

# FIELDforum

ISSUE 16

## EITC AND MICROENTREPRENEURS: ONE PROGRAM'S EXPERIENCE

### Introduction

This *Forum* describes the innovative tax education and preparation services of West Company, a microenterprise development organization in Mendocino County, California. West Company provides tax preparation assistance to welfare recipients and other poor individuals, helping them document their participation in the formal economy and access potentially thousands of dollars in tax refunds through the Earned Income Tax Credit (EITC). With less than 20 percent of microenterprise programs currently offering tax preparation services, West Company's focus on the EITC enables it to reach clients who are poorer than the average microenterprise client and who typically are deeply embedded in the informal economy.<sup>1</sup>

Microenterprise practitioners are uniquely qualified to help families understand their tax obligations and the advantages of filing a return. They can also provide critical assistance; tax preparation can be especially intimidating and

confusing for self-employed individuals, especially those operating outside of the formal economy. Yet, while workers are responsible for paying self-employment and income taxes on their earnings, the EITC can be worth far more than any taxes owed. The tax refunds can be used for immediate living expenses, such as medical bills, food, or transportation, or to access additional funding, e.g., as collateral for a microloan or as a means to obtain the matched dollars of an Individual Development Account (IDA).

We raise the West Company case as an innovative and potentially high-impact service, one that is worth further exploration. However, when considering the potential for replicating this model, there are important questions to investigate.

### Background

FIELD recently completed a study of microenterprises and the U.S. informal economy. The study highlights the recent growth and impact of the informal economic sector alongside the unique role of microenterprise development organizations in reaching informal businesses. Many entrepreneurs in this sector do not consider themselves to be business owners or even officially engaged in self-employment. Therefore, they are unlikely to seek out business assistance. Typically, these individuals are patching together a variety of sources of income – one or more from microenterprise activities – in order to make ends meet.

These “income patchers” often stay under the radar screen of regulators and tax collectors. However, many are losing out on thousands of

<sup>1</sup>Britton Walker and Amy Kays Blair, *2002 Directory of U.S. Microenterprise Programs* (Washington, D.C.: The Aspen Institute/FIELD, 2002), xix.

*Microenterprise Fund for Innovation,  
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The Earned Income Tax Credit (EITC), enacted by Congress in 1975, is a federal tax credit available to assist working families and individuals. The EITC has several important benefits: it reduces the tax burden on workers (especially with respect to Social Security payroll tax), supplements wages, makes work more attractive than welfare, reduces income inequality, and helps low-income families build assets.

– *Center on Budget and Policy Priorities.*

dollars due to them each year from federal and state Earned Income Tax Credits. The EITC, also called the EIC, is the largest federal aid program targeting the working poor. In 2002, the federal EITC provided 21 million workers with more than \$37 billion in refundable credits.<sup>2</sup> While an estimated five million low-income families are brought above the poverty line as a result of their EITC refunds, as many as 25 percent of eligible families do not claim the credit they have earned.<sup>3</sup>

To ensure that eligible families benefit from the program, many states and localities have created extensive EITC and tax preparation outreach campaigns targeting low-income households.<sup>4</sup> During tax season, radio spots, fliers, public service announcements and newspaper ads alert low-income individuals to free tax assistance to determine if they qualify for a refund from the EITC.

Unfortunately, households that include self-employment as an income strategy are at a distinct disadvantage when seeking help with their tax returns. Self-employment tax returns – even those for which self-employment income is a small portion of overall household income – require some degree of specialized knowledge of business financials and related tax rules. Additionally, most free tax preparation sites, such as the vast majority of

those associated with the IRS' Volunteers in Tax Assistance (VITA) program, are structured to assist only with the EITC claims of wage earners.

