eligibility and the size of the refund. During recessions and weak economic recoveries, some families lose their sole wage-earner and become ineligible because only families with at least one working member can claim the credit. More common in a weak job climate, however, is to see eligibility increase as family income declines with the loss of one job in a former two-earner household, reduction in hours of work, or actual wage reduction. For families with one child, the EITC increases until earnings reach \$7,500, and for families with two children, the credit grows until earnings reach \$10,540. The credit plateaus (\$4,204 for two or more children, \$2,547 for one child, and \$382 for single adults) and phases out as earnings reach



Source: Internal Revenue Service

Reprinted from Alan Berube presentation to funders' network June 2004, Brookings Institution, available at www.brookings.edu

approximately twice the poverty line.

BENEFITS

The credit has enjoyed bipartisan support since its inception in 1975 as a poverty-reducing program that encourages work and does not burden businesses. It is relatively easy to administer, discreet, and has higher participation levels than other government programs. Most studies have found that families spend the EITC on paying off bills or purchasing basic commodities, food, education, or transportation.¹ Because it is often provided in a lump sum, the credit can also help families build assets, providing a deposit for an apartment, a small part of a down payment, or an initial sum to start a savings account. Further, tax credits to low- and moderate-income families are more likely to be spent in communities where those families live, providing stimulus to local economies.

BOOSTING PARTICIPATION

In the Cleveland-Lorain-Elyria Metropolitan Statistical Area (Cleveland MSA), 137,237 filers claimed the credit, while Cuyahoga County had 97,925 claimants, and zip codes that include the city of Cleveland had 52,103 claimants.² Using a conservative national estimate, 15 percent of those eligible still do not claim the EITC. In central cities, the rate of non-claimants is probably higher. Based on this estimate of 15 percent, more than 20,500 additional filers in the MSA, 14,600 in Cuyahoga County, and 7,800 in Cleveland were eligible in the 2002 tax year. If these households had filed for the credit, up to \$34 million more of federal money could have been pumped in to families in this MSA.

Table 1
Earned Income Tax Credit Claimants, 2002, by county
Cleveland-Lorain-Elyria Metropolitan Statistical Area

County	Total number of returns	Number of EITC Claims	Total value of EITC refunds paid	Number using re-fund loans (RAL)	Percent of EITC claimants using RALs	Average amount of EITC	Percent of tax returns claiming EITC	Estimated number of eligible non-claimants
Ashtabula	47,961	7,494	\$12,486,542	3,153	42.1%	\$1,666	15.6%	1,124
Cuyahoga	666,797	97,925	\$165,964,532	45,883	46.9%	\$1,694	14.7%	14,689
Lorain	134,471	15,958	\$26,469,230	6,827	42.8%	\$1,658	11.9%	2,394
Lake	118,693	8,813	\$12,996,303	2,628	29.8%	\$1,474	7.4%	1,322
Medina	78,288	4,839	\$7,170,102	1,130	23.4%	\$1,481	6.2%	726
Geauga	41,574	2,208	\$3,070,078	320	14.5%	\$1,390	5.3%	331
Total	1,087,784	137,237	\$228,156,787	59,941	43.7%	\$1,662	12.6%	20,586

Source: Brookings Institution, Policy Matters Ohio

¹ Liao, Yihua. "Expenditure Patterns of High and Low Income Households." Fall 2004. Retrieved June 2004. http://condor.utc.uic.edu/~fta/Information%20Briefs/analysis%20of%20expenditure2_3.pdf

² The borders of the MSA have since changed and the region is now called the Cleveland-Elyria-Mentor MSA, but these data conform to the old borders. A complete listing of this information for all zip codes in the Cleveland MSA can be found in the appendix of the full report.

SKIMMING CREDIT: EXPLOITATIVE LOANS

Fifty-eight percent of all tax filers in the U.S. seek assistance from paid tax preparers for an average cost of \$90 to \$105.

