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The Earned Income Tax Credit: Experiences from and Implications of the Voluntary Income Tax Assistance Program in Georgia

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Abstract
The study reported here used data collected from participants in a Volunteer Income Tax Assistance (VITA) Program to better understand how families anticipated using their Earned Income Tax Credit (EITC) refunds and their use of direct deposit. Data were collected over 3 years. The most common use for a refund by participants was paying bills or debts. One-third of participants planned to use their refund for savings or asset accumulation. Direct deposit participation was not significantly associated with using the EITC refund for savings or asset accumulation, with the exception of one asset, which was a house.

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Introduction

Since its inception in 1975, the Earned Income Tax Credit (EITC) has increased income and increased the ability to meet expenses among the working poor. With expansions to the EITC and welfare reform during the 1990s, the EITC has become the largest cash transfer program and the single most effective poverty reduction program in the U.S. (Greenstein, 2005; Hoffman & Seidman, 2003; Llobrera & Zahradnik, 2004; Sherman, 2005). The EITC is a refundable tax credit, which means that workers can receive assistance from the EITC even if they do not owe any taxes.

The EITC improves work incentives and economic conditions of families receiving Temporary Assistance to Needy Families (TANF), making it easier for TANF families to escape poverty through work by subsidizing earned income (Ozawa, 1995). "If society wants to reward work, especially in light of widening earnings inequality, the EITC appears to be an effective way to target low-wage workers" (Liebman, 1998, p. 96).

Expansion and increased knowledge about the EITC can help the program be even more effective in moving the working poor out of poverty. Scholz (1994) and Phillips (2001) found that in most estimates, 80 to 86% of those eligible for the EITC actually received it--around 2.1 million taxpayers entitled to the credit failed to receive it in 1990. According to Internal Revenue Service (IRS) data, $129,933,793 of available EITC funds went unclaimed in the state of Georgia in 2004 (Empowerment for Self-Sufficiency: Georgia Earned Income Tax Credit, 2005).

Phillips (2001) attributed unclaimed EITC funds to lack of knowledge of the EITC. Low-income Hispanic parents are less likely to know about the EITC than other low-income parents. Less than 50% of low-income parents who did not complete high school know about the EITC, and very poor parents are less likely than higher income parents to know about the EITC (Phillips, 2001). The perceived lack of knowledge about EITC among those who are very poor and those who are Hispanic may suggest the need to develop an EITC awareness program targeting these subgroups.

In 2002, the University of Georgia Extension Service provided leadership to selected counties in Georgia. Counties selected were those that had high percentages of low- to moderate-income families and Extension staff available. The program provided free tax assistance, e-filing, and information about refundable tax credits, refund anticipation loans, and direct deposit.

The study reported here sought to understand how families (1) anticipate using their tax refund and (2) use traditional banking services, specifically their use of direct deposit for their anticipated tax refund. Implications for the EITC and wealth building are discussed later in the article.

Review of Literature

Individuals can receive EITC funds in two ways. They can receive all of their credit in a lump sum tax refund when they file their taxes, or they can receive 60% of their total EITC in their paychecks throughout the year with the remaining amount received in a lump sum via tax refund when their taxes are filed (Barrow & Granahan, 2000). Barrow and Granahan found that expenditures increased in February relative to all other months in households that received the EITC, especially for durable goods (e.g., refrigerators, automobiles, etc.). Recipients spent about 20% of the refundable portion of the EITC during the month that they received the refund and used the rest of the income during the following months (Barrow & Granahan, 2000). Soules (1999) found that in 1991 households consume 35 to 60% of their tax refunds during the first quarter of the year.

Benefits throughout the year may help families cover mid-year budget shortfalls (Beverly, 2002), but a study of 42 randomly selected families in Milwaukee, Wisconsin found that lump sum payments may increase total resources throughout the year because families will find other ways to cover budget shortfalls (Romich & Weisner, 2000). Romich & Weisner also found that people view the combined income tax/EITC check differently than paycheck income and have a higher inclination to make large purchases.