### **The Role of Microenterprise Programs**

Microenterprise development programs have a special role in educating potential and current clients about the EITC. Expert in serving small, start-up and side businesses, program staffs are also skilled in providing outreach, training and technical assistance to the working poor. As such, the nation's 500-plus microenterprise programs stand uniquely positioned to fill the critical need for affordable, or perhaps free, tax preparation assistance for income patchers and other informal entrepreneurs.

Offering EITC services can complement microenterprise programs' efforts at client recruitment, loan origination, asset development and financial management skills-building. Once a program has invested the time and staff resources to understand the EITC eligibility and filing requirements, it can create services that attract new individuals to the microenterprise organization and that enable poor families to access microfinancing products. It can provide tax preparation services directly or partner with another organization with that expertise and mission, complementing that service with business counseling, asset development and financial literacy services. In either case, it will offer a service that provides real financial value to low-income households, as well as a path to business formalization and development with long-lasting impact.

The next section of this paper describes how one organization has used the EITC as an incentive for attracting new clients, borrowers and IDA account holders. Most importantly, the program has helped poor families bring their incomes over the poverty level and has encouraged hundreds of welfare recipients to recognize and value their informal self-employment activity as earned income.

<sup>2</sup>Center on Budget and Policy Priorities, EITC Fact Sheet; available from <http://www.cbpp.org/eic2005/eic05-factbook.pdf>; Internet.

<sup>3</sup>EITC Fact Sheet and IRS Web site.

<sup>4</sup>Alan Berube, The Brookings Institution, 21 June 2004, EITC Funders' Meeting.

## West Company's EITC Experience

**W**est Company began working with its microenterprise clients and welfare recipients after hiring Tola Levison, a former program participant. Levison originally came to West Company as a Welfare to Work (WTW) client in the late 1980's and was hired as a staff person in 1996. West Company had just received funding from the Ms. Foundation for Women for a new WTW initiative and Levison was asked to manage the project. The WTW initiative focused on creating income streams from a range of sources in addition to self-employment. From her own experiences as a welfare recipient and EITC claimant, Levison determined that an EITC education program should be a central part of the new initiative. She believed that the EITC refund was not out of reach for the WTW population, that it could represent a significant portion of annual income, and that it motivated people to increase their earnings.

### Approaching Welfare Recipients

Levison set up regular orientation meetings at the Department of Social Services (DSS) to explain to welfare recipients what the EITC is and how to access it. Initial reactions from both welfare recipients and case workers were skeptical. Most of the welfare recipients had not heard of the EITC and most did not associate anything positive with filing a federal tax return. Others believed that they were not income earners and, therefore, that this tax credit would not apply to them. Levison confronted the skepticism by personalizing the conversation and applying the tax code to their daily lives.

Knowing how ubiquitous the strategy of bartering is for individuals on welfare, she asked the DSS clients to discuss how often they traded services among their friends and neighbors.

Nearly all confirmed that they indeed exchange services. For example, someone cleaned a neighbor's house in return for occasional babysitting; another performed maintenance tasks in exchange for use of a neighbor's car. These bartering activities were happening regularly, but neither the DSS clients – nor their welfare case managers – considered bartering arrangements as sources of income. In fact, many regarded bartering as a way of obtaining needed services without accumulating cash and of avoiding the risk of losing welfare benefits.<sup>5</sup> (See footnote and box below for more discussion.)

California welfare recipients are allowed to earn up to \$225 per month without loss of benefits. West Company ensured that the welfare recipients were aware of this threshold. West staff either worked directly with each client or trained DSS case workers to help the women plan for a time when monthly earnings might trigger a decrease in the amount of welfare payments. The next threshold was any earnings impact on MediCal – the state health insurance program for the poor. For many women, loss of this benefit could not be offset by increased earnings and they made a decision to curb earnings activity in favor of maintaining health coverage.

