

NEW MEXICO ADVOCATES FOR CHILDREN AND FAMILIES

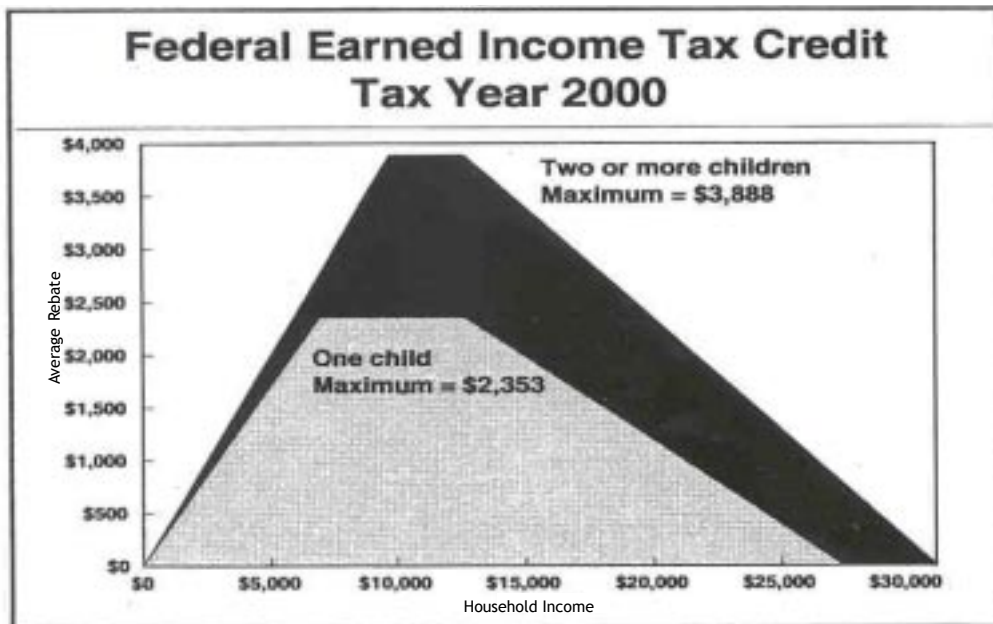
Campaign to Reduce Child Poverty

Policy Brief #3

Enhancing the Benefits of Tax Rebates and Credits

The federal government provides assistance to low-income working families through the Earned Income Tax Credit (EITC). This program is a powerful weapon against poverty in New Mexico but its effectiveness is compromised by under-utilization and the high fees many low-income filers pay for commercial tax preparation and "rapid refund" tax loans. This policy brief examines participation by New Mexicans in EITC and "rapid refund" programs and suggests low-cost policy solutions to under-utilization of EITC and over-utilization of commercial tax preparation in New Mexico.

Working poor families can realize substantial cash returns through EITC:



Failure to file a federal income tax return costs New Mexicans at least \$29 million in EITC annually.

A recent report published by the New Mexico Department of Taxation and Revenue (TRD) concludes that low-income New Mexicans forego *at least* \$29 million in Earned Income Tax Credit (EITC) per year by failing to file a federal income tax return.¹ The report suggests that most low-income New Mexico families take advantage of either the state-administered Low Income Comprehensive Tax Rebate (LICTR) program,² and EITC. It also concludes that by failing to file a federal and/or state income tax return a significant number of low-income New Mexico households forego an average of \$1,000 per year in personal income tax rebates and credits.

In New Mexico EITC lifts approximately 20,000 households and 36,000 children from poverty, a 28% reduction in poverty for the children of working parents.

EITC lifts more children from poverty than any other government program or category of program. Nationwide, it lifts approximately 4.6 million people, over half of whom are children, from poverty.

The EITC is a refundable personal income tax credit administered by the federal government that supplements the earnings of low-income workers. The primary beneficiaries of the credit are working families with children (although workers between 25 and 64 with no children and income less than \$10,200 are eligible for modest amounts of EITC.) The maximum credit (\$3,888 for tax year 2000) is realized by families with two or more children and modified adjusted gross income (MAGI) between \$9,500

and \$12,500. Credit amounts are based on modified adjusted gross income (adjusted gross income plus non-taxable interest) and number of children.

For tax year 1998, 179,459 New Mexico households received \$286 million in EITC. For the large majority of households - 85% - the EITC rebate exceeded the tax liability, and the family received some cash refund. After paying their federal taxes, each recipient household of EITC received an average of \$1,628, for a total of 249.5 million dollars returned to New Mexico.

Forty-eight percent of low-income New Mexicans pay someone to do their taxes. Commercial tax preparation and "rapid refund" loans are costing low-income New Mexicans approximately \$26 million each year.

The High Cost of Rapid Refund Loans

While under-utilization of EITC is cause for concern, more troubling, and perhaps more costly to low-income New Mexicans, is reliance on commercial tax preparation and so-called "rapid refund" programs. Forty-eight percent of low-income New Mexicans (184,235 households) pay someone to do their taxes. Preparation of state and federal income taxes for a household eligible for EITC by a reputable, high volume preparer costs about \$60. Electronic filing, which cuts the average wait time for a refund from seven weeks to three weeks, is an extra \$32.

Many families also opt for a "rapid refund," where the tax preparer pays the family the tax rebate immediately. Rapid refunds are really just high-interest loans based on expected refunds, and usually cost between \$30 and \$60. Thus, even utilizing a mainstream, high volume tax preparation service subtracts an average \$140 from the typical low-income family's EITC benefit. At a minimum this amounts to a cost of \$26 million statewide.