Among recipients who put EITC into savings, receiving the EITC in a lump sum can help very low-income families manage larger purchases such as furniture, cars, and homes in the short run. Smeeding, Phillips, and O'Connor (2000) found that almost 70% of all recipients of the EITC with children had economic and social mobility related uses (such as car purchases, paying tuition, or change of residence) that the EITC refund was used for and that one-half of all respondents plan to save some or all of the EITC. Beverly (2002) found that many families wanted to save a portion of their refunds, but many low-income families had neither a checking nor savings account to deposit the EITC refund.

EITC recipients with greater access to financial institutions are more likely to save a part of their refund (Smeeding et al., 2000). Also, asset accumulation uses for the EITC are positively related with having formal contact with a financial institution (Smeeding, Ross, O'Connor, & Simon, 1999). Therefore, checking and savings accounts may facilitate saving by low wage families to make major purchases (e.g., cars), thus accumulate assets and increase their economic and social mobility (e.g., education, housing, and business ownership). Having a checking or savings account may make it easier for families to establish priorities on the use of the EITC refund (Smeeding et al., 1999), as well as offer a way to store the refund until spending priorities are identified.

Beverly, Tescher, Romich, and Marzahl (2001) found that "helping individuals spend money more slowly and more thoughtfully, introducing some to account ownership or direct deposit, and encouraging some to obtain other mainstream financial products, [checking or savings account programs] may help low-income families 'get on track' for future savings and asset accumulation" (p. 15). Beverly et al. (2001) also found other advantages to checking and savings account programs linked to the EITC, including: 1) individuals did not have to pay to have their tax refund check cashed and 2) having money in an account instead of in cash decreased the chances that the money would be spent quickly, lost, or stolen.

Method

The Volunteer Income Tax Assistance (VITA) sites promoted the availability of refundable tax credits, free electronic filing, and direct deposit. Data were collected at each of the sites. Extension staff were trained and certified by the Internal Revenue Service (IRS) as VITA volunteers. VITA is a program through the IRS that provides free income tax filing assistance to low-to-moderate income families with the use of community volunteers.

The VITA sites were set up in centralized locations in rural southern Georgia counties to file taxes for a set period of time weekly. Extension staff created VITA stations that rotated among large employers in these counties, so employees could file their taxes at their work sites. Extension staff targeted rural areas versus urban areas because access to free tax preparation services is typically concentrated in urban areas.

The data were collected over 3 tax years 2002, 2003, and 2004. The first 2 years, data were collected through informal verbal questionnaires administered by a tax preparer. The tax preparers asked questions of every participant and marked answers on a tally sheet while the participant's taxes were being filed. The third year, the questions were included as part of the intake form that clients completed before a tax preparer saw them. The questionnaire portion was detached from the personal information. The preparer saved this portion of the intake form and indicated use of direct deposit for the current year and noted the amount of the state and federal refunds.

For the 2002, 2003, and 2004 tax filing seasons, 2,306 tax filers were interviewed or responded to the questionnaire. There is a very high likelihood that a portion of the sample completed the survey all 3 years. However, Extension staff did not include any kind of identifier that would enable responses to be matched from one year to the next. Questions were asked about previous years' tax filing, use of refund anticipation loans, whether refund was by direct deposit, how they planned to use their refund, and amount of current year's refund (federal and state). Not every question was asked every year, with most of the questions asked in the 2004 tax filing season.

Results

Below is a description of the study sample and a table that reveals the differences between users and non-users of direct EITC deposit and planned use of the EITC refund.

Previous Tax Preparation Experiences Among VITA Participants

Over 3 years, 2,306 low-income workers (284 in the 2002 tax season, 998 in the 2003 tax season, and 1024 in the 2004 tax season) received an average refund of $1,220.37 from the federal government and $148.55 from the state as a result of the VITA program. Table 1 provides descriptive statistics of the responses to the questions asked of those receiving free tax services for tax years 2002, 2003, and 2004. For each question, frequencies reported are for non-missing responses only, thus the number of participants varies from question to question.