Among EITC claimants, the rate is even higher at 68 percent. EITC claimants are particularly susceptible to exploitative refund anticipation loans (RALs), high-interest,

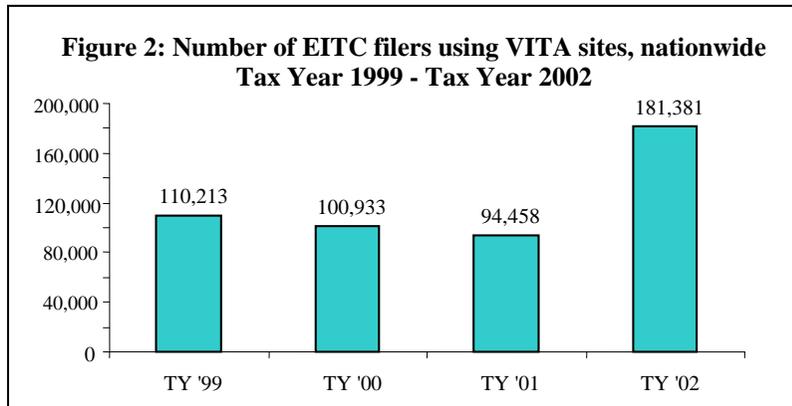
short-term loans marketed to filers needing quick refund access. The Brookings Institution calculated an annual interest rate of 250 percent or more for such loans. Nationwide, 43 percent of EITC claimants purchase RALs, compared to six percent of other tax filers. According to the Internal Revenue Service, RALs are purchased by 43.7 percent of EITC filers in the Cleveland MSA, 46.9 percent in Cuyahoga County and 54.1 percent in Cleveland. Nearly 60,000 taxpayers in the MSA purchased these loans, at an average cost of \$120 in addition to tax preparation fees. In the MSA, we estimate that more than \$7 million was siphoned away from poor taxpayers to paid preparers in 2002.

At the same time, merchants are getting creative in trying to lure EITC recipients. The Home Depot and Lowe's allow consumers to exchange their entire tax refund for a store gift card and coupon for a 5 percent discount on a single purchase.³ Wal-Mart now offers consumers refund check cashing at service and layaway counters. No purchase is necessary, but the credit can be converted into prepaid gift cards or used for immediate purchases. Rent-to-own firms, such as Rent-A-Center, have partnered up with H&R Block and Jackson Hewitt to sway consumers into buying RALs that will subsequently be spent on-site. These partnerships with tax preparers ensure that customers have money to spend in their stores. Wal-Mart and Meijer grocery stores have allowed H&R Block to open tax preparation kiosks within stores – there will soon be 900 H&R Block kiosks in Wal-Mart locations. Businesses hope this one stop approach will drive up sales. They view these new alliances as a way to promote their services to employees and customers while providing exclusive savings. Critics, on the other hand, see these new services as just another expense for the consumer. Susan Morgenstern of the Legal Aid Society of Greater Cleveland advocates the use of free tax preparation sites where filers can deposit their refund into a bank account and eliminate three potential costs: preparation costs, refund loan costs, and costs of making the purchase.

	Number claiming EITC	Number using RAL	Percent of EITC claimants using RAL	Estimated total cost for RAL (at \$120 each)
Cleveland-Lorain Elyria MSA	137,237	59,941	43.7%	\$7,192,920
Cuyahoga County	97,925	45,883	46.9%	\$5,505,960
City of Cleveland	52,103	28,171	54.1%	\$3,380,520

Source: Brookings Institution, Policy Matters Ohio

³ <http://www.buildingonline.com/news/viewnews.pl?id=3040>, accessed July 2004



Source: Brookings Institution funders presentation, "Background on EITC campaigns," Alan Berube, June 2004

COMMUNITY RESPONSE

Many tax analysts believe a strong volunteer income tax assistance system can boost participation in the EITC and reduce reliance on refund anticipation loans. The Cleveland territory, which encompasses all of Cuyahoga County

and some of Summit County, has a volunteer program that assisted 1,973 EITC claimants in 2004. Advocates want to improve participation next tax year. With an estimated 14,689 eligible non-claimants in the county, and an estimated 7,815 in the city of Cleveland, coordinators aim to more than double the number of EITC returns that they help in each of the next two tax years. This would bring more than \$5 million in new federal dollars to the city.

The Cleveland Campaign

Cleveland's efforts to promote the EITC and the use of volunteer income tax assistance (VITA) services are largely modeled after the success of Chicago, where a campaign helped overall EITC claims increase five times faster than any other large American city. In recent years, Greater Cleveland's campaigns have been coordinated by the Cuyahoga County Department of Health and Nutrition, the IRS, and by the Center on Economic Opportunities in Greater Cleveland. This year it is likely that the Enterprise Foundation will oversee the larger effort. Currently, the city is in position to double VITA site participation in the 2004 tax year, and double it again the following year.

