

Scholarly Commons @ UNLV Boyd Law

Scholarly Works

Faculty Scholarship

2003

The Working Poor Are Paying For Government Benefits: Fixing the Hole in the Anti-Poverty Purse

Francine J. Lipman

University of Nevada, Las Vegas – William S. Boyd School of Law

Follow this and additional works at: <https://scholars.law.unlv.edu/facpub>



Part of the [Taxation-Federal Commons](#), and the [Tax Law Commons](#)

Recommended Citation

Lipman, Francine J., "The Working Poor Are Paying For Government Benefits: Fixing the Hole in the Anti-Poverty Purse" (2003). *Scholarly Works*. 813.

<https://scholars.law.unlv.edu/facpub/813>

This Article is brought to you by the Scholarly Commons @ UNLV Boyd Law, an institutional repository administered by the Wiener-Rogers Law Library at the William S. Boyd School of Law. For more information, please contact youngwoo.ban@unlv.edu.

THE WORKING POOR ARE PAYING FOR GOVERNMENT BENEFITS: FIXING THE HOLE IN THE ANTI-POVERTY PURSE

FRANCINE J. LIPMAN*

I. INTRODUCTION

There is universal agreement that the federal income tax laws are too complicated.¹ The complexity of these laws is especially frustrating for the millions of low-income working families who qualified for more than \$30 billion of federal Earned Income Tax Credit (EITC) in 2002.²

* Associate Professor of Law, Chapman University School of Law; B.A., University of California, Santa Barbara; M.B.A., San Diego State University; J.D., University of California, Davis; LL.M. (Taxation), New York University School of Law. The Author would like to recognize her affiliation with the George L. Argyros School of Business and Economics at Chapman University and thank its administration, faculty, and staff for their continued support.

1. "A taxpayer filing an individual income tax return could be faced with a return (Form 1040) with 79 lines, 144 pages of instructions, 11 schedules totaling 443 lines (including instructions), 19 separate worksheets embedded in the instructions, and the possibility of filing numerous other forms (IRS Publication 17, Your Federal Income Tax (273 pages), lists 18 commonly used forms other than Form 1040 and its schedules)." 1 STAFF OF JOINT COMM. ON TAXATION, 107TH CONG., STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND RECOMMENDATIONS FOR SIMPLIFICATION, PURSUANT TO SECTION 8022(3)(B) OF THE INTERNAL REVENUE CODE OF 1986, at 4 (Comm. Print 2001) [hereinafter JOINT COMM. ON TAXATION STUDY]. Not surprisingly, "[i]n 1999, taxpayers contacted the IRS for assistance approximately 117 million times . . . [.]" and the use of paid preparers and computer software for return preparation increased to 55% and 46% of returns filed, respectively. *Id.* (requiring three volumes and over 1200 pages to present the results of the Joint Committee of Taxation's study identifying sources of complexity in the federal tax law and recommending possible simplification proposals); *see also* IRS, NATIONAL TAXPAYER ADVOCATE, FY 2002 ANNUAL REPORT TO CONGRESS, at iv (December 31, 2002) [hereinafter NATIONAL TAXPAYER ADVOCATE], *available at* http://www.irs.gov/pub/irs-utl/nta_2002_annual_rpt.pdf (noting the difficulty faced by taxpayers when navigating the IRS); Amy Hamilton, *Advocate Sends Simplification Proposals to Congress*, 94 TAX NOTES 7 (2002).

2. Nina Olsen, the National Taxpayer Advocate, wrote: "We are a nation of laws. And if those laws are only within reach of the rich or the powerful, then we become a nation of laws for the few and injustice for the many. This is not a recipe for a healthy, democratic society." Nina E. Olson, *Why Pro Bono Service?*, VA. LAW., Dec. 1998, at 19; *see* ALAN BERUBE ET AL., THE PRICE OF PAYING TAXES: HOW TAX PREPARATION AND REFUND LOAN FEES ERODE THE BENEFITS OF THE EITC 1 (Ctr. on Urban & Metro. Policy, Brookings Inst., Survey Series, May 2002), *available at* <http://www.brook.edu/dybdocroot/es/urban/publications/berubekimeitc.pdf>; *see also* NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 47-88 (including the EITC in seven of the top twenty-three problems encountered by taxpayers).

The EITC is one of the nation's largest and most effective anti-poverty, income transfer programs.³ Low-income families will receive more federal expenditures from the EITC than from the Food Stamp Program, Supplemental Security Income (SSI), or Temporary Assistance to Needy Families (TANF).⁴ Without the EITC, an average of 4.3 million working American households, including 2.2 million children, would live in poverty.⁵

The federal government delivers the EITC⁶ and other low-income

3. FRANK SAMMARTINO ET AL., PROVIDING FEDERAL ASSISTANCE FOR LOW-INCOME FAMILIES THROUGH THE TAX SYSTEM: A PRIMER (July 2002), *available at* <http://www.urban.org/uploadedpdf/410526.pdf>. According to Sammartino et al., the EITC is "the largest single source of cash assistance" as compared to total federal spending in fiscal year 2000 of \$18 billion on the Food Stamp Program as well as \$21 billion for the Temporary Assistance to Needy Families program and other family support programs. *Id.* at 8. Total spending for Supplemental Security Income, which provides benefits to nonworking elderly and disabled people, equals that for the EITC. *Id.* And in 2000, low-income families claimed about \$4.2 billion in child tax credits and \$1.5 billion in dependent care credits. *Id.*

4. *Id.*; see also George Guttman, *The Real Cost of Low-Income Tax Preparation*, 96 TAX NOTES 1558, 1559 (2002) (noting that Alan Berube of the Brookings Institution determined that the EITC is almost twice as large as the Food Stamp Program and TANF, four times larger than Title I of the Elementary and Secondary Education Act, eight times larger than the Workforce Investment Act, and ten times larger than community development block grants).

5. See COUNCIL OF ECON. ADVISORS, GOOD NEWS FOR LOW INCOME FAMILIES: EXPANSIONS IN THE EARNED INCOME TAX CREDIT AND THE MINIMUM WAGE 4 (Dec. 1998), *available at* <http://clinton4.nara.gov/media/pdf/eitc.pdf>; see also ROBERT GREENSTEIN & ISAAC SHAPIRO, CTR. ON BUDGET & POLICY PRIORITIES, NEW RESEARCH FINDING ON THE EFFECTS OF THE EARNED INCOME TAX CREDIT 1 (Mar. 11, 1998) (finding that the EITC has lifted more children out of poverty than any other single government program or category of programs).

6. The 2002 EITC is a refundable tax credit of up to \$4,140 (\$4,204 for 2003) for taxpayers with two or more qualifying children; \$2,506 (\$2,547 for 2003) for taxpayers with one qualifying child; and \$376 (\$382 for 2003) for taxpayers with no qualifying children. See Rev. Proc. 2002-70, 2002-46 I.R.B. 845; IRS, FORMS AND INSTRUCTIONS: 2002 1040A INSTRUCTIONS, at 41-48, *available at* <http://www.irs.gov/pub/irs-pdf/i1040a.pdf> [hereinafter 2002 1040A INSTRUCTIONS]. To qualify for the EITC, taxpayers must be eligible individuals with earned income of less than \$33,178 (\$34,178 married filing joint) with two or more qualifying children; \$29,201 (\$30,201 married filing joint) with one qualifying child; and \$11,060 (\$12,060 married filing joint) with no qualifying children. *Id.*; see also I.R.C. § 32(b), (f), (j) (West 2003) (setting forth provisions for determining the amount of the EITC). Taxpayers must not have investment income of more than \$2,550 (\$2,600 in 2003). I.R.C. § 32(i), (j) (West 2003); Rev. Proc. 2002-70, 2002-46 I.R.B. 845; see also I.R.S. Pub. 17, at 247 (2002), *available at* <http://www.irs.gov/pub/irs-pdf/p17.pdf>. Eligible individuals without qualifying children must be at least twenty-five years old and younger than sixty-five years old. I.R.C. § 32(c)(1)(A)(ii)(II). In addition, these taxpayers must live in the United States as their principal place of abode for more than one-half of the taxable year and must not be claimed as a dependent of another taxpayer. *Id.* § 32(c)(1)(A)(ii)(I), (III). The term "qualifying child" means, with respect to any

tax benefits to working families through its complex income tax system.⁷ The U.S. income tax system is a self-assessment system.⁸ Low-income families must prepare and file annual individual income tax returns to receive these critical anti-poverty benefits.⁹ If a family does not file an annual tax return properly claiming the EITC, they will not receive any EITC.¹⁰ Even if a working individual is not required to file a return because her gross income is less than the threshold amount required for filing, she must file an annual income tax return to receive EITC dollars.¹¹ The government delivers EITC dollars to taxpayers by check through the U.S. mail approximately six to eight weeks after taxpayers timely file properly completed annual income tax returns.¹² For a low-income family, EITC cash flow may mean the difference between

taxpayer for any taxable year, an individual who is a child, a descendant of a child, a sibling or a descendant of a sibling who the taxpayer cares for as the taxpayer's own child or an eligible foster child. *Id.* § 32(c)(3)(B). A qualifying child must live with the taxpayer for more than half of the tax year and must be less than nineteen years old or a student less than twenty-four years old and of any age and permanently and totally disabled at any time during the tax year. *Id.* § 32(c)(3)(C).

7. See SAMMARTINO ET AL., *supra* note 3, at 51 (concluding that trend toward increased use of the tax system for supporting low-income families will continue and that tax incentives are relatively better for working families "who experience fairly high costs of dealing with program bureaucracies, than for individuals without earnings, who have lower costs of applying for benefits and no connection to the tax system through withheld earnings"); George K. Yin et al., *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11 AM. J. TAX POL'Y 225, 294-96 (1994) (noting that the EITC is delivered through a complex tax system that creates participation and compliance problems).

8. In the United States, unlike in at least eighty other countries, taxpayers must prepare their income tax returns assessing their annual federal income tax liability and any amount due and payable or refundable for the tax year. See I.R.C. §§ 6011, 6012, 6072 (2002) (requiring any person liable for any tax to make and file a timely tax return).

9. The earned income credit is refundable and, as such, the credit is a "negative income tax," or a welfare benefit for certain low-income families. See JAMES J. FREELAND ET AL., *FUNDAMENTALS OF FEDERAL INCOME TAXATION* 946-47 (11th ed. 2000). Refundable tax credits not only offset a taxpayer's income tax liability but, if the refundable credits exceed the taxpayer's tax liability, then the government will pay the excess to the taxpayer upon application for such excess. *Id.*

10. The government will not pay the EITC to individuals who do not claim the credit on a timely and accurately filed tax return. See 2002 1040A INSTRUCTIONS, at 41-48.

11. See I.R.S. Pub. 17, at 8, 247 (2002), available at <http://www.irs.gov/pub/irs-pdf/p17.pdf>.

12. See IRS, *Frequently Asked Questions: 1.12 IRS Procedures: Refund Inquiries*, at <http://www.irs.gov/faqs/page/0,,id%3D15892,00.html>. The government also provides for automatic deposit of a tax refund in a taxpayer's bank account in a significantly shorter period of time, but many low-income families do not have bank accounts. As a result, they must wait for a check from the government and pay a fee to have it cashed. See Guttman, *supra* note 4, at 1563.

shelter and homelessness; sustenance and hunger; reliable gas, electric, and telephone services and chronic shut-off notices; employment and relentless joblessness; and an opportunity for education and unavoidable absenteeism.¹³

Unfortunately, the complexity of the EITC rules and compliance requirements is notably daunting.¹⁴ Even experienced certified public accountants have stated that preparing a tax return claiming the EITC is more challenging than completing a Form 1040 with itemized deductions.¹⁵ *IRS Publication 596* explains the EITC in fifty-three pages, including multiple tables and six separate worksheets.¹⁶ Not surprisingly, EITC complexity is insurmountable to many EITC qualifying low-income families who have limited literacy, fear of and anxiety over the tax system, or do not speak or read English.¹⁷ Indeed, an estimated 1.6 million EITC qualifying families have not filed for and therefore have not received available EITC benefits.¹⁸

Congress has created an extensive anti-poverty program, which is almost impossible for the targeted families to obtain without professional assistance because it is too complicated to comprehend and claim.¹⁹

13. Kathy M. Kristof, *Earned Income Credit Can Mean a Big Boost for Many*, L.A. TIMES, Mar. 9, 2003, at C3 (noting that EITC allows mother of two to pay off debts, put food on the table and buy some items she could not otherwise afford). When questioned about her success despite her poverty roots, Ruth Simmons, President of Brown University, stated that “[s]egregation was an obstacle, but poverty was probably the biggest one.” Wallace Terry, *The Helping Hand*, PARADE MAG., Dec. 22, 2002, at 4. The 2002 EITC provides a benefit of up to \$4,140 (\$4,204 for 2003) for taxpayers with two or more qualifying children with earned income of between \$10,351 and \$14,550. See 2002 1040A INSTRUCTIONS, at 41–48. This benefit can represent more than 40% of the annual cash flow in a household supporting at least two children and one working adult. The marginal benefit from this cash payment means a family may be able to survive (e.g., shelter, food, clothing).