Table 1.
Frequencies for Tax Years 2002, 2003, and 2004

Variable	2002 Tax Season	2003 Tax Season	2004 Tax Season
Number served	284	998	1024
How did you have taxes done last year?[ab] (n=642)			
Didn't file			24.1%
Here			39.1%
Another free place like this			9.2%
Did my own			12.1%
Friend or family			15.4%
Did you pay a tax preparer last year? (n = 277; n=954; n=950)			
Yes	70.8%	56.9%	34%
No	29.2%	43.1%	66%
Did you get a refund anticipation loan last year?[b] (n=979; n=957)			
Yes		12.5%	10.9%
No		87.5%	89.1%
Did you receive your refund by direct deposit last year?[a] (n=977; n=968)			
Yes		24%	26.2%
No		76%	73.5%
Will you receive your refund by direct deposit this year?[ab] (n=963)			
Yes			48.1%
No			51.9%
How do you plan to use **most** of this year's refund?[ab] (n=908)			

Pay current bills or debts			45.4%
Catch up on bills or debts			17.6%
Save for an emergency			10.5%
On a vehicle			6.8%
On a house			6.6%
On education			6.6%
Saving for retirement			1.9%
Does not apply/no refund			4.6%
[a] Question not asked in 2002 tax season [b] Question not asked in 2003 tax season			

Use of Refund and Direct Deposit

Use of direct deposit increased to 48.1% in the 2004 tax season from 26.2% of VITA participants in the 2003 tax season and 24% in the 2002 tax season. In the 2004 tax season, participants responded to the following questions "how do you plan to use most of this year's refund?" and "will you receive your refund by direct deposit this year?" Of the original 1,024 participants in the 2004 tax season, only 788 participants reported being due a refund (state, federal, or both) and responded to both these questions. Chi-square tests were performed to address two questions. First, does direct deposit use influence whether or not someone indicates that they will use their refund to pay or catch up on bills and debts versus saving or accumulating assets? Second, does direct deposit use influence any of the individual planned uses of refunds? Results are shown in Table 2.

Table 2.
Direct Depositors and Non-Direct Depositors Reported Plans for Using Most of Their Tax Refund in 2004 Tax Season

Reported Plan for Refund	Form of Tax Return					
	Direct Depositors N= 401		Non-Direct Depositors N=387		Total N=788	
	%	n	%	n	%	n
Pay or catch up on bills or debts	64.1%	257	67.2%	260	65.6%	517
Save for an emergency	12.0%	48	10.9%	42	11.4%	90
On a vehicle	6.0%	24	8.3%	32	7.1%	56
On a house*	8.7%	35	5.2%	20	7.0%	55
On education	7.2%	29	7.0%	27	7.1%	56
Saving for retirement	2.0%	8	1.6%	6	1.8%	14
* statistically significant at p<.05						

Overall, the most common use for a refund by participants was to pay or catch up on current bills or debt, followed by saving for an emergency. Other uses identified by participants included buying a vehicle, buying a house, education, and saving for retirement. By combining saving for an emergency and saving for retirement into one savings category, 13% of participants planned to save their tax refund. Twenty-one percent of participants planned to use their refund for asset accumulation (purchasing a vehicle, house, or education).

Chi-square results ($p=.361$) indicated there was no association between direct depositors and non-direct depositors plans for either paying or catching up on bills/debts versus savings or asset accumulation. Among the individual planned uses of their refunds, only using the refund toward the purchase of a house was significantly associated between direct depositors (8.7%) and non-direct depositors (5.2%) ($p = .05$).

