Overcoming Tax Obstacles of Low Income Taxpayers

A Senior Honors Thesis

Submitted in Partial Fulfillment of the Requirements
for Graduation in the College Honors Program

By:
Allison Sawyer
Accounting Major

The College at Brockport
May 13, 2013

Thesis Director: Kari Smoker, Assistant Professor, Accounting

Introduction

The tax season can often be overbearing to some taxpayers, especially low income taxpayers. Some taxpayers file a tax return themselves but often times they go to paid preparers. Low income taxpayers when they go to a tax payer are often taken advantage of during the tax season because of their lack of financial literacy. This lack of knowledge can cause them to not receive the correct service or even become victim of fraud.

Some of the main issues that low income taxpayers face during the tax season are a lack of knowledge about tax credits, lack of access to a bank account, costly options available during filing, and finally a lack of awareness about tax identity theft. The options available or the lack thereof can cause low income taxpayers to miss out on certain tax opportunities.

Low income taxpayers usually have two main options to file their tax return during tax season. They can go to a paid preparer or they can go to a Volunteer Income Tax Assistance site. Both of these provide tax services that can help or harm the low income taxpayer. They are often the only choices available to low income taxpayers who might not know how to file their taxes on their own. Low income taxpayers need to understand the issues commonly found during tax season and the places they can go to file their taxes.

Part I: Issues of Low Income Taxpayers

Low income taxpayers during tax season face many obstacles of completing and filing their taxes. There are many aspects of filing taxes they do not understand and therefore either miss out on the opportunity or ignore because it is too complicated. Four issues that can affect low income taxpayers are: 1) lack of knowledge about tax credits, 2) lack of bank accounts, 3) additional costs incurred during preparation, and 4) lack of knowledge of identity theft.

Lack of Knowledge about Tax Credits:

Earned Income Tax Credit

The Earned Income Tax Credit or the EITC is one of the largest refunds a low income taxpayer can receive on their tax return. This tax relief is the biggest reduction in taxes that a taxpayer may receive on their return. With all of its benefits many taxpayers still do not claim the credit.

The Earned Income Tax Credit (EITC) sometimes called the Earned Income Credit (EIC) was approved in 1975 by Congress. The EITC was an incentive for taxpayers to work and to help low income taxpayers with the burden of social security taxes ("EITC Home Page"). This 30 year program has helped many low to moderate income taxpayers receive large refunds. The EITC is referred to as a refundable credit because "if a worker's income tax liability is less than the amount of the credit for which he or she qualifies, the worker receives the remaining amount of the credit as a refund." (Augare 2). This refundable credit allows the taxpayer to use the refund to help lift them out of poverty levels. When recipients receive the EITC around 99% of them receive the refund as a large lump sum that can be used for savings and retirement (Lim, Livermore, and Davis 16). Other taxpayers may use the refund to help pay off loans for automobiles or mortgages and to make essential repairs.

The EITC is available for families that work, but earn less than 200% of the federal poverty levels (Berube and Tiffany 2). These families usually have part time hours and a low pay rate that cannot support their family's expenses. The Earned Income Tax Credit has become the Nation's largest antipoverty program (Augare 2). The credit is effective because it encourages people to work and put money into their pockets.

The Earned Income Credit is available to taxpayers when they file their taxes through the Federal tax return. Some states and local governments offer a similar refundable credit. As of the 2012 return, 22 states, the District of Columbia, New York City and Montgomery County, Maryland all have their own earned income tax credit ("EITC Home Page"). For residents who live in New York the refundable credit can be up to 30% of the federal credit ("EITC Home Page"). This allows residents of the states to obtain the refund from both the federal and the state return. When households that are eligible know about the EITC they are more likely to file to receive the refund. The purpose of the Earned Income Tax Credit is to help those who have a lower earned income.[1]

Throughout the 30 year life of the credit, the EITC has been able to provide support to millions of taxpayers. A study performed in 2009 states that 75% of eligible households claim the earned income credit (Holt 7). It has benefited a multitude of people who are

[1] To qualify for the EITC a full time year round worker supporting two children cannot make more than $15 an hour. Those that do claim the EITC usually have hourly wages that are lower than that (Berube and Tiffany 3).

eligible. According to Augare, an estimated 22 million people received benefits of $38 billion in 2004. This amount of refunds was equal to the combination of both food stamp programs and federal temporary assistance for needy families combined (Augare 2). The Earned Income Tax Credit has become one of the biggest refunds available, but many eligible taxpayers still won't file their taxes to claim the refund.

A high estimate of those who are eligible for the EITC credit but do not claim the credit is around 25% (Holt 7). These taxpayers are eligible[2] for the credit even if it is a small amount. The CPA Journal reports that more than 50% of federal EITC recipients had an AGI of $15,000. With this AGI limit, the amount of New Yorkers who were eligible for the credit but failed to claim it was around 320,000 people (Doyle, Matt, and Owens 45). To have the correct claimants apply for the Earned Income Tax Credit, tax preparers need to be supplied with the information on how to apply for the credit and how.

Each year the Internal Revenue Service (IRS) states the amount of income that each type of taxpayer is limited to in order to qualify for benefits. In 2012 the Earned Income and Adjusted Gross Income of a taxpayer must be less than the following in order to qualify for the Earned Income Tax Credit:

[2] There are only certain types of taxpayers that are eligible for the EITC. The types of taxpayers that can file for the Earned Income Tax Credit are recipients that are single, married filing jointly, or head of households. Those that are filing married filing separately cannot expect to be qualified. (Bartlett and Chapin 5).

Number of Qualifying Children	**Maximum Earned Income and AGI for filing Married filing joint**	**Maximum Earned Income and AGI for filing Single or Head of Household**
Three or More	$45,060	$50,270
Two	$41,952	$47,162
One	$36,920	$42,130
None	$13,980	$19,190

*Limit Numbers taken from www.IRS.gov

Another requirement of EITC is that investment income must be $3,200 or less during the year ("EITC Home Page"). Those who have earned income lower than the limits can be eligible for the credit. Many low income taxpayers qualify for the credit due to their low investment and earned income. Along with having earned income below the AGI level there are a few requirements needed to be eligible. The biggest requirement for income is that it must be earned[3].