It turned out that nearly every person Levison reached through her DSS orientations was engaged in some bartering arrangement, but none were valuing their services as a way to demonstrate earned income to the IRS. Moreover, the WTW clients did not know that the EITC could translate into significant amounts of money for their families. For example:

- A person reporting \$2,500 of earned income and two children for 2004 received \$1,010 in EITC.<sup>6</sup>

<sup>5</sup>All barter activity that meets the following definition is considered earned income by the IRS and is required to be reported on a tax return: "Bartering occurs when you exchange goods or services without exchanging money. An example of bartering is a plumber doing repair work for a dentist in exchange for dental services. The fair market value of goods and services exchanged must be included in the income of both parties." However, benefit programs vary in their handling of bartering activity. (Available from <http://www.irs.gov/taxtopics/tc420.html>; Internet). Most government benefit programs, such as Food Stamps, do not count bartering as income for the purpose of determining either eligibility or benefit levels. However, microenterprise programs and individuals should review the rules of other assistance – including TANF and other state and local programs – to determine whether barter activity may impact benefits.

<sup>6</sup>For the purposes of simplifying the discussion, the EITC amounts given are based on an assumption of no tax liability and no deductions. The effects of self-employment tax are discussed later in the publication.

- Someone with \$5,000 of income but only one child qualified for a \$2,010 EITC refund.
- A parent claiming two children and \$10,000 in earned income for 2004 received \$4,010 in EITC.

Using barter as the starting point for the EITC proved to be a powerful approach for West Company's WTW target group. It validated what each woman was already doing, rather than requiring an immediate change in her life. It also promoted a view of welfare recipients as contributors and stakeholders in the formal, mainstream economy, rather than just passive beneficiaries.

### Tax Preparation

At each DSS orientation, Levison invited those interested to come to West Company to receive one-on-one tax assistance and to take advantage of West's other program services. Some joined West Company's "New Beginnings," a six-month program providing peer support and accountability for setting and tracking financial and personal goals. Filing for the EITC were goals that most participants added to their goal lists. The program's regular meetings gave Levison a chance to address in-depth the members' common fears of losing benefits and increasing their responsibilities. She worked with each participant to determine what she was willing to give up over the short- and long-terms (for instance, some could envision moving off of cash benefits but were not prepared to forgo their families' state-provided health coverage.)

The one-on-one tax return assistance was much in demand by WTW and other West Company clients. With each client, West Company conducted phone consultations and a personal interview, usually lasting one hour. During the phone consultation, the client was asked to identify other sources of earned income to be included on her tax return. For instance, clients would detail occasional odd jobs, side jobs or hobbies for which they had earned money. They needed to gather documentation of any wages or tips from jobs, receipts and other documentation for expenses

related to their self-employment income. The personal interview was devoted to preparing the individual's tax return and EITC claim. No computers were used in order to make the process as unthreatening as possible. The clients, themselves, wrote on paper tax forms and West Company staff provided instruction. To begin each session, the West Company staff person explained that, as with any free tax-preparation service, all of the information on the tax forms was the sole responsibility of the client in the event of any questions by the IRS.

### Looking to the Future – the EITC as a Motivator for New Earnings Activities

Levison used the example of Mary (see box, page 5) to help clients work through their present earnings picture and to envision what their future earnings and EITC refunds could become with a bit more structure and planning.

West Company continued to offer EITC and tax preparation services to WTW and other West Company clients. A household that met the federal EITC eligibility requirements, including the income limits listed below, and that could show some income from self-employment could use the organization's tax preparation services to get help filing an EITC claim.

#### EITC Adjusted Gross Income Limits for Tax Year 2004

- \$34,458 (\$35,458 for married filing jointly) if you have more than one qualifying child,
- \$30,338 (\$31,338 for married filing jointly) if you have one qualifying child, or
- \$11,490 (\$12,490 for married filing jointly) if you do not have a qualifying child.<sup>7</sup>

### Leveraging the Tax Refund

Whenever possible, Levison counseled clients about their planned uses for the EITC refund. Some clients received several thousand dollars and had their first opportunity to leverage additional funds and develop assets. In some cases, as with most states' IDA programs,

<sup>7</sup>IRS Publication 596 (2004), Earned Income Credit; available from <http://www.irs.gov/publications/index.html>; Internet.