14. See NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 47–88; Jonathan Barry Forman, *A ‘Simpler’ Way to Help Children and Low-Income Families*, 52 TAX NOTES 601 (1991); J. Andrew Hoerner, *SOS on the EITC: Complex Rules Likely to Thwart Low-Income Filers*, 52 TAX NOTES 1336 (1991); James E. Williamson & Francine J. Lipman, *The New Earned Income Tax Credit: Too Complex for the Targeted Taxpayers?*, 57 TAX NOTES 789 (1992).

15. AICPA, *AICPA Submits Tax Simplification Recommendations*, TAX NOTES INT’L, May 16, 1997, LEXIS, 97 TNI 95-21.

16. See IRS Pub. 596 (2002), available at <http://www.irs.gov/pub/irs-pdf/p596.pdf>.

17. Michael A. O’Connor, *Tax Preparation Services for Lower-Income Filers: A Glass Half Full, or Half Empty?*, 90 TAX NOTES 231, 232–37 (2001) (answering the question “Why Lower-Income Filers Use Tax Prep. Services”).

18. *Id.* at 246 (stating that failure to receive EITC may be do in part to lack of access to tax preparation assistance). While this figure may seem high, EITC participation estimates are between 80% and 86%, which is notably higher than participation rates for TANF at 55%. SAMMARTINO ET AL., *supra* note 3, at 46.

19. See Williamson & Lipman, *supra* note 14, at 792.

Academics, practitioners, members of Congress and National Taxpayer Advocates have prepared detailed and broad ranging recommendations for simplification of the EITC.²⁰ Despite the numerous and thoughtful recommendations, the current evidence suggests that Congress will not enact comprehensive EITC tax simplification in the near term.²¹ Indeed, over the last twenty-plus years Congress has added more complexity to the already cumbersome EITC.²²

Despite the inconceivable complexity in the EITC, in 2000, 19.3 million taxpayers claimed \$31.2 billion in EITC benefits.²³ How did these families get this critical relief? The American marketplace, rather than Congress, has provided a response to the working poor's desperate demand for assistance.²⁴ Sixty-eight percent of tax filers who received the EITC hired paid tax practitioners to prepare their income tax returns.²⁵ The American marketplace has responded to the demand and carved out a profitable business niche.²⁶ Many of these tax services offer not only assistance in preparing and filing returns, but also provide refund anticipation loans (RALs),²⁷ refund transfers, and other products intended to help taxpayers obtain their critical EITC dollars quickly.²⁸

20. See AICPA, *supra* note 15; NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 47-88; Hamilton, *supra*, note 1, at 7; Yin et al., *supra* note 7, at 294-96 (noting that the EITC is delivered through a complex tax system which creates participation and compliance problems).

21. O'Connor, *supra* note 17, at 232, 247 (stating that while no comprehensive tax simplification is on the horizon, tax simplification may not be a lost cause).

22. See AICPA, *supra* note 15 (noting that the credit has been changed twelve times from 1976 to 1996). Since 1996, the EITC was modified in 1997, 1998, 1999, and 2001, and it may be modified in 2003. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1085, 111 Stat. 788, 955-57 (improving enforcement of application of the EITC); Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, §§ 6010(p), 6021, 112 Stat. 685, 816-17, 823-24 (various amendments); Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170, § 412, 113 Stat. 1860, 1917 (simplifying definition of foster child); Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. No. 107-16, § 303, 115 Stat. 38, 55-57 (providing marriage penalty relief, certain gross income exclusions, and some simplification); Jobs and Growth Tax Relief Reconciliation Act of 2003, H.R. 2, 108th Cong. § 505 (passed by the U.S. Senate on May 15, 2003, proposing uniformity in definition of qualifying child).

23. SAMMARTINO ET AL., *supra* note 3, at 23.

24. See BERUBE ET AL., *supra* note 2, at 1.

25. See IRS, EARNED INCOME TAX CREDIT (EITC) PROGRAM EFFECTIVENESS AND PROGRAM MANAGEMENT FY 1998-FY 2002, at 3 (Feb. 28, 2002). Senator Jeff Bingaman, in his comments before the Senate, noted that "[a]ccording to the New Mexico Advocates for Children and Families, 83 percent of the low-income population in Gallup used a paid preparer." 147 CONG. REC. S4049 (daily ed. Apr. 30, 2001).

26. BERUBE ET AL., *supra* note 2, at 2.

27. A RAL provides an advance on a borrower's anticipated tax refund and is similar to a "payday loan." *Id.* at 4. "A handful of banks have entered into partnerships with tax preparation services to issue RALs." *Id.* In many cases, "the

Tax practitioners exact significant fees and costs for providing these services.²⁹ These fees and costs consume a significant portion of available EITC dollars.³⁰ An estimated \$1.75 billion of the EITC intended to benefit low-income working families and their neighborhoods has been shifted to profitable paid tax practitioners.³¹ The tax preparation, filing, and RAL industry for low-income taxpayers

bank and tax preparation service share both the risks and the fees [of RALs].” *Id.* at 5. RAL recipients usually receive their loan proceeds “within about two days of electronically filing their tax returns, or about seven to ten days sooner than if they had requested direct deposit of their refund to a personal bank account.” *Id.* at 4. Some tax preparation services offer “‘instant’ RAL[s], so that taxpayers can receive a check as they leave the preparer’s office.” *Id.* Most importantly, RALs allow taxpayers without bank accounts to obtain their refunds much more quickly than waiting for a check from the IRS. *Id.* Moreover, taxpayers who do not have the funds to pay for tax preparation services and RALs up-front may use their refunds to pay for tax preparation and financing fees, which are deducted directly from the proceeds of a RAL. *Id.* at 5.

28. *Id.* at 5.

29. H&R Block prepared about 13% of all individual income tax returns filed with the IRS in 2001. *Id.* at 4. Jackson Hewitt, its largest competitor, filed about 1.7% of all 2001 filed returns. *Id.* “In its fiscal year ended April 30, 2001, H&R Block earned revenues of nearly \$1.7 billion from its tax preparation and related services, including RALs, an increase of 15.6 percent over the previous fiscal year.” *Id.* “Fees from refund loans and other ‘fast cash’ products . . . make up a significant portion of the revenues generated by national tax preparation companies.” *Id.* at 7. The nation’s largest commercial tax preparation service and “rapid refund” lenders (H&R Block, Pacific Capital Bancorp, and Household International Inc.) earned \$357 million from “fast cash” products in fiscal year 2001, “more than double the \$138 million earned by these companies in fiscal 1998.” *Id.* at 8. H&R Block earned approximately \$134 million in RAL fees, an increase of almost \$44 million over its prior fiscal year. *Id.* at 8. H&R Block processed nearly 4.5 million RALs, compared to 2.8 million only two years earlier. *Id.* In the last year for which financial information is available, fiscal year 1997, Jackson Hewitt’s income from RALs and other accelerated refund products comprised 29.8% of its total revenues. *Id.* “[T]he firm issued 472,000 RALs and related products for fees of \$9.4 million, an increase of more than one-third over the previous year.” *Id.* Assuming that a similar percentage of filers purchased RALs in 2001, Jackson Hewitt processed approximately 1.2 million RALs. *Id.* “The popularity of refund loans has, in fact, been a major factor in the phenomenal growth that Jackson Hewitt has enjoyed in recent years, principally in low-income markets.” *Id.*

30. *Id.* at 11.

31. *Id.* The entire IRS budget requested for fiscal year 2003 is \$10.5 billion. This shifting of EITC benefits represents approximately 6.5% of all EITC benefits paid in 2000 and almost 20% of the IRS’s FY2003 budget request. See *FY2003 Budget Request: Hearing Before the Subcomm. on Treasury and Gen. Gov’t S. Appropriations Comm.* (May 15, 2002) (prepared testimony of Commissioner of Internal Revenue Service Charles O. Rossotti), reprinted in Charles O. Rossotti, *Rossotti Testimony Before Senate Appropriations Subcommittee*, TAX NOTES TODAY, May 16, 2002, LEXIS, 2002 TNT 95-22 (setting forth the Commissioner’s request for \$10.418 billion and full-time equivalent employment of 101,080).

is growing to meet the government-driven consumer demand.³² Complexity in the EITC, increased audits of EITC tax returns, EITC advertising and outreach resulting in increasing consumer demand for EITC relief has created an ever increasing profitable niche for tax practitioners.³³ As a result, the American marketplace is progressively undermining the anti-poverty effectiveness of the EITC.³⁴

This Article analyzes the problem of the diminishing benefit of the EITC for the targeted individuals and presents possible solutions to preserve our nation's largest and most effective anti-poverty program. An obvious solution to EITC complexity is EITC simplification. Numerous parties have repeatedly suggested simplification of the EITC over the last several decades in response to increasing complexity in the Internal Revenue Code generally and specifically for low-income taxpayers.³⁵ Suggestions for simplification of the EITC are broad ranging and include removing the EITC from the income tax system to creating a super tax credit comprised of the EITC and other existing tax credits, including the child tax credit.³⁶ Given the lack of congressional response to these extensive and thoughtful proposals, this Article will discuss but not explore the solution of comprehensive simplification of the EITC.³⁷

Another solution to the problem is creating a low-income tax credit for tax preparation costs, thereby ensuring that targeted individuals

32. See BERUBE ET AL., *supra* note 2, at 4 (stating that tax preparation services cluster in neighborhoods where large numbers of families claim the EITC and that over the past four years one tax preparation service "has more than doubled its number of locations and returns filed").

33. See CHI CHI WU ET AL., CONSUMER FED'N OF AM. & NAT'L CONSUMER LAW CTR., TAX PREPARERS PEDDLE HIGH PRICED TAX REFUND LOANS: MILLIONS SKIMMED FROM THE WORKING POOR AND THE U.S. TREASURY 8 (Jan. 31, 2002), available at <http://www.consumerfed.org/taxpreparers.pdf>.

34. See BERUBE ET AL., *supra* note 2, at 2, 5 (stating that high-cost tax preparation services and products can significantly diminish the economic benefits of the EITC—both for low-income working families and for the neighborhoods in which they live).

35. See NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 47-88; see also Jonathan Barry Forman, *Simplification for Low-Income Taxpayers: 2001*, in 3 STAFF OF JOINT COMM. ON TAX'N, 107TH CONG., STUDY OF THE OVERALL STATE OF THE FEDERAL TAX SYSTEM AND RECOMMENDATIONS FOR SIMPLIFICATION, PURSUANT TO SECTION 8022(3)(B) OF THE INTERNAL REVENUE CODE OF 1986, at 11-12 (Comm. Print 2001); Williamson & Lipman, *supra* note 14, at 800-02.

36. See Jonathan Barry Forman, *Simplification for Low-Income Taxpayers: Some Options*, 57 OHIO ST. L.J. 145, 182-86 (1996).

37. Despite decades of requests for and recommendations of simplification of the EITC, the EITC remains one of the most complicated federal tax items. See *id.* at 172, 182 (noting problems with the complexity of the tax code); see also NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 47-88.

receive full EITC benefits.³⁸ This solution would allow the competitive American marketplace to continue to provide fee-based assistance to low-income working families. The government would reimburse low-income working families for these fees paid through a refundable tax credit claimed on their annual income tax return. While this solution may restore full EITC benefits to low-income working families, it could cost taxpayers an estimated \$1.75 billion.³⁹

A third solution may be found in the new agreement between the IRS and a group of commercial tax services businesses (the Consortium).⁴⁰ The agreement will cause the Consortium to make available free on-line tax preparation and filing services to at least 60% of all taxpayers in exchange for the IRS's agreement not to provide its own free on-line tax preparation and filing services.⁴¹ Some low-income taxpayer advocates are opposed to the agreement and suggest that the agreement is seriously deficient.⁴² The agreement to cause private industry to forgo their profitable niche and provide free on-line tax services is a possible solution that the government implemented in January 2003.⁴³ This Article will analyze the benefits and burdens of, and proposed modifications to, this potential solution.

38. See Martin A. Sullivan, *Many Unhappy Returns: Who Will Help Low-Income Filers?*, 88 TAX NOTES 606, 609 (2000).

39. In effect, the government would reimburse low-income taxpayers for the costs they incur to prepare and file their individual income tax returns. The Brookings Institute has determined that in 1999 this cost was approximately \$1.75 billion. See BERUBE ET AL., *supra* note 2, at 11.

