

Reinvestment BRIEF

Issue 1



The Reinvestment Fund
Human Interest Compounded Daily

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The Reinvestment Fund

The Reinvestment Fund is a leading innovator in the financing of neighborhood and economic revitalization. Central to its mission is a commitment to put capital and private initiative to work for the public good. TRF is a development finance corporation with a wealth-building agenda for low- and moderate-income people and places through the strategic use of capital, knowledge and innovation.

TRF manages \$258 million in assets from over 850 investors, including individuals, religious and civic groups, financial institutions, private foundations, and the public sector. It uses these assets to finance housing, community facilities, businesses, renewable energy projects and public policy research.

Philadelphia's Campaign for Working Families

The Campaign for Working Families is a partnership of 17 organizations in Philadelphia united to help working families climb the economic ladder. The Campaign makes existing under-utilized resources available to families, including:

- Free tax preparation with emphasis on maximizing tax credits and refunds
- Screening for public benefits
- Credit counseling and repair
- Assistance with savings and financial education; discouragement of predatory lending activities

In three years, the Campaign has brought over \$45.2 million in credits and refunds to Philadelphia households; completed over 30,000 tax returns for individuals; opened over 500 bank accounts; provided financial education to over 1,000 individuals; and trained almost 1,300 volunteers to provide free tax preparation in community settings.

Tax Service Eliminates Fees

Participants receive EITC benefits through free tax assistance program

Free and Convenient

As part of an effort to improve access to financial services and information, The Reinvestment Fund (TRF) collaborated with Philadelphia's Campaign for Working Families (CWF) to offer free tax assistance in the 2004 tax season. The service was provided to companies in which TRF invests or with which it has other relationships; TRF served a total of 396 employees. While the Campaign managed sites in local libraries, schools, union halls, and churches TRF sent trained tax preparers to each employment site to make the service as convenient as possible.

The tax preparers at each site encouraged participants to file their taxes electronically and use direct deposits in order to expedite the tax return process and eliminate unnecessary fees. They also discussed eligibility for tax credits including the Earned Income Tax Credit.

Through TRF's free tax assistance program, the 396 participants received more than \$767,000 in total refunds for the 2003 tax year. Forty-five percent of the participants qualified to receive the EITC

Demographic & Economic Characteristics of TRF's Tax Assistance Participants

- 62% were 40 years old or younger
- 78% are African American
- 12% are Hispanic
- 72.6% had more than a high school diploma as their highest educational credential
- 90% were employed full time
- 96% had incomes at or below 80% of the Philadelphia metropolitan area average
- Average annual gross income was \$19,968

Problems with EITC Participation

High-Interest Refund Anticipation Loans

EITC recipients often work with private tax services when filing their taxes. In addition to charging a fee, many for-profit service providers encourage clients to purchase high-cost financial products despite their clients' financial restrictions. Through a Refund Anticipation Loan (RAL), customers may receive their anticipated refunds – less fees and interest – immediately. RAL annualized interest rates can range from 250 to 900 percent for a 2 to 3 week loan.³ Comparatively, e-filing and direct deposit result in a 7 to 10 day waiting period, roughly one half of a typical RAL term. Rather than wait the expected processing time, RAL purchasers forgo their maximum refunds to receive money faster. Expedited refund receipts should reduce an anxious tax filer's desire to purchase these increasingly popular

– an average credit of \$2,106 resulting in an average overall tax refund of \$3,302. The remaining participants averaged a tax return of \$1,112.

The Earned Income Tax Credit

Lifting nearly five million Americans above the poverty line each year, the Earned Income Tax Credit (EITC) is one of the United States' most effective anti-poverty policies.¹ In 2002 alone, the EITC aided 21.5 million families through the dispersal of over \$37 billion in tax reductions and cash supplements.²

The EITC's goal is to help low-income working Americans build assets and develop long-term wealth for their families. Unlike most income-support programs, at times criticized for discouraging employment, the EITC program's benefits encourage employment by increasing with household income up to a point where the benefit amount plateaus and then gradually declines as household income continues to increase.

