

How Can I Ensure That Low-Income Workers Receive the Earned Income Tax Credit?

Amy Brown

Answer

Since its creation in 1975, the Earned Income Tax Credit (EITC) has grown to become the nation's largest antipoverty program. The \$31 billion that the credit provided to working families in 2001 equaled what Washington spent on TANF and food stamps combined, and the EITC lifts more families and children out of poverty than any other government program.¹ For tax year 2002, workers earning up to \$34,178 were eligible for the EITC, and the maximum benefit was \$4,140. The EITC has also been a key component in state and local welfare-to-work efforts. By supplementing low-wage work, the EITC helps make work pay, thereby encouraging employment and promoting job retention. The EITC can also be a powerful economic development tool for low-income communities, as tax refunds are spent locally and work their way through the economy. Recognizing all these benefits, state and local governments, as well as nonprofit organizations and some businesses have launched efforts to promote the EITC and help workers access it.

What is the EITC?

The EITC is a refundable tax credit, meaning that it not only reduces the amount of tax owed, but if the tax liability is zero, returns money to the worker as a refund check. Nearly 19 million workers claimed the EITC in tax year 2000, and the average EITC recipient qualified for a refund of more than \$1,600. Some workers receive a portion of their federal EITC each month with their paychecks as an "Advance EITC."

The amount of the credit varies based on the taxpayer's income and number of qualifying children listed as dependents (see Box 1). The largest credits go to families with two or more children earning roughly \$10,000 to \$14,000 a year. For tax year 2002, for the first time, married couples filing a joint tax return receive EITC benefits that are slightly more generous than those refunded to single individuals or single parents.

Box 1: Federal EITC Benefits for Tax Year 2002			
Number of Dependent Children	Maximum EITC Amount	Maximum Income Qualifying for the EITC at Phase-Out	
		Filing Status: Single, Head of Household, Qualifying Widow(er)	Filing Status: Married, Filing Jointly
None	\$376	\$11,060	\$12,060
One	\$2,506	\$29,201	\$30,201
Two or more	\$4,140	\$33,178	\$34,178

The EITC not only provides financial benefits to individuals but is also increasingly viewed as an economic development tool for communities. The lion's share of refunds received by low-

¹ Center on Budget and Policy Priorities, 1998.

income tax filers go to meet immediate needs and get spent locally, providing a significant influx of dollars in many communities. At the same time, many local initiatives are attempting to use the EITC to promote asset development, encouraging tax filers to open savings accounts and even matching savings through Individual Development Accounts (IDAs)

Supplementing the federal EITC, 17 states, including the District of Columbia, offer state Earned Income Tax Credits,² and Montgomery County, Maryland, and the City/County of Denver have local EITCs. These credits are generally calculated as a percentage of the federal credit and may or may not be refundable, depending on the state or locality. State EITCs can further increase the impact of the federal credit, targeting resources to working families and offsetting sales and other local taxes.

The EITC is the largest, but not the only, tax credit available to low-income working families. The federal Child Tax Credit (worth up to \$600 per child), for example, and credits for child care and education expenses can further add to a taxpayer's refund.³ Tax law changes enacted in 2001 expanded the Child Tax Credit and made it partially refundable, increasing its value to low-income families. States often offer additional credits as well (and some state credits may be refundable). When fully utilized, these credits can add up to thousands of dollars in tax refunds for working families. The eligibility rules, required forms, and mathematical calculations for each credit are different, however, complicating the tax filing process.

In most cases, the EITC does not affect eligibility for TANF, food stamps, Medicaid, and other benefits (and receipt of these benefits does not affect eligibility for the EITC).⁴ Indeed, because many recipients of government benefits work part time or part year at low wages, they are likely to be key target groups for EITC outreach.

How Many Families Do Not Receive These Benefits and Why?

Over the past decade, several studies have attempted to determine what proportion of eligible workers receives the EITC.⁵ While each has used a different methodology, their results are strikingly similar in estimating that between approximately 80 percent and 85 percent of those who qualify claim the credit. This figure is much higher than participation rates for other government benefits, such as food stamps (for which participation rates hover around 60 percent).

Nevertheless, some eligible populations have much lower participation rates, and research suggests that these include families with very low incomes (below \$10,000). Within this group, welfare recipients, individuals with less than a high school education, and those with language barriers have especially low participation rates. For example, only 32 percent of very low income Hispanic families know about the EITC, and just 18 percent report that they have claimed it. By contrast, more than three-quarters (76 percent) of non-Hispanic white families are aware of the credit and more than half (53 percent) claimed it. For all families, those proportions were 64 percent and 43 percent, respectively.⁶ Large cities and other areas with large numbers of immigrants or families moving off welfare may therefore have lower participation rates than the national average. Because the number of eligible families is so large, nonparticipation can mean a significant loss of resources. In New York

² Indiana's EITC takes effect in 2003, and Colorado's is currently suspended due to revenue shortfalls.