## Income Patching and EITC – One Welfare Recipient Builds Her Monthly Income

**M**ary has one child and receives \$539 in TANF, \$208 in Food Stamps, and \$50 in child support each month, plus she does odd jobs to make a little extra money. Her monthly income totals \$857 and her monthly earned income is \$60.

Mary was surprised to learn that she qualifies for an earned income credit of \$247 even though she does not have W2s or wage stubs to send in with her Federal Tax Return. Instead she has kept receipts. Whenever she cleans house for her friends, she writes out a receipt and keeps a copy.

After learning how easy it is to claim the Earned Income Credit, Mary started looking for other opportunities to earn income. She started a part-time job at a day-care center. She also started putting up fliers announcing that she was available to do house cleaning. Her part-time employment brought her in contact with working parents who wanted her to baby-sit on weekends and evenings. Soon Mary had increased her income and had added several new income sources:

### **Mary's New Monthly Income Pie:**

20 hours a week day-care center job = \$500

Five hours a week house cleaning = \$200

Weekend baby-sitting = \$135

TANF Cash reduced to \$234

Food Stamps reduced to \$150

Mary has increased her total monthly income from \$857 to \$1,218 a month. Her earned income is now \$835 a month, or \$10,020 a year, and her Earned Income Credit totaled \$2,506. Even with the reductions in her welfare benefits, Mary has increased her household income by \$8,866 a year.

depositing an EITC refund into an Individual Development Account prevented the money from counting against welfare benefits.<sup>8</sup> New Beginnings clients discussed options for using refunds in their group meetings and were well-informed about the IDA or microloan programs available to them. Other clients, including the one whose story is highlighted on page 6,

resolved on their own to use the EITC to build a microbusiness. Of course, many individuals did not use their EITC refund for asset development; immediate needs proved too pressing. The most common uses for EITC rebates among West Company's WTW clients have been to purchase children's clothes or to pay for car repair or car insurance.

<sup>8</sup>On April 12, 1999, HHS published final TANF regulations that include a rationale for excluding IDA benefits from the definition of "assistance." The guidelines also clarify that participation in a TANF supported IDA initiative does not count against a recipient's five-year time limit or jeopardize the receipt of other welfare benefits. Furthermore, at each state's discretion, IDA savings may be exempted from the calculation to determine eligibility for many federal means-tested programs. (Available from [www.idanetwork.org](http://www.idanetwork.org); Internet.)

## Jane: Reinvesting in a Microbusiness

Jane\* had been working with West Company for several years to develop her plant nursery business. In 2004, she earned \$13,459 from a combination of wage employment and self-employment. Jane's amount of earned income and having one child qualified her for an EITC of \$2,604. Because her net earnings from self-employment were well over the \$400 annual threshold for paying self-employment tax, Jane applied part of her EITC to pay her self-employment tax liability. Her remaining rebate was \$1,075. In addition, she received a year of credit for paying into the Social Security system. Levison discussed with Jane uses for her \$1,075 rebate. She decided to reinvest her tax refund in her nursery business, buying new seedlings and soil. Next year, Jane's goal is to make enough money to become ineligible for the EITC altogether. This will mean paying self-employment taxes again and setting aside some of her income during the year. It also means tracking all of her business expenses carefully to ensure that the profits – and taxes paid on the business – are accurate.