Study Highlights

To assess the effectiveness of the free tax program, TRF selected a representative sample of participants and conducted a telephone survey consisting of open-ended questions. The

Claimants often spend more than 10% of their refunds on fees when using a commercial tax preparer.⁵

Low Awareness Rates

Although the EITC has experienced great success, its full potential has yet to be realized. The lack of program awareness among eligible tax payers is a growing concern. According to the National Survey of America's Families, only 52% of families with incomes below 50% of the federal poverty line in 2002 knew of the EITC. Less than 30% of those families applied for and received the credit. The Campaign for Working Families estimates that there are 45,000 eligible families in Philadelphia who fail to file for the EITC, foregoing an estimated \$76.5 million in potential benefits.⁴

sample was composed primarily of African-American females who tended to live in low-wealth and low-income communities. In order to analyze EITC participation and the value of access to free services, participants were asked about previous tax filing experiences. The survey found that in the previous year, 60% of respondents worked with private tax assistance providers, paying an average fee of \$136. Providing the free tax service saved the program's 396 participants a total of \$32,680 in service fees alone. More importantly, 15% received Refund Anticipation Loans the previous year. TRF encouraged direct deposit and did not offer the RAL. TRF's free tax services allowed respondents to receive their refunds on average one week sooner in 2004 than when using a different tax preparer in 2003 and avoided these extraordinarily high interest rate loans.

Refund Allocation

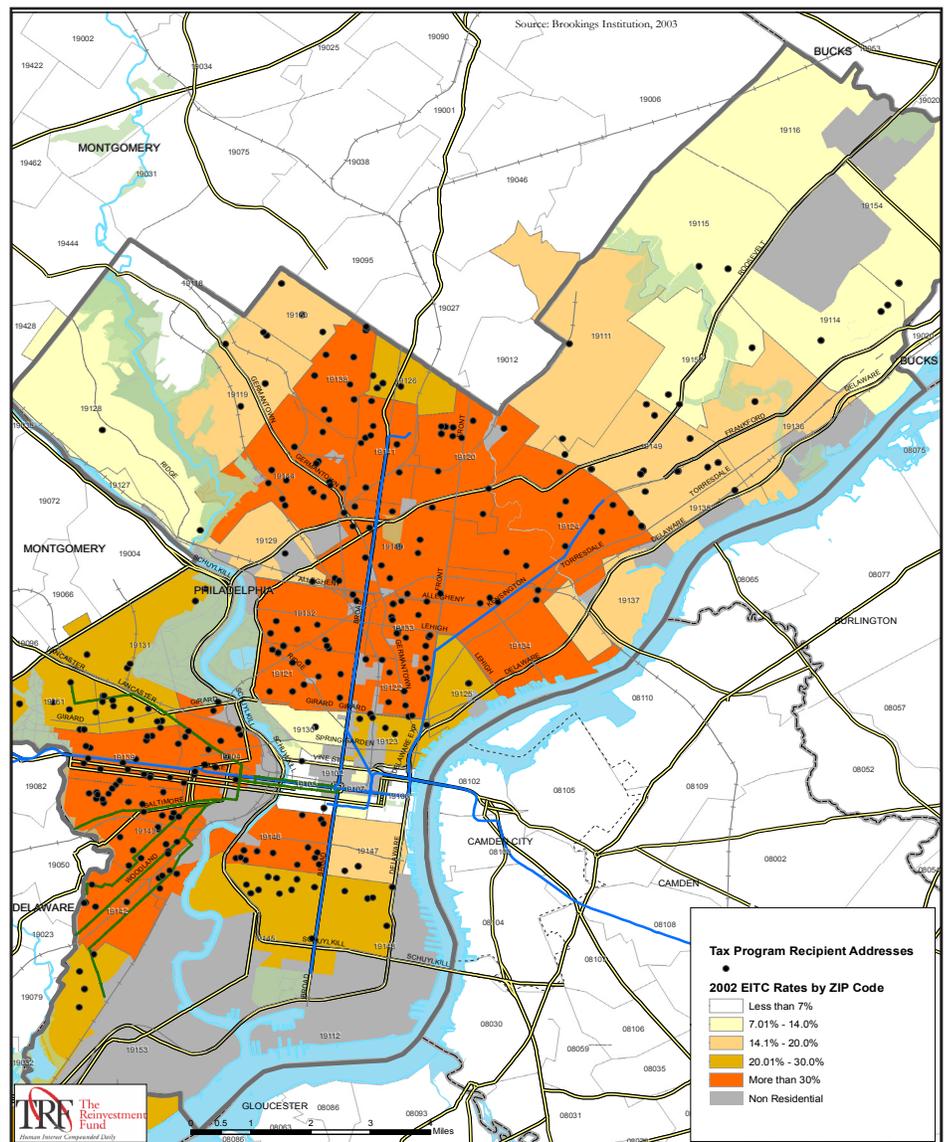
TRF categorized responses to open-ended questions regarding the use of tax refunds as “making ends meet” or “improving social and economic mobility.”⁶ The former category represents regular household expenses including utility bills, groceries, appliances, furniture, and other essential expenditures. The latter consists of debt repayment, savings, obtaining/maintaining a car, home improvement, education, and similar expenditures. Both categories are considered beneficial to long-term personal development.