40. IRS, *IRS Enters Into E-Filing Agreement With Consortium*, 2002 TAX NOTES TODAY, Oct. 31, 2002, LEXIS, 2002 TNT 211-7 [hereinafter *IRS Enters E-Filing Agreement*] (setting forth the *Final Free On-Line Electronic Tax Filing Agreement* between the IRS and a group of tax preparation businesses organized as the Free File Alliance, LLC).

41. *Id.*

42. Letter from Jean Ann Fox et al., to Paul J. Mamo, IRS (Sept. 4, 2002), reprinted in *Consumer Groups' Letter to IRS on Proposed E-Filing Agreement*, 2002 TAX NOTES TODAY, Sept. 9, 2002, LEXIS, 2002 TNT 174-18 (2002); see also *IRS Enters E-Filing Agreement*, *supra* note 40 (setting forth summary of and response to over 700 comments from various individuals and organizations regarding proposed agreement between the IRS and the Consortium including comments from consumer groups concerned about low-income taxpayers).

43. *IRS Enters E-Filing Agreement*, *supra* note 40 (the agreement provides that the IRS will have the Consortium web page ready by December 31, 2002); see also IRS, *2003 Filing Season Begins with New Features on IRS.gov*, NEWSROOM, at <http://www.irs.gov/newsroom/article/0,,id=105077,00.html> (Jan. 2, 2003) (stating that more than 60% of Americans will be eligible for free tax preparation and electronic filing and that information regarding who will qualify for free tax filing will be announced in the middle of January 2003 and will be featured on the front page of <http://www.IRS.gov>).

A fourth solution to the loss of anti-poverty benefits for the working poor is to fund government sponsored volunteer income tax assistance (VITA) programs. As a result of funding, like government funded low-income taxpayer legal clinics (LITCs),⁴⁴ the clinics could be open all year to provide expanded and more comprehensive free assistance to low-income taxpayers. The VITA clinics could provide free income tax preparation and electronic filing, and support for self-service free on-line tax preparation and filing for low-income taxpayers.⁴⁵ During the non-tax season months, the clinics could provide free basic business education classes and work with local banks to help open bank accounts for the 4 million “unbanked” working families.⁴⁶ In December 2002, the Office of the Taxpayer Advocate stated that it supports the creation of a “grant program for free tax preparation for low income taxpayers.”⁴⁷ In April 2003, the U.S. Senate passed the CARE Act of 2003, which provides for a matching grant program “for the development, expansion, or continuation of qualified return preparation clinics” for low-income taxpayers.⁴⁸ The U.S. House of Representatives is expected to begin work on a comparable bill, which may or may not include a matching grant program for tax return preparation clinics.⁴⁹ This alternative will be extensively explored and analyzed. In order to more fully understand

44. See I.R.C. § 7526 (West 2003); see also Leslie Book, *Tax Clinics: Past the Tipping Point and to the Turning Point*, 92 TAX NOTES 1089, 1090 (2001); Sullivan, *supra* note 38, at 608.

45. For example, the Legal Aid Society of Orange County has partnered with a number of low-income taxpayer advocates throughout the country to implement its free Internet-based EITC tax preparation software. See Legal Aid Society & Community Legal Services of Orange County, at <http://www.legal-aid.com/areas/tax.html> (last modified Nov. 19, 2002); The I-Can! Earned Income Credit Module: Welcome!, <http://www.icanefile.com/front/lang.aspx> (last visited May, 15 2003).

46. The VITA clinic could work with the Treasury Department, which received \$12 million from Congress in 2000 and 2001 to pilot innovative strategies to help “bank the unbanked.” See BERUBE ET AL., *supra* note 2, at 17. The Treasury Department has already provided funds to a program in Chicago and Detroit, which plans to connect 1,000 EITC recipients to bank accounts. *Id.*

47. See NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at vii.

48. On April 9, 2003, the U.S. Senate passed the CARE Act of 2003, S. 476, 108th Cong. § 312 (2003), with a 95 to 5 vote. 149 CONG. REC. S5019-20 (daily ed. Apr. 9, 2003). The CARE Act of 2003, among other things, provides a matching grant program for up to \$10 million per year of available appropriated funds for matching grants for qualified return preparation clinics. 149 CONG. REC. S5029 (daily ed. Apr. 9, 2003); see also Low Income Taxpayer Protection Act of 2001, S. 802, 107th Cong. § 3(b) (2001).

49. Fred Stokeld, *House Action Expected on Charitable Giving Legislation*, TAX NOTES TODAY, Apr. 25, 2003, LEXIS, 2003 TNT 80-4.

the implications of the proposed solutions to this anti-poverty problem, it is necessary first to identify the problem itself.

II. IDENTIFYING THE PROBLEM: THE BROOKINGS INSTITUTE AND THE PROGRESSIVE POLICY INSTITUTE 2002 COLLABORATIVE STUDY

In an extensive collaborative study released in May 2002, the Brookings Institute (Brookings) and the Progressive Policy Institute (PPI) analyzed the shifting of anti-poverty benefits from low-income working families.⁵⁰ Brookings and PPI determined that “roughly \$1.75 billion” of the \$30 billion of EITC benefits in 1999 went to paid tax preparers and affiliated national banks rather than the working poor.⁵¹ In response to demand for tax preparation services and quick access to refunds, the survey found that tax preparation businesses have concentrated in low-income communities⁵² and grown significantly over the last several years.⁵³ Brookings and PPI discovered that the EITC has become “an important profit center for [this] multi-billion dollar industry.”⁵⁴ High cost RALs are a significant “reason for the industry’s recent growth, and a large revenue source for the commercial chains.”⁵⁵

50. BERUBE ET AL., *supra* note 2.

51. *See id.* at 12. In H&R Block’s annual report, management stated that “historically, changes in tax laws have increased H&R Block’s business.” *Id.* at 14 (quoting Form 10-K405 filed by H&R Block Inc. with the Securities and Exchange Commission on July 28, 2000, for the fiscal year ended April 30, 2000, available at <http://www.sec.gov/Archives/edgar/data/12659/000095012400004430/e10-k405.txt>).

52. “There is a clear relationship between the location of EITC earners and the location of tax preparation services. In zip codes where less than a tenth of all filers earn the credit, there are roughly ten [commercial tax preparers or electronic return originators (EROs)] for every 10,000 filers.” BERUBE ET AL., *supra* note 2, at 9. With each additional 5% of the filing population claiming the EITC, the number of EROs per 10,000 filers increases by one. *Id.* “The ERO penetration rate reaches 15.6 per 10,000 filers in zip codes where between 35 and 40 percent of all filers receive the credit. These zip codes alone generated 2.2 million returns in 1999.” *Id.* EROs “are clearly over-represented in communities with large concentrations of EITC earners, regardless of population levels.” *Id.*

53. Of the two biggest tax preparation services, Jackson Hewitt has grown significantly over the last few years and H&R Block has remained consistent since the mid-1990’s. *See id.* at 4. H&R Block’s earned revenues of nearly \$1.7 billion for fiscal year ended April 30, 2001 was a 15.6% increase over its prior fiscal year. *Id.* Moreover, Jackson Hewitt is now preparing more than twice the number of returns it prepared in 1997. *Id.*

54. *Id.* at 14–16.

55. *Id.* at 4.

A. Complexity in Tax Laws and Literacy Limitations Create Demand for Tax Preparation Services

Specifically, the study found that the average total cost of tax preparation fees for the 68% of low-income taxpayers using paid preparers was approximately \$100.⁵⁶ Why do low-income taxpayers use paid tax preparation services? A research paper sponsored by the American Tax Policy Institute concluded that “one would expect virtually all lower-income filers, especially those claiming the EITC, to rely on tax preparation and tax counseling assistance.”⁵⁷ Complexity in the tax laws, especially low-income taxpayer items such as the ever-changing EITC,⁵⁸ child tax credits, and the child and dependent care credit, has created a morass of impenetrable rules.⁵⁹

To make matters worse, literacy limitations are sharply higher among low-income adults.⁶⁰ “Literacy research data and the analysis of literacy and census errors indicate that a substantial majority of EITC filers have such limited literacy as to seriously compromise their capacity to prepare their own tax return.”⁶¹ Literacy limitations are especially prevalent among the 25 million foreign-born persons who reside in the United States, 4.6 million of whom live in poverty.⁶² Many of these low-income people speak English as a second language or do not speak or read English.⁶³ If they work in the United States and

56. *Id.* at 2, 5.

57. O'Connor, *supra* note 17, at 236–37.

58. A 1994 IRS compliance study found that error rates for EITC tax returns were 26% for self-prepared and paid-preparer prepared returns. O'Connor, *supra* note 17, at 238–39. A breakdown of the error rates for the paid preparer returns is 14.8% for returns prepared by attorneys, CPAs, and enrolled agents (9% of EITC returns); 23.1% for returns prepared by national tax preparation companies (15.6% of EITC returns); and 30.6% for returns prepared by “other” paid preparers (30% of EITC returns). *Id.*

59. See Forman, *supra* note 14, at 602.

60. As Jeffery S. Gold observed:

Many low-income taxpayers, according to Department of Education studies over many years, are illiterate or functionally illiterate. Whether the percentage is as high as the reported 50 percent or as “low” as 25 percent as doubters contend, there can be little doubt that the bulk of affected individuals have low income.

Jeffrey S. Gold, *Proposed IRS Consortium Deal for Return Prep and E-filing is Flawed*, 96 TAX NOTES 1645 (2002).

61. O'Connor, *supra* note 17, at 235.

62. *Id.* at 236.

63. National Taxpayer Advocate Nina Olsen and her staff determined that one of the twenty-three most serious problems encountered by taxpayers is that “Language & Cultural Barriers Impact Taxpayer Compliance.” NATIONAL TAXPAYER ADVOCATE, *supra* note 2, at 88–94 (stating that the 2000 U.S. Census noted a significant growth in the non-English population over the last decade, but that most IRS literature (tax forms,

have any tax liability or claim the EITC, they must file an annual income tax return.⁶⁴ Given these factors, low-income workers demand and are willing to pay for professional tax assistance.⁶⁵

B. High Cost Loans Provide Fast Access to Refunds and Ability to Timely Pay for Services

The study found that 39% of 1999 EITC recipients purchased a RAL.⁶⁶ Because low-income taxpayers who received large EITC refunds were more likely to purchase a RAL, the government distributed almost 50% of all 1999 EITC dollars through RALs.⁶⁷ The purchase of a RAL doubled the cost of the tax services to \$200 or approximately 10% of the EITC refund.⁶⁸ A typical RAL for \$2,500 in 2002, which saves a family about a one-week wait for their refund, costs a low-income family an annualized interest rate of at least 275% and can be as high as 1,500%.⁶⁹

RALs divert hundreds of millions of EITC dollars from low-income families to a handful of tax preparation service companies and national banks.⁷⁰ The Brookings and PPI study calculated that 7.5 million EITC recipients spent about \$750 million on RALs and related products in 1999.⁷¹ Because RALs are so lucrative, the paid preparer industry

instructions, notices, etc.) is not printed in any language other than English and that a Spanish version of Form 1040 does not exist).

64. See I.R.C. § 6012 (2000); I.R.S. Pub. 17, at 8, 247 (2002), available at <http://www.irs.gov/pub/irs-pdf/p17.pdf>.

65. O'Connor, *supra* note 17, at 232.

66. "Only 4 percent of taxpayers who did not receive the EITC in 1999 purchased a RAL." BERUBE ET AL., *supra* note 2, at 11.

67. "In 1999, the average EITC nationwide was \$1,655, but the average EITC claimed through a RAL was \$2,003." *Id.* at 12.

68. One preparer cited the following prices for a Washington, D.C. working family: \$60 preparation of a federal tax return, \$34 for a state tax return, \$20 for e-filing, and up to \$90 for a RAL, totaling \$204. *Id.* at 1.

69. The 275% annualized interest rate is calculated as follows: \$133 price of the credit/\$2,500 refund advanced = 5.32% annualized for the term for which the loan was outstanding (one week or 1/52 of a year) = 276.64%. In January 2001, the RAL fee was \$121 (H&R Block charged \$43 per-RAL license and documentation preparation fees, plus a \$78 fee to Household Bank); a 2002 quoted \$90 fee to Household Bank increases the 2002 cost to \$133. This estimate may even be understated because H&R Block appears to have increased its fees in 2002 and Jackson Hewitt customers would pay \$149 for the same RAL (310% annualized interest rate). See *id.* at 5; see also David Cay Johnston, *New Questions About Block's Lucrative Tax Loans*, N.Y. TIMES, July 2, 2000, § 3, at 1.

