

AN INVESTMENT LETTER FOR MINNESOTA PHILANTHROPISTS

April 15, 2006

In this issue we will deal with the benefits derived by very low income workers from the Earned Income Tax Credit. Many believe that this tax benefit initiated in 1975 has been the most successful program yet devised to move families out of poverty, into the work force and higher up the income ladder to a point where they achieve self sufficiency. “AccountAbility Minnesota” is a non-profit organization based in the Twin Cities that assists low income Minnesotans in claiming this important financial tax benefit.

The purpose of “*An Investment Letter for Minnesota Philanthropists*” is to demonstrate how return on investment calculations can be applied to the private and public financial investments we make in our non-profit organizations. In the absence of definitive longitudinal studies the “AccountAbility Minnesota” Program analysis requires that assumptions be made about the extent to which the financial incentives of the Earned Income tax Credit actually encourage people to work and move themselves higher up the income ladder. On balance the results appear to be very positive.

Philanthropic investors can deliver returns up to and exceeding 145% to the state of Minnesota. These benefits are derived from reduced social service expense, increased taxes paid and additions to the work force of previously unemployed welfare recipients.

The Earned Income Tax Credit (EITC) is a federal tax credit for working individuals and families whose incomes range from well below the poverty line to about double the poverty line (\$12,830 for a family of two and \$16,090 for a family of three in 2005).

WHAT’S THE PROBLEM?

- The EITC is the largest federal aid program targeting the working poor. The IRS estimates that only 80% of eligible households claim the EITC.
- According to IRS data in 2004 66% of all Minnesota EITC earners paid to have their returns prepared. These services can be costly. A fee of \$120 or more is typical and amounts to a significant subtraction from the average EITC receipt of \$1,549 in 2004.
- Refund anticipation loans (RALs) allow EITC filers to receive funds 8-10 days sooner than if direct deposited to a bank account. Many families choose RALs because they don’t have the funds on hand to pay for the tax preparation fee. The interest rate on RALs is \$100 or more. This computes to an average annualized 2004 Minnesota interest rate of 236%.
- For the USA an estimated \$1.9 billion of EITC money intended for low income families flowed instead to tax preparation and interest charges in 2004. For Minnesota alone the total was \$24 million.

HOW DOES ACCOUNTABILITY MINNESOTA HELP?

- AccountAbility Minnesota (AAM) provides free comprehensive tax assistance services year round to a diverse population of low-income and other disadvantaged residents of Minnesota.
- AAM is the only community-based nonprofit organization in the state with a mission solely devoted to accounting and tax assistance.
- In 2005 nearly 10,000 low-income tax payers were assisted in navigating the tax reporting system and receiving the maximum cash refunds they are due. In addition in 2005 4,239 children benefited from the tax refunds and over 350 small businesses received tax assistance.
- This past year \$11.7 million in cash refunds were received by low income Minnesota families and 18,253 federal and state tax returns were prepared by 450 volunteers.
- A board of twelve directors governs the agency. Eight staff persons handle daily operations and manage more than 450 volunteers (an estimated \$379,000 in donated services in 2005).
- AAM works closely with both the Internal Revenue Service and the Minnesota Department of Revenue to establish training classes and to develop effective learning models the are adapted to volunteers' unique levels of expertise.

WHO BENEFITS ?

By restricting eligibility to families with earnings the EITC promotes work. It significantly increases the number of single parents that join the workforce. The Brookings Institution found that 60% of the increase in the percentage of women with children who work (73% in 1984 and 81% by 1996) was attributable to the Earned Income Tax Credit.

- The US economy and industry in general benefit by new additions to the workforce who become both producers and consumers.
- US Taxpayers claim a double benefit through reduced welfare expense and increased tax receipts.
- Poverty is reduced in communities across the USA. This brings improved quality of life to our neighborhoods manifested by reduced rates of crime, less homelessness and children better prepared to learn in school.

WHAT'S THE RETURN ON INVESTMENT?

The “Center on Budget and Policy Priorities” in Washington D.C. reports that census data indicates that in 2003 the Earned Income Tax Credit lifted 4.4 million people out of poverty including 2.4 million children. That is equivalent to 1.47% of the US population of an estimated 300 million people. Applying that same percentage to Minnesota’s population of about 5.0 million would mean that approximately 73,500 Minnesotans were lifted out of poverty in 2003. Since the average family size in Minnesota is 3.09 members an estimated 24,000 families may have been lifted out of poverty by the EITC in 2003. According to the “Children’s Defense Fund” 242,000 lower income Minnesota working families benefited from the EITC in 2004. This would imply that if the patterns remain close to the same each year that a minimum of about 10% of Minnesota’s EITC recipient families were lifted above the poverty level in 2003.