The Earned Income Tax Credit is an easy refundable credit that taxpayers can receive. The most important thing for them to do is file their taxes even if they don't owe anything. That way they can receive one of the biggest tax refunds. Other credits are available to the taxpayer that may not be as large as the EITC, such as the Child Tax Credit.

Child Tax Credit

The Child Tax Credit is another refundable credit available to taxpayers. The credit is available to taxpayers that have more than one child (Bartlett and Chapin 3). Like the Earned Income Credit, the Child Tax Credit is an important tax credit based off of the

[3] To qualify as earned income it must be wages, salaries, tips, union strike benefits, long term disability benefits received before retirement, and net earnings from self-employment (Bartlett and Chapin 5).

taxpayer's adjusted gross income. The credit is also similar to the EITC in that if the refund is larger than the tax they owe, the taxpayers are eligible to receive the amount as a refund through the additional child tax credit ("Ten Facts").

To qualify for the Child Tax Credit the taxpayer's AGI must be below a certain limit. The limitations for 2012 is $110,000 for married filing jointly, $55,000 for married filing separately, and $75,000 for all other taxpayers ("Ten Facts"). Once a taxpayer's adjusted gross income exceeds this limit the credit is reduced by $50 for every $1,000 that adjusted gross income exceeds the limit (Bartlett and Chapin 3).

The amount of the refund received for the Child Tax Credit depends on the number of children the taxpayer has. The credit as long as they are in the limitations can receive up to $1,000 for qualifying child under age 17 (Bartlett and Chapin 3). This credit is helpful for low income taxpayers that may have multiple children. The only requirement for claiming the children is that they must pass the qualifying child requirements. These tests include the child passing the requirements for age, relationship, support, dependency, citizenship, and residence ("Ten Facts"). If the taxpayer can pass all requirements then they can claim the Child Tax Credit.

The Earned Income Tax Credit and the Child Tax Credit both are large refundable credits that low income taxpayers can claim. Some taxpayer may eligible for one and not the other based off of their Adjusted Gross Income. It is important that tax preparers help assist these taxpayers file the correct paperwork in order to claim the credits. There are multiple credits available for low income taxpayers; with the help of knowledgeable preparers they may be able to receive these credits.

Many Taxpayers Do Not Have Bank Accounts

An issue many low income taxpayers may face during tax season is that they do not have a bank account to deposit their refund. The bank account is a financial cornerstone most people need in their lives and may be lacking for a low income taxpayer. An estimated 7.7% of the U.S. population does not have a checking or savings account (Boshara, Cramer and Obrien 15). By not having a bank account, taxpayers can be at a disadvantage when it comes time to file their taxes.

Low income families tend to be the largest segment of unbanked households. The most common people who don't have bank accounts are those who are less educated, unemployed, under the age of 35, was foreign born and have a lower income (Lim, Livermore, and Davis 18). Low income taxpayers and other taxpayers might not have a bank account for multiple reasons. According to Boshara, Cramer and O'Brien, consumers might not have a bank account because they may "be ineligible to open a bank account or uncomfortable in doing so" (15). These taxpayers need to be convinced of the benefits of having a bank account or be offered an alternative bank service if they are ineligible.

The largest immediate benefit a low income taxpayer may receive by having a bank account is to receive their refund quicker. The fastest way for a taxpayer to receive their refund is through direct deposit. According to Holt, the timeline to receive a refund depends on not only whether the refund is direct deposited but also how the return is filed. A person without a bank account who mails in their return and receives a paper check can take the longest, almost more than 6 weeks to receive their refund. If the taxpayer were to file the return electronically and receive a paper check, the time is reduced in half to 3 weeks. A refund can take up to 1 to 2 weeks when the taxpayer electronically files and directly deposits their refund (Holt 11). Not only is receiving the refund quicker a benefit but by having a bank account the taxpayer has opportunities to save their refund.

When a taxpayer is eligible for the Earned Income Tax Credit and other credits, they usually receive a large refund. The refund a taxpayer receives can end up being the largest amount of income they will receive at one time. It is important that taxpayers know they have the option of saving that amount for a rainy day or for a large purchase such as a car or home. Tax preparers need to help many low income taxpayers save by offering them these refund options.[4] Another option involved with saving that can provide taxpayer benefits for the immediate use is refund splitting. When a taxpayer is provided the option to split their refund they can allocate a portion of their income to a checking account and a partial amount to savings. When provided the option during a tax season one year, 27% of people offered the option to split their refund set aside half of the refund towards savings ("Tax Prep Services" 3). When taxpayers are provided the option of having a bank account it provides them with the option to save for their future.

The disadvantage of not having a bank account can be to wait longer for a refund check and then using alternative methods to cash the check. When a taxpayer doesn't direct deposit their refund they usually are waiting longer for their check. When the taxpayer eventually receives the check they do not have an affiliated bank to cash the check. When a taxpayer does not have a bank account they have, "a higher likelihood of using check

[4] Many preparers do encourage clients to save for the future, especially to save for retirement (Lim, Livermore, and Davis 17).

cashing stores" (Lim, Livermore, and Davis 23). The problem with using a check cashing store is that they usually charge high costs for the taxpayer to receive the refund in cash. By having a bank account a taxpayer may avoid using these high cost stores.

It is important that low income taxpayers consider obtaining a bank account either before tax season or while they are filing their taxes. Many sites offer options for taxpayers to open up an account at their tax site. It is important that low income taxpayers utilize this option.

Costs Incurred during Tax Preparation

Many low income taxpayers come face to face with many different costs associated with tax season. The largest costly items that a taxpayer may encounter are Refund Anticipation Loans, Refund Anticipation Checks, and Alternative Financial Services. These services offered to taxpayers can be very harmful to a low income taxpayer.

Refund Anticipation Loan and Refund Anticipation Check:

The Refund Anticipation Loan (RAL) is a loan offered by some preparers during the tax season. The RAL is often times marketed as "an instant or 24-hour" refund ("As Tax Day Approaches"). Preparers may lure a taxpayer in by saying that the Refund Anticipation Loan will allow them to receive an immediate refund and be able to walk out of the site with cash. In reality the RAL is a short term loan secured by the refund (Holt 3). This loan is harmful to the low income taxpayers.