³ The Child Tax Credit is partially refundable for families earning \$10,300 or more in tax year 2002.

⁴ Under TANF, states have the authority to set their own EITC rules, and no state counts the credits as income. For food stamps, federal EITC benefits are excluded as a resource for new applicants in the month received and the following month; for current food stamp recipients, both federal and state EITC payments are excluded as a resource for 12 months following receipt.

⁵ See Hill et al., 1999; IRS, 2002; Phillips, 2001; Scholz, 1994; and U.S. General Accounting Office, 2001.

⁶ Phillips, 2001.

City, for example, officials estimate that 230,000 eligible workers do not claim the federal and state EITC, resulting in a loss of as much as half a billion dollars to the local economy each year.⁷

To receive the EITC, a worker must file a 1040, 1040A or 1040EZ federal tax return, using a special tax table to determine the correct amount of the credit and entering it on the appropriate line. (Workers with qualifying children may not file the 1040EZ and must complete an additional Schedule EIC.) Eligible workers who have not claimed the EITC or other tax credits in previous years can submit their taxes for up to three years and retroactively receive the credits to which they were entitled.

Those who do not claim the EITC fail to complete the necessary forms or fill in the appropriate lines for the EITC, or they do not file a tax return at all. Many simply do not know about the EITC or that they qualify for the credit. Even when workers are aware of the EITC and know that they qualify, they often run afoul of complicated rules that make it difficult for them to file for the credits, particularly if they complete the returns themselves. Some may have incomes so low that they are not required to file a tax return, and others may fear owing money if they file. Still others may decide not to file because they cannot afford to pay for tax preparation services. People who provide care to grandchildren, foster children, or disabled adult children may not know that they qualify for the EITC.

Box 2: The EITC in MDRC's Research

Although the Earned Income Tax Credit program has not been the specific focus of MDRC's research, several studies of welfare-to-work programs have examined EITC participation and its impact on earnings

The EITC figured prominently as an income source in **New Hope**, a program that operated in Milwaukee, Wisconsin, in the 1990s. New Hope increased by \$1,389 the average two-year earnings of program participants who worked. The program boosted this income with an earnings supplement, which together with the EITC, raised total household income by \$2,645 over the two-year follow-up period. The higher total income made it possible for many participants to work their way out of poverty.

The New Hope program focused considerable effort on marketing the EITC and other work supports. For example, New Hope's board and staff wanted to be sure that participants were aware that by taking advantage of the Advance EITC payments, they could increase the amount of money they had to live on each month. Staff tried many approaches to educate participants about the EITC, including adding a line to participants' monthly New Hope benefit statement to show them how much they could receive in Advance EITC payments from their employer (Bos et al., 1999).

In their evaluation of **Vermont's Welfare Restructuring Project**, MDRC researchers used a follow-up survey to ask if participants received a tax refund or claimed the EITC. Survey results revealed that rates varied by respondents' income and were substantially lower for those with very low earnings. Only 30.5 percent of those earning less than \$1,000 received the EITC, compared with 70.2 percent of those earning between \$1,000 and \$5,000; 91.6 percent of those earning between \$5,000 and \$15,000; and 86.2 percent of those earning more than \$15,000. (Scrivener et al., 2002.)

Survey respondents from **Connecticut's Jobs First** program were asked a similar question with similar results. Only 37.3 percent of those earning less than \$1,000 reported filing a federal tax return, compared to 56.6 percent of those earning between \$1,000 and \$5,000; 86.9 percent of those earning between \$5,000 and \$15,000; and 93.5 percent of those earning more than \$15,000. (Bloom et al., 2002.)

⁷ Mayor Michael Bloomberg, press conference, December 30, 2002.