70. See WU ET AL., *supra* note 33, at 9.

71. BERUBE ET AL., *supra* note 2, at 12.

stresses RALs in their marketing.⁷² Low-income working families with critical cash flow problems respond by demanding and paying for fast refunds.⁷³

Ironically, because tax preparation services are so expensive, the ability to pay for critical tax services with the anticipated refund has itself created a lucrative industry.⁷⁴ In the pile of paperwork produced during the tax preparation and refund loan application process, most low-income clients probably do not understand that they are entering into a loan or comprehend the overall cost of their tax services.⁷⁵ Moreover, because tax practitioners deduct service fees directly from the refund, the transaction costs and fees are less transparent.⁷⁶

Approximately 22% of the 19 million EITC families do not have bank accounts or access to routine financial services.⁷⁷ Working poor desperately in need of cash flow and with no alternatives are faced with high cost RALs or waiting many weeks for a check from the IRS in addition to the high cost of check cashing fees.⁷⁸ Check cashing outlets charge a premium to cash tax refund checks despite the minimal

72. Unfortunately, many RAL borrowers do not even realize that they have entered into a loan. One of H&R Block's tax-season direct-mail advertisements announces boldly:

After 12 months of paying taxes, you shouldn't have to wait to get a check. In a world of instant coffee, instant replay and instant gratification, H&R Block is pleased to offer Instant Money—the H&R Block Instant Money refund loan. Come to H&R Block to have your taxes done, and we'll show you how to take advantage of the world's way to get money instantly. Walk in with your taxes—walk out with a check. It's as simple as that. No more waiting days—or even weeks—for your tax refund. Now you can get money in minutes.

WU ET AL., *supra* note 33, at 22–24 (quoting a direct-mail advertisement for H&R Block, received in January 2002 and on file with the authors).

73. BERUBE ET AL., *supra* note 2, at 11 (stating that 39% of EITC recipients received their refunds via a RAL and that only 4% of taxpayers who did not receive the EITC purchased a RAL).

74. WU ET AL., *supra* note 33, at 10 (“One reason for the disproportionate percentage of EITC recipients who get RALs is the need to pay for commercial tax preparation services.”); *see also* NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at vii–viii.

75. WU ET AL., *supra* note 33, at 21–24.

76. *See id.* at 24.

77. *See* BERUBE ET AL., *supra* note 2, at 17.

78. *See* IRS, Frequently Asked Questions: 1.12 IRS Procedures: Refund Inquiries, at <http://www.irs.gov/faqs/page/0,,id%3D15892,00.html>. The government also provides for automatic deposit of a tax refund in a taxpayer's bank account in a significantly shorter period of time, but many low-income families do not have bank accounts. As a result, they must wait for a check from the government and pay a fee to have it cashed. *See* Guttman, *supra* note 4, at 1563.

business risks.⁷⁹ In response to this lucrative business opportunity, the largest national check cashing chain is collaborating with H&R Block to install automated check-cashing machines in tax services offices.⁸⁰ Brookings and PPI did not include any check cashing fees in its estimate of \$1.75 billion.⁸¹ Accordingly, more than \$1.75 billion of annual EITC anti-poverty funds are diverted from low-income working families.⁸²

C. Lack of Assistance for Post-Tax Filing Correspondence and Audits

While H&R Block and Jackson Hewitt respectively prepared about 13% and 1.7% of all 2001 individual income tax returns filed with the IRS, the vast majority of paid tax preparation services “is provided by a disparate array of unaffiliated professionals.”⁸³ The Brookings and PPI survey determined that a “significant number” of tax preparers are one-person storefronts and operate only during the January through April filing season.⁸⁴ The seasonality of tax preparation services available to low-income taxpayers creates a greater burden for families claiming the EITC who are significantly more likely to be audited than other taxpayers.⁸⁵

“In tax year 2000, the chances of audit for a taxpayer seeking the EITC were about 1 in 47. For other taxpayers, the odds of audit were 1 in 366.”⁸⁶ Hundred of thousands of EITC filers receive math error letters or correspondence audit letters after April 15.⁸⁷ “The lack of response by a substantial portion of EITC filers to correspondence from the IRS is likely due in part to the lack of accessible and affordable tax counseling assistance outside of the regular tax-filing season.”⁸⁸

79. While average fees for check cashing are about 2% of the face value, reports have indicated that tax refund and RAL check cashing may cost up to 4% of face value plus a \$3 first time membership fee. These charges can add another \$80 to the \$200 cost of EITC dollars or approximately 15% of EITC refunds. See BERUBE ET AL., *supra* note 2, at 7.

80. *Id.* at 7.

81. *Id.* at 11–13.

82. *Id.*

83. *Id.* at 4.

84. *Id.*

85. *See id.* at 13.

86. *Id.* at 22 n.49 (citing David Cay Johnston, *IRS Audits of Working Poor Increase*, N.Y. TIMES, Mar. 1, 2002, at C2).

87. O'Connor, *supra* note 17, at 245.

88. *Id.* The 1999 EITC Math Errors Profile Report stated that in tax year 1996 about 5% of the “19.5 million EITC returns had invalid or missing taxpayer identification (TIN) numbers.” *Id.* at 239. Paid preparers handled about 60% of the returns in the study and accounted for 45% of the errors. *Id.* at 240. More alarming the study noted that “[p]reparers were responsible for about 61 percent of EITC returns

Therefore, low-income working families, who are more likely to be faced with post-filing tax correspondence and audits, are not likely to have assistance available for post-filing issues and audits from their tax preparers.⁸⁹ Although these working families pay an alarming percentage of their anti-poverty benefits for tax preparation services, fly-by-night service providers are not available to assist in the resolution of follow-up issues and audits.⁹⁰ As a result, some low-income working families may have to pay for additional post-filing assistance or lose their EITC benefits entirely.

D. Conclusion: Anti-Poverty Benefits Intended for Low-Income Working Families Are Flowing to Tax Preparers and Affiliated National Banks

The proliferation of paid tax preparers and RALs in low-income communities is in response to considerable demand by the working poor for fast EITC dollars.⁹¹ The profitability of these tax services has resulted in increased marketing of EITC benefits and fast refund products.⁹² No doubt, this marketing benefits the industry, but it also benefits low-income working families who may not be familiar with the EITC and otherwise would not receive any EITC benefits.⁹³ While these services are filling a gap in the delivery of anti-poverty benefits to the working poor, they cost these already struggling families almost \$2 billion of annual benefits. Brookings and PPI declare that “[t]he annual diversion of EITC dollars to the commercial tax preparers defeats the intent of both Congress and the American public in their support for the

which repeat TIN math errors [in consecutive years] and for about 75 percent of the EITC returns with Schedule C’s.” *Id.* (alteration in original) (quoting IRS, NAT’L OFFICE RESEARCH AND ANALYSIS, BROOKLYN DORA, EITC MATH ERRORS PROFILE REPORT 29 (Aug. 1999)). As a result of the lack of qualifying information, the IRS issued notices and withheld \$1.3 billion of EITC benefits. *Id.* at 239. Only 48% of the notified taxpayers responded. For tax year 1997, the response rate increased to merely 52%. *Id.*

89. Nina Olsen, the National Taxpayer Advocate, cites numerous problems with EITC audits as the most serious problems facing taxpayers in 2002. Low-income taxpayers and the IRS are both ill-equipped to deal with the pre-filing, filing, and post-filing problems with the EITC. See NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 2, 75–80.

90. See BERUBE ET AL., *supra* note 2, at 4.

91. *Id.* at 3–4.

92. *Id.* at 2, 4.

93. Qualifying individuals not aware of the EITC will not receive it. To receive the EITC an individual must file a timely and accurate tax return properly claiming the EITC. Tax practitioners advertising the benefits of the EITC may draw EITC clients to their offices who had no idea these benefits existed. See I.R.S. Pub. 17, at 247 (2002), available at <http://www.irs.gov/pub/irs-pdf/p17.pdf>.

credit”⁹⁴ and that “the public interest is not served when a tax credit designed specifically” to keep low-income working families out of poverty must be shared with corporate America.⁹⁵

Congress has designated 30 billion EITC dollars for the 19 million qualifying working poor, but has failed to design an effective delivery system. American businesses have responded with a delivery system, but the working poor are paying the delivery bill. “No other means-tested federal benefit program requires its beneficiaries to pay an application fee for the benefit.”⁹⁶ As a result, billions of EITC dollars are in the bank accounts of tax preparers and affiliated national banks rather than rescuing the working poor and their families from poverty. This Article presents and analyzes possible solutions for this incorrigible and pervasive problem.

III. POSSIBLE SOLUTIONS

A. Ignoring the Obvious? Simplification

1. SIMPLIFICATION WOULD ELIMINATE THE SIGNIFICANT COST OF COMPLIANCE

The most obvious solution to relieve low-income taxpayers from the costs of professional tax preparation is to eliminate their demand for professional tax assistance. Significant simplification of low-income taxpayer issues would ensure that the working poor receive their intended benefits. If tax compliance for low-income taxpayers were user-friendly for the targeted group, then the demand for and cost of professional tax assistance by these taxpayers would be reduced significantly.

2. SIMPLIFICATION WOULD REDUCE AFTER-FILING CORRESPONDENCE AND AUDITS

Simplification may even eliminate the demand for after-filing correspondence and audit assistance. If the tax preparation and filing process is simple for the targeted taxpayer, then the incidence of tax preparation and filing errors and incomplete and misinformation regarding the tax return should be reduced markedly. Moreover, simplification may include removing the EITC entirely from the annual tax return compliance function. If the EITC is restructured as a per

94. BERUBE AT AL., *supra* note 2, at 16.

95. *Id.* at 14–16.

96. NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at viii.

paycheck offset of Social Security taxes paid, then many working poor would not be required to file annual income tax returns.⁹⁷ Low-income taxpayers “whose only income is wages and who are entitled to the standard deduction” and personal and dependency exemptions would be removed completely from the federal income tax system.⁹⁸

3. SIMPLIFICATION COULD PROVIDE FAST ACCESS TO TAX REFUNDS

Simplification of the EITC may also provide an answer to the problem of lack of fast access to tax refunds. If the EITC is redesigned as a direct offset against Social Security taxes paid, then the working poor would not have to wait until after the close of the tax year to receive their tax refund, but would receive the EITC throughout the year in each paycheck.⁹⁹ As a result, the problem of fast access to tax refunds would be eliminated.

4. ALTERNATIVES TO THE OBVIOUS BUT IMPOSSIBLE DREAM OF SIMPLIFICATION

There is and has been universal outcry for simplification of low-income taxpayer issues for several decades, and most often for simplification of the EITC.¹⁰⁰ In response to this outcry, Congress has simplified some components of the EITC, but it continues to be too complicated for the targeted taxpayer.¹⁰¹ Moreover, the complexity inherent in recent tax legislation and the expansion of refundable child tax credits has complicated further low-income taxpayer issues.¹⁰² Given the complexity of our tax and welfare systems, individually and working together, it is not likely that the working poor will experience

97. See Williamson & Lipman, *supra* note 14, 800-02 (proposing restructuring of EITC to provide a direct and immediate offset against Social Security taxes paid by employees and provide any appropriate additional funds from the employer through the payroll system).

98. *Id.* at 803.

99. See *id.* at 800-02.

100. See NATIONAL TAXPAYER ADVOCATE, *supra* note 1, 47-88 (setting forth seven different EITC problems as the most serious problems in 2002); see also Hoerner, *supra* note 14, at 1336; Williamson & Lipman, *supra* note 14, at 800; Yin et al., *supra* note 7, at 230-33.

101. See Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001, Pub. L. 107-16, § 303, 115 Stat. 38, 55-57 (codified as amended at I.R.C. § 32) (providing marriage penalty relief, certain gross income exclusions and some simplification); Sullivan, *supra* note 38, at 607-08.

102. See EGTRRA, Pub. L. 107-16, 115 Stat. 38 (codified as amended in scattered sections of 26 U.S.C.); *id.* § 201(c), 115 Stat. at 46-47 (codified as amended at I.R.C. § 24) (setting forth calculation for refundable child tax credit).

simplification.¹⁰³ Accordingly, this Article will focus on alternative solutions.

B. Tax Credit for Low-Income Tax Preparation Costs

1. A PREPARATION TAX CREDIT WOULD SHIFT THE COST OF TAXPAYER COMPLIANCE TO THE GOVERNMENT

One solution to reduce the significant cost of compliance for low-income taxpayers is to reimburse these taxpayers for some or all of their compliance costs.¹⁰⁴ The government could provide the reimbursement to qualifying low-income individuals through the federal income tax system as a tax credit.¹⁰⁵ The tax credit would provide a reimbursement of any qualifying low-income taxpayer's costs for qualifying tax return preparation and filing costs. The credit would shift the cost of low-income taxpayer compliance to the government. In effect, the government would be paying for professional tax assistance for the working poor.