*\*Name has been changed.*

## Jin and Sun: Leveraging the EITC for Start-Up Investment Capital

Two other clients of West Company were able to obtain several years' of unclaimed EITC refunds at once, enabling them to leverage significant investment dollars toward the dream of owning a sushi restaurant. A husband and wife, Jin and Sun\*, came to West Company while on welfare. For years, Jin had been doing construction and maintenance work for his landlord in exchange for rent. Levison explained to Jin and Sun that the IRS would allow them to go back three years to claim their EITC. She asked Jin to request from his landlord a letter detailing their bartering transaction, including the nature and value of the work that he had performed for the past three years – \$600 per month for three years. These earnings and Jin and Sun's three children qualified them for EITC refunds totaling approximately \$10,000. They used the money to secure a loan from a community investor and to leverage a \$5,000 microloan from West Company. The couple also received an investment from Jin's father in Japan. With that, they were able to open their sushi restaurant, which now employs 16 people. They currently earn \$3,000 a month in owner's draw and have started an IDA to save for a house.

*\*Names have been changed.*

### West Company's EITC Services Today

Since beginning its EITC filing services, West Company has assisted approximately 150 households with tax preparation services. Additionally, the organization has reached more than 2,000 welfare recipients through DSS meetings and by training DSS case workers to help individuals to file for the EITC. Nearly all of this work was implemented by one staff

person (Levison) who spent an average of 40 hours per month on EITC-related functions. West Company was able to allocate this staff time to its EITC work as a result of its WTW grant funding from the C.S. Mott Foundation and the Ms. Foundation for Women.

Today, West Company does not have a specific grant to operate a distinct WTW initiative that includes a focus on EITC.



Instead, West has integrated EITC services into its self-employment training and technical assistance programming using a grant from Bank of America. The organization has been seeking additional, ongoing funding for more staff time to research and execute its EITC work to continue the tremendous outcomes that individuals, businesses and communities have experienced. Funding for staff time is important, not only to provide the orientations and one-on-one tax preparation assistance, but also for the ongoing research necessary to provide EITC assistance. Staff must continually learn the changes in the tax code related to EITC claim filings and self-employment tax returns, as well as the state and federal regulations affecting welfare and other benefits for low-income families. Levison studied the IRS Web site and, in particular, its Publication 17, a user-friendly document that breaks down individual tax returns in everyday language. She also used research from the Center on Budget and Policy Priorities and drew on her extensive knowledge of California welfare regulations. (Please see page 11 for a list of resources for further research on EITC.)

### Important Considerations for Microenterprise Programs Offering EITC Services

1. Be familiar with the back-up documentation clients need to have on file when reporting barter transactions as earned income.
2. Understand how self-employment taxes will affect EITC refund amounts.
3. Identify the circumstances that will trigger loss of welfare benefits in your state.
4. Know the qualifying tests for claiming a child as part of the EITC filing.
5. Help clients plan for the time when their earnings exceed the maximum income limits for the EITC and they are no longer eligible for the credit.

*Consideration 1: Be familiar with the back-up documentation clients need to have on file when reporting barter transactions as earned income.*

Formalizing barter activities for the purpose of filing a tax return allows low-income families to meet their IRS obligations and, as noted above, can help them access EITC refunds. According to IRS regulations:

*Bartering is an exchange of property or services. You must include in your income, at the time received, the fair market value of property or services you receive in bartering. If you exchange services with another person and you both have agreed ahead of time on the value of the services, that value will be accepted as the fair market value unless the value can be shown to be otherwise.<sup>9</sup>*

A microenterprise program offering tax preparation services should provide technical assistance to clients reporting barter income. This will help ensure that they document barter income appropriately. In a barter transaction, the two parties have income which each is required to report on their tax returns. For example, a program client trades baby-sitting services with her neighbor in exchange for car repair services. Both parties agree on the fair market value of their respective services at the time of the exchange. The program client should retain a receipt signed by both parties detailing the agreed-upon value of the services, the dates and types of services exchanged, and any other terms of the barter agreement. The program client would refer to her receipts in filling out Schedule C “Profit or Loss from Business” or Schedule C-EZ “Net Profit from Business” depending on the circumstances of her self-employment activity.<sup>10</sup> The value of the car repair is the income she reports. The neighbor supplying the car repair services would do the same in order to report and document the value of the baby-sitting he received as income. For both parties, the income listed on Schedule C or C-EZ is part of any earned income calculation for the EITC.