Free Tax Preparation, Paid Preparers, and Refund Anticipation Loans

The majority of all tax filers — and more than 60 percent of EITC filers — turn to paid tax preparers for assistance in completing their returns. The number and complexity of forms and rules, literacy issues, and concern about making errors all contribute to the demand for tax assistance. Indeed, paid tax preparers often target low-income filers: Neighborhoods with the highest percentage of working poor families also have the highest percentage of commercial tax-preparation services.⁸

Unfortunately, paid preparers too often take advantage of low-income filers, charging high fees and promoting Refund Anticipation Loans (RAL) with interest rates that can run as high as 774 percent APR. The total cost of tax preparation for an EITC-eligible tax filer is typically about \$200, with roughly half the fee covering tax preparation and filing services and the other half for a RAL. (Nearly half of EITC benefits nationwide are refunded through RALs.)⁹ In addition to responding to the lure of getting their money more quickly, low-income filers who cannot pay the cost of tax preparation up front use refund loan proceeds to cover the preparer's fees. In 1999, an estimated \$1.75 billion in EITC refunds was diverted to pay for tax preparation, electronic filing, and refund loans.¹⁰

Free tax preparation is available in some communities through Volunteer Income Tax Assistance (VITA), an IRS-sponsored program staffed by trained volunteers. With training, materials, and other support provided by the IRS, VITA programs are generally managed by community groups that recruit the volunteers and oversee the sites. Unfortunately, there are few VITA programs in most areas, and most of those are available only at very limited hours. In tax year 2001, for example, only 600,000 returns were prepared at VITA sites out of 38 million returns filed by taxpayers with incomes below \$33,000.¹¹

The EITC as a Tool for Asset Development

Low-income families who struggle to make ends meet have a difficult time developing savings and other assets. Most EITC recipients use their refunds primarily for immediate needs, like paying rent and utilities or purchasing such basics as food and clothing. Recognizing how significantly the EITC boosts many families' income, several initiatives are beginning to incorporate the EITC into asset-building campaigns. A significant number of EITC recipients are interested in saving a portion of their refunds for longer-term goals, including tuition, purchasing a car, or paying off debt. A study of 5,000 low-income taxpayers in Chicago found that half planned to save at least some of their EITC.¹²

A major barrier to asset development is lack of access to mainstream financial institutions. According to the Federal Reserve, 22 percent of families earning less than \$25,000 lack a bank account of any kind.¹³ Tax filers with accounts can get their refunds within 7 to 10 days through electronic filing and direct deposit, providing a low-cost alternative to RALs. Furthermore, the Fed study reports, people with bank accounts are more likely to save part of their EITC. Initiatives in several cities have developed partnerships with banks and credit unions to operate VITA in bank branches or outstation bank personnel at VITA sites to help tax filers open accounts. Going a step further, some programs link EITC recipients with Individual Development Accounts (IDAs). IDAs use federal and state funds, together with locally raised funds, to match individual savings for specific purposes, such as education, home ownership, or starting a business.

⁸ Wu, 2002.

⁹ Berube, 2002.

¹⁰ Berube, 2002.

¹¹ National Taxpayer Advocate, 2002.

¹² Smeeding, 2000.

¹³ Berube, 2001.

Nine Ways to Promote the EITC

Now that the 2002 tax season has ended, preparation for 2003 can begin. Here are nine ways to promote EITC use in the next tax season.

- 1. Consider instituting or expanding a state or local EITC.** State and local EITCs supplement the federal credit, offer additional assistance to low-income workers and their families, and can help offset state and local taxes that disproportionately impact lower-income families. Because they work through the tax system, state and local EITCs are relatively easy and inexpensive to administer, especially compared to programs that rely on case management. The cost of a state or local EITC will depend on how many families claim the credit, how generous the credit is, and whether or not the credit is refundable.¹⁴ State credits are most often financed through a state's general fund, though TANF funds may be used to finance part of the cost of a refundable credit. States and localities may also choose to dedicate a specific source of tax revenues to support an EITC. In these times when many states face large budget deficits, it may be difficult to build support for implementing or expanding the EITC. But when considering the costs, it is also important to factor in the expected boosts to the local economy through increased consumer spending and the positive economic and social effects of increased employment and income for poor families.
- 2. Create an EITC education campaign and information hotline.** States and localities can spread the word about the EITC through the media, partnerships with business and community organizations, and direct outreach to potentially eligible workers. Draw media attention through high-profile press conferences and press releases. Advertise through radio, television, newspaper, and public transit ads. Include information on grocery bags and mail-stuffers with utility bills. Many campaigns use telephone hotlines to provide more detailed information and refer callers to free tax preparation sites. Outreach efforts should be multilingual as needed and include basic eligibility guidelines, consumer education about RALs, and referrals to VITA sites. The key season for EITC outreach is early January through mid-April, but planning takes time — be sure to start early to be ready when the tax season begins. Remember that tax law, including rules for the EITC and other credits, is complicated and changes each year. Rather than getting caught up in the details, an outreach campaign should spread a broad message about the availability of tax benefits for working families using general eligibility criteria and refer people to free tax preparation services.
- 3. Publicize and promote the VITA program, and support and expand free tax-filing assistance.** Any local outreach effort should include marketing free income tax preparation programs and referring tax filers to VITA sites. Each state or region's IRS Territory Manager can provide information on local VITA programs. Include information about free tax-assistance locations with all outreach materials, mailings, and hotlines. Work with the local IRS Territory Manager to establish new sites, expand capacity at existing sites, increase the availability of evening and weekend hours, and facilitate transportation to sites in more remote areas. Reach out to community organizations and nonprofits that might be interested in sponsoring a VITA site. Local leaders can use their position to recruit volunteers, especially bilingual volunteers and skilled accountants. Also, help tax sites take advantage of technology to file returns electronically, thereby facilitating quicker refunds for tax filers. Expansion of VITA also requires financial support. Though returns are mostly prepared by volunteers, paid staff may be needed to manage the sites, schedule volunteers, and review returns.
- 4. Maintain a commitment to quality.** When looking to expand the availability of free tax preparation, bear in mind that taxes are complicated. High-quality training and