Campaigns have featured a "super Saturday" event early in the tax season in the city hall rotunda with dozens of volunteers, computers set up for e-filing, and much community fanfare. Some groups have sponsored radio spots, mailings to likely participants, community education, and use of the United Way "First Call for Help" line. Also, the IRS funds VITA sites around the city which according to many observers, can vary in the reliability and quality of the returns prepared. A coalition of advocates, including representatives from the Legal Aid Society, the Enterprise Foundation, the IRS, United Way First Call for Help, the city and the county meets regularly to discuss how to strengthen the VITA system. Advocates are eager to see more VITA sites with more consistent hours, more media outreach, and support efforts that are ongoing and build on the previous years' work.

RECOMMENDATIONS

Increasing EITC participation will reduce poverty and increase income for poor workers in greater Cleveland, but requires the involvement of the entire community to make the effort successful. Cleveland is fortunate to have a strong, committed group of advocates eager to promote the EITC. The following actions will help their work be as effective as possible:

LEGISLATION: The state of Ohio should implement legislation to regulate RAL providers as four states and the city of New York have done. Reducing the use of RALs would keep more refund money in the hands of the low-income working families who have earned it. Also, implementation of a state EITC could help compensate for recent state tax changes that shift the tax burden to lower-income families. Finally, the state can help inform citizens about the EITC, as recommended in a recent Ohio Jobs and Family Services memorandum.

COMMUNITY & BUSINESS PARTICIPATION: Utility companies should be asked to assist, by inserting EITC and VITA site information into utility bills. Schools should be tapped to send the information home in children's school packets. Grocery stores can be brought into the coalition, asked to insert fliers into grocery bags at the start of tax filing season. Area businesses should insert EITC and VITA information into potentially eligible employees' pay stub envelopes. Credits could help workers invest in better transportation, childcare or housing – all of which could make them more reliable employees. In all cases, promotion should encourage use of volunteer preparers and warn about the costs of RALs.

SERVICE PROVIDER COORDINATION: More comprehensive efforts are necessary so that EITC information can be enclosed whenever correspondence is sent regarding Medicaid, Food Stamps, Women Infants and Children (WIC), housing and child care assistance, or Temporary Assistance to Needy Families. To ensure that eligible childless workers claim the credit, the campaign should reach out to homeless shelters, soup kitchens, the Day Laborer's Hiring Hall, the East Side Organizing Project and other organizations that work with the very low-wage or sporadic workers who are likely to have earnings low enough to qualify. Special attention is needed to serving minority language communities where non-native speakers are among the most likely to forego the credit.

BUILDING AN INFORMED PUBLIC: The county and city should build on current efforts to promote awareness of VITA sites and EITC eligibility and to warn about RALs. These campaigns should be launched in the fall, before paid preparers start their advertising blitz. Mayors and city council leaders can join forces with communities particularly in the inner-ring suburbs of Cleveland to ensure that people know about the credit and of the dangers of RALs. Press outreach in newspapers, ethnic publications, radio and television, and guest editorials are also vital. It should be concentrated over three phases, beginning in late December, repeated in January as workers receive their tax information, and concluded in March, before late filers submit their taxes.

Increasing participation in the Earned Income Tax Credit is one element of Policy Matters' vision for an economy that values workers. We have also written reports on wages, economic development, unemployment compensation, incarceration, and other elements of tax and social policy. We believe that reasonable people can disagree about how to solve problems, but no solution can be found without good understanding of how our economy works and a lively debate about how to bring equity and prosperity to Ohio. Help start the discussion by inviting us to discuss issues facing working families with your organization or group. Contact Policy Matters at 216-931-9922.

Policy Matters Ohio is a non-partisan policy research institute, on the web at www.policymattersohio.org. The 31-page [Taking Credit: Boosting Participation in the Earned Income Tax Credit in Greater Cleveland](#), from which this summary report was drawn, is available at that site, as are more than 50 other reports on issues facing working families. The full report includes information on EITC participation, RAL usage and potentially eligible non-filers for every zip code in the Cleveland-Lorain-Elyria metropolitan statistical area.

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Helpful information on the Earned Income Tax Credit can be found at:

Annie E. Casey Foundation
 Brookings Institution Center on Urban and Metropolitan Policy
 Center for Economic Progress, Chicago
 Center of Budget and Policy Priorities
 Charles Stewart Mott Foundation
 Children's Defense Fund of Ohio
 The National Tax Assistance for Working Families Campaign
 Enterprise Foundation
 First Call for Help - Cleveland
 Joint Center for Poverty Research
 Legal Aid Society of Greater Cleveland
 National League of Cities
 State EITC Online Resource Center

This report is based on Internal Revenue Service data available at the Brookings Institution web site.