The Refund Anticipation Check (RAC) is similar to the RAL and is an option offered by some tax preparers. The Refund Anticipation Check is a "temporary bank account established on behalf of the taxpayer into which a direct deposit refund can be received" ("As Tax Day Approaches"). Once the bank receives the refund in the temporary account they then send a check containing the refund to the taxpayer. This option offered to many taxpayers can include costs that can be detrimental to the taxpayer.

Both the RAL and the RAC can be harmful to a low income taxpayer because they have large fees that can drastically reduce a low income taxpayer's refund. With the Refund Anticipation Loan there are high interest rates and other charges when used (Holt 3). When the tax preparer offers the RAL to a taxpayer they often include the fee to prepare the return, a fee to process the RAL, and an interest rate for taking out the loan. The RAL often reduces the amount of the refund a taxpayer receives while providing the preparer with high profits (Holt 3). The large costs of the Refund Anticipation Loan can reduce the amount of a taxpayer's refund.

The Refund Anticipation Check has high fees of its own. In the process of opening the temporary bank account and receiving the check a taxpayer may incur large fees that reduce their refund. Often times the RAC incurs fees for the preparation of the tax return, the opening of the bank account by the tax preparer, and then a fee incurred by the bank to send the refund to the taxpayer (Holt 11). Low income taxpayers already need as much of the refund that they can receive and the options of the RAL and the RAC diminish the amount of the refund until they have very little left. In 2002 an estimated $810 million, according to the National Consumer Law Center, was borrowed as a Refund Anticipation

Loan (Holt 5). Preparers only care about receiving a large profit at the expense of low income taxpayers.

The Refund Anticipation Loan and the Refund Anticipation Check are both targeted towards low income taxpayers. According to a 2006 survey, approximately 25% of all low to moderate income taxpayers took out a RAL (Lim, Livermore, and Davis 18). Usually recipients of the EITC are the major RAL customers due to their lack of knowledge about the loans. Between 1999 and 2002, an average of 41% of EITC returns was associated with a RAL (Holt 10). EITC claimants are usually the main customers due to the fact that they do not have bank accounts and they have little knowledge these tax options. Compared to taxpayers who have a bank account, those who do not have a checking or savings account are more likely to take out a Refund Anticipation Loan and pay the high costs (Lim, Livermore, and Davis 16). Not only does not having a bank account lose a taxpayer an opportunity to save but can also be costly to them when they have to use an alternative payment method. Often times the RAL and RAC are associated with Alternative Financial Services.

Alternative Financial Services:

Alternative Financial Services are often used as a replacement for a bank account. The common types of Alternative Financial Services (AFS) are check cashing stores, payday lenders, pawnshops, and rent to own stores (Lim, Livermore, and Davis 18). Many of these places take advantage of many low income citizens who do not have the financial resources such as a bank. The biggest AFS that can affect a low income taxpayer is check cashing stores and rent to own stores.

During the tax season a taxpayer needs to be careful where they have their taxes prepared. The rent to own stores, furniture stores, and used car dealers often prepare taxes and then provide their own version of the RAL (Holt 5). These places often prepare taxes for low income taxpayers so that they can than have their clients use the refund they receive in their store and purchase their products with a RAL. In the end the taxpayer ends up paying interest on the RAL and more for the items purchased from these alternative financial services.

When it comes time for the low income taxpayer to cash their refund, they often go to check cashing stores. These stores are dangerous for taxpayers to go to because they charge high fees in order for a check to be cashed. In 2005, $45.87 was charged for an average payday check of $290 (Lim, Livermore, and Davis 18). This caused a low income citizen to pay a large portion of their check in fees. The costs of going to the check cashing stores and others is often extremely high and in the end more money is taken away from a low income taxpayer.

Low income taxpayers are often the most susceptible clients for the alternative financial services. Because many low income taxpayers don't have a bank account, this affects where they cash their checks. "The unbanked had a higher propensity for utilizing the services of check cashing operations and other alternative financial services providers" (Lim, Livermore, and Davis 18). These alternative sites in the end hurt the low income taxpayer with their large fees. Many of these AFS obtain sizable profits in the expense of the low income taxpayer (Lim, Livermore, and Davis 18). It is important for low income taxpayers to know about these high costing alternatives and to avoid them during tax season.

Lack of Tax Identity Theft Awareness

Tax identity theft has become a growing concern over the past few years. Often times taxpayers might not know they are victims of tax identity theft until they receive a notice in the mail. Like any other identity theft, tax identity theft is another scam for thieves to get money.

Tax identity theft has become a recent tax season problem. Tax identity theft has become the fastest growing crime involving social security numbers (Kristof). According to the IRS it was the top tax scam in 2012. The identity thief files a fake return so they can then claim the taxpayer's tax refund. The basic premise of identity theft is that the thief will use the person's SSN and then file a bogus return claiming a refund usually early in the tax season before most people file their taxes ("Color of Money"). This type of scamming has been affecting millions of taxpayers.

Often times the social security number is the only thing the perpetrator needs. Some thieves use the victim's name and their social security number; some just use the SSN and a phony name (Kristof). Each case can be different as well as the method of trying to obtain the taxpayer's identification numbers. One method besides stealing a taxpayer's social security card is phishing. Phishing is a scam that is related to tax identity theft, where the thieves will obtain personal and financial information from victims by posing as the IRS and requesting information through an email or social media ("IRS Releases the Dirty Dozen"). The unsuspecting victim answers the email back stating their information to clear up a problem, but instead they are causing a problem for themselves by providing the thieves with valuable information.

Another way thieves steal a taxpayer's information is by posing as a taxpayer. Sometimes when the taxpayer thinks that they are getting their tax return done the preparer can end up being unscrupulous and steal the person's refund. This preparer fraud occurs when a return preparer skims off part of the client's refunds and charges inflated fees for preparation ("IRS Releases the Dirty Dozen"). Other times a tax preparer will change the amount of the refund after the taxpayer has left without the taxpayer's knowledge. The taxpayer might not know about the crime until they receive a letter in the mail from the IRS. Many taxpayers need to be aware of how to avoid becoming a victim of tax identity theft.