Given that the average tax return compliance costs are about \$100, to completely offset these costs and shift the EITC benefits back to the intended beneficiaries, the working poor, the credit must be at least \$100. As a result, this refundable tax credit would cost the government approximately \$2 billion annually.¹⁰⁶ Moreover, Congress would have to index the tax credit for inflation to keep up with rising costs of professional services. The tax credit effectively increases the cost of the EITC by almost 7%.¹⁰⁷

2. THE AVAILABILITY OF PROFESSIONAL TAX ASSISTANCE SHOULD REDUCE AFTER-FILING CORRESPONDENCE AND AUDITS

The tax credit would only be available for qualifying tax assistance, which would only provide assistance from tax preparers who the IRS deemed "qualified." Through the credit requirements, the IRS could motivate the working poor to use qualified professional tax assistance.

103. Sullivan, *supra* note 38, at 608.

104. *See id.* at 609.

105. A tax credit is a dollar for dollar reduction in a taxpayer's tax liability. WILLIAM H. HOFFMAN, ET AL., WEST FEDERAL TAXATION, INDIVIDUAL INCOME TAXES 3-20 (2004).

106. A refundable tax credit reduces a taxpayer's tax liability below zero. "Refundable credits are paid to the taxpayer even if the amount of the credit (or credits) exceeds the taxpayer's tax liability." *Id.* at 13-4 to 13-6. \$100 x 19 million taxpayers qualifying for the EITC = \$1.9 billion revenue costs.

107. \$2 billion divided by \$30 billion total EITC benefits = 6.7%.

With qualified professional tax assistance, the working poor would be more likely to benefit fully from the EITC, and EITC compliance errors and incomplete and inaccurate information should be reduced.

A 1994 IRS study concerning compliance problems and the analysis of compliance problems among categories of tax preparers demonstrated that attorneys, CPAs, and enrolled agents had far superior compliance rates.¹⁰⁸ The study noted that the superior compliance rate was “most likely due to greater expertise in tax laws,” and better skills in identifying and obtaining accurate and complete information for tax preparation.¹⁰⁹ If compliance problems are reduced, the IRS’s administrative costs may also be reduced, which could offset to some extent the \$2 billion cost of the tax credit.

However, the introduction of the tax credit requiring qualified professional assistance will not ensure that professional tax assistance will be available to the working poor. Attorneys, CPAs, and enrolled agents whose costs may qualify for reimbursement through the tax credit, may charge well above the \$100 proposed maximum reimbursement because of their experience and qualifications. Therefore, the working poor using these qualified professionals would continue to suffer compliance costs above any reimbursement.

“Skeptics could also argue that tax credits for preparation service would not provide any financial relief for taxpayers, but would instead be passed forward to the benefit of tax preparers who would charge higher prices for their services.”¹¹⁰ Under basic economic theory, the incidence of a subsidy depends upon the nature of the subsidized marketplace.¹¹¹ If the provider of the good or service has a monopoly on the market and the barriers to entry are impenetrable, then the provider will be able to increase the price of the good or service dollar for dollar.¹¹²

Alternatively, if the market is perfectly competitive, all of the benefits of the subsidy should accrue to the customer.¹¹³ The tax preparation marketplace is competitive and includes a wide variety of choices.¹¹⁴ The competition includes H&R Block, Jackson Hewitt, lawyers, CPAs, enrolled agents, and thousands of “mom-and-pop” preparation services, as well as free tax preparation software and free taxpayer assistance provided by the IRS through VITA and Tax

108. O'Connor, *supra* note 17, at 240–41.

109. *Id.* at 241.

110. Sullivan, *supra* note 38, at 610.

111. *Id.*

112. *Id.*

113. *Id.*

114. See BERUBE ET AL., *supra* note 2, at 4 (describing the tax preparation services industry as highly fragmented).

Counseling for the Elderly (TCE) programs.¹¹⁵ As a result of the numerous tax preparation options, the cost of tax compliance should not increase dollar for dollar due to the tax credit.¹¹⁶ A large portion of the tax credit should accrue to the benefit of the targeted individuals, the working poor. However, due to dollar limitations on the tax credit and not on the cost of tax services, the tax benefit provided through the tax credit may not completely offset the costs.

3. LACK OF FAST ACCESS TO TAX REFUND AND TAX CREDIT

Unfortunately, even if the tax credit were to perfectly offset all of the tax compliance costs, the working poor would still not have fast access to their EITC benefits. In fact, the lack of fast access would be more troublesome because the tax credit would increase the demand for a fast refund. Tax refunds would be larger, because they would include the reimbursement for the tax compliance costs. The taxpayer would be even more anxious for the refund because she may have to pay the tax preparer up front and wait for her refund to receive reimbursement and her EITC benefits. This additional pressure for fast access to tax refunds could add to the demand for and costs of RALs. The additional costs for RALS could diminish significantly any benefits provided by the tax credit.

C. Access to Free Tax Preparation and Filing Services

Another alternative solution is to provide low-income taxpayers with free tax preparation and filing services, not through a tax credit to offset their tax compliance costs, but through the direct provision of free tax compliance services. On October 30, 2002, the IRS entered into a final agreement with a consortium of companies in the electronic tax preparation and filing industry (the Consortium) to provide free, on-line tax return preparation and filing services.¹¹⁷ In the agreement, the IRS states that it believes that the proposal “is the best method (business case)” for meeting the government’s goals “because it will promote higher quality [s]ervices by utilizing the existing expertise of the private sector, maximize consumer choice, promote competition for such

115. *Id.* at 4, 16, 22 n.52; *see also* NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 95–103 (describing free U.S. individual income tax return preparation services).

116. *See* Sullivan, *supra* note 38, at 610.

117. *See IRS Enters E-Filing Agreement*, *supra* note 40; *see also* Electronic Tax Preparation and Filing; Intent to Enter Agreement, Opportunity for Comment, Opportunity to Submit Proposals for Additional Consortia, 67 FED. REG. 51621 (Sept. 4, 2002) [hereinafter Electronic Tax Preparation].

[s]ervices, and thereby meet the objectives in the least costly manner.”¹¹⁸ The IRS is motivated to encourage taxpayers to file electronically because it shifts the burden and cost of tax return processing to the taxpayer.¹¹⁹ Moreover, the IRS has a statutorily mandated goal of having 80% of federal tax and information returns filed electronically by the year 2007.¹²⁰ Additionally, President George W. Bush’s fiscal year 2003 budget includes a specific proposal to encourage on-line tax filings by eliminating charges for such services by “using cooperation with, and encouraging competition within, the private sector to increase e-filing.”¹²¹

The IRS and the Consortium structured their agreement to provide free on-line tax return preparation and filing to at least 60% of all taxpayers through a link from the IRS’s website.¹²² Under the agreement, 78 million taxpayers will be able to file tax returns electronically at no cost.¹²³ Each member of the Consortium must provide taxpayers representing at least 10% of the number of individual income tax returns filed in calendar year 2001 these free services on demand using fileable federal tax forms.¹²⁴ Additionally, each Consortium member must be an authorized IRS E-File provider, have security and privacy certification from an agreeable third party, not contain or provide links to inappropriate content, and disclose clearly to users their customer service support options and privacy policies.¹²⁵

Under the agreement and during its three-year term, the IRS agrees not to compete with the Consortium with its own free, on-line tax return preparation and filing taxpayer services.¹²⁶ The IRS will host and maintain the advertisement free web page for the Consortium’s provided content.¹²⁷ The Consortium and the IRS agree to coordinate their respective marketing of these free taxpayer services to provide uniformity and maximize public awareness.¹²⁸

118. Electronic Tax Preparation, *supra* note 117.

119. Guttman, *supra* note 4, at 1560.

120. See IRS Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 2001(a)(2), 112 Stat. 685, 723 (codified at I.R.C. § 6011 (2000)).

121. Electronic Tax Preparation, *supra* note 117.

122. *Id.*

123. Sonya V. Harmon, *Treasury, IRS Announce E-Filing Agreement*, TAX NOTES TODAY, OCT. 21, 2002, LEXIS, 2002 TNT 211-3.

124. Electronic Tax Preparation, *supra* note 117.

125. *IRS Enters E-Filing Agreement*, *supra* note 40; see also Electronic Tax Preparation, *supra* note 117.

126. *IRS Enters E-Filing Agreement*, *supra* note 40. The agreement has a three-year term with automatic options to renew for successive two-year periods and a clause allowing termination for cause or without cause. *Id.*

127. See *id.*

128. See *id.*

The IRS published its proposed agreement with the Consortium in the Federal Register and requested comments and alternative proposals by September 4, 2002.¹²⁹ The IRS received more than seven hundred comments from various individuals and organizations.¹³⁰ The IRS stated that the “vast majority of the feedback” it received supported the agreement.¹³¹ The IRS noted that the “most common concern” was that the agreement would adversely affect the business activity of accounting and legal tax professionals.¹³² The IRS responded to this comment by noting that its historical data shows that “migration of taxpayers from the services of accounting and legal tax professionals to low cost Internet filing options has been minimal.”¹³³ The second most common concern was that on-line software products do not provide the same level of service as paid professionals and result in more errors.¹³⁴ The IRS replied that the expected target audience for free services are individuals who manually prepare their own tax returns and that “e-filed returns have a lower error rate than paper returns.”¹³⁵

On September 4, 2002, the Consumer Federation of America, Consumers Union, the National Consumer Law Center (on behalf of its low-income clients), and the U.S. Public Interest Research Group submitted a written protest to the proposal.¹³⁶ Their protest stated that the proposal “is seriously deficient and does not protect the interests of taxpayers, especially low-income taxpayers.”¹³⁷ These public interest groups believe the proposal “exposes taxpayers to the risks of usurious tax refund loans.”¹³⁸ The group urged the IRS not to enter into the agreement.¹³⁹

The group proposed two alternatives to the IRS’s agreement with the Consortium.¹⁴⁰ First, rather than provide free tax services through

129. Electronic Tax Preparation, *supra* note 117.

130. See *IRS Enters E-Filing Agreement*, *supra* note 40.

131. *Id.*

132. *Id.*

133. *Id.* (stating that foreign countries have similar experience, including Australia where the government provides free Internet services, but 70% of taxpayers use tax professionals).

134. *Id.*

135. *Id.*

136. Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42; see also Gold, *supra* note 60, at 1645; George Guttman, *EZ Filing Deal Neither Easy Nor Simple*, 96 TAX NOTES 1186 (2002).

137. Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42; see also Gold, *supra* note 60, at 1645; Guttman, *supra* note 136, at 1188 (noting that the proposal lacks sufficient customer support to aid individuals whose returns are rejected or those simply waiting for their refund).

138. Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42.

139. *Id.*

140. *Id.*

the Consortium, the group recommended that the IRS provide free e-filing on its own website and more free tax preparation services to low-income taxpayers.¹⁴¹ Second, if the IRS proceeds with its proposal it should ensure that the commercial companies providing free tax services will not (1) make or facilitate RALs for taxpayers who participate in the program; (2) charge for customer assistance; and will (3) disclose and charge reasonable fees for state tax returns preparation and filing; (4) provide services to at least 10% of all EITC-eligible taxpayers; (5) provide bank account options to “unbanked” taxpayers; and (6) include taxpayer representatives as advisors to the consortium of commercial companies.¹⁴² The group further suggested that “[t]he IRS should ensure that taxpayers who don’t have a computer or Internet access will not be forced to go through a paid preparer, and will be served by this program through free community tax preparation programs.”¹⁴³

The IRS responded to these comments, asserting that “[t]he Agreement clearly states the use of any Free Service cannot be contingent on the sale of any other product or service.”¹⁴⁴ Moreover, the IRS noted, “taxpayers will not have to go through additional steps or barriers to access the Free Service, beyond those steps required or imposed to access the comparable paid service.”¹⁴⁵ The IRS also responded that existing federal tax laws strictly prohibit unauthorized taxpayer marketing and require explicit taxpayer consent for use of any tax return information.¹⁴⁶ Moreover, the agreement requires that all free tax products will receive third party privacy and security certifications.¹⁴⁷ On January 16, 2003, the IRS and the Consortium unveiled “Free File,” their historic public-private partnership, under which the Consortium agreed to provide free tax preparation and e-filing to approximately 78 million taxpayers for at least three years.¹⁴⁸

1. WOULD FREE TAX SERVICES SHIFT THE COST OF TAXPAYER COMPLIANCE FROM THE TAXPAYERS TO THE CONSORTIUM?

Businesses in the tax services industry provide many of these services at a profit.¹⁴⁹ For-profit businesses acting consistently with

141. *Id.*

142. *Id.*

143. *Id.*

144. *IRS Enters E-Filing Agreement*, *supra* note 40.