It may be helpful for microenterprise programs to have this information on handouts

<sup>9</sup>IRS Publication 525, section on “Miscellaneous Income.”

<sup>10</sup>In some case, other forms may be necessary. For example, a landlord providing a break on rental income as part of a barter exchange would complete Schedule E to report income from rental property.

written in simple terms and, perhaps, multiple languages. Handouts would enable the program client to explain to her neighbor how and why she is documenting their transaction. Ideally, a program could assist the neighbor with his taxes as well, educating both sides about the reporting of barter transactions.

***Consideration 2: Understand how self-employment taxes will affect EITC refund amounts.***

Self-employment tax (SE tax) is a Social Security and Medicare tax assessed on people who have income from self-employment. It is not the same thing as the income tax due on self-employment income. The SE tax is the employee and employer shares of FICA taxes that are withheld from wage earners' paychecks. Unlike income taxes, the SE tax does not have an income floor. Low-income filers who may not earn enough to have an income tax liability will nearly always have to pay SE tax, if they use self-employment as an income strategy. The EITC was created largely to offset the impacts of these Social Security and Medicare taxes on the poorest taxpayers.

It is important that clients identify any SE tax liability above their EITC refund amount so that they can plan for this payment before it is due. When clients understand how this tax is calculated, they have an additional incentive to maintain accurate records of their self-

employment income and expenses. The SE tax is figured using net earnings from self-employment, which are 92.35 percent of the net profit from business(es). When this amount is \$400 or more for the year, a client must file a tax return. The self-employment tax is 15.3 percent of the client's net earnings from self-employment. Schedules C and SE are necessary to figure and report SE tax.

It can be helpful for programs to know ahead of time which groups are likely to have an EITC refund greater than their SE tax liability. In other words, will an EITC claim result in a refund check or will a tax payment be due because of SE taxes? When a refund check is anticipated, programs can emphasize clients' options for using the refund to leverage asset development opportunities. In cases where outgoing payment will be needed, staff can emphasize the benefits of paying into the Social Security system, as well as discuss future options for paying the SE tax in segments over the course of the following year.

Table 1 below indicates the dollar value of the EITC at different income levels and for different family compositions. A program can use the table as a rough way to compare the refundable EITC amount with the amount that Schedule C filers will owe based on SE taxes. To simplify the discussion, the table below assumes that all income on the return is from self-employment. The figures in

**Table 1: EITC Amount (Percent of *Income*) From 2004 Tax Year Tables<sup>11</sup>**

Income	No Children	1 Child	2 or More Children
\$1,000	\$78 (8%)	\$349 (35%)	\$410 (41%)
\$2,500	\$193 (8%)	\$859 (34%)	\$1,010 (40%)
\$5,000	\$384 (8%)	\$1,709 (34%)	\$2,010 (40%)
\$10,000	\$112 (1%)	\$2,604 (26%)	\$4,010 (40%)
\$15,000	\$0 (0%)	\$2,447 (16%)	\$4,093 (27%)
\$20,000	\$0 (0%)	\$1,648 (8%)	\$3,040 (15%)

<sup>11</sup>IRS Publication 596: Earned Income Credit. Appendix.



parentheses indicate what percent of income the EITC refund will represent. As long as the EITC is worth more than 15.3 percent of income (the SE tax percentage), then the tax filer's EITC will likely be more than his or her SE tax liability.

For instance, the value of the EITC is not more than SE tax for self-employed filers without children. Clients without children can use the EITC to cover part of their SE tax, but need to be prepared to pay the remainder. For those with one child, the EITC will be greater than SE tax for those households earning \$15,500 or less in self-employment net earnings. For those with 2 or more children, EITC is greater than SE tax until self-employment earnings reach approximately \$20,000. (Again, because the table assumes that the only income is from self-employment, calculations will be different if the tax filer is income patching, e.g., combining wages from a job with self-employment.)