AccountAbility Minnesota served 8,489 taxpayers in 2003 and 9,864 in 2005. Applying the 10% factor to AAM taxpayers served in 2003 results in about 850 taxpayers or an estimated 500 families (averaging 2.0 persons per family) having been raised out of poverty that year. The assumption is that a minimum of 10% of AAM’s clients would not otherwise have known to file for the EITC. The poverty rate for a family of two was about \$12,200 in 2003 or the equivalent of earning nearly \$6.00 per hour.

Assuming the lift out of poverty was a modest gain from \$6.00 to \$7.00 per hour the resulting savings in federal and state expense would amount to \$2,384 per family according to the Minnesota Legislative Auditors Table illustrating cash and non-cash resources at various employment and wage levels (see page 4). Because we are assuming an average size of 2.0 persons per family for AAM a 30% discount has been applied to the net benefit derived from the Auditors Table on page 4 which assumes a family size of 3.0 persons. The resultant savings would be about \$1,670 per family. This assumes that the family took advantage of the entire range of benefits provided by government.

- Applying this amount to the estimated 500 families raised out of poverty by AccountAbility Minnesota means that in 2003 alone AAM saved federal and state government and their taxpayers at least \$835,000. This savings exceeds the AAM annual budget of \$340,000 by more than two times for an equivalent return on investment of 145%. While the numbers change modestly each year it is likely that the 2003 returns reflect the minimum average annual return on investment for AAM in 2006.

The state of the art must evolve further to develop more precise measures of AAM’s ROI. A longitudinal study comparing EITC benefits received by AAM and non-AAM clients would be very helpful. Tracking the wage patterns of EITC recipients from their non-working status to employment at each \$2.00/hour increment of the wage scale would add credibility to the “motivation to work” issue associated with the EITC. The returns derived from the basic data appear high enough to warrant significant added investment by government, foundations and philanthropists.

**GOVERNMENT & PRIVATE CASH & NON-CASH RESOURCES AT
VARIOUS EMPLOYMENT & WAGE LEVELS IN 2000***

		<u>Hourly Wage</u>				
	<u>Not Working</u>	<u>\$5.15</u>	<u>\$6.00</u>	<u>\$8.00</u>	<u>\$10.00</u>	<u>\$12.00</u>
<u>Cash Resources</u>						
Annual Earnings	\$0	\$10,712	\$12,480	\$16,640	\$20,800	\$24,960
USA. & MN. Taxes	0	0	0	-94	-318	-811
Payroll Taxes	0	- 819	-955	-1,273	-1,591	-1,909
EI Tax Credit	0	3,888	3,888	3,059	2,175	1,301
Working Family TC	0	972	972	1,330	1,055	633
Dependent Care Credit	0	17	17	103	138	251
Property Tax Refund	291	491	543	634	705	763
Child Care Expense	0	-60	-60	-396	-576	-1,140
MFIP/AFDC	6,384	689	0	0	0	0
 <u>Non-Cash Resources</u>						
MFIP Food Assist.	\$3,084	\$3,084	\$2,677	\$98	\$0	\$0
WIC	363	363	363	363	363	363
Nat. School Lunch	404	404	404	404	326	326
Medical Assistance	5,952	5,952	5,952	5,952	0	0
Minnesota Care	0	0	0	0	4,716	3,876
Section 8 Housing	5,477	3,989	3,666	2,519	1,325	246
Energy Assistance	100	100	100	100	100	100
 Total Resources	 \$22,055	 \$29,783	 \$30,048	 \$29,439	 \$29,218	 \$28,958
 Annual Wages	 0	 \$10,712	 \$12,480	 \$16,640	 \$20,800	 \$24,960
 Net Federal & State Support	 \$22,055	 \$19,071	 \$17,568	 \$12,799	 \$ 8,418	 \$3,998
 <u>Tax Payer Savings Per Family</u>						
Moving from \$6.00/Hour to \$8.00/Hour				\$ 4,769		
Moving from \$6.00/Hour to \$7.00/Hour			\$2,385			

* Source: Office of the Legislative Auditor, State of Minnesota, "Economic Status of Welfare Recipients", January 2002. Benefits based on a family of three.

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