145. *Id.*

146. *Id.*

147. *Id.*

148. Amy Hamilton, *Administration Unveils Free Filing for 78 Million Taxpayers*, 98 TAX NOTES 305, 305-06 (2003).

149. See BERUBE ET AL., *supra* note 2, at 13-14.

their for-profit goals will only join the Consortium if they believe that they will profit from the relationship in some other manner.¹⁵⁰ In fact, the Department of Justice had to approve the IRS's agreement's interference with the for-profit business activities of the members of the Consortium by providing an antitrust waiver.¹⁵¹

The Brookings study estimates that the average tax preparation and electronic fees for federal and state tax returns is approximately \$100.¹⁵² Other estimates are that 78 million taxpayers would be eligible to file for free filing under the Consortium agreement.¹⁵³ As a result, businesses in the tax services industry could lose \$7.8 billion of tax services revenue. These businesses will have to make up for this lost revenue with alternative revenue streams. Groups and individuals opposing the agreement believe that one alternative revenue stream will be low-income taxpayers who will end up paying for their free tax services through new costs and fees.¹⁵⁴ If so, the cost of the free tax services will not be shifted to the Consortium, but will remain with low-income taxpayers, albeit through alternative cost and fee structures. Low-income taxpayers may be exposed to even more high-priced ancillary products and services and may mistake the IRS's link as evidence that the services or products are required and priced fairly.¹⁵⁵ Opponents to the agreement fear that members of the Consortium will charge low-income taxpayers excessive fees for (1) customer service support and assistance, (2) state income tax preparation and filing fees, (3) enhanced RALs, and (4) other advertised fee-based services and products.¹⁵⁶ If

150. Management of any for-profit business owes a duty to the business owners and the employees to act in a manner consistent with the for-profit motive.

151. Office of Management and Budget Circular A-76 discourages government competition with the private sector. In effect, the IRS is not permitted to interfere with for-profit business activities and, therefore, must get permission from the Justice Department to enter into this interference agreement. Letter from Assistant Attorney General Charles A. James, to Stephen M. Ryan, Manatt, Phelps, & Phillips (Oct. 7, 2002), reprinted in *Justice Letter on Approval for Tax Services Consortium*, TAX NOTES TODAY, Oct. 11, 2002, LEXIS, 2002 TNT 198-23 (indicating Justice Department approval of the agreement).

152. BERUBE ET AL., *supra* note 2, at 5.

153. See *IRS Enters E-Filing Agreement*, *supra* note 40; Guttman, *supra* note 136, at 1187.

154. ELEC. TAX ADMIN. ADVISORY COMM., ANNUAL REPORT TO CONGRESS 11 (June 30, 2002), available at <http://www.irs.gov/pub/irs-pdf/p3415.pdf> (noting that "tax preparation companies may realize significant client development benefits from providing free Internet access in their offices").

155. Gold, *supra* note 60, at 1646 (stating that taxpayers will likely see the federal government as "blessing" the Consortium members).

156. Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42. Additionally, "[wh]en electronic filing debuted, some car dealerships offered it free if the refund was used for a down payment on a new car. Approximately 70 percent of

the agreement is not modified to address these issues, low-income taxpayers may shift even more than the nearly \$2 billion of EITC benefits currently delivered to providers of commercial tax preparers.

Consortium members will only enter into the agreement if they anticipate some benefit. If the anticipated benefit does not materialize or is less than required for participation, then they will likely try to terminate their membership in the Consortium.¹⁵⁷ If the Consortium dissolves, then the IRS will not likely provide free on-line tax compliance services. Although taxpayer advocate groups have proposed this alternative,¹⁵⁸ the costs are too great. Congress would be unlikely to provide funding of the potential \$100 million cost of a government created e-filing system.¹⁵⁹ Moreover, other countries have not had success with similar systems.¹⁶⁰ The IRS's total costs could be more than the \$100 million initial start-up. If the IRS's web-based tax preparation and e-filing system was successful, then the IRS would have significant and ongoing site maintenance costs to update the site regularly and provide customer support services.¹⁶¹

Designing, delivering, and maintaining free tax preparation and filing services is an exorbitantly expensive endeavor, and someone (e.g., the government, taxpayers, or private industry) must bear the cost. Private industry operates with a profit motive and, therefore, may enter into the Free File endeavor planning to incur the cost but ultimately enjoy increased revenues. The increased revenues will likely come from their customers or taxpayers. If private industry cannot profit from Free File, then the government may have to use its resources (e.g., taxes) to fill the gap. In short, Free File is not free.

federal return filers receive a refund. If the taxpayers spend their refund with a business that offers e-filing, there is money to be made." Guttman, *supra* note 136, at 1188.

157. See Guttman, *supra* note 136, at 1188. Under the agreement, the Consortium may terminate its agreement only for cause after thirty days written notice of the IRS's failure to comply with the agreement and cure such failure. *IRS Enters E-Filing Agreement*, *supra* note 40; *Electronic Tax Preparation*, *supra* note 117.

158. Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42.

159. See Guttman, *supra* note 136, at 1188.

160. See *IRS Enters E-Filing Agreement*, *supra* note 40 (stating that in Australia, where the government provides free Internet filing, over 70% of all taxpayers still use a tax professional); Guttman, *supra* note 136, at 1187 (stating that the Australian government's e-filing website is used by less than 5% of taxpayers and the United Kingdom's three year old e-filing website is used by less than 1% of filers). Intuit offers free electronic filing through its website, www.taxfreedom.com, to individuals with an adjusted gross income of \$25,000 or less. In the 2001 filing season, 1,040,307 taxpayers filed a federal return and 799,061 filed state returns using this free software. Guttman, *supra* note 136, at 1187.

161. See Guttman, *supra* note 136, at 1187.

2. THE AVAILABILITY OF FREE TAX SERVICE MAY INCREASE AFTER-FILING CORRESPONDENCE AND AUDITS

If Free File is utilized to the extent anticipated¹⁶² and the Consortium charges unreasonable fees for customer service support and assistance, then taxpayers may forgo assistance and file returns that generate more after-filing correspondence and audits. “Just because a tax return is accepted by a sophisticated computer does not mean it is correct.”¹⁶³ These tax returns may include numerous errors and misinformation.¹⁶⁴ The agreement does not provide that Consortium members agree to provide any customer service support before, during, or after the tax preparation and filing process.¹⁶⁵

In fact, low-income taxpayer advocates fear that Consortium members may use customer service charges to replace their lost revenues.¹⁶⁶ Low-income taxpayers will be left to their own resources to respond to potentially increased IRS correspondence and audits. Low-income taxpayers will most likely turn to the member of the Consortium who provided their free assistance for any post-filing tax services. The Consortium member may use this opportunity to charge above market prices for any post-filing services to recoup some of the lost tax services revenues. Low-income taxpayers desperate for post-filing assistance may not see any alternative and will have to pay precious dollars for this uncovered service.

3. LACK OF FAST ACCESS TO TAX REFUNDS OR INCREASED RALS?

Ironically, Free File may expose even more taxpayers to RALs. The Consumer Federation of America estimates that nearly 11 million

162. Although Free File was made available to approximately 78 million taxpayers from January 16, 2003 through April 25, 2003, the Consortium members processed and transmitted approximately 2.7 million tax returns. The newly appointed Commissioner of the IRS commented that these results were “most encouraging.” See *IRS Compliance Efforts: Hearing Before the House Appropriations Subcomm. on Transp., Treasury and Indep. Agencies* (May 7, 2003) (prepared testimony of Commissioner of Internal Revenue Service Mark W. Everson), reprinted in Mark W. Everson, *Everson Testimony at House Appropriations Panel Hearing on IRS Compliance Efforts*, TAX NOTES TODAY, May 8, 2003, LEXIS, 2003 TNT 89-36.

163. Gold, *supra* note 60, at 1646.

164. See *IRS Enters E-Filing Agreement*, *supra* note 40 (noting that free software products are not comparable to the services provided by an accounting or legal tax professional and are not intended to replace such required services).

165. See *id.*

166. See *id.*; Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42.

taxpayers receive a refund loan each year.¹⁶⁷ In 2001, H&R Block filed 13.3 million returns electronically accompanied by a “fast cash” product and approximately 38% of taxpayers who earned the EITC in 1999 received their refunds via refund loans.¹⁶⁸ If the 30 million taxpayers who currently prepare their own returns by hand use the free tax services or all 78 million qualifying taxpayers use the system, members of the Consortium may find a huge new target market for their triple-digit interest rate RALs.¹⁶⁹ Consortium members may also offer free Internet access to lure millions of unsuspecting taxpayers into their offices. Approximately 75% of taxpayers with earnings under \$15,000 and 67% of taxpayers with earnings between \$15,000 and \$25,000 do not use the Internet and approximately 46% of all taxpayers do not use the Internet.¹⁷⁰ In short, the potential revenue stream from new and existing RALs customers could well make-up for lost tax services revenues.

Opponents of the agreement suggest that the IRS should unequivocally forbid paid preparers to make or facilitate RALs to taxpayers who receive any free benefits.¹⁷¹ The IRS responded by noting that because taxpayers will e-file through the free filing service they will receive “their refunds twice as fast.”¹⁷² The demand for RALs therefore should decrease and even if the Consortium members do not offer RALs, thousands of other banks provide similar services.¹⁷³ Alternatively, low-income advocates suggest that the IRS must require Consortium members to provide bank account options and help the Treasury Department to bank the unbanked.¹⁷⁴ More than 4 million low-

167. Guttman, *supra* note 4, at 1562. In 2000, RALs cost consumers an estimated \$810 million in RAL fees. WU ET AL., *supra* note 33, at 4.

168. BERUBE ET AL., *supra* note 2, at 4, 7, 11 (determining that 39% of 19 million EITC taxpayers in 1999 received refunds via refund loans).

169. See Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42; see also WU ET AL., *supra* note 33, at 6.

170. Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42 (citing U.S. DEP'T OF COMMERCE, ECON. & STATISTICS ADMIN. AND NAT'L TELECOMM. & INFO. ADMIN., A NATION ONLINE: HOW AMERICANS ARE EXPANDING THEIR USE OF THE INTERNET, 5, 8, 28 (Feb. 2002), available at <http://www.ntia.doc.gov> [hereinafter A NATION ONLINE]). “A 1999 IRS study on the traffic at IRS ‘walk-in’ sites concluded that only 31 percent of taxpayers seeking return preparation services had internet access.” NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 100 (citing surveys conducted at North Florida, Brooklyn, Central California, and Houston IRS sites).

171. Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42.

172. *IRS Enters E-Filing Agreement*, *supra* note 40.

173. See *id.*

174. Senate Finance Committee member Jcfff Bingaman, Dem.-N.M., introduced the Low-Income Taxpayer Protection Act of 2001, which required that the IRS offer all taxpayers without bank accounts the option of having one set up for them. See Low Income Taxpayer Protection Act of 2001, S. 802, 107th Cong. § 3(e) (2001).

income families (many of them EITC recipients) do not have bank accounts.¹⁷⁵

Most low-income working families receive their EITC benefits in a lump-sum annual check from the federal government after they have timely filed their individual income tax return. These families have great financial needs, but limited access to convenient, low-cost bank accounts.¹⁷⁶ Some low-income taxpayer advocates recognize that RALs exist due to a variety of factors and that, under certain circumstances, properly regulated RALs may be a legitimate answer to a taxpayer's need for quick access to refund dollars.¹⁷⁷ Therefore, regulation (rather than elimination) of RALs may protect low-income taxpayers and provide a solution to their fast cash requirements.

a. Regulation of RALs

Current regulation of RALs is virtually nonexistent.¹⁷⁸ Providers of RALs intentionally structure them to avoid usury laws that would in most cases cap interest rates at 36%.¹⁷⁹ Typically, RAL loan fees translate into annual percentage rates of 67% to 774%.¹⁸⁰ Many large tax preparers partner with banks chartered in states with no usury caps or disguise the loans as "an assignment of the right" to receive the tax refund to avoid the usury interest rate restrictions.¹⁸¹

The IRS describes its position regarding RALs in Chapter 3 of *IRS Publication 1345*, the governing document for providers of electronic tax return filing.¹⁸² "The IRS is in no way involved in or responsible for RALs" and "[t]he Department of Treasury is not liable for any loss

175. Guttman, *supra* note 4, at 1563.

176. *Id.*

177. Carolyn Wright LaFon, *ABA Tax Section Meeting: Low-Income Taxpayer Reps Struggle with RALs and Unscrupulous Preparers*, TAX NOTES TODAY, Jan. 23, 2002, LEXIS, 2002 TNT 15-5 (containing comments from James Dennis, tax counsel to Senate Finance Committee member Jeff Bingaman).