Avoiding tax identity theft:

Taxpayers need to become aware of identity theft and prevent their tax refund from being stolen. One of the best basic ways to prevent a perpetrator from stealing taxpayer's SSN is to get the tax return done early (Kristof). When the taxpayer files the return early there is less of a chance that the crook will get a chance to steal the refund. It is important for the taxpayer to always protect their social security number. Ways to prevent your SSN from being stolen are to never carry it with you, never give it to businesses, use firewalls on your computer and check your credit report every 12 months (Ciavarri). Most businesses do not need a taxpayer's SSN, so when they request the number it can mean they might be trying to scam the taxpayer. Also by checking a credit report every 12 months, the taxpayer can be alerted if their identity has been stolen.

In order to prevent tax identity theft through a preparer, the taxpayer needs to be aware of who is preparing their taxes. Taxpayers should use established companies, research the tax preparer's history before going to the site, ask the preparer for an estimation of fees, and never use a preparer who bases the fee as a percentage of the refund ("As Tax Day Approaches"). Tax preparers that use a percentage of the refund as the fee often times are altering the refund with false information in order to increase the amount of the refund. Often times when the offer seems too good to be true, it is probably a scam. The preparer should also have a Preparer Tax Identification Number (PTIN) ("As Tax Day Approaches"). The PTIN issued to all legitimate tax preparers means that they are registered with the IRS. Taxpayers should never file a return without a PTIN on it.

When the return is completed it important that taxpayers look over the return before signing it and never sign a blank return ("As Tax Day Approaches"). It is important that you never consent to a tax return if it looks false. By taking these few steps during tax season the taxpayer has a less likely chance of becoming a victim.

Signs of tax identity theft:

There are a few signs that a tax preparer may be fraudulent. Most often fraudulent tax preparers will not sign the return or list a PTIN on it ("IRS Releases the Dirty Dozen").

The preparer would not have a PTIN if they are just trying to obtain taxpayer's SSN. Another sign is that the tax preparer doesn't provide the taxpayer with a signed copy of the return ("IRS Releases the Dirty Dozen"). By not providing the client with a copy they may be trying to hide something. If the return has false papers in it, or anything looks unknown, it may be a scam to increase the refund ("IRS Releases the Dirty Dozen"). These types of actions by a tax preparer should alert the taxpayer that the preparer might not be genuine.

The taxpayer may know that they have become a victim of tax identity theft by a number of things. When a taxpayer is filing a return electronically and the return is rejected because of a duplicate SSN, often times it means the taxpayer is a victim and should file a paper return with an identity theft form (Kristof). A tax preparer can alert the taxpayer of an identity theft situation if more than one return was filed. Other signs are that you receive a letter in the mail stating your wages on the return don't match your earnings, you have a balance due, or other benefits were cancelled due to an increase in income (Ciavarri).These other alerts may mean that you have become a victim and should seek help right away.

All taxpayers can become victim of tax identity theft. Often times low income taxpayers are more susceptible than others. Low income taxpayers might not know how to protect their financial information or even how to determine who is a genuine tax preparer. It is important that all taxpayers become aware of the harm of tax identity theft.

Low income taxpayers can be at a disadvantage when it comes to filing taxes. The common issues such as a lack of knowledge or more costly options can harm the taxpayer.

Low income taxpayers need assistance from VITA sites and paid preparers to help them navigate through these issues.

Part II: Volunteer Income Tax Assistance

The Volunteer Income Tax Assistance (VITA) is an available site where low income taxpayers can have their taxes prepared for them. This site is available in many states throughout the nation. The VITA program is supported by the IRS and available to many taxpayers who usually have low income, are elderly or are disabled. This section of the paper will include information about VITA, the benefits of the VITA sites and potential problems of the VITA sites.

Background of VITA

Description of VITA

Volunteer Income Tax Assistance program or VITA was created in 1969. Congress created the VITA program due to the need for free filing assistance for low-income taxpayers (Holt 2). Since then the program has progressed to help the IRS raise awareness about the EITC. The VITA programs are supported by the IRS and other organizations but managed through local coalitions.

The VITA program is spread nationwide through many different local coalitions. The most common VITA sites were located at universities, not for profit agencies, house of worship, libraries, prisons, malls, and senior and community centers (Outslay 501). In the local Western New York region the local coalition is called CASH or Creating Assets, Savings and Hope. This coalition helps provide income tax preparation for low income taxpayers in the Buffalo and Rochester region. Illustrated in the table below, Rochester and Buffalo had two of the highest total VITA returns out of all other cities in 2008 (Holt 9).

Table 2. Cities with Highest Shares of Returns Prepared by VITA, 2008

ALL RETURNS		EITC RETURNS	
City	**% VITA-prepared (2008)**	**City**	**% VITA-prepared (2008)**
Rochester	7.8	Tulsa	12.5
Buffalo	7.1	Cambridge	11.8
Tulsa	6.8	Rochester	11.4
Hartford	6.7	Boston	8.3
San Antonio	6.2	Buffalo	8.2
Provo	5.3	San Antonio	8.1
Bridgeport	4.6	Hartford	7.7
New Orleans	4.1	Austin	6.8
New Haven	4.0	Provo	6.7
Syracuse	3.9	Albuquerque	6.4

*Table from "Ten Years of the EITC Movement

VITA sites have filed many tax returns by volunteers. Between 2001 and 2008 the total number of returns prepared by VITA sites increased from 674,000 to 1.37 million (Holt 8). The VITA sites offer a large scope of tax preparation nationwide for low income taxpayers.

The VITA sites are directed toward clients with low income. The local CASH coalitions help low income taxpayers with an income lower than $55,000 with qualifying children and less than $40,000 with no qualifying children ("Eligibility for Service"). The most common clients at the VITA sites are low to moderate income level as well as elderly, disabled and those with limited English proficiency (Outslay 500). Other types of clients are students, taxpayers eligible for EITC, retirees and professors from abroad who need help with international taxes (Davis, Harrison, and Turner 60). This wide range of clients can all benefit from the VITA programs and what they offer.

What it offers

The VITA sites were created to offer free tax preparation. These VITA sites goals is to "reduce or eliminate the transaction costs faced by low-income filers seeking to claim the tax-based earnings supplements and child benefits" (Holt 10). By offering free tax services the VITA sites help eliminate the cost of preparing low income taxpayer's taxes allowing them to keep more of their refund.