High Interest “Tax Loans” are Business as Usual in New Mexico’s Poorest Communities

In Gallup, 72% of 1998 federal income tax filers reported income less than \$22,000 and the average household income for a family of three is about \$12,000 (8% *below* the poverty threshold). Eighty-three percent (83%) of the low-income population utilizes a paid preparer, but the costs of tax preparation are much higher than in other communities.

Tax form preparation averages \$90 in Gallup (compared to \$60 elsewhere). “Rapid refunds” cost an additional 15% of the refund expected. The average refund is \$1,504, so the cost of the rapid refund is \$225 (again, compared to \$30-\$60 elsewhere). Thus, the typical family in Gallup pays over \$300 to have their taxes done.

But, the costs are even greater for the working poor families in Gallup, many of whom are eligible for the maximum \$3,888 EITC. If they choose a rapid refund of the full amount they pay over \$670 to the tax preparer – \$90 for preparing the tax forms and \$580 for the rapid refund.

The turn-around time on a tax refund filed electronically is 3 weeks. Charging 15% of the principle on a three week loan is equivalent to an annual percentage rate of 180%, 9 times the rate charged on a credit card cash advance.

Increasing EITC Utilization

The Taxation and Revenue Department report suggests that increasing EITC utilization by New Mexicans could be as simple as including an EITC reminder in the New Mexico personal income tax packet on or near the application. Low-income households that file neither state nor federal taxes could be informed of EITC through a notice accompanying Medicaid or EBT cards.

An alternative response is a targeted letter campaign similar to that recently undertaken to inform eligible households of child Medicaid (please see NMACF policy brief #2 *Mail In Medicaid Enrollment: Removing the Barriers to Health Insurance for New Mexico’s Low-Income Children*)³. The same process could be undertaken in reverse: Medicaid households that appear to be EITC eligible, but cannot be matched to a state or federal tax return, would be sent a letter informing them of how, when, and why they should file a tax return.

Unfortunately, neither of these approaches will prevent unscrupulous tax preparers or predatory “loan sharks” from extracting an exorbitant share of the benefits realized through increased utilization of EITC. Tax forms, particularly the federal form EIC and state form PIT RC, are complicated and intimidating. Literacy and language may pose substantial barriers for some potential filers. Thus, the only way to ensure that EITC recipients retain the full benefit of their participation in the program is to provide them with low or no cost tax preparation assistance.

During tax season, the New Mexico Taxation and Revenue Department provides state tax preparation assistance to low-income filers at its field offices. TRD does not have the resources to assist in federal income tax preparation. Tax preparation assistance for low-income filers is provided through IRS-sponsored Volunteer Income Tax Assistance (VITA) programs in some areas of the state, but VITA services are limited and under-publicized and, as a result, only utilized by approximately 1.5% of New Mexico filers.⁴

Policy Briefs #1, #2, and #3 are available in PDF format online at www.nmadvocates.org



Recommendations

- Legislators and the Governor can reduce child poverty by insuring that New Mexicans receive the full EITC rebate. This can be accomplished by regulating the amount charged by tax preparers for rapid refunds through enactment of Refund Anticipation Loan (RAL) legislation.⁵
- Employers can help employees take advantage of EITC and avoid the “rapid refund” trap by helping them to utilize the *Earned Income Credit (EIC) advance payment option* which allows some recipients to receive their EITC rebate in advance installments. EIC advance payments, included in every paycheck, are available to workers with at least one qualifying child who expect to earn less than \$27,413 in the year 2000. Advance EIC payments increase the typical worker’s take home pay by over \$100 a month. In 1997, the last year for which data are available, less than one third of one percent of the EITC paid to New Mexicans was received through advance payments, despite the fact that most EITC recipients were eligible for the program.
- State agencies can also help by expanding awareness of VITA and actively recruiting VITA volunteers in under-served areas, such as Gallup and Grants. Training these volunteers in both federal and state tax preparation will help ensure that all low-income tax benefits go into the pockets of the intended beneficiaries.
- The Human Services Department can enhance EITC utilization among its clients by providing federal tax preparation assistance at its Income Support Division field offices.⁶

¹ TRD results are based upon a match by social security number of Medicaid case files, federal income tax returns, and state income tax returns. Research cited with permission from the New Mexico Taxation and Revenue Department. The views expressed in this policy brief do not reflect those of the Taxation and Revenue Department or its employees.

² For a more comprehensive discussion of LICTR, see NMACF policy brief #1.

³ Households deemed to be Medicaid eligible on the basis of data provided on a 1998 state income tax return were matched to Medicaid case files. Households that couldn’t be matched were sent a letter by TRD informing them of their apparent eligibility and the benefits of Medicaid for their children.

⁴ A list of VITA providers is available from the IRS 1-800-TAX-1040 and the New Mexico Taxation and Revenue Department 1-505-841-6200 during tax season.

⁵ The Refund Anticipation Loan legislation should contain these components:

- a requirement of annual licensure and full disclosure of fees by refund anticipation loan providers;
- a definition of an “unconscionable” fee for refund anticipation loans; licensure must be contingent on charging a fee that is lower;
- stiff penalties for providing refund anticipation loans without a license, or charging fees other than those posted or reported for purposes of licensure;
- a clear statement of interest rates, expressed so they can be compared to credit card or mortgage interest rates;
- a requirement that VITA locations and phone numbers be posted at tax preparation and loan companies; and
- a requirement that tax preparers inform customers that they can file electronically without taking out a “rapid refund” loan.

⁶ HSD could probably apply some of the money spent on such assistance against its TANF maintenance of effort requirements.