***Consideration 3: Identify the circumstances that will trigger loss of welfare benefits in your state.***

As previously discussed, it is essential to understand the circumstances that will trigger a client's loss of welfare benefits when encouraging welfare recipients to file for the EITC. According to the IRS:

*Earned income credit has no effect on certain welfare benefits. Any refund you receive because of the EIC and any advance EIC payments you receive will not be considered income when determining whether you are eligible for the following benefit programs, or how much you can receive from these programs. However, if the amounts you receive are not spent within a certain period of time, they may count as an asset (or resource) and affect your eligibility.*<sup>12</sup>

- *Medicaid and Supplemental Security Income (SSI).*
- *Food Stamps.*
- *Low-income housing.*

However, TANF benefits can be affected by the EITC depending on state regulations. Welfare benefits also can be impacted by the

increased earnings a client generates, even ones that result from barter. The loss of Medicaid benefits and child care subsidies can be devastating for a poor family. Once these subsidies are gone, families often have a difficult time withstanding the market costs of health and child care. Of all government benefits, these thresholds in particular present significant challenges for families trying to move off government aid.

***Consideration 4: Know the qualifying tests for claiming a child as part of the EITC filing.***

EITC eligibility is based on specific rules concerning the situations of both the tax filer and the child or children being claimed. Microenterprise programs should understand these rules and educate clients about their eligibility. In general (based on tax year 2004 rules):<sup>13</sup>

- the filing status must be other than Married Filing Separate;
- the tax filer must have earned income below the maximum limits outlined in the box on page 4;
- the tax filer, spouse and any qualifying children must all have a valid social security number; and
- the tax filer cannot be the qualifying child of someone else.

Furthermore, the qualifying child must:

- be your son, daughter, adopted child, grandchild, great-grandchild, stepchild, niece, nephew, or eligible foster child (but does not have to be your dependent);
- be under age 19, under age 24 and a full-time student, or any age if permanently and totally disabled; and
- have lived with you in the United States for more than half of the year.

***Consideration 5: Help clients plan for the time when their earnings exceed the maximum income limits for the EITC and they are no longer eligible for the credit.***

The maximum earned income limit for any EITC claim for 2004 was \$35,458 (and is lower for households with fewer than two qualifying children). In designing outreach specifically for

<sup>12</sup>IRS Publication 596.

<sup>13</sup>See IRS Publication 596, Earned Income Credit, Chapter 2.

EITC services, programs need to target families and individuals at the low end of the income scale. Ideally, however, tax preparation services would be available to clients whose present or future financial circumstances make them ineligible for the EITC, particularly since these individuals often will be turned away from other free tax preparation services in the community. Clients no longer eligible for the EITC should know of the other benefits to filing taxes besides receiving the EITC. One of the most important is the receipt of credits for Social Security retirement benefits, which are assigned to individuals for each year that they file taxes demonstrating sufficient earned income. For 2005, one claiming at least \$3,680 in net earnings will receive the maximum number of credits (four) toward their lifetime Social Security benefit.

To prepare families who are used to having the EITC cover part or all of any tax liability, e.g., their self-employment taxes, but who are suddenly earning too much money to qualify, a microenterprise program can integrate financial planning services into their tax preparation sessions. Tax time is perhaps one of the only times of the year when large numbers of clients will seek out and implement planning advice. West Company did this in an informal but effective way using its New Beginnings peer groups. West Company also tried to educate clients about ways to leverage their EITC refunds to build up assets and shore up their future financial well-being.

## Conclusion

This publication describes a set of services that the microenterprise development field, as a whole, is not yet offering to low-income microentrepreneurs. The field needs to consider how best to expand these services to many others, either directly, as West Company has done, or possibly through strategic alliances with tax preparation services.