Other options available at VITA sites along with free tax preparation can include financial assistance. The VITA sites can connect taxpayers to public benefit programs, financial education and services, and advocate for low income families (Holt 6). The VITA sites are continually looking to promote and provide financial services to help the low income taxpayers achieve financial stability. Some financial services offered can include access to credit reports, and some offer financial and retirement planning (Holt 14). All of these financial services as well as services to open up a checking or savings account offered to low income taxpayers can improve their financial status.

All of the VITA sites offer federal tax preparation of some sort whether it is preparing the actual return or offering FAST. Free Assisted Self Tax or FAST is offered at a few sites to allow some low income taxpayers to file their own taxes with tax assistance if they need it. Many VITA sites also prepare state returns for free (Berube and Tiffany 12). This allows sites for low income taxpayers to receive credits from both federal and state level. Many cities offer outreach campaigns such as the Volunteer Income Tax Assistance program to, "inform low income working families about the EITC, the refundable Child Tax Credit and other credits from which they can benefit" (Berube and Tiffany 12). The VITA sites are knowledgeable about the EITC and other credits so they can help low income taxpayers receive the much needed credits.

Benefits of VITA

The Volunteer Income Tax Assistance program offers low income taxpayers a wide variety of benefits. The most important advantage of a VITA site is the free tax filing assistance. According to Lim, Livermore and Davis, free tax filing assistance provides low income taxpayers with, "access to their own income retained by the federal government and tax credits to which they are entitled by tax code" (24). The sites allow the low income taxpayers to keep the refund that they earn by providing free tax preparation.

The VITA sites provide more than just free tax preparation that can benefit low income taxpayers. The sites are a way for volunteers to introduce benefit programs and financial services to the low income taxpayers (Holt 8). Some of these financial services include checking and savings accounts. Many of the free volunteer organizations help low income taxpayers use their tax refund to help start and build long term assets (Berube and Tiffany 13). By offering bank accounts and other financial investments such as CDs to low income taxpayers, preparers can help the taxpayer have a means to save money for larger purchases. A survey done at one free tax clinic states that those who had opened up a bank account the previous tax year, 70% of those people were influenced to start saving money

(Haney 20). By opening a bank account low income taxpayers are encouraged to save their money to help them become financially stable.

A common theme at many VITA sites in one form or another is referred to as "Earn It, Keep It, Save It." The three components of the theme according to Holt are:

1) ensuring that eligible households know about and claim the EITC as well as other credits.

2) helping claimants avoid costly transaction fees and other expenses; and

3) using tax credit influenced refunds as an opportunity for asset development (Holt 6).

The "Earn It, Keep It, Save It" campaign throughout VITA sites provides clients with the opportunity to claim the EITC, receive their entire refund by not charging a preparation fee, and then help clients build their money and save by opening a bank account. Other good behaviors that the "Earn It, Keep It, Save It" campaign promoted was to not utilize a RAL, not have to pay a preparer to file return, and to direct deposit the refund into a financial institution (Holt 6). The campaign addresses many issues that many low income taxpayers generally face.

The volunteers of many of the VITA programs can sometimes be a benefit. It is important that VITA sites have trained tax preparers that can help low income taxpayers claim the EITC. Many VITA sites have found volunteers at local universities with student volunteers. As stated by Doyle, Matt and Owens, "students often make ideal volunteers because they generally have excellent computer skills, a desire to learn through experience, and the motivation to provide service" (44). Students usually are willing volunteers at VITA sites because they either want to receive tax experience or because their school offers internship credit to volunteer. The students are not only helping the community but also helping to develop their academic and social skills (Doyle, Matt, and Owens 44). These students and other volunteers are helping those with economic problems that need to receive the much needed refunds and receive the free assistance. The AICPA and the IRS have been working together to help strengthen the volunteer tax return preparation at the VITA clinics ("AICPA, IRS Seeking" 4). This improvement will help many low income taxpayers receive more benefits in the future.

The Volunteer Income Tax Assistance program provides many benefits to low income taxpayers as the sites are directed toward helping low income clients. The VITA sites offer many programs and opportunities in financial service or in the tax preparation that can help the taxpayer emerge out of the low to lower middle income level.

Problems of VITA

The VITA sites may be very helpful for low income clients, but they sometimes have problems that may cause them to not prepare quality tax returns.

Although the Volunteer Income Tax Assistance program is directed towards low income taxpayers many of them do not receive the needed credits that they need to file for. Only a small portion of VITA filers receive the EITC, even though the VITA program was created to help low income taxpayers receive the credit (Holt 9). It is important that taxpayers receive the EITC when they qualify for the credit. In 2003, approximately 500,000 or 2% of all EITC claimants filed a tax return at a VITA clinic (Mantegani, Holub, and Porter 763). Since then the number of EITC claimants have increased, but not by that much. In 2010, only 39% of the returns prepared claimed the EITC (Holt 9). It is important that the volunteers filing the tax return know about the credit availabe to low income taxpayers' returns.

The volunteers are very crucial to the VITA sites but they often make mistakes and do not claim the EITC and other helpful credits for their clients. The volunteers often times are not tax experts but are trained to help a certain type of client that they would be assisting (Doyle, Matt, and Owens 44). This lack of tax knowledge can harm the taxpayer if the volunteer is not equipped to file a more complicated or different return. Volunteers receive the minimum training including the basics needed to file an easy Form 1040 form; they do not file complex tax returns (Outslay 503). The basic training usually covers telling the volunteers how to file the EITC worksheet but not what it means or how it can help taxpayers.

Volunteer Income Tax Assistance program is continuously trying to improve its sites along with its volunteers. Some parts of the clinics that need to be changed according to Pursley are: improve training of volunteers and their commitment to quality, improve tax preparation process, improve accuracy of site information, and finally to improve oversight and quality assurance (Outslay 501). These suggestions by Pursley indicate the changes needed by many sites to make sure that the volunteers are claiming all credits that taxpayers should be and that the returns are filed correctly.