178. WU ET AL., *supra* note 33, at 17. North Carolina regulates the facilitators of RALs. N.C. GEN. STAT. ANN. §§ 53-246 to 53-254 (2002). This state law prevailed in a federal preemption challenge. See N.C. Ass'n of Elect. Tax Filers, Inc. v. Graham, 429 S.E.2d 544, 549 (N.C. 1993). Wisconsin imposes disclosure requirements on RAL lenders. WIS. STAT. §§ 421.301, 422.310 (2001-2002); see also *IRS Enters E-Filing Agreement*, *supra* note 40 (noting "that RALs are generally governed by state, not federal law").

179. WU ET AL., *supra* note 33, at 17.

180. *Id.* at 6.

181. *Id.* at 17-19.

182. Revenue Procedure 2000-31 is the official set of rules governing the IRS e-file program. Section 5.01 of this Revenue Procedure requires all e-file providers to abide by all IRS publications and notices governing the e-file program, including *IRS Publication 1345*. See Rev. Proc. 2000-31, § 5.01, 2000-02 C.B. 146.

suffered by taxpayers, [e-file providers], or financial institutions" with respect to a RAL.¹⁸³

The IRS's RAL rules require any e-file provider to disclose that (1) a lender has made a RAL with respect to a return; (2) the RAL is an interest bearing loan; (3) the RAL is not a substitute for a faster way to receive a refund; and (4) the taxpayer/borrower may be liable for additional interest if her refund is not received by the lender within the estimated period.¹⁸⁴ The IRS forbids an e-file provider and tax preparer from entering into a RAL as a lender.¹⁸⁵ However, the IRS does allow an e-file provider to charge a flat fee for facilitating a RAL.¹⁸⁶ However, before disclosing tax information to any RAL lender, the e-file provider must obtain the taxpayer's written consent. The government forbids a tax preparer from cashing a taxpayer's refund check with respect to a tax return she prepared. The IRS can sanction an e-file provider for any violation of *Publication 1345* by issuing a written reprimand, or suspending or expelling the provider from the e-file program.¹⁸⁷

Notably, the existing IRS's rules do not regulate RAL fees. Legislation introduced by Senator Jeff Bingaman, D-N.M., in April 2001 would require all RAL providers to register with the Treasury Department.¹⁸⁸ The proposed legislation provides that the Treasury Department would regulate RAL interest and fees to ensure that they are reasonable based on the benefit to the borrower and risk to the lender.¹⁸⁹ RAL providers who do not follow these requirements would be subject to a \$500 penalty for each incidence of noncompliance.¹⁹⁰

Additional regulation of RALs and strict enforcement of existing IRS rules may ensure that low-income taxpayers and lenders can engage in fair transactions, each deriving a reasonable benefit at a reasonable cost. Moreover, the more options low-income taxpayers have to receive their EITC benefits—for example, RALs, temporary bank accounts, free e-filing—the more competitive and acceptable RALs should become.

183. See IRS, HANDBOOK FOR AUTHORIZED IRS E-FILE PROVIDERS OF INDIVIDUAL INCOME TAX RETURNS 50–51 (2001) [hereinafter HANDBOOK], available at <http://www.irs.gov/pub/irs-pdf/p1345.pdf>.

184. See *id.*

185. See I.R.C. § 6695(f) (West 2003).

186. See HANDBOOK, *supra* note 183, at 52. The e-file provider may not accept a fee from a RAL lender that is contingent on the amount of the RAL. *Id.*

187. Rev. Proc. 2000-31, § 7.02, 2000-2 C.B. 147.

188. Low Income Taxpayer Protection Act of 2001, S. 802, 107th Cong. § 2(b)(1)(A)(i) (2001).

189. *Id.* § 2(b)(3).

190. *Id.* § 2(c)(2). The bill would have amended § 6695 of the Internal Revenue Code to provide for a \$500 penalty for each incidence of noncompliance. See *id.*

b. Providing Access to Free Tax Services: The I-Can! EITC Module

One problem in the IRS-Consortium's agreement is that low-income taxpayers do not have access to the Internet.¹⁹¹ Approximately 75% of taxpayers with earnings under \$15,000 and 67% of taxpayers with earnings between \$15,000 and \$25,000 do not use the Internet and approximately 46% of all taxpayers do not use the Internet.¹⁹² The Legal Aid Society of Orange County & Community Legal Services has identified lack of Internet access as a problem for its many low-income clients.¹⁹³ In response, this group has designed and installed I-Can! kiosks throughout Orange County, California and an Internet-based module to help a user prepare her tax return claiming the EITC.¹⁹⁴

I-Can! is a kiosk and Internet-based legal services system designed to provide free, "convenient, and effective access to vital legal services for lower income people."¹⁹⁵ I-Can! kiosks are located in courthouses, legal aid offices, community centers, women's shelters and libraries.¹⁹⁶ The Legal Aid Society staff designed I-Can! modules specifically for individuals with little knowledge of computers and many modules are in Spanish and Vietnamese.¹⁹⁷ The modules minimize the information submitted by a user "by providing multiple choices when possible."¹⁹⁸ Users can get instant assistance from a Help Center by touching an icon on the screen.¹⁹⁹ Specifically, the newest I-Can! module allows taxpayers who are eligible for the EITC to prepare their own tax returns on-line for free.²⁰⁰ The EITC module assists the taxpayer using text and a video tour guide in English, Spanish, or Vietnamese.²⁰¹

191. NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 100 (noting that the free on-line filing and tax preparation service "would not reach low-income taxpayers who lack access to or knowledge of this technology").

192. Letter from Jean Ann Fox et al., to Paul J. Mamo, *supra* note 42 (citing A NATION ONLINE, *supra* note 170).

193. See Legal Aid Society of Orange County, I-Can! Frequently Asked Questions, http://www.legal-aid.com/I-CAN/ican_faq.html (last modified May 21, 2001).

194. *Id.*

195. *Id.* The Legal Aid Society of Orange County developed I-Can! and was jointly sponsored by local, state, and public agencies as well as the State Bar of California-Legal Services Trust Fund Commission. *Id.*

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.*

200. See The I-Can! Earned Income Credit Module: Welcome!, <http://www.icanefile.com/front/lang.aspx> (last visited May 15, 2003).

201. *Id.*

In addition to the I-Can! EITC module providing free Internet-based, user-friendly tax assistance to low-income taxpayers, Senator Jeff Bingaman has proposed a bill to start a pilot program to create four mobile tax return filing offices with electronic filing capabilities.²⁰² Effectively, the idea is to put a free tax preparation system, similar to the I-Can! EITC module, on the road to deliver free income tax services to as many low-income taxpayers as possible. Mobile tax return filing offices will maximize taxpayer access by bringing the mountain to Mohammed. A mobile free income tax preparation system may answer access problems for the working poor who often do not have convenient transportation or flexible work schedules.²⁰³

4. PROPOSED CONSORTIUM AGREEMENT SUMMARY

The IRS-Consortium agreement has numerous notable and identified problems. However, free taxpayer services for low-income taxpayers are an appropriate and necessary goal.²⁰⁴ If the government can shift the cost of free services to the Consortium without the Consortium shifting the costs back to low-income taxpayers our government will have made great strides toward accomplishing this goal. A modified version of the agreement with certain enhancements may provide low-income taxpayers with a low-or no-cost alternative to their nearly \$2 billion per year expense. The following modifications to the Consortium agreement could go a long way toward that goal: (1) regulation, monitoring, and full disclosure of RALs and other fast cash and ancillary products and services; (2) assurance of free pre-filing customer service assistance for technical software and hardware issues (rather than customer service for specific tax questions, which the IRS already provides and should continue to deliver); (3) reasonable state tax preparation and filing fees; and (4) support for fast access to EITC dollars through free and convenient Internet access and bank accounts.

202. See Low Income Taxpayer Protection Act of 2001, S. 802, 107th Cong. (2001). In his comments introducing his bill to the Senate, Senator Bingaman noted that 83% of the low-income population in Gallup, New Mexico used a paid preparer. 147 Cong. Rec. S4049 (daily ed. Apr. 30, 2001) (statement of Sen. Bingaman).

203. 147 Cong. Rec. S4049 (daily ed. Apr. 30, 2001) (statement of Sen. Bingaman).

204. See NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 95-103 (noting that one of the twenty-three serious problems encountered by taxpayers is inadequate free U.S. individual income tax return preparation).

D. Expanded VITA Clinics

Another alternative solution to the problem is to provide low-income taxpayers with free tax preparation and filing services, through the direct provision of these services through an expanded and funded version of the IRS's formal volunteer program, VITA.²⁰⁵

I. HISTORY OF VITA PROGRAM

The IRS established the VITA program in 1970 using trained volunteers to assist low-income taxpayers with free tax preparation services in libraries, community centers, college campuses, and other public facilities.²⁰⁶ While there is no direct funding from the IRS to support VITA clinics, the IRS does provide on-site training, extensive training materials, free tax preparation software, and temporary use of computer equipment.²⁰⁷ During 1999, 40,000 VITA volunteers from 7,701 sites assisted 1.88 million taxpayers.²⁰⁸ Unfortunately, the actual number of tax returns completed is significantly lower than the number of taxpayers assisted. For the 1997 tax year, VITA clinics prepared 500,000 tax returns, including only 101,000 EITC returns and 90,000 returns with adjusted gross income exceeding \$30,000.²⁰⁹ In 2000 and 2001, VITA clinics prepared over 596,000 and 648,000 tax returns, respectively, or .5% of the total returns filed for all income levels.²¹⁰ However, most notably, VITA clinics prepared less than 1% of tax returns for EITC eligible individuals in 2000 and only .5% of tax returns for EITC eligible individuals in 2001.²¹¹

Without any funding, VITA clinics often operate without adequate resources or professional supervision during the two or three months preceding April 15.²¹² Due to significant staffing shortages, the IRS

205. See *id.* at vii. Nina Olsen, the National Taxpayer Advocate, supports the creation of an IRS-administered grant program for free tax preparation for low-income taxpayers, but does not want such funding to dilute existing VITA programs. *Id.* Similarly, the proposed program is in addition to rather than instead of existing VITA clinics.

206. See Sullivan, *supra* note 38, at 608.

207. NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 98 (describing VITA and TCE programs).

208. O'Connor, *supra* note 17, at 244.

209. *Id.*

210. NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 97.

211. See *id.* at 99-100.

212. *Id.* at 98-99. Computer equipment and technical support needed in VITA programs are lacking significantly. *Id.* The IRS estimates that at least 4,500 additional computers are needed to support the volunteer programs. PAMELA J. GARDINER, ACTING TREASURY INSPECTOR GEN. FOR TAX ADMIN., FINAL AUDIT REPORT—THE INTERNAL

expects to close approximately 1000 volunteer sites nationwide in 2003.²¹³ “This continued decline in volunteer sites contradicts the IRS’s strategy of reducing the volume of taxpayers it serves in its walk-in tax assistance sites by expanding the number of volunteer sites.”²¹⁴ Access to free income tax preparation is one of the most serious problems encountered by taxpayers.²¹⁵ In response to this problem, “[t]he National Taxpayer Advocate recommends that Congress authorize and appropriate funding for a grant program modeled after the [LITC] program, for community-based coalitions to provide low income taxpayers not only with free tax preparation but also with education about and opportunities to bank and save their tax refunds.”²¹⁶

2. EXPANDED VITA PROGRAM WOULD SHIFT THE COST OF TAXPAYER COMPLIANCE FROM LOW-INCOME TAXPAYERS.

An expanded and funded year-round VITA program would shift the cost of taxpayer compliance from taxpayers to the government and other nonprofit organizations and local sponsors. Several proposals to fund VITA programs range from \$6 million to \$50 million of funding to prepare 800,000 to 4,000,000 low-income tax returns.²¹⁷ VITA program advocates argue that an expanded VITA program could

REVENUE SERVICE NEEDS TO IMPROVE THE PRE-FILING TAX SERVICES PROVIDED TO TAXPAYERS 11 (Sept. 2002), available at <http://www.treas.gov/tigta/2002reports/200240174fr.pdf>.

213. See GARDINER, *supra* note 212, at 7; NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 98–99.

214. GARDINER, *supra* note 212, at 7.

215. See NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 101.

216. *Id.* at 103.