¹⁴ For information on calculating the cost of a state EITC, see Center on Budget and Policy Priorities (2000).

quality-control mechanisms are essential components of tax preparation programs, even if volunteers are experienced accountants. Using computer software to prepare returns can reduce mathematical and other errors. Many sites use paid tax accountants to review returns as a quality-control measure. It is also important to protect consumers from unqualified or disreputable paid tax preparers. Enforce existing disclosure laws related to RALs and other consumer protections. Legislative action can also be taken to regulate preparer fees and control RALs.

- 5. Educate consumers about RALs and promote alternatives to high-priced loans.** Many tax filers do not realize that “rapid refunds” are actually loans, nor do they understand how much they cost. Consumer awareness about high-priced refund loans should be balanced by knowledge of lower-cost alternatives. Electronic filing can facilitate quicker refunds at substantially less cost than a loan. Direct deposit to a bank account can make a refund available to the tax filer in as little as seven to ten days, nearly as fast as many loans. Help ensure that VITA programs have the technology to file tax returns electronically and work with financial institutions to open accounts for direct deposit. Offer advice to tax filers who use paid preparers, including how to choose a reputable preparer, the need to check that the preparer has signed the return, the importance of reviewing and keeping a copy of the return, and the need to understand what fees they are being charged.
- 6. Build a local coalition around the EITC.** Bring together elected officials, government agencies, the business community, faith-based institutions, community organizations, organized labor, and the media to work together to promote awareness about the EITC and expand free tax assistance. Include the IRS as a key partner, and begin by collecting local data about EITC eligibility and benefits claimed, community demographics, VITA programs, and commercial tax preparers. As in any coalition, it is important that one person or agency be responsible for coordinating activities and that clearly defined roles and expectations be established for each partner. In Chicago, Mayor Richard Daley hosts an annual corporate breakfast at which he promotes the importance of the credit to employees, consumers, and the local economy. Staff from the Mayor's office then follow up with corporate leaders to develop specific plans for their involvement in the campaign.
- 7. Reach out directly to eligible populations, and target groups that are less likely to receive the EITC.** Direct outreach should target low-income workers and families likely to be eligible for the EITC. Businesses, government agencies, and nonprofit organizations can publicize the EITC to their low-wage employees through paycheck stuffers. Information can be included as inserts to utility and other bills or printed on grocery bags. Government agencies and nonprofit organizations that serve low-income individuals and families can send information to their clients. Schools, child care providers, foster care agencies, and job-training programs can all distribute information. Often overlooked, labor unions that represent low-income workers, such as home health aids or restaurant workers, can provide targeted outreach to their members; for example, they might focus on those who have not been eligible in the past but who have seen their incomes decline due to a lost job or a cut in hours or wages. Focus on very low-income workers who are less likely to know about or receive the EITC. Welfare-to-work programs generally maintain contact with individuals who have taken jobs, and they can help link former recipients with the EITC and free tax assistance. Work with the non-English-language press and other media, like radio stations, to build links with organizations that are trusted in immigrant communities.
- 8. Combine EITC outreach with asset-building strategies.** To help EITC recipients make the most of their tax refunds, combine education and free tax assistance with opportunities to open bank accounts and begin saving toward long-term goals.

