



Earned Income Tax Credit in Iowa

Tax Credits Help Striving Families Become Thriving Families

The Earned Income Tax Credit (EITC) is a federal tax credit that helps low-income working families help themselves. It rewards low- and moderate-income families for their hard work and helps them close the gap between what they earn and what they need to get by and get ahead. Columbia University's National Center for Children in Poverty found the EITC reduces poverty among young children by nearly one fourth.

The EITC has a long history of bi-partisan support. Started by President Ronald Reagan and expanded by Presidents George H.W. Bush and Bill Clinton, the EITC has become the nation's largest and most effective anti-poverty program. Nearly 20 states have followed suit and enacted state EITCs.

The EITC can make a significant difference for hardworking families. For Tax Year (TY) 2004, it is worth as much as \$4300 to families. For example, in 2004, a single parent raising two or more children and earning \$12,000 is eligible for an EITC refund of \$4,140 – a 35% increase in family income. Many qualifying families are also eligible for the Child Tax Credit, as much as \$1000 per child this year.

Workers access the benefits of the EITC by filing a tax return. Workers who qualify can get back some or all of the federal withholding they paid throughout the year. They may also get additional cash back from the IRS, because the EITC is a *refundable* credit. The amount is based on how much people work and the number of qualifying children.

EITC Helps Iowa Workers Throughout the State

The federal EITC benefits thousands of families in Iowa. In 2002, 163,000 families in Iowa claimed the federal EITC. Statewide, about 12.5% of Iowa tax filers collected the EITC in 2002. It is claimed equally by Iowans living in *rural*, *suburban*, and *urban* areas.



The total amount of EITC going to Iowa workers in TY2002 was \$260 million. To put that into perspective, that's nearly the total amount of wages and salaries that people in the state's hotel industry earned all year long (\$285 million in 2003).

The local economy is stimulated by the EITC. When families spend their EITC refunds on goods and services, local merchants benefit. Economists estimate that such dollars will be re-spent 3 – 5 or more times within the local economy. The real economic impact of the \$260 million received by families in 2002 may have been as much as \$1 billion statewide.

Many Eligible Iowa Families are Missing Out

Many eligible families miss out because they are not aware that they could benefit from EITC. Recent IRS estimates suggests that approximately 37,000 Iowa workers may miss out on the credit annually, leaving as much as \$44 million of local economic stimulus on the table.

Many families who claim the credit lose a significant sum to high transaction costs. Large numbers of families who claim the EITC pay \$100 to \$200 to commercial preparers. Such preparers often encourage "refund anticipation loans" (also known as instant refunds) which cost families additional fees and interest rates as high as 800%. The number of refund anticipation loans issued to EITC earners in Iowa has grown each year since the IRS has tracked the data: from 32,000 in 1999, to 33,500 in 2000, to 36,500 in 2001, to 37,700 in 2002.

There is a large, unmet need for free or low-cost tax preparation in Iowa. IRS data indicate that only 2 percent of all returns statewide claiming the EITC in tax year 2003 were completed at free tax clinics, suggesting a large, unmet demand for free or low-cost tax assistance in communities throughout the state.

The pilot program conducted in communities across the state generated more than \$800,000 in EITC refunds for Iowans – for free or minimal cost – last year. The pilot program suggests that local and



regional coalitions can accomplish a great deal with modest investment and a strong commitment to volunteerism.

EITC Can Help Families Meet Practical Needs and Grow Assets

Families use their EITC refunds to pay off debt, invest in education, finance transportation to work and secure decent housing. According to exit interviews, one of the most frequent uses of EITC refunds is school clothing and school supplies for children.

EITC refunds can help families build assets if they have access to savings opportunities. Matched savings accounts, often called Individual Development Accounts (IDAs), can be excellent vehicles for helping families convert their EITC refund into an occasion to start or strengthen a habit of savings and financial planning.

Coupling free or low-cost tax preparation with financial education and access to low-cost financial services may be the most effective approach to help families not just get by but get ahead.