What Was Learned from the VITA Program and Other Conclusions

Among those participants who received a refund and responded to questions regarding planned uses of their refund, 13% of EITC recipients planned to save their refund, and 21% of recipients planned to use their refund for asset accumulation (e.g., purchase a house, vehicle, or education). This is considerably less than the finding by Smeeding et al. (1999) that revealed one-half of EITC recipients plan to save some of their refund and the finding by Smeeding et al. (2000) that revealed almost 70% of EITC recipients would use the EITC for asset accumulation.

These differences may be attributed to differences in the phrasing of questions in these studies. In the study reported here , participants were forced to choose one major use of their EITC refund, while in the studies by Smeeding et al. (1999; 2000), participants could indicate multiple uses for the EITC. Perhaps participants in the current study planned to use a portion of their EITC refund for savings or asset accumulation after using a portion for a primary need of paying off or catching up on bills and debts.

In contrast to findings of Romich and Weisner (2000), participants in the current study did not seem to be highly inclined to make large purchases with their EITC refund. Approximately 66% planned to use their income tax/EITC refund to pay off or catch up on bills or debts. Only 7.0% planned to spend their refund on a house, and another 7.1% planned to spend their refund on a vehicle.

EITC recipients in the study reported here who used direct deposit to receive their refund were no more likely than non-direct depositors to save their refund or use their refund for asset accumulation. When considered individually, direct depositors were more likely than non-direct depositors to indicate that they planned to use their refund toward the purchase of a house. These findings are not consistent with the findings of Smeeding et al. (1999; 2000) that showed EITC recipients are more likely to save part of their refund if they have access to financial institutions and that asset accumulation uses for the EITC are positively related with having formal contact with a financial institution.

Implications for Extension Educators

Although not recommended by financial practitioners and educators, many taxpayers have more taxes withheld than necessary as a forced mechanism for savings. When filing their tax returns, many EITC recipients in the study reported here had zero tax liability after subtracting adjustments, deductions, exemptions, and the child tax credit; therefore, all money withheld from their paychecks during the tax year was returned along with the EITC they qualified to receive. With the exception of using the refund toward the purchase of a house, there were no differences between direct depositors and non-direct depositors. Therefore, use of direct deposit to encourage low-income persons to save may not be very helpful.

Programs that teach the working poor about the advantages of receiving the advanced EITC during the tax year may be beneficial. If families don't have access to a Credit Union or their employer does not offer automatic debits, they could open a checking and/or savings account at a financial institution to have their paycheck and EITC directly deposited into an account.

The majority of the participants in the program were aware of the advanced EITC, but had chosen not to file a W-5 with their employer to receive the advanced payments. Based on anecdotal information, there were several reasons for their decision not to file the W-5 to receive the advanced EITC payments. Some participants feared that they would become ineligible sometime during the tax year and have to repay the advanced EITC payments. It is possible to have overpayment of the advanced EITC if recipients hold multiple jobs, and some of the participants did have more than one job. Some EITC recipients thought they could possibly get married throughout the tax year and become ineligible, thus, having to pay back the money they received in advance.

Another possible reason for EITC participants failing to use the advanced payment option is lack of encouragement by employers. It is not typical for most employers to provide the W-5 form with the W-4 form when they hire employees. Since there is no conclusive evidence as to why EITC recipients fail to use the advanced EITC, more research is needed to explore this issue.

Anecdotal information from the VITA program indicated that many people were not aware that direct deposit was free. Many people asked how much it cost to use direct deposit. Many EITC filers were not aware that they could use a savings account for direct deposit. In an effort to educate and encourage EITC recipients to save at least a portion of their refund, the tax preparers deliberately pointed out the amount of EITC benefits they received.

Some conclusions and implications can be made based on the anecdotal information. Educational programs that help people understand that e-filing is free and that money can be directly deposited into a savings as well as a checking account are needed. Experiences and results from the VITA program discussed in this article do not support efforts to link tax refunds to targeted saving programs. However, more research with larger samples sizes is needed before coming to a definitive conclusion.

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