217. The CARE Act of 2003, see *supra* note 48, among other things, provides a matching grant program for up to \$10 million per year (of available appropriated funds) for “qualified return preparation clinics.” A “qualified return preparation clinic” must (1) not charge more than a nominal fee (except for reimbursement of actual costs incurred) for tax return preparation and (2) assist taxpayers (at least 90% of assisted taxpayers must have income levels which do not exceed 250% of the poverty level) with tax preparation and filing through (a) a clinical program at an eligible educational institution with student assistants or (b) another qualifying tax exempt organization. CARE Act of 2003, S. 476, 108th Cong. § 312 (2003). The U.S. House of Representatives is expected to begin work on a comparable bill, which may or may not provide for a similar matching grant program, in the next few months. Stokeld, *supra* note 49; BERUBE ET AL., *supra* note 2, at 16 (proposing matching grant program of at least \$7 million and requesting \$20 million to support expanded VITA clinic preparation of 800,000 low-income tax returns); see also Low Income Taxpayer Protection Act of 2001, S. 802, 107th Cong. § (3)(b)(3)(a) (2001) (proposing authorization of appropriation of \$6 million for VITA clinics); O'Connor, *supra* note 17, at 249–50 (proposing \$50 million federal funding for VITA clinic preparation of 4 million low-income tax returns).

decrease the demand for tax preparation at IRS walk-in offices.²¹⁸ “If the number of returns prepared by IRS staff is reduced by only half, from 850,000 to 425,000, the IRS will save about \$25 million (250 person years) now allocated to tax preparation work.”²¹⁹ Moreover, if funded VITA clinics drive at least 50% of marginal tax preparers out of the industry, the number of overclaimed EITC benefits could drop by almost \$770 million.²²⁰ If VITA volunteers shift these overclaimed benefits to working families who could not claim their legitimate EITC benefits because they lacked access to capable tax preparation assistance, the government and low-income advocates would accomplish several goals.

The proposals for expanded and funded VITA clinics mirror the IRS’s matching fund grant program for LITCs.²²¹ LITCs are one of the true successes of the IRS Restructuring and Reform Act of 1998.²²² Currently, there are more than 100 LITCs providing services to thousands of taxpayers.²²³ In 2002, Congress appropriated \$7 million for LITCs to provide legal assistance to thousands of individuals attempting to resolve tax disputes.²²⁴ Advocates of LITCs argue that “largely because of the success and remarkable growth of the LTC program” they need more funding.²²⁵ An expanded VITA program may resolve some of the lack of funding for LITCs, because some LITCs are using LTC program funds as a means of addressing the demand for low-income tax return preparation.²²⁶ LTC advocates welcome and

218. O’Connor, *supra* note 17, at 250; *see also* NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 98 (stating that Director of Field Assistance has found that 25% of available resources were used to serve 10% of taxpayers requesting assistance with tax return preparation).

219. *See* O’Connor, *supra* note 17, at 250 (requiring \$100 million (\$50 million of federal funds matched with \$50 million of other funds) for preparation of 4 million tax returns at an estimated cost of \$25 per return).

220. *Id.* at 250 & n.103 (calculating that regulation of marginal preparers (who file about 6 million EITC tax returns (or 30% of the almost 20 million EITC returns)) could decrease the EITC error rate from 30% to 18% causing the number of erroneous returns to decrease by more than 700,000 returns (that is, from 1.8 million returns (30% of 6 million) to 1.1 million returns (18% of 6 million)) resulting in almost \$770 million in savings (\$1,098 average overclaimed EITC x 700,000 returns)).

221. The IRS Restructuring and Reform Act of 1998 provides that up to \$6 million may be expended annually, up to \$100,000 per clinic, per year. I.R.C. § 7526 (c)(2) (West 2003); *see* Sullivan, *supra* note 38, at 608; *see also* NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 103 (suggesting that tax preparation assistance grants be modeled after the LTC program).

222. *See* Book, *supra* note 44, at 1089–90.

223. *See id.* at 1090.

224. *See* BERUBE ET AL., *supra* note 2, at 16.

225. Book, *supra* note 44, at 1092.

226. *See id.* at 1093.

applaud efforts to fund expanded VITA programs to ensure that LITCs may focus on representation and ancillary nonreturn preparation outreach work to non-English speaking individuals.²²⁷ The matching grant requirement for VITA programs, like the matching grant requirement for LITCs, may encourage state and local governments and non-profit groups to create and support free state income tax services through their local VITA programs.²²⁸

3. VITA CLINICS COULD ASSIST TAXPAYERS WITH AFTER-FILING CORRESPONDENCE AND AUDITS.

An expanded VITA program “should be expected to maintain limited capacity for assistance to eligible taxpayers outside the regular filing season, with regard to counseling on responses to math error letters and correspondence audits.”²²⁹ This additional assistance should reduce taxpayer demand for these services from the IRS²³⁰ and LITCs. Moreover, expanded VITA clinics could reduce the cost to government and taxpayers of nonresponsiveness and the all too common and unnecessary costs due to acceleration of a trivial matter to a major problem.²³¹

4. VITA CLINICS COULD FACILITATE BANKING AND PROVIDE EDUCATIONAL PROGRAMS.

An expanded VITA program could facilitate the Treasury Department’s program to move the “4 million low-income unbanked families into successful relationships with mainstream financial

227. *Id.* at I094.

228. O’Connor, *supra* note 17, at 249.

229. *Id.*; see Leslie Book, *The IRS’s EITC Compliance Regime: Taxpayers Caught in the Net*, 81 OR. L. REV. 351, 390-92 (2002) (noting that of the 325,000 taxpayers receiving EITC correspondence for 2000 almost 70% failed to adequately respond and 25% of taxpayers denied EITC benefits by IRS compliance efforts were entitled to the EITC).

230. See NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 97-98 (setting forth the fiscal year 2003 IRS Operations’ Strategic Plan to reduce tax return preparation by 25% or approximately 77,000 low-income taxpayers not receiving assistance).

231. Among the list of the most serious problems encountered by taxpayers, the National Taxpayer Advocate noted several problems that could be mitigated by expanded VITA clinics. If trained VITA preparers assist taxpayers with EITC tax preparation and post-filing matters taxpayer problems with the burdensome EITC eligibility (Topic #6), financial hardship caused by EITC audits because the taxpayer’s entire refund is held (Topics #5 & #7), taxpayer frustration with lack of IRS response during EITC exams (Topic #8), unscrupulous EITC return preparers (Topic #9), taxpayer frustration with extensive length of EITC audits (Topic #10), and the burdens of EITC recertification (Topic #11) should be minimized. See *id.* at 47, 55, 64, 69, 75, 81.

institutions.”²³² In 2000 and 2001, Congress appropriated \$12 million for this project.²³³ VITA volunteers could assist low-income families in setting up temporary bank accounts for EITC funds as well as develop more permanent banking relationships. Throughout the year, VITA professionals could teach basics of household budgeting and debt management including full disclosure and explanation of the true costs of RALs.²³⁴ Raising awareness about the costs of and alternatives to RALs may help to ensure that only knowledgeable individuals willingly enter into RAL transactions.

5. EXPANDED VITA PROGRAM PROVIDES A TARGETED AND EFFECTIVE REMEDY

Expansion and funding of the VITA program is a multi-layered complement to the success of LITCs. As a result, LITCs will be able to focus more specifically on their mission to assist in legal taxpayer representations.²³⁵ VITA programs will have the resources to hire full-time, permanent professionals and buy computer equipment to support the Consortium’s free tax preparation and filing software, I-Can! EITC modules, mobile tax preparation vehicles, and tele-filing.²³⁶ VITA volunteers and employees will be integral in the regulation of RALs by their educational and disclosure efforts for low-income families and their constant monitoring of the Consortium member’s websites and services.²³⁷ Moreover, VITA volunteers and employees can facilitate

232. BERUBE ET AL., *supra* note 2, at 17 & 23 n.60 (noting that a “First Accounts” program has been implemented in Chicago and Detroit to connect 1,000 EITC recipients to bank accounts).

233. *Id.*

234. See NATIONAL TAXPAYER ADVOCATE, *supra* note 1, at 103 (suggesting that the grant program fund education about and opportunities to bank and save refunds).

235. See Book, *supra* note 44, at 1093.

236. Funding should mitigate the lack of resources that has undermined the effectiveness of volunteer VITA clinics. See GARDINER, *supra* note 212, at 10–13. The IRS currently provides that certain taxpayers may prepare and file their Form 1040EZ tax returns over their telephone using a toll-free number. This tax preparation system is very user-friendly and provides broad access to low-income taxpayers. Senator Bingaman has proposed that this program should be more broadly available. See Low Income Taxpayer Protection Act of 2001, S. 802, 107th Cong. § (3)(b)(3)(c) (2001) (proposing that tele-filing be available for all taxpayers for the filing of tax returns with respect to taxable years beginning in 2001). Unfortunately, more complicated tax preparation and filing is not likely to be adaptable to a telephone preparation and filing system for the IRS or taxpayers. However, if the program could be broadened to more taxpayers, it could provide a very accessible free tax preparation system.

237. In response to low-income advocate concerns over excessive RAL costs, the IRS has asked the National Taxpayer Advocate and the Taxpayer Advocacy Panel to

the Treasury Department's goal to bank the unbanked. State and local government and nonprofit groups should support VITA programs with cash and noncash resources to ensure that they achieve their complementary goals of providing user-friendly state tax preparation services to low-income individuals.²³⁸

IV. CONCLUSION

A. Belts, Suspenders, and Safety Pins

While all of the foregoing solutions offer some promise and some challenges, there is no one remedy to the problem of expensive and burdensome low-income tax preparation and filing. Unfortunately, complex national problems demand complex national solutions. Simplification of our tax system has been a persistent, unfulfilled dream and may be an unreachable star. The working poor and their children have neither the time nor the patience for Don Quixote and Sancho Panza to right this unrightable wrong. These families have upheld their side of the welfare to work contract; they are out in the work force scraping out a living. We owe these children and their working parents a fighting chance at survival; that is, the funding necessary to provide adequate shelter, food, clothing, and warmth.

Congress has set aside EITC benefits to lift the working poor and their children out of poverty. The problem is that, through the delivery process, EITC benefits intended for the working poor end up in the pocketbooks of commercial tax preparers and RAL lenders. The anti-poverty purse has a hole. Congress must weave a patch.

Numerous materials are available with which Congress can weave its solution. The tax services tax credit would shift the cost of tax preparation and filing to the government. Given increasing budget deficits, a war on terrorism and a stalled economy, the government is out of the \$2 billion of required spare change. Moreover, under certain economic conditions the tax credit could result in increased tax service costs equal to the amount of the credit. The result would be that the government shifts \$4 billion (\$2 billion of EITC benefits and the \$2 billion tax credit) rather than the current \$2 billion to commercial tax

advise the IRS regarding Consortium member activities. See *IRS Enters E-Filing Agreement*, *supra* note 40.

238. See, e.g., David Kersten, *California FTB OKs Major Expansion of Free Electronic Filing*, ST. TAX TODAY, Dec. 6, 2002, LEXIS, 2002 STT 235-2 (voting to expand free e-filing for nearly 9 million of the 14 million taxpayers and bring its e-filing system in line with twenty-four other states that offer free on-line filing of returns).

preparers. The tax credit may exacerbate, not solve, this complicated and expensive problem.

The last two options packaged together may provide the most effective patch for the hole in the anti-poverty purse. The IRS should amend its Consortium agreement as follows: Consortium members must provide effective customer service regarding technical applications of their software at no cost to taxpayers using the free software. State tax returns may be included in the software for free or for a reasonable fee. Consortium members already have facilities to service customers and provide state tax preparation and filing and any increased costs should not be material. RALs and similar fast cash products and services should be government regulated and strictly monitored by the IRS under its existing rules.

The government should save more than one hundred million dollars by entering into the agreement with the Consortium. The government should spend some of these savings to fund year-round VITA clinics, I-CAN! kiosks and mobile units, and increased tele-filing capability to support active and on-going assistance for low-income taxpayers. These programs would provide free tax preparation and e-filing services and assistance using the Consortium's or alternative free tax preparation and filing products. VITA clinics could use the Consortium's free tax preparation and filing products and provide a regular check and balance on Consortium products, services, and each member's compliance with the IRS's requirements. Year-round VITA clinics, I-Can! kiosks and mobile units could facilitate the Treasury Department's goal of establishing millions of bank accounts for the 4 million unbanked. Year-round VITA clinics could assist low-income taxpayers with after-tax season IRS correspondence and audits, and education regarding and monitoring of RALs.

The government can begin to patch the hole it made in the anti-poverty purse by joining the strong will of American businesses to make a reasonable profit and the strong sense of responsibility low-income advocates have to deliver the promised benefits under America's contract with the working poor. Implementation of a modified Consortium agreement coupled with funding of accessible, convenient, and effective low-income taxpayer support programs could provide the much-needed fix.