Partnerships with banks and credit unions can provide access to low or no-fee savings accounts, home ownership programs, IDAs, financial literacy education, credit counseling and debt-management assistance, and other services. Chicago's ShoreBank provides space in retail branches for free tax preparation, and offers tax filers the opportunity to open bank accounts with no monthly fees and no minimum balance. For programs already working on asset development, linking with tax preparation services can take advantage of the time of year when people assess their financial situation as well as receive what may be a significant cash refund.

- 9. Link EITC outreach with other work supports to ensure families receive all the supports available to them.** Work supports can fundamentally change the income calculus for low-wage workers, and in many cases can lift families out of poverty. In addition to the EITC, many working families may be eligible for food stamps; health insurance, including transitional Medicaid, Medicaid, and the Children's Health Insurance Program (CHIP); and child care subsidies, including transitional child care and other state and local programs. However, it can be difficult for working people to learn about these supports and other employment assistance, or apply for them, because these programs are usually not housed in one accessible location. To ameliorate this situation, MDRC is developing the National Work Advancement and Support Center Demonstration in several communities around the country to establish Work Support Centers — locations where staff would assist low-wage workers for job retention and advancement services as well as help them gain access to financial work supports

QUESTION: How Can I Ensure That Low-Income Workers Receive the Earned Income Tax Credit?

FOR FURTHER INFORMATION

EITC Campaigns, Organizations, and Web Sites

Annie E. Casey Foundation: (www.eitc.info). The foundation's "National Tax Assistance for Working Families Campaign" supports EITC campaigns in 24 cities and three rural areas. The campaign promotes outreach; free or low-cost tax preparation; and asset-building activities. The project's Web site includes materials from the various campaigns as well as a "How-to" kit for emerging campaigns.

Brookings Institution: (www.brookings.edu). The Center for Urban and Metropolitan Policy has issued a series of reports examining the impact of the EITC on metropolitan regions and the price of paid tax preparation services, including RALs. The Web site provides links to these reports as well as detailed data by zip code, city, and metropolitan area.

Center on Budget and Policy Priorities: (www.cbpp.org). CBPP produces a comprehensive annual Earned Income Credit Campaign Kit that includes information on the EITC and other tax credits, recommendations for planning and operating an outreach campaign, and descriptions of efforts from across the country. The kit also includes sample outreach materials, such as posters and envelope stuffers, available in many languages.

Center for Economic Progress: (www.centerforprogress.org). Based in Chicago, the Center for Economic Progress operates the nation's largest tax preparation program, completing 27,000 federal and state income tax returns in 2002. CEP also houses the National Tax Coalition, a coalition of tax assistance programs that provides technical assistance to emerging initiatives and speaks out on tax issues impacting the working poor.

Community Action Project of Tulsa County: (www.freetaxes.net). CAP conducts an outreach campaign in Tulsa utilizing both media advertising and outreach through government, community agencies, and faith-based organizations. The Project also runs tax preparation sites, using Community Development Block Grant funds. In 2001, its sites completed more than 12,000 tax returns, generating \$12.7 million in EITC refunds.

Internal Revenue Service: (www.irs.gov). The IRS Web site provides all tax forms and instructions, EITC and other tax data by zip code, and information for both employers and tax filers about the EITC. Contact the local IRS Territory Managers for a list of VITA programs and support for new programs. The IRS also produces outreach materials about the EITC that can be ordered for distribution by local campaigns.

Los Angeles EITC Campaign: (www.eitc-la.com). The City and County of Los Angeles conduct an annual informational campaign about the EITC, distributing information to all local government employees, as well as through "one-stop" offices and a telephone hotline. The efforts helped Los Angeles increase EITC filing rates faster than the country as a whole.¹⁵

Mayor Daley's Earned Income Tax Credit Outreach Initiative: (www.chicago-eitc.org). Mayor Richard Daley conducts an annual campaign to promote the EITC in Chicago. Key partners include the business community, media, and nonprofit tax preparation programs. To help spur similar initiatives elsewhere, the city has developed a publication describing its efforts and has made it available on its Web site.

¹⁵ Berube, 2001.

National League of Cities: (www.nlc.org/iyef). The Institute for Youth, Education, and Families provides information and assistance to local efforts. The Web site includes a "Helping Working Families Action Kit for Municipal Leaders" that describes steps local leaders can take to develop city-led outreach campaigns to link families with food stamps, health insurance, and the EITC.

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About the Author

Amy Brown is Director of Social Justice at Community Food Resource Center in New York City. In the 2003 tax season, CFRC's EITC campaign expects to provide information to more than 20,000 people and free tax preparation to more than 6,000 low-income workers, resulting in refunds of \$10 million.