Another problem that is often found with the quality of the work of volunteers is the liability of preparers with the return. Under the Volunteer Protection Act of 1997, volunteers at VITA sites do not have to sign any tax returns (Doyle, Matt, and Owens 44). Unlike a paid preparer who must sign a tax return once it is complete, a volunteer at a VITA site does not have to sign the return. The act has helped protect the volunteers in the cases where taxpayers come back on the preparer for not helping them receive a larger refund or incorrectly completing the return. After the passing of the act, the volunteers did not owe any liability if the return was filed incorrectly. This can also hurt the low income taxpayer if the volunteer fills out the return incorrectly and the client owes instead of receiving a refund. The role of the volunteers is important and the quality of their returns must increase and should be checked over by a more experienced preparer to ensure a correct return is being filed.

The VITA sites offer many outside benefits such as opening a bank account and other low income benefits. These benefits can sometimes be unasked for, by some VITA clients. Some clients may want the information on more services and products on site or at a later time but often time others don't (Holt 17). The VITA program and the sites must realize that the main focus of the program is to provide free tax preparation to low income taxpayers. Even though they may need the other services, many taxpayers just want their tax return filed. The Volunteer Income Tax Assistance program must remember why they are helping the low income taxpayers.

Other VITA sites sometimes do not offer the additional benefits of opening up a bank account. Some communities offer the free tax service but do not educate taxpayers about the bank accounts and other financial lessons (Bergman 2). Even though the VITA program is spread nationwide the services provided at each site can vary greatly. If the VITA program wants to offer support to low income taxpayers they need to be thorough and offer it to all clients.

Finally the last problem that low income taxpayers may have with a VITA site is the specific type of client they may be assisting. The Volunteer Income Tax Program usually has a "means test" that excludes taxpayers over the adjusted gross income limit (Rankin 1). The taxpayer may still need the service and the provided benefits but cannot receive the tax preparation because their income is too high. Taxpayers are often rejected from a site if their income is too high or if their return is too complex. This limited clientele at the VITA sites helps the preparers to focus on those under the limits but can often hurt the taxpayers just barely outside of the limit.

Conclusion about Volunteer Income Tax Assistance Program

VITA sites are available for many low income taxpayers. Their free tax preparation, as well as offering other low income programs is beneficial to the low income taxpayer. Improving the quality control and the education of the volunteers at the sites so they can better help the taxpayers is some problems that the VITA sites face and need to fix for future clientele.

Part III: Paid Preparer

During the tax season a taxpayer may have the option of preparing the return themselves or going somewhere else to have their taxes prepared for them. The tax preparation can be through either a free tax preparation service or a paid preparer. There are many types of paid preparers but the most common for low income taxpayers to go to are commercial preparer. Many commercial preparers provide benefits and quality service to low income taxpayers, but they often times pose problems that can harm the taxpayer.

Types of Paid Preparers

When a taxpayer has the choice of going to a paid preparer to file their taxes, they generally have four types of paid preparers to choose from. The four kinds of paid preparers are enrolled agents, certified public accountant (CPA), attorney, and other tax preparers.

The enrolled agent and the attorney both can represent a taxpayer before the IRS. The enrolled agent is someone certified by the IRS and who has worked for the IRS for over five years ("Income Tax Preparation"). The enrolled agent is allowed to represent the taxpayer when it comes time to defending the taxpayer's return if the IRS questions it. An attorney has the same right. An attorney must pass their bar exam and might have tax training, but has the right to represent a taxpayer ("Income Tax Preparation"). These tax professionals might file a tax return but they are available as a tax advocate for IRS cases.

A general public accountant and other tax preparers cannot represent a taxpayer before the IRS. A CPA is a professional who must pass a qualifying exam and is authorized to represent a taxpayer before the IRS ("Income Tax Preparation"). A public accountant who may specialize in tax and doesn't have a certification cannot represent a taxpayer. Other tax preparer may not have any special training, certifications or experience ("Income

Tax Preparation”). This makes them not fit to represent the taxpayer. The most common type of other paid tax preparer is a commercial tax preparer.

Commercial tax preparers are larger tax operations such as H&R Block and Jackson Hewitt. The can also be paid preparers with seasonally operated, one person store fronts in the commercial industry (Holt 5). A commercial tax preparer does not necessarily have to be a large operation but can be an individual tax preparer that performs taxes but does not fall into the other professional categories. According to the NYS Department of Taxation, a commercial tax preparer is described as someone who is paid to prepare 10 or more tax returns in 2012 and will prepare at least one in 2013. These smaller individual tax preparers provide tax preparation service in return for a fee that makes them qualified as a commercial tax preparer.

Options available to taxpayers by a paid preparer that can be costly usually are similar with many commercial tax preparers. Commercial tax preparers often times offer, “a suite of refund-payment bank products” (Holt 5). These other products provided by commercial tax preparers are products such as the refund anticipation loan. One type of commercial tax preparers that is likely to offer the RAL during tax season are fringe preparers. Tax preparers who are fringe preparers are usually loan stores such as a payday loan store that often exploit consumers (Noble). This type of commercial tax preparers often offers more than just tax preparation that can hurt unsuspecting clients.

Many taxpayers need the help of paid preparers during the tax season. More than half of taxpayers used paid preparers to file their returns (Lim, Livermore, and Davis 17).

There is still a great need for all types of paid preparers. Low income taxpayers especially need paid preparers to help them with the tax returns. Around 98% of families with income below $30,000 need the assistance of paid preparers (Maag 1). It is important that taxpayers receive the correct benefits from paid preparers, especially commercial tax preparers.

Benefits of Paid Preparers

Paid preparers help taxpayers file their taxes each year. Except for the cases when a taxpayer has to pay taxes to the IRS, most taxpayers benefit from the paid preparers. Most taxpayers are not comfortable or have too complex of returns to prepare themselves. During the 2004 tax season more than 70 million of the 131 million tax returns filed were prepared by tax professionals (Rankin "Congress" 2). Many taxpayers whether they have low or high income use tax preparers to file their taxes due to the complexity of filing. There is a "high degree of reliance on tax professionals" due to the complexity of the law (Rankin "Congress"2). All taxpayers who have their returns professionally done must depend upon the preparer that their taxes are filed correctly.

Many of the paid preparers help taxpayers during tax season to file their return and receive a refund. Most paid preparers whether they are commercial or not usually try their best to file clients' taxes. The preparers usually provide taxpayers very high quality service (Berube and Tiffany 12). Many times many clients discover credits by filing taxes through a paid preparer. By filing taxes through a paid preparer, the likelihood of the taxpayer hearing about and taking advantage of tax incentives increases (Lim, Livermore, and Davis

17). These credits and other incentives are what allow taxpayers to receive a refund that they might not have had before.