Based on their experience and knowledge, West Company staff members believe that the potential outcomes of generating more EITC claims among income patchers, the self-employed and those transitioning off welfare

generally outweigh the effort necessary to design and execute tax preparation services. The potential impacts that West Company staff, as well as EITC specialists, describe are for individuals, businesses, communities and for the microenterprise organizations.

At the **individual level**, potential outcomes include:

- clients obtain money from their EITC, with some able to cross the poverty line and/or access other sources of asset-development funding (IDAs, microloans);
- tax filers, especially those on welfare, have the opportunity to build a credit history through their tax returns showing recorded income documentation, which can be used when trying to rent an apartment, purchasing equipment, etc.;
- informal economy participants begin to partake in the mainstream economy and are more able to seek out services and resources from local, state and the federal government programs; and
- parents take pride in modeling their new roles as income-earners and financial planners for their children.

Potential **business level** outcomes of a marriage between EITC/tax services and microenterprise development include:

- the formalization of informal business activity, such as when programs assist clients engaged in barter transactions to generate cash for their services, to expand their service area, and eventually to create a business plan;
- businesses gain access to microloan and other investment capital through funds received from the EITC; and
- self-employed individuals and income patchers become more motivated to maintain accurate, up-to-date bookkeeping records – an outcome that often corresponds to better business results.

At the **program level**, potential outcomes include:

- the delivery of services to more poor individuals who may previously have been unable to benefit from traditional



microenterprise training, technical assistance and financing;

- new loan originations and Individual Development Accounts, bringing more program fees and grant funding to a program;
- ability to partner in a new way with welfare case managers and social services departments;
- increases in programs' total number of clients served as a result of the compelling EITC outreach message; and
- over the long-term, the ability of programs to demonstrate longer-term, deeper **community outcomes** resulting from their

services, i.e., the collective community impact of aggregate EITC dollars, more tax filers, fewer welfare recipients and the creation of new stakeholders with a personal investment in their communities.<sup>14</sup>

In conclusion, investigating the possibility of microenterprise programs offering EITC and general tax services is an innovative idea that has the potential to bring in new clients, as well as produce important income and asset-building benefits for the lowest-income clients. From this initial research, however, there are clearly many issues involved in replicating such services. This requires a broader and more in-depth inquiry and dialogue about how best to move forward.

### List of Resources for Further Research

- Anne E. Casey Foundation Family Economic Success site: <http://128.242.238.174/initiatives/fes/fes/supports>
- Brookings Institution Metropolitan Policy Program, EITC Series: <http://www.brookings.edu/es/urban/eitc>
- Center on Budget and Policies Priorities: Facts about the Earned Income Tax Credit booklet, part of The 2005 Earned Income Tax Credit Outreach Kit: <http://www.cbpp.org/eic2005/eic05-factbook.pdf>
- C.S. Mott Foundation: [www.mott.org](http://www.mott.org)
- The EITC Funders Network: <http://www.financeproject.org/irc/win/eitc.asp>
- Internal Revenue Service: [www.irs.gov/eitc](http://www.irs.gov/eitc)
- IRS Territory Managers List for more info on VITA: <http://www.cbpp.org/eitc-partnership/territory-manager.htm>
- National Community Tax Coalition: [www.tax-coalition.org](http://www.tax-coalition.org)
- The National EITC Outreach Partnership of the Center for Budget Policy Priorities: <http://www.cbpp.org/eitc-partnership/directory.htm>
- Points of Light Foundation: <http://www.pointsoflight.org/programs/eitc>
- State EITC Web site: [www.stateeitc.org](http://www.stateeitc.org)

<sup>14</sup>Research shows that many EITC recipients use their EITC refunds to make investments that enhance their economic security and promote economic opportunity in their neighborhoods, making them safer and better places to work and live.” State EITC Online Resource Center; available from <http://www.stateeitc.com/basics/important.asp>; Internet.



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