Most respondents expressed concern for improving their financial situation. More than 80% of respondents said their EITC dollars would be spent in one of the two categories discussed above. Over 40% of the respondents planned to pay down debt, including student loans and credit cards to improve their credit ratings and increase their future ability to obtain mortgage financing.

Discussion

TRF’s tax assistance program provided filers with an opportunity to create household wealth. Participants may be able to improve credit ratings, increase borrowing capacity and homeowner equity, and finance education expenses through tax refunds. By building financial stability, families have the opportunity to reduce their dependence on subsidy programs and improve their long-term upward economic mobility.

Many participants cited the program as having increased their awareness of budgeting issues, tax code rules, filing requirements and penalties. Survey results indicate, however, that



The map above shows TRF tax program participants' home addresses and the percentage of all returns receiving EITC benefits in the 2002 tax year.

On average, respondents using our free tax service in 2004 received their refunds one week sooner than when using a different tax preparer the previous year.

this type of program must expand to include general financial awareness and responsible spending habits. A high percentage of participants requested additional information about non-tax related services, including heating assistance, money management, health insurance, housing counseling, credit counseling, child care costs, and food stamps.

A number of respondents also said their experience with the program has not influenced their financial behavior. Increasing household income without improving financial habits does not achieve all of the program's intended long-term impacts.

This study suggests that the Campaign for Working Families

and TRF should develop a program where participants can learn of the many financial services available to low-income working families. Tax assistance providers should emphasize the importance of both personal financial management and ways to maximize the participant's return.

By increasing financial awareness, providers can facilitate responsible budgeting and access to other public benefits, which improves the opportunity for wealth creation.

As a result, TRF will focus its program and future related efforts on better understanding the financial education needs of participants and the services that may best create wealth for these participants.

**More than 80%
of respondents
said they were
satisfied or
very satisfied
with TRF's
Tax Assistance
Program.**

Endnotes

1)Berube, Alan et al. "The Price of Paying Taxes: How Tax Preparation and Refund Loan Fees erode the Benefits of the EITC." Survey Series. Center on Urban & Metropolitan Policy: The Brookings Institution and the Progressive Policy Institute. May 2002. Page 1. 2) IRS Individual Master File Data, tax year 2002 3) Ferrick, Tom. "ACORN's effort pays off—mostly." The Philadelphia Inquirer. January 14, 2005. 4)Campaign for Working Families Fact Sheet. <http://www.gpuac.org/programs/CWFfactsheet.htm> 5) "Berube, Alan et al." 6) Smeeding, Timothy, Michael O'Connor and Katherine Ross Phillips. "The EITC: Expectation, Knowledge, Use, and Economic and Social Mobility." April 2000.

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