The clients that usually need paid preparers the most are low income taxpayers. Those who are usually in the low income range are more likely than higher income taxpayers to use paid preparers (Holt 10). Most low income taxpayers do not have the knowledge they need to have to apply for the EITC. Those who report having less knowledge about EITC and other credits often times rely upon paid preparers to file their returns (Maag 4). Paid preparers are essential for many low income taxpayers to receive their much needed refund.

The most common credit that many taxpayers help low income taxpayers discover and apply for is the Earned Income Tax Credit. According to the Center of Budget and Policy Priorities, "approximately 70% of filers claiming the EIC use paid preparers" (Mantegani, Holub, and Porter 763). Many of those eligible go to paid preparers for assistance. Many preparers are successful in obtaining credits for their low income clients. In 2002, of those who claimed an EITC around 56% of them used a paid preparer (Williams). It is then very important that paid preparers have the knowledge and the expertise to apply and file for the EITC and other credits to help low income taxpayers.

Paid preparers often times not only provide quality service and assistance in applying for tax credits, but they are often helpful for many low income taxpayers to apply for other programs. Some paid preparers will help low income taxpayers apply for nontax benefits (Maag). These other non tax programs can be food stamp and other low income programs that require a professional's help. It is important that low income taxpayers seek out the correct paid preparer during tax season in order for them to not become victim to unscrupulous preparers.

Problems of Paid Preparers

Some problems that taxpayers can face with paid preparers are that they have high costs, can offer other products with additional fees, and can sometimes be incompetent and steal the taxpayer's identity. Taxpayers, especially low income clients, need to be aware of all of these issues when looking for a paid preparer.

The most common issue among all paid preparers that taxpayers must face is the fees for the tax preparation. Many times the costs associated with a commercial tax preparer include the tax preparation, filing and other processing fees (Holt 10). Often times the cost of the filing fee can be expensive and get into the hundreds of dollars. Taxpayers must be aware of preparers that base the preparation fee off of the amount of the refund. These preparers provide unclear pricing information, fail to provide the taxpayer with other information such as the fact that RAL are loans and may make errors on the return to inflate the returns (Holt 11). These preparers will alter the return so that the taxpayer believes they are receiving a refund allowing the preparer to receive a larger fee, but in reality the taxpayer owes taxes and has already paid a large amount of fees.

Many times it is low income taxpayers who are using paid preparers to file their taxes and often times they do not have the money to pay the preparer. There is, "a disproportionate number of tax filers least able to pay … [that] have utilized commercial preparers" (Holt 10). Low income taxpayers do not have the money to pay the paid preparer so they are often hoping to receive a refund so they can pay the preparer. The mere preparation fee for the return erodes and minimizes the amount of the EITC refund.

When taxpayers - especially low income taxpayers - don't have any method to pay the prpeparer except with the refund the paid preparers may offer the Refund Anticipation Loan to their clients. The RAL is a way for taxpayers to pay for the preparation fee but it also siphons away the taxpayer's refund and in return is profitable for the preparer (Holt 3). Many times the taxpayers that are most susceptible to the RAL are low income taxpayers. In a 2006 study, nearly a quarter of all low and moderate income taxpayers who used a paid preparer took out a refund anticipation loan (Lim, Livermore, and Davis 18). Even though the paid preparers may be helping the low income taxpayers receive the EITC to receive a refund they are doing this so that eventually they can get paid through the RAL.

The refund anticipation loan is often a great way for preparers to receive a large profit. They not only use the RAL to allow taxpayers to pay for the preparation fee but they also benefit from the additional interest fees. In 2006 an estimated 9 million taxpayer took out a RAL which equaled around $1 billion paid in loans and fees (Williams). Not only is the RAL a problem with paid preparers but they often don't tell taxpayers about direct deposit and other free refund options. Often times the taxpayer have no choice but to use alternative financial services such as check cashing stores.

Many retailers in low income communities such as furniture or rent to own stores offer tax preparation and usually insist that the taxpayer take out a RAL (Holt 5). These stores often times not only prepare the taxpayer's return but often times talks them into buying their products. In order to pay for the return fee and the product the retailers will tell clients that a RAL would be the best way to pay for everything. The taxpayer is paying more than they will receive in refunds due to RAL interest fees and other fees. It is estimated that 10.8 million people in 2006 spent $324 million on other types of financial products to help them receive their refund quickly (Williams). Many low income taxpayers are susceptible to many of the high costs of paid preparers that dwindle down their refund.

Some paid preparers who are in the commercial tax business to make money are often incompetent to help taxpayers. The most susceptible taxpayer to corrupt and incompetent tax preparers are elderly and low income taxpayers (Rankin “Congress”2). These incompetent tax preparers put the taxpayer, their identity, and their refund at risk. In one filing tax season, 2 million taxpayers overpaid their income taxes by $945 million due to not claiming itemized deductions for which the paid preparers neglected to apply (Rankin “Congress”2). These taxpayers end up not having a larger refund because the tax preparer didn’t know how to itemize their expenses. Some low income taxpayers who do use the paid preparer in hopes of receiving a refund often times do not. Some families who are eligible for the EITC and used a paid preparer did not claim the credit (Maag 1). These preparers are often times not competent enough to file tax returns.

Some commercial tax preparers do not need to pass any examinations to file a taxpayer’s return although beginning after 2013, they will in order to file federal returns. For many tax preparers there are no requirements to prepare taxes, no requirement to pay for a registration fee or a competency exam (Noble). While many commercial taxpayers might not need to pass a competency exam, all other tax professionals do. CPAs and even the free tax preparation sites require all their employees or volunteers to be certified to prepare taxes.

Having their returns prepared by a paid preparer, a low income taxpayer is faced with more financial burdens instead of wondering whether they owe taxes or not. It is important that taxpayers look for paid preparers that will not take be unscrupulous with the taxpayers refund.

Conclusions about Paid Preparer

Paid preparers especially commercial tax preparers are often times what low income taxpayers turn to during tax season. These paid preparers can often provide benefits such as quality service, recommendation and application of the EITC, and other tax benefits. Other paid preparers are there not to help the general public but they are seeking to make a large profit by providing excess fees to taxpayers.

Conclusion

Common issues such as lack of knowledge about the EITC and the high costs of a RAL can hurt a low income taxpayer during tax season. Low income taxpayers need to have an understanding about different tax issues that affects filing their return so they can avoid harmful choices. Once the low income taxpayers understand the issues that can limit them during tax season, they must then evaluate different tax preparation options.

The two common places low income taxpayers would go to get tax assistance would be at a VITA site or a paid preparer. The VITA sites were created for the use of low income taxpayers but they might not have the correct tax preparer expertise. A paid preparer on the other hand might have the correct tax expertise but also might have an underlying motive along with the tax preparation, that is not necessarily in the taxpayer's best interest.

The IRS has realized in the past that low income taxpayers needed more financial support so it created the EITC and other tax credits. To help low income taxpayers, the IRS is continuing to improve the services offered by VITA sites and reduce the amount of tax scams by paid preparers. Low income taxpayers need to understand their options and go to the best tax preparation site that will benefit them during tax season.

References:

"As Tax Day Approaches A.G. Schneiderman Issues Consumer Alert On Hiring Tax Preparers." *Attorney General: Eric T. Schneiderman*. New York State Attorney General, 19 Mar. 2013. Web.

Augare, Shannon. "VITA Initiative Provides Free Tax Preparation In North Central Montana." *Fedgazette* (2005): 2. *Business Source Complete*. Web.

Bartlett, Arthur, and Erica Chapin. "Dealing with Common Tax Issues." *Legal Services of Southern Piedmont*. Legal Services of Southern Piedmont. Jan. 2011. Web.

Bergman, Hannah. "Classroom-Based Financial Programs Criticized." *American Banker* 169.238 (2004): 4. *Business Source Complete*. Web.

Berube, Alan, and Thachher Tiffany. "The "State" of Low-Wage Workers: How the EITC Benefits Urban and Rural Communities in the 50 States." *The Brookings Institution*. The Brookings Institution, Feb. 2004. Web.

Boshara, Ray, Reid Cramer, and Rourke OBrien. "The Assets Agenda 2007." *New America Foundation*. New America, Apr. 2007. Web.

Ciavarri, Amanda. "Tips to Protect Yourself from Identity Theft." *WHEC.com*. WHEC, 07 Feb. 2013. Web.

"Color of Money: Identity Thieves Target Tax Refunds." *BuffaloNews.com*. The Buffalo News, 11 Feb. 2013. Web.

Davis, Alan, Keith Harrison, and Laurie Turner. "Practical Guidance For Establishing Or Improving A Volunteer Income Tax Assistance (VITA) Program." *CPA Journal* 80.7 (2010): 59-62. *Business Source Complete*. Web.

Doyle, Patrick E., Michael W. Matt, and Bradley T. Owens. "A Student Perspective On The IRS's VITA Program." *CPA Journal* 75.2 (2005): 44-47. *Business Source Complete*. Web.

"EITC Home Page--It's Easier than Ever to Find out If You Qualify for EITC." *IRS*. IRS, 2, May 2013. Web.

"Eligibility for Services." *C.A.S.H.*. Empire Justice Center, n.d. Web.

Davis, Alan, Keith Harrison, and Laurie Turner. "Practical Guidance For Establishing Or Improving A Volunteer Income Tax Assistance (VITA) Program." *CPA Journal* 80.7 (2010): 59-62. *Business Source Complete*. Web.

Haney, Beth. "Earned Income Tax Credits: helping low-income families build lives and assets." *Fedgazette* Mar. 2004: 20. *Business Source Complete*. Web.

Holt, Steve. "Ten Years of the EITC Movement: Making Work Pay Then and Now." *The Brookings Institution*. The Brookings Institution, 18 Apr. 2011. Web.

"Income Tax Preparation." *CROWN Do Well*. Crown Financial Ministries, n.d. Web.

"IRS Releases the Dirty Dozen Tax Scams for 2012." *IRS*. IRS, 16 Feb. 2012. Web.

Kristof, Kathy. "Tax Refund Theft Is Nation's Fastest-growing Fraud." *Money Watch*. CBS Interactive, 06 Mar. 2013. Web.

Lim, Younghee, Michelle Livermore, and Belinda Davis. "Tax Filing and Other Financial Behaviors of EITC-Eligible Households: Differences of Banked and Unbanked." *Journal of Financial Counseling and Planning* 22.2 (2011): 16-27. *Social Science Research Network*. Social Science Electronic Publishing Inc., 27 Jan. 2012. Web.

Maag, Elaine. "Paying the Price?: Low-Income Parents and the Use of Paid Tax Preparers." *New Federalism: National Survey of America's Families Report B-64*. Urban Institute, 1 Feb. 2005. Web.

Mantegani, Barbara J., Steven F. Holub, and Jeffrey A. Porter. "PRO-BONO TAX ASSISTANCE--Cpas WANTED ALL YEAR LONG." *Tax Adviser* 36.12 (2005): 762-764. *Business Source Complete*. Web.

Noble, Sean. "Basic Rules for Commercial Tax Preparers Needed to Curb Fraud, Abuse, and Harm to Consumers." *National Community Tax Coalition*. National Community Tax Coalition, 08 Apr. 2013. Web.

Outslay, Ed, et al. "Pro--Bono Tax Services: The Role Of Tax Academic And Students." *Tax Adviser* 36.8 (2005): 500-504. *Business Source Complete*. Web.

Rankin, Ken. "Congress Targeting Fraudulent Preparers. (Cover Story)." *Accounting Today* 19.14 (2005): 1-37. *Business Source Complete*. Web.

Rankin, Ken. "Lawmakers: Vendors Are Abusing Free File. (Cover Story)." *Accounting Today* 29.9 (2006): 1-4. *Business Source Complete*. Web.

"Tax Prep Services Help Build Relationships." *Credit Union Executive Newsletter* 31.19 (2005): 2-3. *Business Source Complete*. Web.

"Ten Facts about the Child Tax Credit." *IRS*. IRS, 10 Feb. 2011. Web.

Williams, Roberton. "Taxes and the Poor: Why Do Low-income Families Use Paid Tax Preparers?" *Tax Policy Center*. Urban Institute and Brookings Institution, 22 Apr. 2008. Web.